

# IMPACT EXACTIONS: ECONOMIC THEORY, PRACTICE, AND INCIDENCE

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## I

### INTRODUCTION

The public capital stock, commonly called infrastructure, has been allowed to deteriorate to the extent that its lack of availability frequently constitutes a serious impediment to economic progress. This lack of adequate public capital results in part from a failure to maintain the public capital facilities constructed in the past, and in part from the failure of public capital investments to keep pace with needs brought about by growth. The solution to both maintenance and expansion of infrastructure problems is more fiscal resources. The traditional systems of infrastructure finance for both capital and maintenance projects, however, have been unable to keep pace with need. The result has been the deterioration of the public capital stock, which has been well documented by Choate and Walter.<sup>1</sup> The focus of this article is the recent approach many jurisdictions are taking to provide more fiscal resources to capital projects. Impact exactions have gained popularity as an alternative to traditional methods of infrastructure finance. Although such exactions do not make any contribution to maintenance of existing facilities, they do constitute available resources.

Although much of the now deteriorating capital stock was originally financed by state and federal governments, these governmental units have been reducing their role in funding infrastructure improvements. Local governments have thus been forced to direct available fiscal resources toward operating and maintaining the facilities that state and federal grants originally paid for, leaving little to finance new construction. This reduction has resulted in an increasing financial role for local governments at a time when they have also been experiencing fiscal pressure.

The increased financial role for local governments was not reassigned through any rational process but rather through inaction and underappropriation. The federal and state governments, the traditional sources of public capital finance, tend to derive most of their receipts from

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1. P. CHOATE & S. WALTER, *AMERICA IN RUINS* (1981).

income and sales taxes. One substantial advantage of these sources is that they automatically increase with both growth and inflation.

Local governments, however, must take positive action in the form of property reassessments and tax and fee increases in order to augment their revenues and assume this expanded role. The reason is due to the nature of their tax base and the limited availability of alternative revenue sources. Because local governments must rely heavily on taxes for revenues, local governments are assuming a greater role in infrastructure finance. Thus, fiscal issues have come to the forefront. Perhaps the best known fiscal issue is the public resistance to a primary local governmental revenue source, the property tax. The most significant effect of regulation as a means to supplement tax sources has been in the manner and extent of the regulation of new development.

Generally, local governments attempting to raise the money required to make infrastructure improvements have been faced with a choice: imposing the burden of higher costs on the general public with higher taxes or burdening users with higher user fees. User fees have become a common means of maintaining the existing capital stock. An example of this trend is increasing motor fuel taxes. User fees as a source of funding for new capital investment, however, are a recent occurrence. The bonding of revenues from user charges is an attractive and frequently employed means of financing revenue producing facilities.<sup>2</sup> This approach, however, has no applicability to nonrevenue producing facilities such as public schools. Even in the case of services or facilities that are revenue producing, there are serious problems in utilizing general user fees to fund capital improvements. The lack of readily available alternative (nontax) revenue sources has led local governments to explore their police powers as a means of attaining the needed capital investment. The obvious objective in utilizing regulation rather than taxation is to avoid the necessity of tax or fee increases.

The police powers, including the power to regulate land development, are delegated to local governments by the states.<sup>3</sup> The extent to which local governments may exercise these powers to regulate development varies from state to state. In general, local governments have broad grants of power to regulate.<sup>4</sup> This power contrasts with the narrow delegation of the power to tax. Increasingly, local governments have turned to their land regulatory police powers to offset their inability to employ innovative methods of taxation.<sup>5</sup>

Even in municipalities where user fees are utilized to finance capital and maintenance expenses, problems have arisen with the need to finance capital expansion in the face of growth. New revenue bonds typically require

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2. R. VAUGHAN, *REBUILDING AMERICA: FINANCING PUBLIC WORKS IN THE 1980's*, at 44 (1983).

3. E. YOKLEY, *ZONING LAW AND PRACTICE* 3 (2d ed. 1953).

4. J. METZENBAUM, *LAW OF ZONING* 16 (1955).

5. Juergensmeyer, *Funding Infrastructure: Paying the Costs of Growth Through Impact Fees and Other Land Regulation Charges*, in *THE CHANGING STRUCTURE OF INFRASTRUCTURE FINANCE* 31 (J. Nicholas ed. 1985) [collection hereinafter *INFRASTRUCTURE FINANCE*].

increased user fees for all users because of higher current construction and interest costs. Thus, all users of a system will be charged higher user fees in order to meet the capital needs of new users. Because local governments lack the delegated authority, they are typically prohibited from imposing a tax on new users that would preclude the necessity of a general increase in user charges.<sup>6</sup> The result has been that local governments in growing areas have been required to impose higher taxes and user charges upon all taxpayers and users.

There are two basic premises of exaction or payment-in-lieu systems under the police power. First, it is contrary to the public health, safety, and welfare for development to proceed more rapidly than the public capital stock can be expanded. Second, imposing higher taxes or user charges upon existing users to finance capital improvements that service new development results in some loss to existing users of the beneficial use of their property.

It is well recognized that the availability of a sufficient public capital stock is an important element in the economic development of a community as well as an important component of quality of life.<sup>7</sup> It is also recognized that insufficient capital stock is a valid basis for the denial of new development under the police power.<sup>8</sup> It follows, then, that owners of developing property will benefit from public capital improvements because their property will increase in value. The alternative would be a lack of adequate public capital, which is a valid basis for denying development approval. The exaction or cash-in-lieu payment, as a precondition for approval, follows from these premises.

From the perspective of infrastructure needs, growth is much more than new homes or similar types of physical improvements. Rather, growth means an increase in activity of all forms that create the need for increased quantities of public capital facilities. Three basic activity agents exist within a community: firms, institutions, and households.<sup>9</sup> As any of these agents grow in number or size, the community will experience more activity and thus greater need for services and facilities. The concept of activity accounts for many areas that, though declining in total population, nevertheless need additions to the infrastructure base because they are growing in other respects.

The general approach to defining infrastructure need has been to link all facilities to population growth and to define that growth in terms of residential population. This approach, however, deals with only one aspect of growth in activity. Commuters and shoppers in a given jurisdiction who do not reside there create needs while present in the community, similar to those created by residents. A shopping center requires police and fire protection,

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6. *See, e.g.,* Broward County v. Janis Dev. Corp., 311 So. 2d 371 (Fla. Dist. Ct. App. 1975).

7. *See* COMMUNITY BUILDERS COUNCIL, URBAN LAND INST., THE COMMUNITY BUILDERS HANDBOOK 86-191 (1968).

8. Golden v. Planning Bd., 30 N.Y.2d 359, 285 N.E.2d 291, 334 N.Y.S.2d 138 (1972), *appeal dismissed*, 509 U.S. 1003 (1972).

9. F. CHAPIN, URBAN LAND USE PLANNING 226 (2d ed. 1965).

road improvements, and the like, irrespective of whether any of the shoppers or employees reside within the community. The same is true for office buildings and factories. It is activity that must be served, and it is the service of such activity that imposes the infrastructure improvement costs on local governments.<sup>10</sup>

Increasingly, local governments have been turning to impact exactions or payments in lieu (impact fees) as a means of financing the growing need for capital improvements. Such approaches shift the incidence of the cost of such improvements from the public to the developer. In turn, this shift can impose the ultimate burden upon the developer, the purchaser, or the property owner.<sup>11</sup>

This shift in public policy has been met with frequent controversy and litigation. Several states, most notably California, have responded with legislation that authorizes impact taxes.<sup>12</sup> Most states, however, have not authorized any form of taxation or similar means that will allow the imposition of capital costs only upon new development. Local governments in these states must utilize their police powers, rather than their taxation powers, to shift the incidence of the burden of capital costs from existing tax and fee payers.

It is important to view systems of impact exactions or payments in lieu within the broader context of local governmental finance. All units of government have found that the demand for governmental expenditures tends to exceed the public's willingness to pay general taxes. This differential has resulted in all levels of government tending to move toward user fee approaches of finance.<sup>13</sup> Although exactions may or may not constitute user fees as such, exactions and user fees share a common heritage.<sup>14</sup>

An alternative to local government's assumption of infrastructure capital (and even maintenance) costs is the creation of special districts. For several decades, special districts have been the most rapidly growing type of government in the United States. Between 1942 and 1982, the number of counties decreased by 9, the aggregate number of municipalities and townships increased by 671 (1.9%), and the number of special districts increased by 20,289 (240%).<sup>15</sup> A majority of the special districts (66.7%) provide infrastructure-type services,<sup>16</sup> and are being used to handle problems

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10. Chapin, *Activity Systems and Urban Structure: A Working Scheme*, 34 J. AM. INST. PLANNERS 11 (1968).

11. J. NICHOLAS, *STATE REGULATION/HOUSING PRICES* 27-42 (1982).

12. See CAL. GOV'T CODE §§ 65970-65979 (West 1985); Juergensmeyer, *supra* note 5, at 31.

13. See W. COLMAN, *A QUIET REVOLUTION IN LOCAL GOVERNMENT FINANCE: POLICY AND ADMINISTRATIVE CHALLENGES IN EXPANDING THE ROLE OF USER CHARGES IN FINANCING STATE AND LOCAL GOVERNMENT* (1983).

14. Holland, *User Charges in the Wake of Tax and Expenditure Limitations*, in *THE IMPACT OF FISCAL RESTRAINTS: ALTERNATIVE FINANCING BY LOCALITIES* 47 (1982).

15. BUREAU OF THE CENSUS, U.S. DEP'T OF COMMERCE, *STATISTICAL ABSTRACT OF THE UNITED STATES* 272 (1984).

16. BUREAU OF THE CENSUS, U.S. DEP'T OF COMMERCE, *CENSUS OF GOV'TS PUB. NO. 4, FINANCES OF MUNICIPAL AND TOWNSHIP GOVERNMENTS* at XII (1982).

of financing new development. They have been used most extensively in California, Texas, and Florida.<sup>17</sup> Although the record concerning special districts is somewhat mixed, they have proven to be most effective in dealing with the needs of suburban development in a manner that does not impose costs on the general community.

## II

### EXTERNALITIES AND IMPACT EXACTIONS

The economic role of the exercise of the police power in land use regulation is the limitation of negative externalities or, as they are commonly known, social costs.<sup>18</sup> Beginning with *Euclid v. Ambler*,<sup>19</sup> this role has been interpreted to mean the exclusion of certain land uses that have the potential of diminishing the beneficial use of property owned by surrounding residents. The exclusion of industrial uses from residential areas represents the traditional example. As land use regulations have evolved, it has become recognized and institutionalized that even allowable uses, such as residential development within residential areas, can impose negative externalities upon surrounding areas. Thus, the same situation has arisen with respect to allowable uses as did with industrial uses, except that it is not the use itself that is the basis for the externality but rather the inability of the existing capital stock to accept that development. For example, crowding of schools, parks, and roads leads to a decline in the beneficial use of property in a manner similar to smoke or odor from an industrial development.

## III

### THE EXAMPLE OF ROAD CAPITAL FINANCE

Roads present an excellent case in point. If the existing road system in a given location operates at capacity, any additional traffic will diminish the benefit to existing users—a classic negative externality. The obvious solution to the traffic problem, one that will also eliminate the externality, is the construction of additional roads. The finance issue focuses on which group, among the several possibilities, should be financially responsible for the new roads.

Given the various revenue sources available, there is a given quantity of roads that can be built and a given quantity that can be maintained during an identifiable period of time. These quantities are functions of the motor fuel tax rate, the magnitude of growth, and the quantity and condition of roads to be maintained. In order to focus attention on capital finance, assume that the existing roads are in reasonable shape and do not require extraordinary maintenance. There are two basic sources of road capital finance in a growing

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17. DeHaven-Smith, *Special Districts: A Structural Approach to Infrastructure Finance and Management*, in *INFRASTRUCTURE FINANCE*, *supra* note 5, at 59, 68.

18. Davis, *Economic Elements in Municipal Zoning Decisions*, 39 *LAND ECON.* 375, 379-86 (1963).

19. 272 U.S. 365 (1926).

community: motor fuel taxes paid by existing residents and motor fuel tax increases resulting from growth. Of course, these sources can be supplemental to general appropriations.

In 1967, the general cost of building one lane mile of road was \$100,000, exclusive of right of way.<sup>20</sup> The Highway Capacity Manual indicates that the general capacity to accept traffic per lane mile would be 7,000 trips per day.<sup>21</sup> Thus, in 1967, the capital cost per trip mile was \$14.29. Given an average trip length of 6 miles, the capital cost (to provide the needed road capacity) was \$85.74. A typical single-family home generates 10 such trips per day.<sup>22</sup> Thus, the 1967 cost of road construction per single-family home was \$857. In 1967, the typical federal, state, and local motor fuel tax was 12 cents per gallon.<sup>23</sup> The 21,600 miles of travel resulting from the single-family home would yield \$172.80 annually in motor fuel taxes at 15 miles per gallon. Experience in Florida has shown that 35% of the motor fuel tax revenues are available for capital projects.<sup>24</sup> This experience is rather typical of many states. The result is that \$60.48 is available annually for road capital projects. In 1967, the prevailing municipal interest rate was 3.98%, which would yield a capitalized value of these annual payments of \$944. It follows that, in 1967, the addition of one single-family unit would contribute motor fuel taxes with the ability to construct \$944 worth of roads at a cost of \$857.

The rate at which the community can accept growth (in terms of traffic) is a function of the motor fuel tax rate, road construction costs, and interest rates. In 1967, these fiscal parameters would have given a community the ability to grow at an annual rate of up to 7.7% per year, when the capital allocations of new and existing residents are aggregated.<sup>25</sup> As these parameters change, so to does the community's ability to accept new traffic at an acceptable level of service.

By 1986, the cost to construct a lane mile of road increased to \$300,000 and the municipal interest rate rose to 8%.<sup>26</sup> Using these figures, and holding the motor fuel tax constant, the ability of a community to accept traffic growth declined substantially. At a cost of \$300,000 per lane mile, the per single-family unit cost was \$2,571, and the annual motor fuel tax receipts remained

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20. FLORIDA DEP'T OF TRANSP., 1980 ANNUAL REPORT 2 [hereinafter ANNUAL REPORT].

21. HIGHWAY RESEARCH BD., HIGHWAY CAPACITY MANUAL 130 (1965).

22. INSTITUTE OF TRANSP. ENG'RS, TRIP GENERATION 200 (3d ed. 1983).

23. BUREAU OF THE CENSUS, U.S. DEP'T OF COMMERCE, STATISTICAL ABSTRACT OF THE UNITED STATES 652 (1976).

24. ANNUAL REPORT, *supra* note 20, at 2.

25. The growth-absorptive capacity of a local government is defined in terms of the relative ability of the available capital receipts to finance needed improvements. The calculations herein are based upon the following formula:

$$\text{Absorptive Capacity} = [\text{Annual Revenue per Unit of Development} / \text{Cost per Lane Mile (capacity/average trip length)}] \times \text{Daily Trips per Unit of Development.}$$

Using 1967 costs of \$100,000 per lane mile and a tax rate of \$0.04 per gallon (applicable to capital), the ability of an area to accept growth will increase at 5.85% per year. By 1986, with costs of \$300,000 per lane mile and a \$0.04 per gallon tax, the absorptive capacity will have fallen to 1.95%. Tax increases to \$0.06 will increase the 1986 capacity to 2.93%

26. EXECUTIVE OFFICE OF THE PRESIDENT, 1986 ECONOMIC REPORT OF THE PRESIDENT 333.

at \$172.80, with \$60.48 being available for capital. The higher 8% interest rate reduced the present value of this stream of future payments to only \$646. Consequently, the ability of a community to accept growth in traffic declined from 7.7% to 2.1% per year.<sup>27</sup>

Between 1967 and 1985, the federal motor fuel tax increased by 4 cents and many states furthered that increase by an additional 4 cents or more. The result is that annual motor fuel revenues have increased to a total of 20 cents per gallon. Annual motor fuel receipts per single-family unit are therefore \$288, with \$100.80 going to capital. At 8% interest, the present value of these payments is \$1,076.

Costs having risen to \$2,571 in 1986, the cumulative effect of the changes to the road finance system is a situation in which new development still tends to result in a deficit even after an increase in taxes. Without figuring in the tax increases, a growing community could accept traffic growth at a rate of 7.7% in 1967 and 2.1% in 1986. After tax increases are included in the calculation, the rate at which a community could accept traffic increases to 3.6% per year. Deficits per unit still result, however, and the ability of the community to accept any growth is due only to the allocation of the capital portions of motor fuel taxes from existing activity. If a community grows at a rate greater than its absorptive capacity, the local government has four basic alternatives:

1. reduce, or allow for increased traffic to reduce, the level of service;
2. increase revenue through a further increase in taxes;
3. limit new access (new development) to the road system;
4. provide alternative financing for road improvements.

Both reducing the level of service and increasing taxes impose costs upon the existing users of the system. Limiting new development will impose no direct cost upon existing users, and implementing some new alternative may or may not impose burdens upon existing users depending upon the method elected. If the alternative is an impact exaction or in-lieu fee, then the incidence of the burden will not fall upon the existing community.

Equity considerations come to the forefront when the rate of increase in the cost of new roads (or any capital facility) exceeds the rate of increase in the revenues available to build those roads, given that a decline in the level of service is unacceptable. The relevant equity question is whether, on the one hand, taxes or fees should be raised in order to finance the needed improvements or whether, on the other hand, the new development should be charged an amount sufficient to finance the needed improvements without requiring tax or fee increases.

Table 1 shows metropolitan growth rates for the state of Florida. From 1960 to 1970, 3 of the 19 Metropolitan Statistical Areas (MSA's) of Florida were growing at a rate that exceeded their ability to finance road improvements (5.8%). Moreover, 16 of the 19 MSA's were growing at a rate that exceeded their unadjusted 1986 ability to provide roads (1.9%) during

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27. See *supra* note 25 and accompanying text for an explanation of the method for determining the revised absorptive capacity.

the 1970's. Even after including a 50% increase in the capital portion of the motor fuel tax, 11 of the 19 MSA's are growing at rates greater than their ability to provide roads (2.9%).

TABLE 1  
POPULATION GROWTH OF FLORIDA METROPOLITAN STATISTICAL  
AREAS  
1960 - 1980

MSAS	Population			Growth Rates (%)	
	1960	1970	1980	1960-1970	1960-1970
Bradenton	69,168	97,115	148,445	3.45	4.33
Daytona Beach	125,319	169,487	258,762	3.07	4.32
Ft. Lauderdale- Hollywood	333,946	620,100	1,018,257	6.38	5.08
Ft. Myers	54,539	105,216	205,266	6.79	6.91
Ft. Pierce	56,226	78,871	151,196	3.44	6.72
Ft. Walton Beach	61,175	88,187	109,920	3.72	2.23
Gainesville	86,520	119,389	171,392	3.27	3.68
Jacksonville	522,169	612,585	722,252	1.61	1.66
Lakeland- Winter Haven	195,139	228,515	321,652	1.59	3.48
Melbourne	111,435	230,006	272,959	7.52	1.73
Miami	935,047	1,267,792	1,625,724	3.09	2.52
Ocala	51,616	69,030	122,488	2.95	5.90
Orlando	337,516	453,270	700,055	2.99	4.44
Panama City	67,131	75,283	97,740	1.15	2.64
Pensacola	203,376	243,075	289,782	1.80	1.77
Sarasota	76,895	120,413	202,251	4.59	5.32
Tallahassee	116,214	142,231	190,329	2.04	2.96
Tampa-St. Petersburg	820,443	1,105,553	1,613,621	3.03	3.85
West Palm Beach	228,106	348,993	576,812	4.34	5.15

SOURCE: BUREAU OF ECONOMIC AND BUSINESS RESEARCH, COLLEGE OF BUS. ADM., UNIV. OF FLA., 1984 FLORIDA STATISTICAL ABSTRACTS.

The impaired ability to accept growth is a direct result of the erosion of the road infrastructure finance system. This impaired ability, in the face of growth rates that exceed the local governments' ability to accept them, results in increased traffic congestion, postponement of road maintenance, and higher taxes. It also leads to regulatory measures such as performance standards, exactions in the form of approval conditions, and regulatory impact fees. An interesting observation with respect to Table 1 is that the MSA's that most exceeded their absorptive capacity have been among the first Florida communities to implement systems of exactions and payments in lieu. The Fort Lauderdale-Hollywood and West Palm Beach MSA's were the first to adopt such programs in 1979, and were soon followed by Sarasota, Fort Myers, Tampa, and Fort Pierce. Most of the other MSA's are now in the process of developing such programs.

Local governments in Florida have always had the option of raising their single discretionary source of revenue, the property tax, as a means of paying for road capital and maintenance costs. This option, however, has been avoided because of the resistance to property tax increases. This resistance has been felt in both public pressure to limit taxes and in legislation that limits taxation. In 1985, the Florida Legislature passed legislation allowing local governments to impose up to a six cent per gallon optional motor fuel tax to finance road improvements.<sup>28</sup> Most local governments have made use of this option. What was effectively a fifty percent increase in the motor fuel tax, however, was simply insufficient to provide roads for the very rapid growth of many areas in Florida. Florida local governments are still faced with the need either to raise the unpopular property tax or to manage growth so that it proceeds at a rate consistent with the community's declining ability to provide services.

The managed growth alternative, frequently employed by local governments, commonly includes exactions imposed on large-scale development. This latter approach has not responded to the problem. Within the rapidly growing state of Florida, only five to twenty percent of new growth has been occurring within such large-scale developments. Attempts to deal with infrastructure inadequacy by focusing only on large-scale developments are bound to fail because of the dominance of small-scale or "vested" developments. The alternative increasingly used is the impact fee, which is paid by all new development regardless of its scale or its status with respect to vesting.

#### IV

#### USE OF THE REGULATORY IMPACT FEE

Developers have frequently challenged attempts to bridge the infrastructure finance gap with regulatory impact fees. Such litigation is based, in part, upon the failure of local governments to receive authorization from the legislature to impose what developers allege are really taxes. Moreover, developers claim that regulatory impact fees are unfair because existing developments did not have to pay such assessments. Notwithstanding that these arguments may have merit, the fact remains that municipalities need additional sources of revenue. The issue then becomes who will pay. Given this dilemma, in *Contractors & Builders Association v. City of Dunedin*, the Florida Supreme Court stated that a regulatory impact fee imposed on a developer would be valid if: (1) new development actually requires expansion of capital facilities; (2) the fee required does not exceed

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28. Transportation Reform, Accountability and Cooperation Act, ch. 85-180, § 33, 1985 Fla. Sess. Law Serv. 719, 757-58 (West) (codified as amended at FLA. STAT. ANN. § 336.025(1)(a) (West Supp. 1986)).

the costs incurred by the local government; and (3) the fee revenues are specifically earmarked and spent for the purposes collected.<sup>29</sup>

These criteria have shifted the focus of the exaction process from costs to benefits. This approach bears some resemblance to special assessments. The resemblance to special assessments has become even greater since the courts have required that the impact fee revenues be spent for the benefit of the development paying the fees.<sup>30</sup> The prohibition against collecting fees higher than costs, and the requirement that revenues be spent to benefit the fee payer effectively preclude communities from charging "entrance" fees.

The *Dunedin* decision did not address the issue of defining the local government's cost. In the 1986 road example above, there are two possible definitions of a local government's cost. The total cost per single-family unit is \$2,571.<sup>31</sup> Is this cost the upper limit for a regulatory fee? The local government will receive \$60.48 annually to pay for roads. These payments have a present value of \$594. Local government's net cost is thus \$1,977. It then becomes necessary to determine what portion of the taxes received is used to provide the facility that is the subject of the exaction. If a local government ignores the various road taxes in assessing the exaction and also retains those payments, the new development will be paying more than its fair share.

Moreover, if the local government considers both the origin and the destination of a vehicular trip in its calculation of the capital cost of the new road, there must be adjustments for this apparent overcharge. An example may be of assistance. Assume that a new development has 1,000 residential units, 30,000 square feet of commercial area, and 10,000 square feet of industrial area. The homes would be the origin of trips and the commercial and industrial areas would be the destination. If the 1,000 homes generated ten trips each with a length of six miles, total daily travel would be 60,000 miles. If, at the same time, 30,000 square feet of commercial area attracted 6,000 trips and the 10,000 square feet of industrial area attracted 4,000 trips, total attracted travel would be 60,000 miles. The sum of the two would be 120,000 miles per day, which is exactly twice the actual new travel. Some adjustment is required to compensate for this double accounting. Many communities have elected to divide evenly a trip between the origin, the home, and the destination,<sup>32</sup> resulting in a gross cost of \$1,286 and a net cost of \$989 for a single-family home. Such considerations are essential in order to ensure that the local government does not impose charges that exceed the actual cost of accommodating new development.

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29. 329 So. 2d 314, 320-21 (Fla. 1976) (exaction deficient), *reconsidered on appeal from unpublished remand*, 358 So. 2d 846 (Fla. Dist. Ct. App. 1978) (amended exaction held legal), *cert. denied*, 370 So. 2d 458, *cert. denied*, 444 U.S. 867 (1979).

30. *See Jordan v. Village of Menomonee Falls*, 28 Wis. 2d 608, 620-23, 137 N.W.2d 442, 449-50 (1965), *appeal dismissed*, 385 U.S. 4 (1966).

31. *See supra* text accompanying notes 26-27.

32. *See, e.g., Lee County, Fla., Ordinance 85-23* (July 31, 1985).

Many other states find themselves in a position similar to that of Florida. California has provided legislative authorization for certain impact fees,<sup>33</sup> and California courts have approved regulatory exactions and payments in lieu where there has been a reasonable relationship between the required conditions and the need imposed by new development.<sup>34</sup> Colorado and Utah follow similar rules.<sup>35</sup> Statutory authorization does not guarantee success, as indicated in the *Emerson College v. City of Boston* decision.<sup>36</sup> In that case, the Massachusetts Supreme Court struck down a statute authorizing a benefit charge for fire protection. Many other states, however, will allow off-site exactions if the facility exacted is used exclusively to benefit the individual development.<sup>37</sup>

Inasmuch as exclusivity of benefit is rarely the case, off-site exactions or payments in lieu are used only in limited cases in these states. Most states that follow the exclusivity-of-benefit rule are not rapidly growing and therefore do not have to cope with problems of rapid growth.<sup>38</sup> The declining ability of communities to accept growth, however, is apparently causing courts to modify their holdings. A New York court prohibited local governments from imposing requirements on new development except where the resulting facilities were solely for the benefit of the residents of the particular subdivision,<sup>39</sup> but its decision was subsequently overruled.<sup>40</sup> As the inability to maintain and expand the local infrastructure is increasingly perceived as a problem, there may be more instances where restrictive requirements are overruled.

## V

### WHO PAYS?

A central issue raised in the exaction debate is who pays the exaction? A necessary first step in resolving this issue is to ask why exactions exist in the first place. It has been argued that they exist primarily to protect existing property owners from either a loss in the quality of public services or an increase in taxes as a consequence of growth.<sup>41</sup> The protection of existing

33. See CAL. GOV'T CODE § 66477 (West 1985).

34. *Associated Home Builders v. City of Walnut Creek*, 4 Cal. 3d 633, 638, 484 P.2d 606, 610, 94 Cal. Rptr. 630, 634 (1971), *appeal dismissed*, 404 U.S. 878 (1971).

35. See *City of Arvada v. City and County of Denver*, 663 P.2d 611 (Colo. 1983); *Banberry Dev. Corp. v. South Jordan City*, 631 P.2d 899 (Utah 1981).

36. 391 Mass. 415, 462 N.E.2d 1098 (1984).

37. See *Pioneer Trust & Sav. Bank v. Village of Mount Prospect*, 22 Ill. 2d 375, 176 N.E.2d 799 (1961) (local government can demand facilities only when need is specifically and uniquely attributable to particular subdivision).

38. For example, Illinois follows the exclusivity-of-benefit rule, see *Pioneer Trust*, 22 Ill. 2d 375, 176 N.E.2d 799, and it is not facing rapid growth.

39. *Gulest Assocs. v. Town of Newburgh*, 25 Misc. 2d 1004, 209 N.Y.S.2d 729 (Sup. Ct. 1960), *aff'd*, 15 A.D.2d 815, 225 N.Y.S.2d 538 (1962), *rev'd sub. nom. Jenad, Inc. v. Village of Scarsdale*, 18 N.Y.2d 78, 218 N.E.2d 673, 271 N.Y.S.2d 955 (1966).

40. 18 N.Y.2d 78, 218 N.E.2d 673, 271 N.Y.S.2d 955 (1966).

41. Fischel, *The Economics of Land Use Exactions: A Property Rights Analysis*, LAW & CONTEMP. PROBS., Winter 1987, at 101, 101-02.

property owners, however, explains only why exactions exist and not which individuals should pay the cost.

Exactions or payments in lieu are costs of producing new development, but these costs differ from other such production costs as material and labor. Exactions can be structured in such a manner that they are ultimately borne by the developer. The developer, in turn, can shift this cost backward to the property owner (in the form of lower land prices), or forward to the buyer (in the form of higher rental prices). Thus, it is important to determine who should pay.

To the extent that exactions exist to provide necessary facilities to support new development, then property served by the facility will be the primary beneficiary, for the availability of these facilities will be capitalized into the value of the property. Because the existence of the facility will raise the value of the property, the property owner should bear the burden of the exaction, and the system should be designed in such a manner that the cost is shifted backward in the form of lower land prices. On the other hand, to the extent that the exaction is simply a means to capture some pro rata share of the cost to provide a particular benefit, then the recipient of that benefit, the user or buyer, should pay the cost. This scheme is also consistent with the user fee approach, for it is the occupant of the developed property who is the user of the facility. Alternatively, if the objective of exaction systems is to capture a portion of presumably windfall profits received by the developer, then the system should be structured so that the cost will be borne by the developer.

The developer is typically the agent who actually incurs the cost. To the extent that the property is already owned by a developer, there is no opportunity to shift the cost backward to a property owner. If backward shifting is the goal and the system is so structured, then developers who already own the land will bear the burden in the form of lower profits.

Even if the cost of building increases by the amount of an exaction, prices will not necessarily increase to shift the cost forward either. The reason is that competition, not costs, sets prices. To the extent that the buyer should bear the ultimate burden, imposing the cost on the developer will shift the cost forward to the buyer only in two cases: (1) where all developers must incur similar exaction costs; and (2) where demand for new construction is sufficiently inelastic to actually shift the cost forward. If the objective is to impose the burden upon the ultimate user, then some form of special assessment imposed at occupancy would be a better method than an exaction or payment in lieu. In that case, neither property owners nor developers would make the payment.

A predictable exaction system, one that substitutes performance standards for in-lieu payments, has a greater likelihood of being shifted backward to the property owner. This shift would occur only after some period of time. In the interim, the developer would bear the final incidence of the cost. A uniform exaction system that is *not* predictable (assuming it is possible to have a uniform, unpredictable exaction) would not affect the property owner and

would tend to be passed forward to the buyer. A nonuniform, unpredictable exaction system falls on those developers who have little opportunity to pass the cost either forward or backward. Such an exaction, which results in lower profits, would discourage new development and could lead to shortages. These shortages, however, would eventually result in higher prices that reflect the manner in which the exaction is shifted forward. This result would only occur if all forms of development were subject to the same exactions. If only one or a limited number of developments was exacted, then the developer would incur higher costs in building that type of development without an opportunity to recoup those costs in the form of higher prices. Such a result would discourage that type of development. The frequent application of exactions only to large-scale development is an example of this approach. To the extent that this approach to exactions discourages large-scale development, the community loses the benefits of what is frequently considered to be a preferable form of development.<sup>42</sup>

Because the timing of the imposition of an exaction can affect the magnitude of the burden and its ability to be shifted, another relevant issue is the time for payment. There are several possible stages in the development cycle when an exaction or payment in lieu may be imposed. The first opportunity to require payment would be at the development approval stage. Types of development approval include rezoning, plat approval, and site-plan approval. Imposing an exaction as a condition to approval is the most commonly used means of imposing an exaction, although typically application is confined to on-site improvements. Off-site exactions, especially payments in lieu, imposed at the development approval stage could have substantially higher burdens than those imposed later in the development cycle. The land development process can take many years. Any cash costs are capitalized into the project, and any returns on such investments are received at the end of the process. Such costs require interest payments, which go either directly to a financial institution or are accumulated through achieving a calculated investment return. For example, a \$1,000 in-lieu payment for parks collected at plat approval on a lot that will not be built upon for 5 years will entail the \$1,000 payment plus interest at, say, 12% (which, when compounded over the 5-year period, would equal \$762) for a total cost of \$1,762.

This situation can be remedied by allowing postponement of the payments until some later point in the development cycle.<sup>43</sup> The building permits and site-plan approval phases would present the next opportunities to require payment. Finally, a municipality could impose a regulatory fee as a condition for issuance of a certificate of occupancy. It is highly probable that fees imposed at this point would be passed forward to the buyer. The building permit phase represents the midpoint of the development process. A uniform and predictable exaction system or payments in lieu imposed as a condition for the issuance of the building permit could be passed backward to the

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42. R. BURBY III & S. WEISS, *NEW COMMUNITIES, U.S.A.* 7-16 (1976).

43. *See, e.g.*, BROWARD COUNTY, FLA., CODE § 5-192(e) (1981).

property owner and also forward to the buyer. There is also a distinct possibility, however, that the ultimate burden could fall on the developer if market conditions preclude the possibility of passing the cost along to the buyer in the form of higher prices, that is, if there is a large inventory of unsold structures relative to demand.

Of those local governments that have imposed impact fees, the experience of Sarasota County, Florida, is noteworthy. Sarasota County imposes a fee (actually a special assessment) for roads and parks as a condition for issuance of a certificate of occupancy. This charge is passed on to the buyer and is actually shifted to the buyer at closing. The appearance of this charge on the closing statement causes surprise and hostility toward the local government, not to mention complications with closings.

Exactions are imposed, either as performance standards or payments in lieu, based on the quantity and cost of facilities needed by the development. No consideration is given to the ability to pay. A park impact fee of \$500 per single-family unit does not vary in accordance with the value of the unit or the burden that this imposition places on the ultimate payer. To the extent that the burden of the payment is passed back to the property owner or remains with the builder, the exaction is arguably fair because those parties are willing participants to the contract. To the extent that the burden of the payment falls on the buyer, however, the exaction is undoubtedly regressive because it imposes a greater financial burden on those with less ability to pay.

Although on-site exactions are widely used, payments in lieu and off-site exactions are usually confined to more rapidly growing areas. Empirical research on the ultimate burden of off-site exactions and payments in lieu has concluded that, regardless of how the system is structured, the final burden falls upon the buyer. Elliott found that the fees imposed in California communities are frequently associated with housing price increases.<sup>44</sup> Black and Hoben found that community growth management programs are correlated with price increases in residential lots.<sup>45</sup> The studies undertaken in a wide cross-section of communities all come to the same general conclusion that exactions and other regulatory costs are shifted forward to the buyer. These studies, however, have generally been undertaken in areas experiencing rapid growth. It is quite possible that the ability to shift costs forward is related more to the growing demand for housing than to any other single factor. No studies have been undertaken that test exaction systems across communities with varying rates of growth. According to economic theory, the final burden of regulatory exactions would vary depending upon the structure of the exaction system and the nature of the demand for new construction. The empirical studies, however, indicate that the burden falls solely upon the purchaser, at least in rapidly growing areas.

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44. Elliott, *The Impact of Growth Control Regulations on Housing Prices in California*, 9 AM. REAL EST. & URB. ECON. A. J. 115 (1981).

45. Black and Hoben's findings are discussed in Weitz, *Who Pays Infrastructure Benefit Charges—The Builder or the Home Buyer?*, in *INFRASTRUCTURE FINANCE*, *supra* note 5, at 79, 85 (1985).

## VI

## CONCLUSION

Developer exactions must be seen as a bargaining approach to dealing with development approval. Developer exactions exist within the police powers, however, and are therefore limited to regulating land development in order to prevent public harm. To constitute a legitimate exercise of the police power and an equitable method of cost recoupment, an exaction should be restricted to three situations: (1) where capital improvements are required; (2) where requirement payments do not exceed those necessary to correct the deficiency; and (3) where revenues raised through in-lieu payments are separated from the general fund and are spent to improve the needed facilities. Otherwise, local governments would have the opportunity to charge entrance fees as a means of reducing taxes and charges to the existing residents at the expense of future residents.

Clearly, taxpayers should not be expected to subsidize new development. Moreover, new development should not impose reductions in current benefits, higher taxes, or increased user fees upon the community. To the extent that the objective of exaction systems is to achieve an equitable distribution of costs, the exaction should be designed to assure that the new development pays its pro rata share in a community that is already paying its pro rata share. Alternatively stated, the goal of exaction programs is to shield existing residents, taxpayers, and facility users from the costs of growth. Although these principles may be relatively simple, their implementation is much more complicated. New development will pay property taxes and user fees along with existing development. If some portion of existing taxes and fees is dedicated to payment of past capital costs, new development will pay at least a portion of the capital costs incurred to serve the existing community. Some consideration of such payments should be incorporated into exaction assessment programs. Otherwise, by imposing exactions or in-lieu payments, a community can require new development to pay all of its capital costs and then lower property taxes or user fees when the new development begins to pay taxes and fees.

Exactions are designed both to improve the value of property and to benefit users of the facilities. Because property value is increased by construction of a road, park, or school, property owners should pay some portion of the cost for the benefit they enjoy. A predictable system of performance-standard exactions could achieve this end. Construction of facilities, however, also benefits the users; users should, therefore, pay some portion of their cost. This result could be achieved by imposing a special assessment at occupancy. Given that both aspects of benefit are involved, it follows that a complex system of exactions might be the proper approach. Such an approach would impose exactions in the form of performance standards for construction of facilities that tend to enhance property values at an early stage in the development cycle, such as at the plat approval stage. If these requirements are predictable, they would most likely shift backward to

the property owner in the form of lower land prices. For the services and facilities that are more user oriented, a predictable and uniform payment occurring at or near the end of the development cycle would shift forward to the buyer.

The fiscal condition of local governmental capital improvement programs is a clear indicator that new approaches to infrastructure finance are necessary. Exactions and payments in lieu are means of partially dealing with infrastructure finance problems. But by no means should exactions be the only solution because, as they currently stand, exactions are regressive. Furthermore, to the extent that exactions in their current form grow as a means to finance infrastructure improvements, local fiscal systems will become more regressive. Given the current case law, legislative action will be necessary to implement less regressive exaction systems.