

# **IMPACT FEES: THE SILVER BULLET?**

**EMPSA Capstone Project  
Dr. Brian Nakamura  
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## **AUTHORS**

**Rumaldo Abonce | Grady Carpenter | Blake Dalina |  
Rhonda Daugherty | Timothy Gautier | Jesse Hennage |  
Chris Jett | Laura Ozinga | Toni Portwood |  
David Rainwater | Cody Stewart | Sarah Thompson**



TEXAS A&M UNIVERSITY

**The Bush School**

of Government & Public Service

## **Abstract**

Since America was established, city planners and citizens alike have debated how best to fund the development of their communities. The costs associated with constructing and maintaining public roads, rainwater and wastewater systems, and water access are not trivial to an annual budget. Some municipalities have found great success in issuing impact fees to developers so that funding is available to the city when new development projects begin. Others argue that the costs passed from the developers to the end-users cause economic hardship and are not the best funding option for development. This report explores the history of development funding in America and the legal restrictions to the use of impact fees in the State of Texas through a literature review. A survey of Texas cities presented a view of various funding methods currently in use, providing cities with new ways of funding development growth. Ultimately, this report provides best practices for success for municipalities that choose to implement impact fees.

## Table of Contents

<b>Executive Summary</b>	<b>6</b>
Target Audience and Project Sponsors	6
Project Description	6
Project Methodology	7
Summary	7
<b>Abbreviations</b>	<b>8</b>
<b>Introduction</b>	<b>9</b>
<b>Purpose Statement</b>	<b>10</b>
<b>Background</b>	<b>11</b>
History of Infrastructure	11
Timeline of Infrastructure Funding	11
State Planning Infrastructure	13
<b>Project Methodology</b>	<b>14</b>
Literature Review	14
Survey of Selected Cities Across the State of Texas	15
Analysis of Survey Data	15
Determination of Key Findings	15
<b>Literature Review</b>	<b>15</b>
History	15
Legal Considerations to Impact Fees	18
Chapter 395	23
<b>Funding New Infrastructure Survey</b>	<b>28</b>
Survey Methodology	29
Survey Development	29
Sampling	30
Response Rates	31
Survey Results	32
Methods of Funding New Infrastructure	32
Impact Fees Based on Population	35

Impact Fee Waivers	36
Public Relations	37
Use of Consultants	40
<b>Findings</b>	<b>41</b>
Introduction	41
Gross Domestic Product (GDP)	42
Population Growth	45
Tax Base and Debt Obligation	46
Are Impact Fees the Silver Bullet?	49
Opposition Points to Impact Fees	51
The Equity Argument	51
The Exclusion Argument	53
The Double Billing or “Taxation” Argument	53
The Stop or Deter Growth Argument	54
Summary	56
<b>Alternative Funding Sources</b>	<b>57</b>
Property Tax	57
Sales Tax	58
Right-of-Way Rental Fees	59
Municipal Utility Districts	60
Tax Increment Financing	61
<b>Recommendations for Success</b>	<b>62</b>
Education	66
City Administration	67
Community Education	68
Developer Education	69
Financial Considerations	70
<b>Conclusion</b>	<b>70</b>
<b>References</b>	<b>71</b>
<b>Appendix A</b>	<b>82</b>
Accounting Considerations	82

Impact Fee Fund - Project Revenue Report	84
All Funds - Project Expenditure Report	85

## **Executive Summary**

New infrastructure growth creates a need for new or upgraded services such as roads, water distribution, stormwater management, and wastewater. In the most basic terms, impact fees are a means to recover a portion of the financial burden placed on the city for new capital infrastructure. An impact fee program is designed to create predictability for the city regarding revenue for capital projects and give the developers knowledge and transparency of the cost in advance for any project they may want to build.

### **Target Audience and Project Sponsors**

This report is designed to provide research and recommendations to the City of Amarillo's elected officials and designated city employees to assist in the consideration of the implementation and potential effects of impact fees. Beneficiaries may include, but are not limited to, the offices of the City Manager, Assistant City Manager, and Chief Financial Officer.

### **Project Description**

The content of this project is intended to answer the following questions:

1. Does the implementation of impact fees provide a viable option to assist in the financial burden placed on the city for new capital infrastructure?
2. Does the impact fee program create predictability for the city when it comes to revenue for capital projects, as well as giving the developers

knowledge and transparency of the cost in advance for any project they may want to build?

3. What are the positive and negative effects on existing impact fees throughout the State of Texas and the nation?
4. What are the recommendations to the City of Amarillo based on the research and project methodology utilized in this report?

### **Project Methodology**

With the Texas A&M University Institutional Review Board approval - IRB 2021-1018, reference number 129019, the project included four distinct research components:

1. Literature review.
2. Survey of selected cities across the state of Texas.
3. Analysis of survey data.
4. Determination of key findings.

### **Summary**

Texas Local Government Code Chapter 395 states the methodology to determine the maximum amount an impact fee can charge. This ideology is based on the concept that growth should pay for growth. In addition to impact fees, there are several other options the city may want to consider for funding these projects. Property taxes, sales taxes, right-of-way rentals, Municipal Utility Districts (MUDs), voter-approved bonds, and tax increment financing are various

alternatives to fully or partially fund these projects. One of the major components for success in implementing impact fees will be determined by how the city can successfully engage all stakeholders. By doing so, a comprehensive review and complete understanding of Texas Local Government Code Chapter 395 must be obtained. It then becomes crucial that the city administration, community members, and developers are thoroughly educated on the entire program. The engagement process should begin as early as possible to create transparency for those affected by impact fees, which will help with perceived challenges associated with their implementation.

### **Abbreviations**

<b>Full Title</b>	<b>Abbreviation</b>
Capital Improvements Plan	CIP
Economic Development Corporations	EDC
Extraterritorial Jurisdiction	ETJ
Gross Domestic Product	GDP
Land Use Assumption	LUA
Municipal Utility District	MUD



## **Introduction**

Everything is bigger in Texas, including its population growth rate. Between 2019 and 2020, Texas accounted for 33% of the US population growth (Texas Demographic Center 2021). This isn't anything new – Texas has experienced an average growth rate that ranked 3<sup>rd</sup> in the US from 2010 – 2020 but dwarfed any other state in terms of population numbers by adding 4 million people in that period (Terrell, 2021). This growth is not without issue. Texas has been battling a housing shortage that worsened during the pandemic (Freddie Mac, 2020).

With over 1,000 people adding to Texas's population every day, and the latest trends of people moving to the suburbs, mid-size cities are seeing a boom in housing development. To meet demand, cities are scrambling to find ways to pay for new infrastructure while maintaining two of the reasons why people flock to Texas – low tax rates and affordable housing.

Historically, to fund new infrastructure, cities have used general obligation or revenue bonds. More recently, cities have added methods such as special taxing districts, MUDs, user fees, and impact fees to lessen the burden that new infrastructure has on a city's bottom line.

The City of Amarillo, TX, is no exception. Low mortgage rates caused a surge in housing in Amarillo in 2020, and real estate forecasts expect 2021 to have more housing starts based on permits in the last eight years of available data

(Amarillo National Bank n.d.). Amarillo boasts a total tax rate significantly less than the median for Texas cities (Texas Comptroller of Public Accounts n.d.), but this is concerning when the challenge of footing the bill for new infrastructure arises. This report will serve as a resource to help the city of Amarillo navigate the waters of its assessment of impact fees by knowing what to look for, understanding what questions the City must ask itself, and what considerations need to be addressed to understand the financial, administrative, and political implications of assessing impact fees. This will be accomplished by diving into existing literature, summarizing laws and regulations, showing what comparative cities in Texas have been doing, understanding drawbacks, and what recommendations for success have stemmed from this research.

### **Purpose Statement**

The purpose of this research project is to evaluate impact fees as a source of funding for infrastructure in new development for the City of Amarillo. A combined framework of surveying comparable cities in Texas, reviewing scholarly literature, and examining information gleaned directly from city websites allowed the research team to make evidence-based recommendations for the City of Amarillo. Consideration of impact fees includes an understanding of the city's historical, current, and projected financial functions, present fiscal capabilities, and future development goals.

## **Background**

### **History of Infrastructure**

Infrastructure funding in the United States has a long history of being behind the curve compared to other countries. Each President since George Washington has shared their ideas and efforts to increase the funding for infrastructure. Yet today, in the twenty-first century, we continue to be behind the times of funding for the necessary infrastructure. The funding of infrastructure in the United States has not kept up with the ever-growing population of the nation. The spring of 2014 marked the 80th anniversary of the Works Progress Administration (WPA), the biggest and most ambitious of more than a dozen New Deal agencies created by President Franklin D. Roosevelt (Stone 2014). Infrastructure has a finite useful life and is either renovated to meet current needs or is demolished. Some of the larger infrastructure built during this era has been demolished, and more will soon follow.

### **Timeline of Infrastructure Funding**

From 1972 to present the infrastructure in the United States has fluctuated. To demonstrate the flux in infrastructure spending, in 1972 local infrastructure spending was approximately \$200 billion (in 2012 US dollars). From 1972 to 2012 all five infrastructure categories experienced a large growth. Between 1977 and 1987 infrastructure rose and fell and was inconsistent. In 1992, the local infrastructure peaked at \$478 billion. Between 1992-2002 the local infrastructure

fell dramatically causing a lot of uncertainties for the future. There was modest growth in the next decade, 2002-2012. The rising cost of materials has reduced real spending power. As a result, real infrastructure spending nationally has fallen over the last decade, from \$450.4 billion in 2007 to \$440.5 billion in 2017.

Although there was a surge in real spending in 2009 and 2010, following the American Recovery and Reinvestment Act (ARRA), this bump was short-lived, and spending has only increased marginally over the last five years (Kane and Tomer 2019). In 2012, the local government spent \$339 billion on infrastructure, well below the historic spending level of 1992. According to responses to a 2016 International City/County/Management Association (ICMA) survey of local governments, nearly 42% respondents believe that the current state of the jurisdiction's infrastructure needs additional local, state, and/or federal funding to sustain even baseline maintenance and that the current state of local infrastructure adversely affects the community's quality of life.

Special Assessment Districts (SAD's) are formed to include a geographical area in which property owners or businesses agree to pay a special property tax assessment to fund a proposed improvement or service from which they expect to benefit directly. SAD's account for the second largest amount and share of local infrastructure spending. They also experienced steady growth in both the amount and share of local infrastructure spending: From \$24 billion, representing 12% of total local infrastructure expenditures in 1972 to \$93 billion,

representing 24% in 2012 (Chen and Bartle 2017). Amarillo, Texas has three SAD's that are located in Hutchinson, Moore, and Randall counties.

### **State Planning Infrastructure**

Based on the infrastructure bill passed by President Biden, in November 2021, Texas will receive \$35 billion in funding. The amount for each city has not been determined. The money will be spread out over a five year period and below is how the infrastructure will be spent in the state of Texas (Oxner 2021).

- \$26.9 billion for highway programs
- \$537 million for bridge replacements
- \$53 million to protect against wildfires
- \$42 million to fight cyberattacks
- At least \$100 million to expand broadband coverage
- \$3.3 billion to improve public transportation options
- \$1.2 billion to develop infrastructure for airports
- \$3.5 billion for weatherization measures
- \$2.9 billion to improve drinking water access

The above funding has the potential to impact Amarillo and only time will tell. Over the next five years will prove which cities in the state of Texas will be impacted by the \$35 billion funding. If Amarillo is impacted by the funding, it

will save taxpayers money and will potentially help with passing the budget in the future.

The City of Amarillo is the primary stakeholder, including its citizens, businesses, and city administration. Additional stakeholders include surrounding cities and communities. Notably, the rate of development southward has seen an increase toward the City of Canyon and its suburbs. In addition, businesses and industries are moving in, bringing more jobs and more people. As a result, Amarillo is becoming a desirable location in the Texas Panhandle for economic growth, highlighting the importance of infrastructure funding.

### **Project Methodology**

With the Texas A&M University Institutional Review Board approval - IRB 2021-1018, reference number 129019, the project included four distinct research components:

#### **Literature Review**

The literature review included the discovery of federal court cases involving the implementation of impact fees, a breakdown of the importance of Texas Local Government Code Chapter 395, the history surrounding the funding of infrastructure development, and other funding options outside of impact fees available to entities in Texas.

## **Survey of Selected Cities Across the State of Texas**

City officials from across Texas were invited to participate in a survey collecting data about infrastructure funding in their specific entities.

## **Analysis of Survey Data**

The data analysis made use of the Qualtrics Survey analytics tools and cross-comparison tables with a literature review to determine correlations and findings.

## **Determination of Key Findings**

The survey results demonstrate that cities generally want to keep tax rates low. One reason cities choose impact fees is the citizens' desire for everyone, including developers, to pay their fair share of development costs. General obligation bonds are a primary mode of operation for many of the cities.

## **Literature Review**

### **History**

Impact fees have existed since they were created by the Standard Planning Enabling Act of the U.S. Department of Commerce in 1922 (Ross et al. 1992). This act provided a means by which connection fees, development charges, and buy-in fees could be charged and were used to control urban development. The philosophy of impact fees is that new development should bear the cost of providing public facilities required for growth. Impact fees are not used to correct existing deficiencies in facilities or service delivery (Ross et al. 1992). The use of

impact fees for funding public service expansion has gained greater acceptance since the 1970s, during which taxpayer revolts, primarily in California through Proposition 13, put limits on government and forced jurisdictions to explore other sources of revenue (Ross et al. 1992). California and Florida are often considered leading states in the development of theory, practical models, legislation, and methods for calculating growth-related costs (Ross et al. 1992).

There are three traditional methods of financing public services and facilities that were used before the emergence of impact fees. These include general fund revenues, general obligation bonds, and revenue bonds (Development Planning & Financing Group 2016). General revenue funding of growth-related expansion is done through the regular budget of a governmental entity and allocates revenue away from other budgeted services, which may result in service reductions. General obligation bonds are debt liability against future property taxes and may necessitate property tax increases to raise sufficient revenue to meet the debt obligations. Revenue bonds are debt liability against future utility service revenue, which may require utility rate increases to meet the debt obligation. These methods of financing public service expansion are often politically unpopular with existing residents because they directly affect the availability of services, cost of property ownership, and/or utility costs (Development Planning & Financing Group 2016). Additionally, many



jurisdictions have statutory and/or constitutional limitations on the amount and type of debt that can be incurred, which often requires a vote by the public.

Over the last 30 years, the fiscal stress of managing growth with limited resources and taxing ability has been a problem for many jurisdictions. Taxes and user fees can often keep up with fiscal stresses such as population growth, inflation, and increased cost of public projects (Development Planning & Financing Group 2016). During the 30 years from 1966 to 1996, tax revolts by voters (particularly in California and Massachusetts), resulted in property taxes as a source of local revenue dropping from approximately 50% in 1966 to 28% in 1996 (Development Planning & Financing Group 2016). This has resulted in jurisdictions looking to alternate financing sources, such as development impact fees, to make up the difference when financing growth-related projects.

The profile of capital spending has evolved over the last several decades. The net result is that public projects are simply more expensive than in years past, even taking inflation into account. Technological advancements have increased the complexity and sophistication of many public works projects. Increased environmental awareness has increased the cost of infrastructure projects through increased environmental prevention and mitigation laws, regulations, and strategies (Development Planning & Financing Group 2016). Increased citizen sophistication and increased government regulation have resulted in demand for better infrastructure than was acceptable in previous years. Finally, there has been

a public policy shift that those benefiting from growth should pay for public projects that support growth rather than the burden falling on existing residents. (Ross et al. 1992). As of 2015, 29 states had authorized impact fees through enabling legislation (Development Planning & Financing Group 2016).

Across the country, there are approximately 22 potential project types that have been financed through impact fees. These include projects such as water supply, wastewater, drainage, streets, public safety facilities (police and fire), libraries, public art, and daycare facilities (Ross et al. 1992). However, through Local Government Code Chapter 395, Texas has authorized only four allowable types of public facilities projects that may be financed with impact fees: water supply, wastewater, stormwater drainage, and roads.

### **Legal Considerations to Impact Fees**

Enacted in 1987, Texas Local Government Code Chapter 395 allowed for the implementation of impact fees. Impact fees have been cloaked in various names since taxes and fees have been assessed; however, regardless of what they are called, they have always been contentious. When considering all the aspects of impact fees, *Munn v. Illinois*, 94 U.S. 113, 24 L.Ed. 77 (1877) must be the first case reviewed. In this case, the U.S. Supreme Court held, “Property does become clothed with a public interest when used in a manner to make it of public consequence, and affect the community at large. When, therefore, one devotes his property to a use in which the public has an interest, he, in effect, grants to the

public an interest in that use, and must submit to be controlled by the public for the common good, to the extent of the interest he has thus created. He may withdraw his grant by discontinuing the use; but, so long as he maintains the use, he must submit to the control."

One of the first cases that set a precedent for future rulings on impact fees dates back to 1910, *Harter v. Barkley*, 158 Cal. 742, 112 P. 556, (1910), a California case involving an ordinance by the city of Redondo Beach. The City charged \$5.50 for permits and \$20.00 for labor and parts to make the connection for a private citizen to connect to the city sewer system. The court held that as long as the city was using the funds for the lawful expenditure for the benefit of the defendant's property as well as in the interest of other owners of realty within the city, the fees are reasonable. This is a key ruling which has been referred to by other courts.

The question of what is reasonable continues to be at the heart of most cases. Many of the cases revolve around authority to charge fees. Most of the early cases involve access to sewer services, however, they are not limited to just sewer services. One thing all the cases have in common when it comes to rulings is the final or expected use of the funds. Historically, any funds created for the betterment of the community as a whole is considered a tax, thus time and again those cases have been resoundingly defeated in court.

There are numerous cases defining taxes versus fees. While there is no difference in reality, however, there is a legal distinction between a tax and a fee. This was clarified in *City of North Little Rock v. Graham*, 278 Ark. 547, 647 S.W.2d 452 (1983), defining a tax as imposed by the government to raise general revenue funds, whereas a fee is imposed in the government's exercise of its policing powers.

In *Bldg. Ind. Ass'n of S. Cal. v. City of Oxnard*, 198 Cal.Rptr. 63 (Cal. App. 2 Dist. 1984), the court held that a growth requirement capital fee applicable to new development was a tax because the fee was designed to collect revenues to benefit the community as a whole. In *Contractors & Builders Ass'n v. City of Dunedin*, 329 So.2d 314 (Fla. 1976), connection fees to expand water and sewage systems were held to be a tax because the use of the money collected was not limited to the costs of expansion. *Eastern Diversified v. Montgomery County*, 570 A. 850 (Md. 1990) stated development impact fees assessed to raise funds to finance the construction of roads was a tax because funds benefited the general public.

Even though impact fees have been around for a very long time, *City of Marion v. Baioni*, 850 S.W.2d 1, 312 Ark. 423 (1993) may be the most relevant. This case closely relates to impact fees in Texas. This case involves certain sewer and water tap and access fees the City of Marion, Arkansas charged developers of residential land in and around the city. Marion experienced considerable growth in

population since 1975, and this influx of new people resulted in the city exceeding the design capacity of both its water and sewer systems. Between July 1988 and August 1990, the city enacted a series of ordinances that placed tapping fees on builders or lot owners connecting onto the city's existing water and sewer systems and required access fees from any person or entity connecting to city services. These fees only applied to new development. The ordinances, as amended, provided that the funds collected from these respective fees must be placed in separate accounts designated as the water expansion account and sewer expansion account. These accounts were used solely to expand the city's water and sewer systems. Texas Local Government Code Chapter 395 stipulates that funds collected for impact fees must be accounted for separately.

One of the most recent cases to consider is the 2015 case of *Quality Built Homes Inc. v. Town of Carthage*, 798 S.E.2d 521 (N.C. 2017). In this case, Quality Built Homes Inc. alleged the Town of Carthage did not have the authority to impose the impact fees for future use. Quality Built Homes Inc. alleged that even though they had the intention of building the houses for which they were charged an impact fee, the homes were never built, and therefore the town of Carthage owed them a refund with interest. The appeals court held that the requirement to build the homes for which the impact fee is paid rests solely with the developer, provided the services paid for are delivered. The City of Carthage now requires impact fees to be paid upon final plat approval for new subdivisions

or upon application for building permits, whichever occurs first. Where this case comes close to being contrary to Texas law is some of the funds were used to maintain the entire system. The court also held that even though the funds are primarily for the installation of new services or upgrades to existing services, neglecting the maintenance of the existing system jeopardizes any new or upgraded services.

The salutary purpose of Ordinance 72-26, as referenced in *Hartman v. Aurora Sanitary District*, 23 Ill.2d 109, 177 N.E.2d 214 (1961), strikes a sympathetic chord with the Court. Implicit in the ordinance is the philosophy that those creating the inordinate demand for services ought to bear the prime cost of the same. The court also held that the rapid expansion of municipalities had rendered prior facilities inadequate compared to when they were developed for the health and welfare of the community. It is only proper that all citizens of the community should share equally in the cost of maintaining a sanitary plant that benefits the health and welfare of the entire community by the proper disposal of sewage. It would seem equally fair that those property owners who benefit especially, not from the maintenance of the system, but by the extension and expansion of the system into an entirely new area, should bear the cost of those improvements.

In conclusion, these cases relied on the principal idea of a tax being used for the general fund, whereas a fee is used for a specific project. As long as the

governing entity understands this premise and develops impact fees according to state law and following previous court ruling, any legal challenge should be short-lived and successful in the city's favor.

### **Chapter 395**

In the State of Texas, Local Government Code Chapter 395 is the enabling and governing statute for development impact fees. Chapter 395 is very specific about the process by which impact fees may be enacted, and there are several steps in the process that are statutorily required before charging development impact fees. This statute authorizes the implementation of impact fees for very specific capital improvements or expansions. It codifies the process of developing and adopting impact fees, the methods of impact fee calculations, how collected impact fees are accounted for, and acceptable uses of collected fees. It has been said that this Texas law is so restrictive that it is essentially “prohibition by authorization” (Ross et al. 1992).

Chapter 395 narrows the scope of impact fee funding by mandating that impact fees only be used for capital improvements and expansions to accommodate new developments. Only capital projects involving water, wastewater, stormwater, and roadways not in the city's extraterritorial jurisdiction (ETJ) that will serve the new development are eligible for impact fee funding.

Impact fees may *not* be used:

- For the repair, operation, or maintenance of existing facilities.

- To upgrade, update, or expand existing facilities that already serve existing developments to bring them into compliance with new, stricter safety, efficiency, environmental, or regulatory standards.
- To pay for the administrative or operating costs of the city.
- To reimburse bond funds that were used for public facilities not identified in the Capital Improvements Plan (CIP).

The overall effect of these restrictions is that impact fees may *only* be used for the construction of new capital projects (or facilities expansions) that will serve new development and fall within the four allowable categories. Every other use of impact fees is, essentially, prohibited by law.

Chapter 395 also codifies the prerequisites and process for a city to adopt impact fees. An advisory committee must be formed that is composed of no less than five members. No less than 40% of this committee must be drawn from representatives of real estate, development, or building industries and must not be involved in government. If the city already has a planning and zoning commission, this commission may be used as the advisory committee provided that at least one member is from one of the listed industries. If not, the city must appoint an ad hoc voting member from one of the listed industries. Additionally, if the proposed impact fee will be applied to the city's ETJ, the committee must include a representative from that area.



According to Chapter 395, the Advisory Committee is tasked with several functions that make it an integral part of the impact fee adoption and implementation process. The committee is to advise on the adoption of Land Use Assumptions (LUA) by the city council, review the Capital Improvements Plan, and file written comments regarding the plan with the city council. They are further tasked with monitoring the implementation of the Capital Improvements Plan and advising on any updates that are needed to the Land Use Assumptions, Capital Improvements Plan, and the impact fee itself. Finally, the committee must file semiannual reports on the progress of capital improvements and notify the city council of any discovered inequities within the Capital Improvements Plan or with the impact fee itself. The city council must also make available any professional reports or documents relating to the development of the Capital Improvements Plan.

To enact a development impact fee, a city is statutorily required to adopt a Capital Improvements Plan that must be prepared by qualified professionals and obligates the city to the implementation of the plan within a “reasonable” time. The CIP is a very thorough and extensive document that must contain the following items which are required by Chapter 395:

- A list of existing capital improvements and their capacities to document and justify the implementation of impact fees to fund new capital improvements or facilities expansion.

- A description of existing capital improvements within a service area and the costs to upgrade, update, improve, expand, or replace these existing improvements to meet existing needs for stricter safety, efficiency, environmental regulations, and regulatory standards.
- An analysis of total capacity, level of current usage, and commitments for the usage of the existing capacity of existing capital improvements.
- A description of all or parts of the proposed capital improvements or expansions that are attributable to the new development area based upon the adopted Land Use Assumptions.
- A table showing the specific level of use for each category of capital improvement.
- A table showing equivalence or conversion that establishes the ratio of service units to various types of land uses (residential, commercial, or industrial).
- The projected number of service units expected to be generated within the service area based upon the adopted Land Use Assumptions and projected demand (up to ten years) for capital improvements necessary to meet the demand of the projected new service units.
- A plan for awarding property tax credits based upon projected utility revenue by the projected new service units OR a credit equal to 50% of the total projected cost of implementing the Capital Improvements Plan.

In addition to a Capital Improvements Plan, the city will have to produce a Land Use Assumptions document. This document must include a description of the service area for which impact fees will be charged. In addition, it must project changes in land uses, as well as project densities, intensities, and the population of the service area for at least ten years.

After the city develops both a Capital Improvements Plan and Land Use Assumptions and the advisory committee provides its input, the CIP and LUA must go through an adoption process that includes public hearings. The city must adopt an order, ordinance, or resolution that establishes a public hearing date. Before the first hearing date regarding their adoption, the CIP and LUA must be made available to the public. Prior to 30 days before the hearing, the city must notify anyone who has requested notification of such hearings within the previous two years and must publish the hearing date in one or more local newspapers. The CIP and LUA must be approved or disapproved by the city council within 30 days of the public hearings.

Like the CIP and LUA adoption process, impact fees are also subject to public hearings. The city must adopt an order, ordinance, or resolution establishing the public hearing date. Prior to 30 days before the hearing date, persons that have requested notification within the previous two years must be notified, and notice of the hearing must be published in one or more local

newspapers. Within 30 days of the hearing on the impact fee(s), the city council must approve or disapprove the impact fee(s).

After a city has gone through the process of enacting impact fees, there are numerous statutory requirements regarding the implementation, collection, and accounting of impact fees. Of particular importance, once an impact fee has been collected, the city is obligated to begin the associated capital improvements project within two years, and completion of the capital improvement must be completed within five years.

### **Funding New Infrastructure Survey**

As a part of the tools used to assess impact fees in Texas, the research team opted to conduct an online survey. This survey is a crucial piece of the puzzle, as it provides insight into what cities are doing currently to ease the burden of new development costs in Texas. Gaining perspective from cities that have already used impact fees allows the research team to base recommendations on what should be done if Amarillo chooses to implement impact fees.

Additionally, the survey is set up to also glean information from cities on what they have either considered or implemented to fund new infrastructure instead of impact fees.

## **Survey Methodology**

### ***Survey Development***

The survey was developed to be taken online via a web-based survey software tool called Qualtrics. Qualtrics was chosen for its ease of use in data collection and skip logic, allowing the survey to base new questions on previous answers. The survey was designed and tested to take less than ten minutes to complete to increase the likelihood of full participation. The Texas A&M Institutional Review Board found the survey not to be human-subject research. All results were received from September 27, 2021, through October 12, 2021.

Two initial qualifying queries guided the remainder of the survey questions, which were 1) the respondent's role at their respective city (i.e., city engineer, city manager, or finance department) and 2) whether their city collects, has collected, or has considered collecting impact fees. While other queries might have asked for more clarification of previous answers, the first two queries directed a substantial portion of the survey. In total, there were 43 queries in the survey; however, if the query of their city collecting impact fees indicated "yes," the respondents answered an average of 32 queries; if answered "no," the respondents answered an average of seven queries. The median time to complete the survey was under 6.5 minutes.

### *Sampling*

To promote query responses free from scrutiny and ensure anonymity, all collected data are only presented in aggregate form. Any results were omitted if the answer could identify the city. Overall, 30 Texas cities were selected based on population, average growth rates, size in square miles, geographical location, tax rates, and average economic growth rates compared to Amarillo, TX. Each of these factors is important in different capacities, and each represents why Amarillo is unique compared to many other cities.

With the many unique factors, the research team has chosen population size to be the standard for most comparisons with other cities to Amarillo. Census data from April 2020 was used to identify Amarillo's population of 200,393 (Census.gov 2021). From this data, a midpoint population of 200,000 was used to create three categories of cities, including:

1. Small city with a population between 75,000 – 149,999
2. Midsize cities with a population between 150,000 – 249,999
3. Large cities with a population of over 250,000

Once the 30 target cities were chosen, the research team searched online and contacted cities directly to collect names, email addresses, and phone numbers for each city's city manager, city engineer, and finance department head. When possible, calls or emails were made before the survey was sent out in an effort to increase response rates. With many cities cracking down on phishing attempts, the

research team wanted to alleviate any issues with city officials believing the survey link to be fraudulent. With a small sample size, this direct approach was essential to maximize response rates.

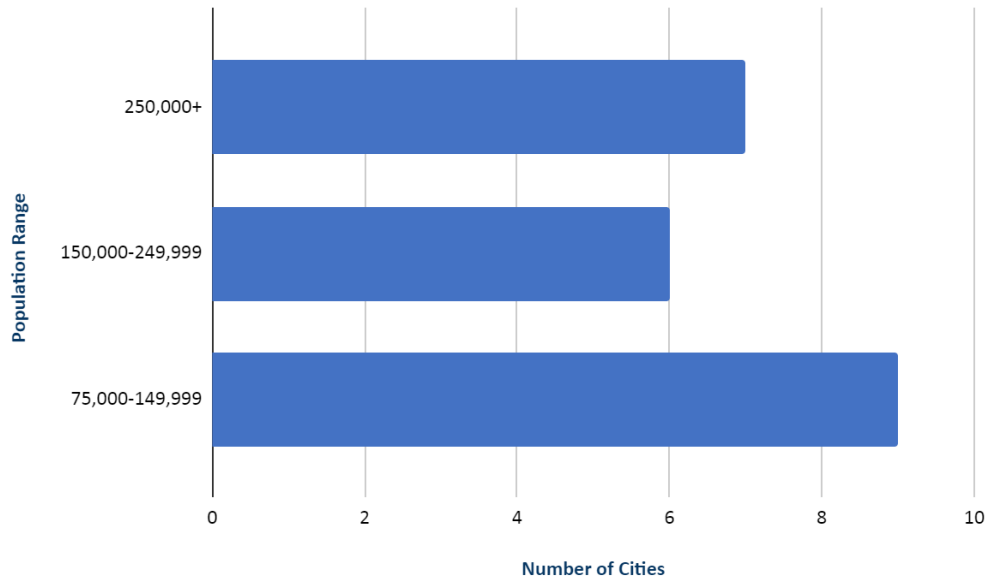
### ***Response Rates***

The research team sent out emails with the survey link with a follow-up email the next week to those presumed not to have responded. In total, 85 people were contacted from the 30 cities selected. The research team received 46 responses, but nine responses were omitted for not being complete. The remaining 37 responses indicate a 44% total response rate from the original 85 city officials contacted. More importantly, the responses represented 22 of the 30 cities – over a 73% response rate in that regard. Through email communication with some of the cities, it was indicated that several officials from cities worked together to complete the survey. Cities communicating internally and submitting a single survey back is a probable explanation for the city response rate being substantially higher than the individual response rate.

When looking at response rates based on city size, the research team received responses from nine small cities (75,000-149,999 people), six mid-sized cities (150,000-249,999 people), and seven large cities (over 250,000 people), as displayed in Figure 1.

**Figure 1**

*Cities Surveyed by Population*



**Survey Results**

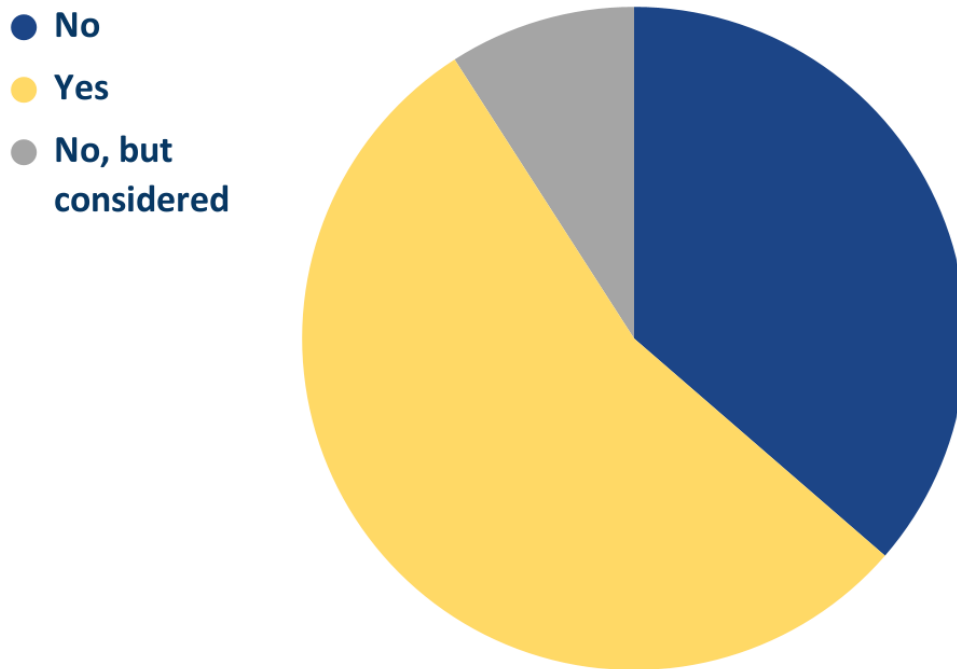
***Methods of Funding New Infrastructure***

Sixty-four percent of the cities in the survey have used or considered using impact fees. Of those, 55% currently use impact fees to fund new development and infrastructure, as shown in Figure 2.



**Figure 2**

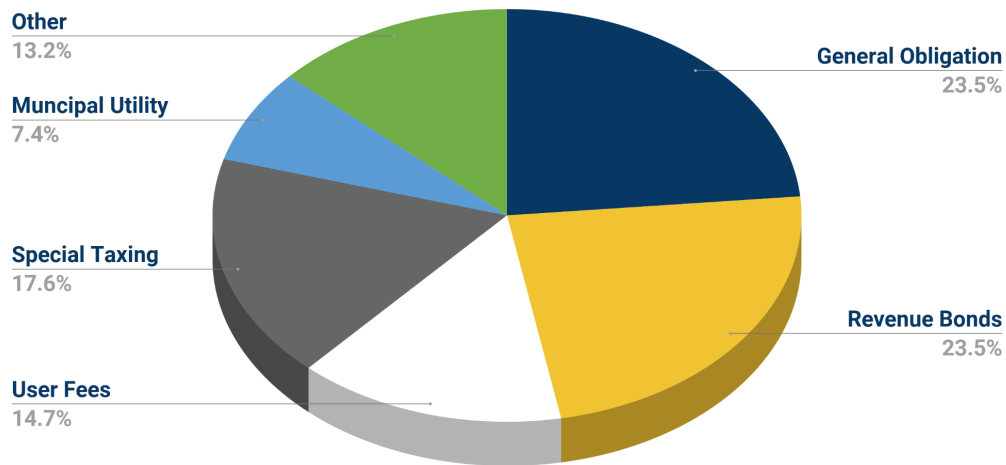
*Percentage of Cities Surveyed on Impact Fee Usage or Consideration*



The cities that do not collect impact fees, making up 45.5% of our sample, have found alternative ways to fund their new development. Some of these alternatives include: municipal utility districts, general obligations, special taxing districts, revenue bonds, user fees, and a category labeled just as “other.” If impact fees (or other) were not implemented for use, cities did also consider pro-rata, rate increases, debt, and bond programs, among a few other funding options. Figure 3 below shows where the cities surveyed lie in their funding decisions.

**Figure 3**

*Alternatives to Impact Fees for Funding New Development*



Since impact fees are very specific in what they can be used for, we also wanted to look at what the surveyed cities currently spend on maintenance for streets, water distribution, and stormwater. However, when we looked at the allotted percentages as part of their annual budget for these needs, we saw a wide range of percentages in each city. For example, the range of the maintenance allotted from the budget was: street maintenance, 3 - 32%, water distribution and maintenance, 6 - 50%, and stormwater drainage maintenance, 1 - 20%. Once the money from impact fees is allotted, there can sometimes be leftover financial obligations and long-term maintenance. These are funded via property and sales tax revenue, utility rate revenues, general fund revenues, maintenance fees, and

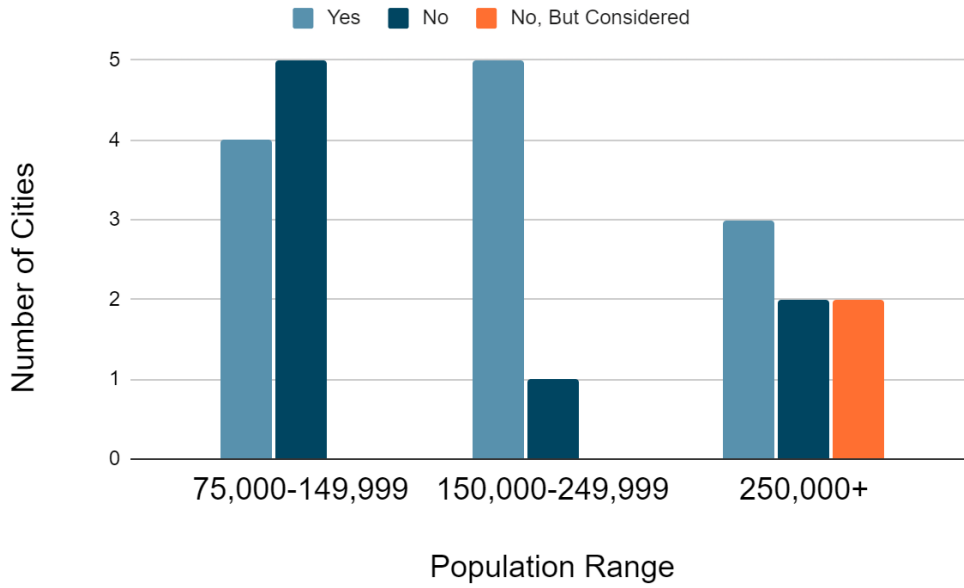
other varieties of taxes, revenues, and fees. For those cities that do not implement impact fees, nine of them use alternative funding sources to cover the same type of projects. Alternative funding can be (but not limited to) developer agreements and/or trust funds, tax increment finance districts, property owner fees, certificates of obligation, and one-time fees.

### ***Impact Fees Based on Population***

The research team examined possible correlations between city population and their choice to utilize impact fees for new infrastructure funding. Figure 1 shows how the 26 cities surveyed are broken down by population range. The survey appears to show that mid-sized and large cities are more likely to use or consider impact fees. Figure 4 shows the correlation between population size and impact fees. The years the cities adopted impact fees ranged from 1989 - 2021.

**Figure 4**

*Number of Cities Using Impact Fees by Population*



***Impact Fee Waivers***

Texas Local Government Code 395.016 offers waivers to reduce or not enforce impact fees if development qualifies as affordable housing (Gaines and Fambrough, 2007). Out of the 12 cities in the survey that collect impact fees, nine (75%) have the option to waive or reduce impact fees.

Respondents cited the use of development agreements in almost all of the cities that offer waivers. In the development agreements, most cities will waive impact fees on the infrastructure that the development builds. For instance, if the developer builds a road on the development plan, that road is left off from the

impact fee. Likewise, if the developer builds part of a road, the city will credit a portion of the impact fee.

Some cities created impact fee ordinances, so approval of waivers or discounts must be within the confines of the ordinance. Other instances of waived or discounted impact fees include:

1. Development in the core of the city/infill areas,
2. “380 Agreements” (Stemming from Local Government Code Section 380),
3. Certain specified types of development/businesses,
4. Existing business expansion or relocation,
5. Roadway impact fees will be waived if the water supply and wastewater fees exceed a specified dollar amount,
6. Special council approval, and
7. For residential lots that receive final plat approval before the effective date and at least 80% of the lots have permits issued.

### ***Public Relations***

Public relations are at the core of many political decisions. Cities have figured out that these relations can make the difference between the public and developers receiving impact fees positively or negatively. In fact, all but one respondent who dealt with developers indicated the city received developer

opposition (two respondents were “unsure”). With this opposition in mind, the cities were surveyed on what, if any, actions they took to mitigate.

When asked if the city attempted to educate citizens on impact fees, the results were mixed. Four cities responded “no,” six responded “yes,” and two selected “unsure.” Among the six cities that did attempt to educate citizens, most used social media, printed materials, and different forms of public presentations, such as at Homeowners Associations (HOAs), civic societies, and town hall meetings. Only one city listed TV and radio infomercials.

However, of the six cities that did elect to educate their citizens, only half considered their education efforts effective. The other half rated their efforts as “somewhat” effective, noting the limited reach and lack of concern with impact fees for the general public. Notably, one city did indicate issues stemming from misinformation received by citizens from other sources, while another respondent stated that most citizens are not concerned with impact fees since it primarily affects developers.

Regarding the most significant issues facing city administration, about half of the cities specifically referenced developer opposition. To help alleviate this, cities approached developers in a variety of different ways. A few cities were simply very transparent with the facts – infrastructure costs money. City officials shared this fact-based narrative with the development community and included them as ad hoc members of their Impact Fee Advisory Committee. Comparative

analyses were made by the city and/or their consultants to examine cost estimates for growth-related infrastructure and also to show that by developers putting money towards the infrastructure system, their development would thrive more in the long term. Some cities have monthly breakfasts with developers where attendees can exchange ideas.

In the interest of transparency and continued conversations with developers, city officials are making compromises to help meet in the middle. Some cities chose not to go with the maximum collection rates, or have reduced rates for certain types of development, such as industrial. Cities did note that frequently, *change* of any sort to long-standing processes is difficult. But once impact fees are adopted, barring large spikes in impact fee assessments, impact fees become easier to maintain.

In addition to developer opposition, the many fiscal and administrative unknowns and constraints also proved to be significant issues for city administrators. Cities wanted to make sure they were collecting sufficient fees while staying competitive with their peer cities. There are also transitional challenges, such as how to handle current developments already in progress. Overall, cities are trying to keep tax rates and fees low for existing residents by utilizing impact fees.

### *Use of Consultants*

Consulting firms were used to address the different codes under the Texas Local Government Code 395 within 75% of the cities that returned surveys. The reasons for using a consulting firm included:

- Expertise and experience
- Time that the consulting firm could commit to the city project
- Lack of staffing or that the current staff is already over-booked (and/or could not add another big project)

Additionally, the cities that used a consulting firm reached that decision via a recommendation from their city elected officials. If a consulting firm was not used to implement impact fees, the city's existing staff addressed the different Texas Local Government codes. At no point did any cities consult with an accounting firm, although a few cities used an existing accountant or analyst on staff to help analyze and account for the impact fee funds. To do this, they mostly used financial management software, and/or spreadsheets. A small number (three) of cities used a lawyer to help with the Chapter 395 requirements on top of a consulting firm. If the decision was to use legal aid, this decision was made by the city administration.

When queried if cities addressed Chapter 395 requirements internally, only one respondent had information on the length of time the implementation process for impact fees required, which was 12 - 14 months. There were eight cities that



used consulting firms and knew how long the implementation process took. For those eight cities, the impact fee implementation process took two cities between 6 - 11 months, three cities between 12 - 14 months, and three cities needed more than 14 months. In addition, no cities hired and/or brought in new staff to help meet the Chapter 395 requirements. Therefore, no additional funds were needed for payroll.

## **Findings**

### **Introduction**

Many communities continue to seek new sources of revenue to meet the new infrastructure demands as they grow. Impact fees have been utilized in many communities experiencing significant population growth while simultaneously facing overcrowding of school resources, aging infrastructure, and reduced revenue (Opp 2007). The question for many cities across Texas is how to fund this needed infrastructure and manage the growth and demand for service that comes with development.

In 2019, Texas passed Senate Bill 2, the Texas Property Tax Reform and Transparency Act, which, among other things, reduced the cap on maintenance and operations revenue increases from 8% to 3.5% without voter approval (Lieber 2019). However, this new law is not the only reason municipalities are forced to look for alternative funding sources. Most of these communities have underfunded and deferred expenses for much of the infrastructure, especially

roadways, for years. Currently, the existing infrastructure is requiring attention and reducing the available money for new projects. “In 2012 infrastructure spending accounted for 20% of total local government expenditures, the lowest percentage in more than 50 years” (Chen and Bartle 2017, 4). All of these factors, as well as unique local community issues, are driving the discussion and forcing communities to seek new funding for current and future infrastructure. Impact fees allow local governments to levy a one-time fee on the property developer to fund the future infrastructure needed to meet the increased demands created by the development (Gaines and Fambrough 2007).

To assess the overall benefits of impact fees in the revenue structure of a municipality, several things must be considered. The first, and most obvious factor, is the overall economic development of the area. Cities that experience significant and rapid growth will have a different benefit from impact fees than a municipality with stagnant or declining development. Other factors to consider are population growth, the tax base, and debt obligations for the municipality. Each of these will be discussed in greater detail and how the City of Amarillo fares in each area.

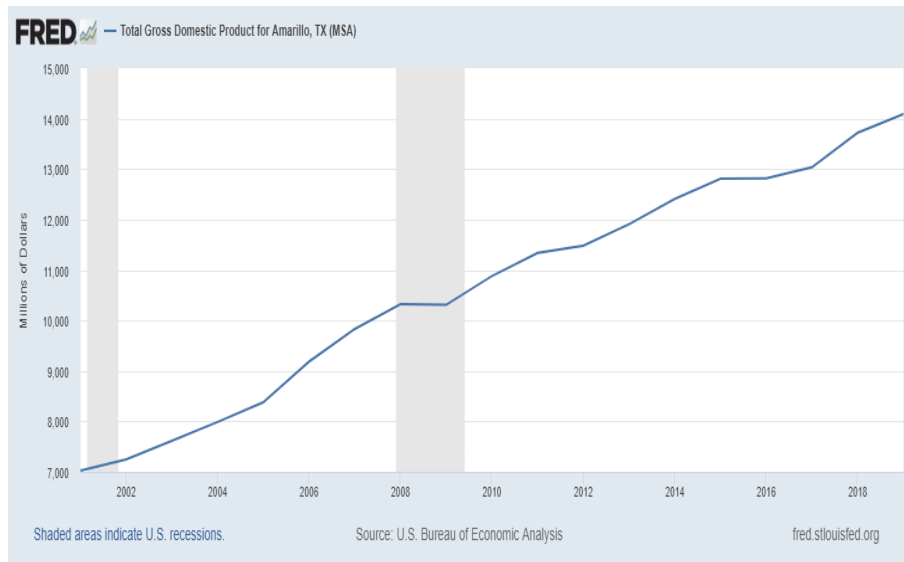
### **Gross Domestic Product (GDP)**

Economic growth and economic development are often used interchangeably, but economic development in the context of this analysis references the physical development of residential and commercial properties,

which will ultimately have an impact on the systems and services provided by a municipality, specifically roads, water, stormwater, and sewer. However, economic growth, most often measured in the gross domestic product (GDP), is the total dollar value of goods and services produced in a given year (5 Ways Economic Growth Occurs 2016), which correlates with economic development. GDP increases in five ways: 1) a rise in labor participation; 2) the discovery of new resources; 3) an increase in labor specialization; 4) the development or implementation of new technology; and 5) an increase in trade (5 Ways Economic Growth Occurs 2016).

GDP data collected for the City of Amarillo demonstrates a steady increase over the 20 years from 2001 to 2019 has an average growth rate of 3.97% annually (U.S. Bureau of Economic Analysis 2019).

### Annual GDP for Amarillo, Texas 2001 to 2020



Source: U.S. Bureau of Economic Analysis

Although not a stand-alone indicator for economic growth or the health of a municipality, most economists agree that an ideal manageable growth rate is between 2% and 3% (Amadeo and Boyle 2021). A rate above 3% possibly indicates a growth rate that is difficult to manage, however, this is not absolute. Impact fees may be a useful tool to manage economic development at high rates. The Panhandle Regional Planning Commission (PRPC) 2019 report states that the area has some challenges for economic growth. The majority of this regional economy is based on oil and gas, cattle, and agricultural production; however, Amarillo has demonstrated itself to be the epicenter of new growth and developing industries (Meyer and Ingham 2019).

## **Population Growth**

Population growth is a critical variable when assessing the benefits of impact fees. With increased population comes increased demand for existing services, as well as the need to expand new infrastructure. The Panhandle Regional Planning Commission identified that, while the region has experienced population growth and projects this trend to continue, it also acknowledges that about half of the counties in this region have experienced significant population declines. Population in the City of Amarillo has steadily increased annually based on data from the Federal Reserve Economic Data from 2000 to 2020, with an average annual growth rate of 0.8% (U.S. Census Bureau 2021). Although there are multiple factors of influence, as a general rule, population growth typically increases residential property values and thus increases the ad valorem tax base (Weber and Buchanan 1980, 6–8). It is also worth noting that the Panhandle region as a whole has a low annual average wage that is 19.2% behind the state average. This will also have an impact on tax revenues in the area, primarily sales tax revenue (Meyer and Ingham 2019).

**Comparison Cities Average 20 Year Population Growth and GDP**

	<b>20 Yr Avg GDP</b>	<b>20 YR Avg Pop Growth</b>
<b>Amarillo</b>	3.97%	0.79%
<b>Lubbock</b>	4.19%	1.34%
<b>Abilene</b>	4.33%	0.40%
<b>Midland</b>	12.73%	2.36%
<b>Odessa</b>	7.78%	1.67%
<b>San Angelo</b>	4.69%	0.75%
<b>Bryan - CS</b>	6.07%	1.87%
<b>Killeen - Temple</b>	4.96%	1.75%
<b>Longview</b>	3.93%	2.22%
<b>Tyler</b>	4.14%	1.49%
<b>Waco</b>	4.36%	1.31%
<b>Wichita Falls</b>	2.75%	0.03%

Source: U.S. Bureau of Economic Analysis

**Tax Base and Debt Obligation**

“Aging regional infrastructure and increasing infrastructure demands pose great concern to many of the communities in the Texas Panhandle. Water and sewer infrastructure was largely put in place before 1960 throughout the region; limited local fund availability over the last half-century has resulted in failing infrastructure that cities must address. The use of local funds, low-interest loans, and the Community Development Block Grant Program are all being used by localities to address this issue and increase local infrastructure capacity to address growing economic demands” (Meyer and Ingham 2019, 7). This issue is not exclusive to the Panhandle region, and specifically, in the Align Amarillo Strategic Plan produced by the City of Amarillo in partnership with the Amarillo

Economic Development Corporation (EDC), it was identified in Goal 2: “many of the city’s roads are in disrepair, and streetscapes are not attractive, especially when entering the city – creating a poor first impression for visitors” (DeLisi n.d., 23).

As stated previously, the existing revenue sources for the City of Amarillo are not adequate to meet the needs of this goal. The City of Amarillo had proposed a property tax rate of \$0.48404 in its Fiscal Year 2022 budget, which was a 22.77% increase to property taxes over the previous year to help raise taxes by \$11,855,088. However, with the recent defeat of Proposition A, the proposed increase in the property tax rate to \$0.48404 per \$100 valuation, with over 55% percent of voters voting against this 22% increase the city, will revert to the voter-approval tax rate of \$0.44334 per \$100 valuation for this current fiscal year.

The PRPC identified stagnant tax bases as a threat in the SWOT analysis of its 2019 report stating, “The cities and counties of the Texas Panhandle take great effort to keep the region a friendly place for both businesses and citizens. As such, most communities take great efforts to keep tax rates and utility rates as low as possible. The unfortunate side effect of this is that there are very limited resources available for many communities in the region to maintain and upgrade infrastructure. Economic Development is key within the region because further diversification of the region will help to prevent tax bases from stagnating. With low rates, it is key that the regional economy continues to grow” (Meyer and

Ingham 2019, 14). Therefore, identifying additional revenue sources is paramount to the long-term success of the City of Amarillo.

In a 2017 paper published for the International Association of City Managers called “Infrastructure Financing: A Guide for Local Government Managers”, the authors reported the following summary findings: In 2012, the average local government spending on infrastructure accounted for approximately 20% of total expenditures, which was the lowest percentage in 50 years. In the 1970s the average spent on infrastructure was 40%. This steady decline, combined with other public service demands, has rendered spending on infrastructure ineffective to keep pace with the needs of the community.

When paying for capital projects, local governments traditionally have two basic options, pay-as-you-go using existing cash on hand, or debt. Cash is most commonly used “in cases when capital project sizes are small, project sponsors have limited access to debt, local governments are closely approaching their debt limits, or there are prohibitions on use of debt” (Chen and Bartle 2017, 11). Debt financing, however, “means issuing long-term debt in the form of general obligation bonds or revenue bonds to fund capital projects. Infrastructure projects often involve large or lumpy investments and benefit both current taxpayers and future generations. The use of debt financing is justified in part by the rationale of spreading out the costs of public infrastructure investments throughout the life of the asset” (Chen and Bartle 2017, 11).



Some of the most significant findings from this project's survey were:

- The average percentage of the budget spent on infrastructure was 13%.
- The primary source of funding for infrastructure projects was general obligation bonds.
- Twelve of the thirty cities surveyed collect impact fees, and two more have considered them.
- Most of the cities surveyed use tax revenues for their long-term infrastructure maintenance.
- Nine of the thirty cities surveyed collect user fees as an additional revenue stream for infrastructure.
- Cities that utilized impact fees stated their main reasons for implementing them were to keep tax rates low and to utilize the current growth to pay for future growth.
- Of the cities that collect impact fees, all but one use the fees as one of multiple infrastructure funding sources combined.
- The majority of cities collecting impact fees also contracted with consulting firms to navigate the complex Chapter 395 law.

### **Are Impact Fees the Silver Bullet?**

Impact fees are not a one-size-fits-all solution, and eventually, as development wains, they will become unreliable. The adoption of impact fees provides an additional funding tool for infrastructure systems. Funds collected

within a service area must be spent on projects within the same service area within ten years. Water and sewer service areas can be citywide. Roadways, however, must not exceed a six-mile limit on the development area. Amarillo must do a ten-year Capital Improvement Plan that provides an analysis of land use and population projections. In addition to providing additional revenue, impact fees act as a growth management tool for local governments by coordinating “the financial burden of infrastructure incurred from new development” (Jeong and Feiock 2006, 7). The fees may serve as a regulator of growth while providing the revenues to sustain it.

With the recent increase in tax revenue Amarillo has received, implementing an impact fee now would significantly help city leaders invest in much-needed infrastructure needs. Under Chapter 395 of the Texas Local Government Code, Amarillo can charge a one-time fee for any new development in the area. These fees would be applied to new water distribution, wastewater, roadway, and drainage construction, which also reallocates other budgeted dollars toward infrastructure not eligible for impact fee use. It would also allow for a balanced funding combination that would recognize areas that are impacted through growth. Impact fees help ensure these new developments will have the necessary infrastructure required to be provided by the City of Amarillo.

## **Opposition Points to Impact Fees**

Any municipality considering the implementation of impact fees will likely face some opposition. As part of the research conducted for this report, several opposition talking points were identified to provide some additional perspectives for consideration. It should be noted that this list is not exhaustive, and the unique needs of each community could create scenarios not envisioned here.

### ***The Equity Argument***

Developers are traditionally the most vocal opposition to impact fees. One of the main arguments made by the development community is that the impact fees place an undue share of the burden of costs for the infrastructure on them. They argue that infrastructure is a community-wide benefit, and therefore should not be placed at the feet of developers alone (Bassett and Worshtil 2016). For example, new roadways constructed with development impact fees are public, but all citizens and visitors are allowed to use them, which impact fee payers may argue is unfair.

Impact fees also increase the risk for developers and home builders when trying to establish price points for housing stock. The developers and builders may decide to build in a neighboring jurisdiction based on whether impact fees are applied or not. According to the Impact Fee Handbook, “If impact fees are imposed in one jurisdiction but land is readily available in a surrounding market

area that does not impose impact fees, builders may choose not to purchase land in the jurisdiction that imposes the fee unless owners of land within the jurisdiction are willing to take a reduction in price that fully compensates for the fee” (Bassert and Worshtil 2016). Essentially, this argument stems from when the impact fees are collected. Developers paying these fees early may lose money since impact fees increase the net costs of the project, and other jurisdictions may be more lucrative by providing lower net costs without the addition of the impact fees.

Developers also argue that there is a great disparity in impact fee implementation among municipalities, but also within a single jurisdiction. Developers and home builders are looking at impact fees from the perspective of how to navigate and marginalize cost. Fixed costs, such as building materials and labor are somewhat predictable over time. An introduction of impact fees creates an additional cost in all financial planning and modeling, and the difficulty comes in predicting these costs and the variation between jurisdictions. A challenge exists when developers attempt to determine how much, if any, impact fee costs can be placed on the end-user, and if the impact fee costs are absorbed by the end-user, a challenge arises with home value and affordability equity (Bassert and Worshtil 2016). Even the fee application within a jurisdiction can have inequity in their application. Developers argue that municipalities can waive or reduce impact fees for certain projects which opens the door to “negotiation abilities and

political currencies of developers and their attorneys” to create “major differences or inequities in the implementation of fees” (Kolo and Dicker 1993, 5).

### ***The Exclusion Argument***

There is an additional equity talking point often made regarding impact fees over time concerning the population of a community. The argument is that impact fees place an undue burden on lower-income households and first-time home buyers. Homebuyers desire to obtain reasonably priced housing and when development impact fees and property taxes are taken into account, additional fees become a significant factor in purchasing power. First-time home buyers are disproportionately impacted, for example, as down payment requirements may increase due to fee assessments (Bassert and Worshtil 2016). The idea suggests that higher fees are passed on to renters and first-time homebuyers which potentially limits these groups’ opportunities to enter a community (Bertolet 2017). Although arguments can be made that smaller homes incur lower impact fee costs, additional costs impact purchasing power, especially those who are income constrained.

### ***The Double Billing or “Taxation” Argument***

It can be argued from a political perspective that impact fees struggle to make the connection between those paying and those benefiting from them because new and current users benefit and share costs for improvements over time. A new user who pays the impact fee contributes financially to the original

cost of infrastructure, but it is unclear how much benefit is received by existing residents. In the case of residents who are relocating, the argument can be made that as current residents they have already paid their share of the development burden, whereas someone new to the area is creating a new demand for service (Kolo and Dicker 1993). An activist group in College Station, Texas put together a video, website, and social media campaign against development impact fees, most of which stems from a lack of understanding of the law. However, two specific claims of the group are that impact fees would stop new businesses from establishing in the community and that impact fees also drive up property values, thus increasing the property taxes paid by the same resident (Citizens for College Station 2021). There is also empirical evidence that the use of impact fees drives up the cost of land and housing. “The findings confirm and extend the results of past studies and show that impact fees, while providing an alternative funding source for municipal improvements, also result in increased property values. The net effects of these higher property values are less affordable housing, increased capital gains to existing homeowners, and increased property valuations for tax purposes” (Evans-Cowley 2009, 189).

### ***The Stop or Deter Growth Argument***

Impact fees are often at the heart of a community’s growth discussion because, with increases in population, businesses, and industry also come increases in needs for basic infrastructure. The benefits of the growth, such as

increased tax base and sales tax revenues, can be outpaced by the immediate need for infrastructure. Impact fees are touted as an effective tool for municipalities to manage rapid growth, allowing them to offset upfront infrastructure costs and better manage development projects (Jeong and Feiock 2006). However, detractors argue that impact fees stop growth and development. In a community attempting to counter urban sprawl, impact fees may be necessary as explained by Dan Bertolet with the Sightline Institute: “Expansion into undeveloped ‘greenfield’ areas, policymakers have a legitimate case for impact fees. In that scenario, land may be worth next to nothing until a municipality extends basic infrastructure (roads, power, water, sewer) so that functioning homes can be built. If the public foots the bill, it’s a direct subsidy to the owners of the property served—and worse, a subsidy that encourages unsustainable sprawling growth. Impact fees justifiably recapture some of that subsidy from the property owners, while at the same time chilling the incentive to sprawl” (Bertolet 2017, 3). However, in the case of a municipality that is heavily urbanized, impact fees may encourage sprawl and disincentivize development within the infill urban areas (Bertolet 2017). Groups like the Citizens for College Station, for example, cite that impact fees are a deterrent “against lifestyle improvements, against restaurants, against entertainment and the like” (Citizens for College Station 2021, 4). Finally, when attempting to use impact fees as a growth management tool, opponents suggest that the slowing of development will also impact the growth of

the municipalities' tax revenues and drive growth toward neighboring communities (Bassert and Worshtil 2016). There are no guarantees that development impact fees will curtail growth, but the question that needs to be addressed is, if development impact fees are assessed and housing becomes less affordable and the economy slows, what happens next? This question may be generic, but extremely relevant for discussion and serious consideration. As much as impact fees may encourage growth, they may also discourage new development, creating a non-competitive environment with other communities with lesser or no impact fee assessments.

### ***Summary***

“Impact fees have evolved as an important means of bridging the gap between facility needs and the revenue available to pay for them, however, impact fees have many detractors who argue correctly on public finance and social welfare grounds that impact fees are not the best solution to solving local [infrastructure] financing problems. As many policymakers, developers, homebuilders, legal counsel, and citizens argue with validity, impact fees are often viewed as the necessary evil to solve pressing needs” (Bassert and Worshtil 2016, 93). Is the benefit of charging and collecting development impact fees worth the costs associated with housing affordability, accessibility, and infrastructure development and expansion? This may be a situation where costs exceed benefits and other options for infrastructure development and expansion



may be more viable and acceptable to stakeholders. Although municipalities may reasonably justify policy decisions regarding the adoption of development impact fees, such choices come with economic, social, and political consequences.

### **Alternative Funding Sources**

The Texas Municipal League has compiled a list of all revenue sources available for Texas cities. The manual is a resource for city officials and staff when considering new revenue ideas and a guide for understanding each of the revenue streams available. Even if not directly used to fund new infrastructure projects, this document could serve as a resource to identify funding sources that the government could utilize to increase the general fund revenue (Texas Municipal League 2019).

#### **Property Tax**

“According to a recent survey conducted by TML, property taxes are the leading source of city revenue, accounting for 36 percent of city revenues on average statewide. Sales taxes are second at 23 percent” (Texas Municipal League 2019, 60). Of the two largest funding sources available for municipal governments, property tax revenue is the more flexible of the two.

The property tax rates for a municipality are set annually by council ordinance. The process for setting the tax rates is listed in and must comply with the Texas Tax Code, Section 26 - Assessment, specifically Section 26.04. Article 8, Section 21 of the Texas Constitution is the basis for those calculations.

In this calculation, the property tax revenue generated from the maintenance and operations (M&O) tax rate that can be adopted by the governing body is limited to a 3.5% growth rate determined by a complex calculation performed every year after the receipt of the appraisal roll from the County Appraisal Districts. The allowable growth rate of M&O taxes was reduced from 8% to 3.5% as a result of the passage of Senate Bill 2. This puts more restrictions on a municipality to raise the necessary revenue to maintain operations, much less to fund increasing capital infrastructure needs. (Hegar, n.d. - 2)

### **Sales Tax**

“The Development Corporation Act of 1979 gives cities the ability to finance new and expanded business enterprises in their local communities through economic development corporations (EDCs). Chapters 501, 504, and 505 of the Local Government Code outline the characteristics of Type A and Type B EDCs, authorize cities to adopt a sales tax to fund the corporations, and define projects EDCs are allowed to undertake” (Hegar, n.d.- 3).

Sales tax revenue for local government general revenue is limited to two percent of all goods sold within the city limits. The City of Amarillo levies a sales tax rate of 2% on the sale, rental, and use of most tangible property, labor, and selected services. There are exceptions to the sales tax assessment for “machinery and equipment used directly in the manufacturing process or for pollution control; and items that become a component part of a manufactured item, are consumed in

the manufacturing process or delivered out of state” (Amarillo Chamber of Commerce 2019). Since Amarillo’s sales tax rate is at the statutorily maximum rate allowable for a local government, increasing the sales tax rate for an economic development district is not feasible. However, the increased sales tax revenue could come from growth in the commercial retail sector which could be developed utilizing a variety of other economic development tools.

### **Right-of-Way Rental Fees**

These are also known as franchise fees, and are another potentially significant source of revenue for Texas cities. These fees are assessed on utility companies (telephone, electricity, natural gas, cable, etc.) for their use of the city’s right-of-way to deliver their product to the citizens of the city. These fees are also known as franchise fees or gross receipts taxes. The fees are calculated on the gross receipts of the company for services sold within the city limits. “At present, electric, telecommunication, gas, water, cable television, and video service providers each have their own legal framework with regard to how the fee is calculated and assessed” (Texas Municipal League 2019, pg. 78). The City of Amarillo currently budgets general fund revenue receipts expected from electricity, natural gas, water, sewer, telecommunications, and cable utility companies (City of Amarillo 2021).

## **Municipal Utility Districts**

MUDs are another alternative source for funding utility projects and developing residential areas. “The size varies, but MUDs generally serve communities of a few hundred to a few thousand households. There are more than 900 MUDs in Texas, with many of them sitting outside city limits in extraterritorial jurisdictions (ETJ) where municipal services are not provided” (“Municipal Utility Districts: What Are They And How Do They Benefit Developers And Residents? Jones|Carter” 2020).

Chapter 54 of the Texas Water Code allows for “the creation of MUDs under and subject to the authority, conditions, and restrictions of Article XVI, Section 59, of the Texas Constitution” (Texas Water Code 2011). MUDs are a political subdivision of the State of Texas and an independent limited government with its own board of directors elected by the property owners of that district. This chapter specifies the steps necessary to create the MUD, from petition to creation. “No land within the corporate limits of a city or within the extraterritorial jurisdiction of a city shall be included in a district unless the city grants its written consent, by resolution or ordinance, to the inclusion of the land within the district” (Texas Water Code 2011). If a city does not approve the creation of the MUD, the property owners have 90 days to petition the governing body to provide the utility services to the area. If the municipality and the petitioners do not come to mutually agreeable terms for the provision of utility

services after 120 days, this in effect authorizes the creation of the MUD (Texas Water Code 2011).

After the development of the district has sufficient taxable value, the MUD can issue bonds to repay the developer for the construction of the water, wastewater, drainage, roads, and other authorized projects. The MUD levies a property tax and assesses usage fees to repay the bonds and fund other capital and operating expenses of the MUD ("Municipal Utility Districts: What Are They And How Do They Benefit Developers And Residents? Jones|Carter" 2020).

### **Tax Increment Financing**

Tax Increment Financing (TIF) is one other alternative method for funding necessary development improvements that may bring private investment into the area. Chapter 311 of the Texas Tax Code governs tax increment financing. This is not a new tax, but a redirection of a portion of the property tax in a specific geographic area that has been designated as a Tax Increment Reinvestment Zone (TIRZ) (Hegar, n.d.). The terms TIRZ and TIF are sometimes used interchangeably. "Only a city or county may initiate tax increment financing. Tax increment financing requires the governing body of a city to create a Tax Increment Reinvestment Zone (TIRZ). The governing body of a city by ordinance may: designate a contiguous or noncontiguous geographic area (a) within the corporate limits of a municipality; (b) in the extraterritorial jurisdiction of the municipality, or (c) in both to be a reinvestment zone. The designation of an area

that is wholly or partly located in the extraterritorial jurisdiction of a municipality is not affected by a subsequent annexation of real property in the reinvestment zone by the municipality” (Hegar, n.d.).

When a TIRZ is established, a base year taxable value of the properties in the zone is determined. Each year, as the values increase, the incremental revenue generated from the increased values is designated for the TIRZ projects, payment of debt, or reimbursement to the developer. The city may also be considered a developer of the property. “A TIRZ provides a way for cities to build much-needed public infrastructure. Through this type of funding, private development is encouraged, and the cost of building is reduced. A TIRZ can help provide public facilities in a timely and cost-effective way. It can help build or repair transportation, utilities, and other necessary services to meet the needs of the residents. One of the major advantages of a TIRZ is that the funding does not come from the existing tax base. TIRZ monies are a direct result of economic expansion” (Murdock 2019).

### **Recommendations for Success**

When charting the path forward to the implementation of development impact fees, several steps are considered best practices. Perhaps one of the most important steps is that the impact of new development on the capacities of existing infrastructure must be quantified in such a manner that impact fees are defensible logically and legally (Ross et al. 1992). This involves identifying

service areas and logically defining service units that meet the legal requirements under the *rational nexus* standard of federal case law as well as the requirements of Texas state law.

The first step in the implementation of impact fees is the “realization phase.” This phase is characterized by the governing body (city council) realizing that existing sources of revenue (property taxes, sales tax, business fees, and utility fees) are insufficient to fund the expansion necessary for growth while still maintaining service for existing citizens (Ross, et al. 1992). According to Ross et al. (1992), this realization may come after rapid growth is already underway or imminent. While growth may already be upon a community before this realization occurs, the governing body must first recognize the necessity for development impact fees and commit to a course of action to implement them.

A comprehensive list of current infrastructure and its capacity needs to be created to justify to the public and developers that existing capacity is insufficient to meet future growth needs. It must be made clear in the document that impact fees will only be utilized for projects necessary to meet the demands of growth and that the maintenance of existing infrastructure is the responsibility of existing residents of the city (Ross et al. 1992). This is done to show developers that they are only paying for future needs resulting from development. This particular best practice is required under Texas Local Government Code Chapter 395 to develop the LUA and CIP.

It is important to include developers and special-interest groups early in the discussion regarding the implementation of impact fees. Examples of groups that should be included in the process include builders, developers, realtors, environmental groups, anti-growth groups, and the local Chamber of Commerce (Ross et al. 1992). By including these groups early in the process, a local government can avoid accusations that these groups were not given adequate notice or input in the process. Additionally, a planning commission should be included in the process that includes members outside of the local government. Texas Local Government Code Chapter 395 provides for this by mandating the formation of an advisory committee composed of representatives from real estate, development, and/or building industries and members from local government. In place of an advisory committee, the local government's planning and zoning commission can be utilized with the provision that it includes one ad-hoc member from the listed businesses.

Formal hearings should be held to allow public input and feedback on proposed fees and changes to existing fees. It is prudent that these hearings be conducted transparently with adequate notice given so that interested and affected parties can be part of the discussion (Ross et al. 1992). Texas Local Government Code Chapter 395 mandates that public hearings be conducted and prescribes the amount of time before a public hearing that notice must be provided. These



hearings are necessary before adopting LUA and CIP, and again before the proposed impact fees can be adopted.

Transparency and public accountability regarding how impact fees are calculated and expended is another suggested best practice. As discussed previously, impact fees should only be used for growth-related projects, and these projects should be outlined in a community's CIP. Maintenance and upgrades should be handled through methods of financing other than impact fees. Collected funds should be accounted for and expended within a reasonable timeframe on the projects for which they were collected. Texas Local Government Code Chapter 395 mandates this practice and specifies acceptable uses of impact fees and how impact fees are to be calculated, collected, accounted for, and deadlines for expenditure.

Finally, public education is an important and often overlooked step in impact fee implementation. Ross et al. (1992) state that many communities have been unsuccessful in implementing impact fees because of inadequate public support due to a lack of an effective public education initiative. Because cities often find themselves unable to maintain current service levels while funding growth-related expansion under existing revenue streams, the public should be educated about this dilemma. It is important to inform the public of the necessity for impact fees by quantifying existing infrastructure capacity and the cost of future improvements necessary to accommodate growth. It must be made clear to

the public that impact fees are collected solely from the new growth to fund that growth and that they are not collected from existing citizens already using community services and infrastructure. Therefore, a public education initiative to inform existing citizens about the current capacity of the city's infrastructure, sources of revenue, and financial ability to fund expansion, all need to be effectively communicated to gain "buy-in" from the public (Ross et al. 1992). Lack of a comprehensive, honest, and frank discussion with the public about the financial strain that growth is putting on a community's budget may lead to a lack of public support and, ultimately, failure of the impact fee initiative. This is the one suggested best practice that is not mandated by Texas Local Government Code Chapter 395. However, this does not make a public education campaign any less important to the success of impact fee implementation.

Most of the suggested best practices for success are statutorily required under Texas Local Government Code Chapter 395. These include the development of the LUA and CIP, the formation of an advisory committee, public hearings with adequate notice, and transparency in the collection and expenditure of impact fees. While not required by Texas law, a public education initiative about the necessity for impact fees is no less important in the path to success.

### **Education**

The education of stakeholders plays a crucial role in the consideration of impact fees. Three major opportunities for education include city administration,

the community, and developers. Gaines (2007) recommends that engagement among all stakeholders occurs as early as possible.

### ***City Administration***

First and foremost, city management must have an understanding of Texas Local Government Code Chapter 395, which outlines the requirements for impact fee implementation in the state. It is paramount for city management to have a clear understanding of the city's directions and goals. This includes current and projected fiscal opportunities and limitations, physical and population expansion, potential industry and business needs, and the political climate.

City management should be prepared to educate all members of city administration. The finance, development planning, and legal affairs offices are a starting point, but this can also include city engineers and elected officials. In addition, there should be a strong mixture of outreach mediums to inform members of city and community leadership. A primary source of information would be the city website with links to how impact fees were approved, why impact fees are necessary, and how the impact fees will affect new construction developments as the impact fees are adopted.

A specialized consulting firm can work with the city to develop a plan for impact fee implementation and determine readiness, capability, and timing. In addition, cities can collect data from similar cities to help administrators draw

comparisons, understand impact fees in practice, and learn about the implementation challenges.

### ***Community Education***

A city considering implementation should develop a plan to engage the public. This includes simplifying the concepts and answering common questions and objections. The ability to communicate the process with the public is instrumental when advocating for impact fees. Opportunities for community education include public hearings, web media, social media, television, radio, printed materials, and City officials visiting with HOAs, civic societies, and other community groups. The survey results showed that previous education campaigns should inform the effectiveness of methods varied among cities and the best method on other city topics.

Some challenges to educating the public expressed in the survey results are lack of awareness and civic participation, reaching transient populations, and combating misinformation from competing stakeholders that do not support impact fees. Examples include city administrators who see it as more work than what it is worth, developers, elected officials leaning toward developers, and community members and investors who see it as an increase in property costs. Citizens are often drawn to information that impacts them directly. Some of the primary questions from the public may include the impact on tax rates, housing affordability, business impacts, and even infrastructure maintenance. One strategy

for citizen engagement is to deploy a campaign that focuses on alternatives to raising taxes. The city may also hire a consulting firm for this purpose, especially if opposition from developers is anticipated. In the survey, the majority of cities conducting a public education campaign utilized a firm in at least some aspects. Seventy-five percent of those that used an outside firm confirmed that it was a good use of resources, and the other 25% selected that it was at least somewhat effective.

### ***Developer Education***

Impact fees may affect some stakeholders more than others. Citizens may recognize the benefits of impact fees as an alternative to increases in tax rates. Elected officials may also be drawn to them for the same reason, but must also consider maintaining good relationships with businesses because they play an important role in city growth. Businesses, and developers in particular, may see impact fees as an unnecessary expense that significantly influences their bottom line. In the survey results, this was a shared concern among developers. As a result, they represent one of the most important groups of stakeholders to engage and may take an interest in an overall development plan, complete with impact fees. In a recent interview with Jessica Brown (2021), a civil engineer at consulting firm Freese & Nichols, it was noted that impact fee adoption under Texas Local Government Code 395 is much more streamlined for existing developments, while for new developments, the process is more involved. The

American Planning Association (1998) recommends continued dialogue to reach an understanding of the public cost for new development and how impact fees are an alternative.

### **Financial Considerations**

The goal for proper project accounting is to have a solution capable of tracking the impact fee revenue derived from a specific project or area, as well as the project expenditures to ensure that the revenue received is expended in the same project area in compliance with Chapter 395.

Ideally, the method chosen should interface seamlessly with the current financial accounting system to avoid duplication of work in tracking projects and the possibility of human error when recording project transactions. For more detailed information, refer to Appendix A.

### **Conclusion**

As cities across the nation continue to need new infrastructure, the discussion will continue to be had about how to fund it. There are many funding options available for local governments to consider. In Texas, cities will have to rely upon the guidance and requirements stated in Texas Local Government Code Chapter 395 should they decide to implement development impact fees.

Understanding the projected long term growth and needs of the area will help officials make the best decisions for the city.

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## **Appendix A**

### **Accounting Considerations**

Texas Local Government Section 395.024 addresses how the local government is required to account for the impact fees collected and interest earned on those collected fees. Specifically,

- (a) The order, ordinance, or resolution levying an impact fee must provide that all funds collected through the adoption of an impact fee shall be deposited in interest-bearing accounts clearly identifying the category of capital improvements or facility expansions within the service area for which the fee was adopted.
- (b) Interest earned on impact fees is considered funds of the account on which it is earned and is subject to all restrictions placed on the use of impact fees under this chapter.
- (c) Impact fee funds may be spent only for the purposes for which the impact fee was imposed, as shown by the capital improvements plan and as authorized by this chapter.
- (d) The records of the accounts into which impact fees are deposited shall be open for public inspection and copying during ordinary business hours.

To comply with 395.024 (a) & (b), it is not necessary, nor required, to have a separate interest-bearing bank account for the impact fees, however, the

government should have a method of allocating the interest earned on deposited funds on a proportional basis. It is necessary for the government to keep and maintain detailed records such that a report on the impact fee revenues indicates from where the funds have been received. A commonly used tool for such tracking purposes is project codes. This same project code should be used to track the expenditures for that specific project area.

Project codes are not specific to a fund, department, division or account. When added to a general ledger account number string, project codes allow the grouping together of revenues and expenditures under a common project, allowing for easy searching and reporting of all revenues and expenditures across multiple funding sources for each project.

The need for complexity in the project codes will depend on the areas identified in the capital improvement plan. An example of an accounting segment string with a project number is as follows: where the first segment is the fund number, the second segment is the department or division number and the third segment is the revenue or expenditure category number. The project number is added to the end of the accounting string.

Revenue	Expenditure
525-00000-37499 PJCT - A	525-52240-78001 PJCT - A
539-00000-37609 PJCT - B	539-52450-78001 PJCT - B

The accounting division of the government will have an established nomenclature and numbering system for the funds, departments, functions, and divisions. This system should be used along with the project numbers for tracking the impact fees and other funding sources for each capital improvement project.

An example project reporting structure is as follows:

***Impact Fee Fund - Project Revenue Report***  
(in thousands)

A	B	C	D=A+B+C	E	F=D+E
Beginning Balance LTD	YTD Revenues (Including Interest)	YTD Project Transfers / Refunds	Ending Balance LTD	Allocated to Future Projects	Available Funds LTD
\$0	\$250	\$0	\$250	\$0	\$250
\$500	\$1,250	\$0	\$1,750	\$0	\$1,750
\$1,250	\$750	\$(250)	\$1,750	\$(750)	\$1,000
\$1,000	\$100	\$0	\$1,100	\$0	\$1,100
\$2,750	\$2,350	\$(250)	\$4,850	\$(750)	\$4,100

LTD = Life-to-Date  
YTD = Year-to-Date

***All Funds - Project Expenditure Report***  
(in thousands)

Project Code	Impact Fees	Bond Proceeds	General Funding	Water & Sewer Fees	Total
PJCT-A	\$250	\$1,000	\$0	\$350	\$1,600
PCJT-B	\$1,750	\$5,000	\$100	\$0	\$6,850
PCJT-C	\$1,000	\$2,000	\$0	\$0	\$3,000
PCJT-D	\$1,100	\$2,000	\$1,000	\$0	\$4,100
Total	\$4,100	\$10,000	\$1,100	\$350	\$15,550

Most municipal government finance departments have a financial system in place that is capable of recording all revenues and expenditures in the detail necessary for tracking impact fee revenue and the related project expenditures associated with that impact fee. In the event the system is not capable of recording the expenditures by project code, a separate system may have to be developed. The government should consider project management software such as Microsoft Project, database software such as Microsoft Access, or spreadsheet software such as Microsoft Excel. These solutions are separate from the financial accounting system, which undergoes an annual external audit review, therefore a regular reconciliation between the two systems is recommended to ensure the project reporting system is accurate and up-to-date.