Development Impact Fees: A Fair Share Formula for Success

A Court-Tested How-To Guide for Local Governments

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Development impact fees or exactions have been enacted by local governments across the United States in a variety of forms for more than 30 years. They are viewed by officials as a necessary and viable alternative to taxes and other forms of revenue. Impact fees, however, have proven controversial.

On numerous occasions, the argument over impact fees has resulted in litigation. This usually involves a property developer faced with an ordinance requiring the payment of a fee, a contribution of land, or the construction of public works. The developer objects to the mandate for a fee or for an exaction of some kind, claiming one or more of the following:

- It is not equitable in that owners of undeveloped property are a targeted group.
- It will stifle development.
- It really is a tax.
- The locality has no statutory authority to impose it; nor does it have the authority per the state constitution to impose it.
- The financial burden is too extensive.
- It is a duplication of some other assessment imposed by the local government.
- It amounts to a taking of the land as a form of inverse condemnation.
- It bears no relation to the claimed impact under any established legal test.

Despite the potential difficulty of enacting development impact fees, it is a revenue-raising method worthy of serious consideration, especially where governmental officials favor community growth and want to manage it effectively. Local governments can avoid placing an undue burden on existing residents and businesses while simultaneously accommodating desirable property development.

This article will focus on one community where officials successfully implemented and defended their impact fee ordinance in court.

A Case of Infrastructure Impact

The village of Rochester, Illinois, is adjacent to the capital city of Springfield in the central region of the state. In the late 1980s, the village president and board of trustees were faced with water and sanitary sewer systems that did not meet the state's Environmental Protection Agency (EPA) standards. In particular, the sanitary treatment facilities were not sufficient to process the wastewater, according to the state environmental standards. Water system pressure and volume for fire flow were deficient. Engineers were hired to conduct a study of the utilities.

In the meantime, a moratorium was placed on new development. An amendment to the wastewater facilities plan and a water studies report were completed by spring 1990. The engineers concluded that the system could be upgraded to serve the existing community solely or could be expanded to accommodate potential new development. A no-growth approach would result in a static population of 2,707 per the 1990 U.S. census.

A referendum was conducted in fall 1990 on whether the village should be annexed to the metropolitan sanitary district for wastewater treatment services, and the proposal was adopted, signaling the village board to move toward a policy of managed growth rather than no growth. Board members responded by retaining a planning consultant to assist in the preparation of the community's first comprehensive plan.

This plan, which was completed in 1991, contained information on how and where development could occur in the greater Rochester area and described how a population in excess of 6,400 could be accommodated. Preferred land uses and necessary capital improvements were illustrated. For example, residential and commercial areas were identified for possible annexation into the village. A large-diameter sanitary sewer main also was needed to connect to the sanitary district before the moratorium could be lifted to allow consideration of new property development. Water system needs included new lines and a tower.

Pursuant to the financial reports, members of the village board increased water and sewer fees to cover the increased costs of operations. They needed to identify additional funds to ensure the success of long-term bond financing for the utility capital improvements. For this reason, the board retained the services of a management consultant to study the potential of a development impact fee.

Annexation Agreement

The village considered its first residential development prospect during spring 1993. Because an ordinance on development impact fees did not exist, an annexation agreement was devised that allowed the moratorium to be lifted and houses to be built. It was prepared with reference to ordinances adopted by other communities and to case law. Illinois courts have applied the strictest standard of the three basic tests of impact fee analysis: the "specifically and uniquely attributable" test.

The other two are the "rational nexus" test and the "reasonable relationship" test (for definitions, see note at end of this article).[1] The fee was designed to relate only to those costs borne by the village that are specifically and uniquely attributable to new development activity. The annexation agreement met this legal requirement by calculating the per-house cost of the multimillion-dollar

Figure 1: Development Impact Fee Formula from the Annexation Agreement

Factors		
Capital	**Phases**	**Cost**
Water Utility	IA,IB	$1,600,000
Sanitary Sewer	I, II	$1,600,000
Total		$3,200,000
Number of Households and Ratio		
Existing in Rochester	922	
One Additional Household	1	
New Total	923	

Formula

$$\frac{\$3,200,000}{923} = \$3,466.955579$$

Result: Impact Fee of $3,467 per Household

Figure 2: Fair Share Assessment Formula from the Original Ordinance

Factors		
Capital	**Phases**	**Cost**
Total Improvement Costs:		
Water Utility	IA, IB	$1,059,000
Sanitary Sewer Utility	I,II	2,118,000
Total Service Area		$3,177,000
Existing Developed Areas:		
Water Utility	IA,IB	$ 601,000
Sanitary Sewer Utility	I,II	200,000
Existing Service Area		$ 801,000
New Subdivisions/Developments:		
Water Utility		$ 458,000
Sanitary Sewer Utility		1,918,000
Total		$2,376,000
Number of Households and Ratio		
Existing in Rochester	922	
One Additional Household	1	
New Total	923	

Formula

$$\frac{\$2,376,000}{923} = \$2,574.2145$$

Result: Impact Fee of $2,574 per Household

utility improvements (see Figure 1). It also contained a clause providing that the developer may receive a reduction in the fee if an ordinance was adopted later that called for a lesser fee. Another provision allowed an offset against the fee for infrastructure improvements provided upfront by the developer per agreement with the village. The developer would pay the fee at the time when a building permit was issued for each property.

Fair Share Assessment Ordinance

Over the next several months, village officials and their professional advisers worked on an ordinance. By fall 1993, the Fair Share Assessment Fee Ordinance was on the board agenda. This new title reflected the village's perspective that public/private costs were being shared equitably and proportionally. The formula still contained multimillion-dollar capital project costs. However, cost estimates were revised and utility improvements to the older area were deleted, resulting in a reduction of the fee (see Figure 2). Village officials considered this change to be fairer in that new developers would be assessed only for the cost of the new infrastructure required to serve their projects.

Several developers who had submitted preliminary subdivision plats during the summer strongly opposed the impact fee, so the village president scheduled a public meeting to explain the proposed ordinance and to offer Rochester citizens an opportunity to give input. When verbal and written statements for and against the fair share assessment were submitted, developers threatened to file a lawsuit if the ordinance was adopted. The proposed ordinance also was opposed by the metropolitan Association of Realtors and the Home Builders Association.

The village's professional advisers studied the public input and reviewed the draft ordinance. Capital cost estimates were further refined, and the formula was changed to strengthen the nexus between the fee imposed and the improvements required by the developments. The unit factor was changed from per-household to per–plumbed fixture. These changes lowered the average per-unit assessment (see Figure 3).

An offset against the fee was allowed for other quantifiable developer contributions. A paragraph was added to mandate that all fees be deposited in a special water and sewer systems assessment account to be solely dedicated to utility improvements, including the retirement of bonds. This language linked the assessment to the infrastructure needed to serve newly developed properties.

In November 1993, the village board voted to adopt the Fair Share Assessment Ordinance. The trustee vote was 4 yes, 1 no, and 1 abstention, and the ordinance became effective immediately upon execution.

Litigation

Several developers and landowners attempted to persuade the board to rescind the ordinance on fair share assessments. When there was no rescission, the group filed a lawsuit in Sangamon County Circuit Court in February 1994. Its petition asked the court to declare the ordinance null and void, making the arguments listed at the start of this article.

Rochester countered the petitioners' assertions by stating the following:

- The fee is equitable because only those capital improvement costs specifically and uniquely attributable to the new development were factored into the formula.
- Rather than stifle development, the fair share assessment fees would provide a financial resource to pay for the capital improvements required to serve the proposed developments.
- The fee is not a tax because it is fundamentally user-based, as opposed to a general flat levy.
- The village has statutory authority to impose the fee through subdivision regulation and does not lack this power by virtue of being a non-home rule municipality.
- The financial burden is manageable because the developer can plan in advance how to pay it and the fee has much less impact than other economic factors involved in residential development.
- The fee is distinguished from the subdivision requirements for mains and private hookups because it is calculated as a proportional per-unit cost of the major system improvements that are necessary to serve the subdivision.
- There is no inverse condemnation because the property owner can develop within the village code requirements.
- The fee is specifically and uniquely attributable to the new development, with the costs of needed improvements being proportionally assessed.

Rochester's attorney filed a motion to dismiss the lawsuit, and the circuit court judge dismissed the inverse condemnation allegation as having no basis in fact, but the court did proceed to review the other claims. In November 1994, almost one year to the day after the ordinance was adopted, the circuit court judge upheld it as lawful.[2]

Figure 3: Fair Share Assessment Formula from the Final Ordinance

Factors

Capital	**Phases**	**Cost**
Water Utility	IA,IB	$ 779,000
Sanitary Sewer Utility	I, II	2,118,000
Total Service Area		$2,897,000
Existing Developed Areas:		
Water Utility	IA,IB	$ 461,000
Sanitary Sewer Utility	I,II	200,000
Existing Service Area		$ 661,000
New Subdivisions/Developments:		
Water Utility		$ 318,000
Sanitary Sewer Utility		1,918,000
Total		$2,236,000

Number of Interior Plumbed Fixtures

Residential	9,220	Estimate of 10 per household
School	381	Per metropolitan sanitary district
Commercial	66	Per metropolitan sanitary district
Total	9,667	

Formula

$$\frac{\text{Number of Interior Plumbed Fixtures/New Building}}{\text{Number of Interior Plumbed Fixtures in Village (existing plus one)}} \times \text{Improvement \$}$$

Example:

$$\frac{\text{1 fixture}}{\text{9,668 (existing plus one)}} \times \$2{,}236{,}000$$

$$0.0001034 \times \$2{,}236{,}000$$

Results: $230.31 Fair Share Assessment per Fixture
$2,312 Fair Share Assessment Fee for Typical 10-Fixture House

Issues on Appeal

The developers appealed to the state appellate court in April 1995.[3] Oral arguments on the seven remaining issues convened in early fall 1995. Three major counts remained before the court.

No authority? First, the plaintiff developers asserted that the village had no implied or expressed authority to impose the fair share assessment fee. The respondent village contended that it had implied authority because it had the power to create a comprehensive plan for future development.

The court found both parties to be wrong, and judges noted that the respondents' comprehensive plan argument was highly tenuous but chose not to decide its validity. They stated that Rochester had overlooked its expressed statutory authority to impose a fair and reasonable charge for utility system connections, as provided in the Illinois Municipal Code. Court precedent also was cited in

support of connection charges.[4]

The court addressed the plaintiffs' argument that Rochester had no authority to enact an assessment fee ordinance without listing the specific newly developed areas for which the fee would be imposed. The judges examined case law that declared that a municipality has no right or power to charge persons for the construction or extension of infrastructure whose existence is not known at the time that the charge is made.[5]

The court distinguished the Rochester ordinance from the other cases because a fee is imposed on each new plumbed fixture to be connected to its water and sewer systems. The fee is a condition of final plat approval and of the issuance of a building permit. Therefore, Rochester need not have enumerated specific connections when it enacted the ordinance because a fee for each fixture connection would not be collected until just before each actual connection to the system is about to be made.[6]

This court determination is crucial. Thanks to this ruling, a local government that has documented the extent of needed improvements to serve a development or group of developments may calculate and charge a fee as the properties are built on to recoup the costs incurred to facilitate the development.

Is it a tax? The second issue involved the nature of the so-called fair share assessment. Plaintiffs contended that the assessment was a tax and therefore was unconstitutional per se. The court cited longstanding case law on the difference between a tax and a service charge. A tax is based upon the concept of state sovereignty, with local governments being political subdivisions of a state. A tax is levied as a contribution for the support of the government. In contrast, service charges, tolls, water rates, and the like are contractual in nature, either expressed or implied. A charge or fee is made, not by virtue of the sovereignty of the governmental unit but in its business or proprietary capacity.[7]

The court decided that the Rochester ordinance clearly and unambiguously states that the impact fee is to be applied only to new connectors to the village water and sewer systems and, moreover, that it is based only on the cost of new connections.[8] Judges emphasized the following ordinance section to distinguish the assessment from a tax: "The Fair Share Assessment shall be imposed only when improvements are specifically and uniquely attributable to new growth as regulated by the village through the subdivision ordinance and as otherwise defined by the village board."[9]

Is it a taking? The third and last count concerned the plaintiffs' argument that the assessment fee is a form of inverse condemnation resulting in a taking of their land by the respondent village. The court referred to Illinois case law in which the impact fee test is the most demanding and exacting of jurisdictions (see note 1 on the three prevailing tests). The courts have decided that if the specifically and uniquely attributable test cannot be met, the exaction becomes a taking. A forbidden fee is one that is imposed to pay for improvements made necessary by the total activity of the community, while a permissible fee is one that is imposed to pay for improvements required by the activity of a developer.[10]

The court found that the Rochester fee formula is permissible because it is calculated using only cost factors for new capital improvements. In particular, it was noted that the total cost of improvements was estimated at $2,897,000. This amount is an aggregate of two categories: $661,000 for existing developed areas of the village and $2,236,000 for new subdivisions/developments, with the latter exclusively used as the cost-factor base for the formula.

Plaintiffs also argued that they were being overcharged or that a duplicate charge was being required of them. They were referring to the fact that they must build water lines, sewer mains, and private service lines in a subdivision. The court stated as follows: ". . . [P]laintiffs misunderstand the nature of the impact fee. Plaintiffs are responsible not only for the cost of newly constructed infrastructure necessitated by new developed areas, but also for the cost of improvements to existing infrastructure necessitated by new developed areas. The impact fee seeks to recuperate these latter costs."

Then, the court went on to state: "In addition, plaintiffs receive a direct and material benefit from the improvements financed by the impact fee assessment. Without the additional load placed on the existing infrastructure caused by new developed areas, only $661,000 worth of improvements would be necessary to the existing infrastructure to support the load from existing developed areas. The impact fee assessment will support additional improvement of the existing infrastructure so new areas of Rochester to be developed by plaintiffs can be supplied with water and sewer service."[11]

Plaintiffs extended the above argument by asserting that new residents will be overcharged by being required to pay a monthly user fee for connection to the water and sewer systems. The court again distinguished the situation in favor of the village. On one hand, the monthly service charge is an amount paid equally by all new and existing users of the system to cover the cost of regular and ongoing maintenance and operation of the overall system. On the other hand, the assessment fee imposed against developers is a one-time connection charge intended to compensate Rochester for one-time construction costs of improving existing infrastructure to support newly developed areas.

An Instructive Experience

Rochester's experience with fair share assessment is instructive for local governments across the nation. This is particularly true because the development impact fee test applied by the Illinois court system is the most restrictive of such tests. An ordinance that survives in this jurisdiction can be a model for other localities.

The formula, as enumerated in Figure 3, is clear and equitable. The land use and capital improvement factors were based upon advance reports of professional engineers and planners. And the direct relationship between proposed developments and needed capital infrastructure is defined and quantified. The formula can be duplicated and tailored to different situations in other communities.

The Rochester case study reaffirms the concept of development impact fees as a viable alternative to other forms of revenue production. PM

[1]Three tests were analyzed in detail with reference to court decisions in the textbook *A Practitioner's Guide to Development Impact Fees* by James C. Nicholas, Arthur C. Nelson, and Julian C. Juergensmeyer (Chicago: Planners Press, American Planning Association, 1991); in the article "Tree Preservation Ordinances: A New Type of Exaction?" by Pamela Cardullo Ortiz, which appeared in *Municipal Attorney*, Volume 33, Number 5, (September/October 1992), p. 126; and in the article "Naperville Revisited" by Richard G. Flood in *Local Government Law*, Volume 27, Number 4, (April 1991), p. 2.

The specifically and uniquely attributable test has been called the most restrictive of all the reasonableness tests of development impact fees. This test requires an absolute fit between the need created and the burden imposed. It places an almost insurmountable burden on local governments seeking monetary payments for extra capital spending from developers whose activities have necessitated such expenditures. Notable case: *Pioneer Trust & Savings Bank v. Village of Mount Prospect*, 22 III. 2d 375, 176 N.E. 2d 700 (1961).

The rational nexus test has been adopted by a majority of states. It represents a middle ground between the specifically and uniquely attributable test and the reasonable relationship test. It dictates that conditional exactions be allowed only where the dedications or contributions required of the developer cover the proportion of the new infrastructure (e.g., a new water treatment facility) for which the new development is responsible. Two criteria must be met:

1. Impact fees must be calculated by measuring the public infrastructure needs created by the new development that is being charged the impact fees. Such charges cannot exceed the cost of such infrastructure to the relevant unit of local government.
2. Impact fees must be earmarked (or spent) for the purposes for which they are collected, so as to benefit those who pay them. Notable case: *Jordan v. Village of Menomonee Falls*, 28 Wisc. 2d 608, 137 N.W. 2d 442 (1966).

The reasonable relationship test offers the most relaxed standard of the three tests, requiring only that the condition imposed bear a reasonable relationship to the use of the facilities by the future inhabitants of the subdivision. A local government need not show that the subdivision necessarily and primarily would benefit from the developer's contribution. Notable case: *Associated Home Builders v. Walnut Creek*, 4 Cal. 3d 633, 94 Cal Rptr. 630, 484 P.2d 606 (1st. Dist. 1971).

[2]*M. Robert Fairchild et al. v. Village of Rochester*, Circuit Court of Sangamon County, Case No. 94MR0034 (1994).

[3]*M. Robert Fairchild et al. and Robert K. Scott and Mary K. Scott v. Village of Rochester*, Appellate Court of Illinois, 4th District, Case No. 4-95-0420 (1995).

[4]Illinois Municipal Code 65 ILCS 5/11-150-1 (West 1992); *City of Pontiac v. Mason*, 50 III. App. 3d 643, 434 N.E. 2d 549 (1982); *LaSalle National Bank v. City of Warrenville*, 105 III. App. 3d 643, 434 N.E. 2d 549 (1982); *Heinrich v. City of Moline*, 59 III. App. 3d 278, 375 N.E. 2d 5572 (1978); Illinois Municipal Code 65 ILCS 5/11-139-8 (West 1992); *Estate of Besinger v. Village of Carpentersville*, 258 III. App. 3d 218, 630 N.E. 2d 178 (1994); and *Fairchild v. Rochester*, ibid, p. 4.

[5]*Norwich v. Village of Winfield*, 81 III. App. 2d 201, 225 N.E. 2d (1967).

[6]*Fairchild v. Rochester*, ibid, p. 8.

[7]*People ex rel. County of DuPage v. Smith*, 21 III. 2d 572, 173 N.E. 2d 485 (1961).

[8]The court reproduced verbatim the Village of Rochester, Illinois, Ordinance 93-19 at Section 11-8-7(9), which requires assessments to be deposited in an account solely dedicated to retiring any loans and bonds issued to facilitate improvements in the new developments.

[9]Village of Rochester, Illinois, Ordinance 93-19 at Section 11-8-7(10).

[10]*Northern Illinois Home Builders Association, Inc., v. County of DuPage*, 165 III. 2d25, 649 N.E.2d 384 (1995). DuPage County, Illinois, had enacted a road improvement fee. When developers challenged the fees, the Illinois Supreme Court upheld one of the impact fees but struck down the others because the funds collected could have been used for areas outside the transportation impact district. The court opined that a carefully drawn district could ensure direct and material benefit to the fee payers.

[11]*Fairchild v. Rochester*, ibid, p. 15.

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