INDIANA IMPACT FEES: A Potential New Tool for Economic Development Financing?

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The Developer's Perspective

Many developers view impact fees as a disincentive to real estate development. One reason is that many fee structures include the cash payment early in the development process. Another reason is that current conditions within the marketplace may not allow the cost of the impact fee to be transferred to the purchaser. In this instance, the profit of the developer is directly impacted. In other instances, impact fees appear to the developer to establish another layer of approvals by local governments.

Viewed this way, impact fees add to the expense of the real estate development process. First, there is the actual cash payment of the fee, and secondly, there is added expense to the developer for his time in securing the approval and paying the impact fees.

The Economic Developer's Perspective

However, if properly constructed, impact fees can be viewed as a potential new form of economic development financing. If the impact fee system allows the developer to schedule the payment of the impact fees at an opportune time in the development process, the system can benefit both the community and developer. With this in mind, local communities could possibly use impact fees as an economic development financing tool to encourage development where the community has established development priorities.

Typically, a community desiring to spur development will absorb required infrastructure costs as an inducement to developers. Alternatively, the developer bears those costs upfront in his development. Where impact fees are assessed to encourage development in the manner suggested here, the municipality and the developer become partners, with the ultimate end purchaser bearing the costs as part of the purchase price.

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In this scenario, the municipality bears the initial infrastructure costs, assessing the impact fee at the time of sale of individual lots or structures. This eliminates the need for the developer to borrow from banks (or other) funding sources to construct infrastructure for the project, resulting in a potential cost savings for the project, since the developer does not have to pay interest on these funds. The impact fee infrastructure cost in all likelihood will be passed on to the purchaser and be paid through their mortgage financing at the time of closing on the sale, spreading the repayment over many years.

Case Study

A case example is helpful in illustrating how impact fees can potentially serve as an economic development financing mechanism. A joint venture partnership between a private landowner and Small Town, Indiana can be used to show this particular financing mechanism. Indiana was selected because of the recent enactment of impact fee legislation (see **PZN** April 1992, p. 18-19).

Small Town wishes to develop an industrial park on approximately sixteen acres of privately owned land adjacent to the Town. The assumptions for this case example are as follows:

- Project size: 16 acres
- Average lot size in project: 1 acre
- Number of lots: 16
- Lot sales: Year 1 = 1; Year 2 = 3; Year 3 = 6; Year 4 = 4; Year 5 = 2
- Cost of land purchase: $40,000 ($2,500 per acre)
- Cost of infrastructure and signage: $250,000
- Legal, accounting and sales expense: Year 1, $60,000; Year 2 and thereafter, $5,000 per year
- Developer borrowed funds: 10% interest rate
- Municipal borrowed funds: 6% interest rate.

Small Town, Indiana has contacted a developer with a proposal to finance infrastructure on real estate owned by the de-

Table 1
Impact Fee Example
Prospective Cash Flow Analysis June 1992

Year	One	Two	Three	Four	Five	Total
Lots Sold	One	Three	Six	Four	Two	Sixteen
Lot Price	$40,000					
REVENUE Sale of Lots	**$40,000**	**$120,000**	**$240,000**	**$160,000**	**$80,000**	**$640,000**
EXPENSES						
Land	$40,000	$0	$0	$0	$0	$40,000
Legal/Acct/Sales	$60,000	$5,000	$5,000	$5,000	$5,000	$80,000
Impact Fee	$20,313	$60,938	$121,875	$81,250	$40,625	$325,000
Interest	$6,512	$1,228	$0	$0	$0	$7,740
	$126,825	**$67,166**	**$126,875**	**$86,250**	**$45,625**	**$452,740**
CASH FLOW						
Period	($86,824)	$52,834	$113,125	$73,750	$34,375	$187,260
Cumulative		($33,990)	$79,135	$152,885	$187,260	$187,260

About the Authors

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Table 2
Summary of Financial Results
Developer Financed Project

LOT SALE PRICE	REVENUE	EXPENSES	PROFIT	LOAN AMOUNT	EQUITY REQUIRED	RETURN ON EQUITY	INTERNAL RATE OF RETURN	NET FEES VALUE CASH FLOW
$30,000	$480,000	$417,424	$62,576	$345,946	$86,486	0.72	0.12	$17,658
$35,000	$560,000	$412,808	$147,192	$340,541	$85,135	1.73	0.25	$128,464
$40,000	$640,000	$410,285	$229,715	$335,135	$83,784	2.74	0.36	$236,515

Table 3
Developer - Impact Fee Financed Project
($20,313 Per Lot Fee)

LOT SALE PRICE	REVENUE	EXPENSES	PROFIT	LOAN AMOUNT	EQUITY REQUIRED	RETURN ON EQUITY	INTERNAL RATE OF RETURN	NET FEES VALUE CASH FLOW
$30,000	$450,000	$457,952	$22,048	$97,635	$24,409	0.90	0.15	$10,824
$25,000	$560,000	$455,263	$104,737	$82,230	$23,057	4.54	0.52	$119,094
$40,000	$640,000	$452,740	$187,740	$80,824	$21,706	8.63	0.83	$227,145

veloper. After completion of water, roads, sewer, etc., the community and the developer will launch an aggressive marketing campaign to sell approximately sixteen lots during a five year time period, hopefully with a portion of the lots being *"presold."* This will fulfill the community goal to create jobs and investment, plus develop the industrial park in conformance with the Town's comprehensive plan.

While impact fees may, on the surface, appear to be another burden to a developer, they can be offered as another form of tax increment or special assessment financing beneficial to a developer.

A land development partnership will be organized for this project to purchase and develop the land. A prospective financial statement showing the projected cash flow for the project is shown in Table 1. For this project, a developer borrows funds at a 10 percent interest rate to finance the necessary infrastructure. The developer's profit after selling 16 lots ranges between $62,576 to $229,715, depending on the sale prices of the lots. Feasibility indicators are shown on Table 2.

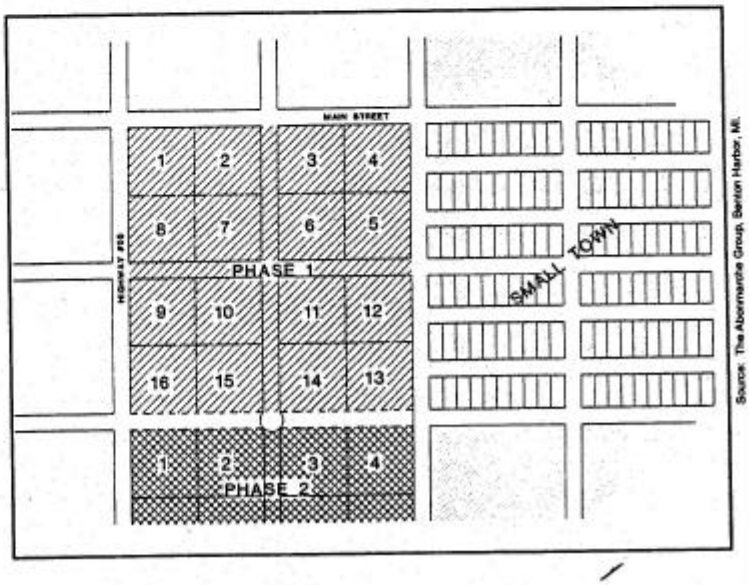
As an alternative, the prospective financial statement has been modified to illustrate payment of impact fees on a per lot basis by the developer in lieu of developer financing of infrastructure. In this illustration the municipality issues a general obligation or special assessment revenue bond (likely with a full faith and credit guarantee) for the construction of the infrastructure with repayment made from the fees paid by the developer. In this illustration, the developer's total amount of profit is reduced to a range of $22,048 to $187,740, however, the amount of developer funds employed and the rates of return for the project are substantially improved (see return on equity calculations in above Table 3).

Conclusions

While impact fees may, on the surface, appear to be another burden to a developer, they can be offered as another form of tax increment or special assessment financing beneficial to a developer. From a community's perspective, they can be an economic development tool to help guide desired developments to specific locations.

As yet, no Indiana community has considered the use of impact fees for municipal bond financing purposes. However, according to Warren Creamer, Senior Vice President, Hutchinson, Shockey, Erley & Assoc., a municipal investment banking firm located in Chicago, *"Impact fees can be considered as one of several sources of revenue available to finance infrastructure. Moreover, impact fees could be used to enhance tax increment financing programs."*

The value of tax abatements and other traditional incentives are increasingly questioned by both public officials and developers. Given the continuing reduction of state and federal financing for local infrastructure, many communities are searching for alternatives for development inducements. In this climate, Indiana communities are fortunate to be able to enact impact fees. Use of impact fees in this manner may provide for a new approach to economic development financing of real estate development projects. ❑



Source: The Abernathie Group, Benton Harbor, MI.