

October 11, 2004

Representative Larry Wolpert
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The Ohio House of Representatives
77 South High Street
13th Floor
Columbus OH 43215-6111

Senator Steve Stivers
District 16
The Ohio Senate
Senate Building
Room #034, Ground Floor
Columbus OH 43215

Subject: Impact Fees as a Mechanism for Funding Schools in High Growth Districts

Dear Representative Wolpert and Senator Stivers,

Thank you for the time you both spent on September 29, 2004 at the school funding forum held at Thomas Worthington High School, and for the brief individual conversations I had with each of you afterwards concerning the potential for using what could be termed "Impact Fees" to address the current school funding challenges for high growth districts.

*The simple notion is this: When a **new** residential property is constructed in a school district, a one-time fee, payable to the school district, is assessed at the time the buyer closes the purchase transaction, takes title to the property, and is issued an occupancy permit. The fee could be incorporated in the mortgage if so desired by the buyer. In recognition of this one-time fee, the buyer's semiannual property tax payments would be reduced by an amount reasonably close to the increase in the mortgage payment necessary to cover the additional amount borrowed.*

The primary objective of this one-time fee is to relieve high growth school districts of the necessity of repeatedly going to the voters with bond levies to fund the construction of school buildings to house the additional students who arrive with these new residential properties. This impact fee program would automatically generate income for school district as residences are built.

I believe that the key problem with getting school levies passed in high growth districts is that the property owners in those districts do not understand why their property tax bills keep increasing (my own property tax bill has doubled in the past 10 years), and falsely attribute the increases to "fancy new buildings," high administrator salaries, and ineffective management. We have not sufficiently made the connection between residential growth and increased property taxes.

The structure of operating levies is such that as new residential properties are built, the millage rate for existing operating levies are applied to the new properties, and new operating revenue is generated for the schools. There is also additional State Aid granted to the school district for each student, but if the district is both rapid growing and affluent, the amount of State Aid is diminished (38% of total funding in the case of Hilliard City Schools, compared to 90% for Dawson-Bryant Local Schools in Lawrence County¹). When the commercial tax base is not growing at the same pace as residential growth, much of the burden of funding growth falls on the residential property owners.

This issue is particularly acute relative to capital funding. The traditional method of funding school construction is for the school district to issue bonds in conjunction with a levy which, over many years, retires the bond and pays interest. Unlike an operating levy, a bond levy raises a constant dollar amount each year, and the dollar amount is kept constant by reducing the millage rate on both new and existing properties. Therefore, while growth creates demand for additional buildings, the bond levy process neutralizes the potential for collecting additional revenue.

There are, of course, additional details which need to be considered. A number of those are addressed on the following pages:

¹ LOEO Analysis of the Amount of State Education Funding to School Districts as a Percent of Personal Tax Liability, Revenue per Pupil, Report Card Ratings, and Adequate Yearly Process Designations date 4/2/04

- **How is the actual fee amount set?**

The creation of the fee and the initial formula would be enacted by a vote of the citizens of the school district. I propose that each district be allowed to adjust the fee periodically to approximate the fixed construction costs incurred to house the average number of additional students per residence at a campus configured to be a high school. The benchmark would be the replacement cost of the most recently constructed high school campus in the district. If no new high school has been built in the district in the past ten years, then the cost of a recently constructed high school in a similar district could be used.

For example, if a high school was built 8 years ago to house 2,000 students, and replacement cost is estimated to be \$20 million, then the average cost per student would be \$10,000. If there is an average of one student per incremental dwelling unit, this equates to \$10,000 per dwelling unit, and is the basic Impact Fee. Both the replacement cost estimate and the students-per-dwelling-unit ratio could be re-evaluated and adjusted no more often than once every three years, presumably in parallel with the triennial property reappraisals.

By connecting the impact fee to recent actual construction costs, it prevents the impact fee from being used merely as a discriminatory "entrance fee" into the community.

- **How much would property taxes be reduced for this property owner?**

For a period equal to the approximate useful life of a school building, the homeowner's property taxes would be reduced in an amount equal to the stream of annuity payments which, if discounted back in time using a present value calculation, would be equal to the impact fee. The discount rate would be the most recent rate quoted to the Treasurer of the State of Ohio for discounting lottery winnings to a single payment.

The reduction would be applied in the form of a credit. This simplifies the administration of the impact fee program, as all properties would continue to be assessed all levies as is done today. However, for those properties for which an impact fee is collected, only two additional data items would be required: a) the semiannual credit amount; and, b) the expiration date of the credit.

For example: If the useful life of a building is determined to be 20 years, and the discount rate is 5.05%, then the semiannual property tax bill would be reduced by \$400 per dwelling unit for a period of 20 years, in the form of a property tax credit, as a result of the \$10,000 impact fee.

- **It seems like applying an equal fee to all housing units is a regressive tax. How can this be made fairer?**

The actual fee assessed to any dwelling unit would be adjusted by a factor which relates the property's assessed value to that of the average dwelling unit in the district.

For example: If the average assessed value of a dwelling unit is \$100,000, but a new property is given an assessed value of \$50,000, then the impact fee would be \$50,000 divided by \$100,000 times \$10,000, or \$5,000.

- **Doesn't this approach cause the homeowners to pay interest on the impact fee?**

Yes, but there has always been an interest cost built into school construction levies. When the school district issues tax-free municipal bonds, it agrees to pay the bond purchasers an interest rate set at the time the bond is issued. The amount of the bond levy is that which is needed to pay back the principal, and make the interest payments.

- **If the impact fee is incorporated into the mortgage, won't this reduce the amount the buyer can pay for a house?**

Mortgage lenders are concerned about the total cash flow picture for the borrower. While the amount borrowed would be increased by the impact fee, which causes an increase in the mortgage payment, there would be an offsetting reduction in the property taxes due to the impact fee credit. The net cash flow for the borrower would remain about the same, and lenders could be expected to view this as a neutral change.

- **When new houses are built, don't those homeowners already have to pay property taxes associated with bond issues?**

Yes, and no.

Owners of new dwellings do pay a millage rate which is applied to outstanding bond obligations. However, the structure of a bond levy is such that a fixed dollar amount is collected each year, regardless of the number of residential properties in the District. Therefore when more dwellings are constructed, causing an increase in the aggregate appraised value in the District, the millage rate is reduced to keep the dollar amount collected constant.²

In the current system of funding, the construction of new homes does NOT cause the total capital funds available to the schools to increase.

- **What about multi-family housing units?**

It can be expected that many residential development plans will include multi-family housing units, such as apartments. The approach outlined above can still be applied to multi-family units as long as each apartment is considered a dwelling unit. Because the cost per dwelling unit will normally be much less than a single family home, and the number of school-age children per dwelling unit may be very different than single family homes, separate calculations may be needed to compensate for these factors.

The formula for both single-family and multi-family classes could be:

Fee = Average Number of Children per Dwelling Unit × (Assessed Value / Average Assessed Value)

If the Average Number of Children per single family Dwelling Unit is 1.0, the Average Assessed Value of a single family dwelling unit is \$100,000, and a new house is built which is appraised at \$50,000, the impact fee would be \$5,000.

In the case of an apartment complex appraised at \$5,000,000 with 500 apartments, and an average number of children per dwelling unit of 0.1 (averaged across all apartment units in the District), the assessed value per apartment would be \$10,000. This calculates to an impact fee of \$100 per apartment, or \$50,000 for the entire apartment complex. However, if the actual ratio of students per dwelling unit across all apartments in the district were 1.0, this same complex would be assessed an impact fee of \$500,000.

Both the average assessed value and the ratio of children per dwelling unit would be reviewed and adjusted periodically.

² Note that the reverse is also true. If the aggregate property value in a district declines, the millage rate which is applied to service the bond debt must be increased

- **What if the average assessed value of new dwellings changes materially over time?**

It is likely that during the triennial reappraisal process, the average value of properties, by class (e.g. single family & multi-family) will change. There will however, be no adjustments made to the size of the property tax credit associated with the original impact fee once it has been assessed for a particular property. The impact fee associated with new properties would be subject to the new average values.

- **What about those who own existing property in the District?**

There would be no impact fee assessed to owners of existing residential properties, but they would continue to pay taxes associated with non-capital levies, and for any new capital levies approved in the future (which should happen less frequently as a result of impact fees).

- **Once an impact fee is assessed to a property, is it now exempt from any new capital improvement levies?**

No. The community might choose to raise additional capital dollars to repair, replace or enhance existing buildings. In that case, the revenue would be raised as it is today, either by bond issue or other capital levies. The new levies would be paid by all property owners in the district as is done today, whether or not an impact fee had been assessed.

- **What happens if a residence is sold prior to the expiration of the impact fee credit?**

The credit passes to the new homebuyer, and remains in force until it expires.

- **If one home had been assessed an impact fee, and a similar home next door had been built prior to the initiation of impact fees, would it not be very difficult to sell the home upon which an impact fee had been assessed?**

The premise of this question is not that common. Residential real estate is developed in tracts of many homes - sometimes in the hundreds - and all new homes after the initiation of the impact fee system would be treated identically. In the case of a development partially completed when the impact fee system begins, the developer would have sales personnel who could educate potential buyers on the mechanics of the system.

- **What can the school district do with money collected under this system?**

The school district must place the money collected into a trust fund which can be used only for those same purposes allowed in the case of a permanent improvement levy. This fund may invest in low-risk securities only, such as inflation-indexed US Treasury issues.

- **What happens if a new school is needed before the Impact Fee fund grows large enough to pay for the new building?**

In this scenario, the funding must take place via a conventional bond issue. Unfortunately, many high growth school districts need buildings now. The Impact Fee system is designed to break the traditional capital levy cycle, but the District will need to "prime the pump" with perhaps one more traditional bond issue. Enacting a bond levy in conjunction with the impact fee should be less difficult than a bond levy alone, if the property owners are adequately informed that the impact fee transfers most of the future burden to new property owners.

- **What about operating levies?**

This proposal does not address impact fees for operating costs. Operating cash flows are more appropriately funded by traditional levies. The primary purpose of this impact fee is to invert the traditional "build now, pay later" (via bond issues) approach used currently, and replace it

with one where funding is accumulated in advance of the need. This allows the school system to fund most, if not all, of a school building program from cash already collected.

- **What happens when all the land has been developed, and the District needs to start replacing school buildings?**

The Impact Fee approach deals with growth. Once a District has been fully developed, its residents will decide, as they do today, if they should issue bonds and collect additional taxes to raise capital for school improvements and replacement.

- **How are businesses involved in the impact fee program?**

Businesses, other than residential rental properties, would be exempt from the impact fee program. It is advantageous for the community to attract businesses, which generate tax income, but house no additional students. Businesses would continue to pay both operating and capital levies.

Impact Fees Viewed from the Perspective of:

	High Growth Districts	Stable Or Shrinking Districts
School Board and Administration	<ul style="list-style-type: none"> • Capital funds generated automatically as new residences are occupied • Much less reliance on levies to raise capital funds 	<ul style="list-style-type: none"> • Not applicable
Existing Homeowners	<ul style="list-style-type: none"> • Stops the practice of subsidizing the cost of new dwellings in the District by increased taxes on all residents • Rate of tax increases dramatically lowered by shifting the burden of funding growth the new residents causing that growth 	<ul style="list-style-type: none"> • Not applicable
New Homeowners	<ul style="list-style-type: none"> • Offsetting credit neutralizes additional up-front cost. 	<ul style="list-style-type: none"> • Not applicable
Developers	<ul style="list-style-type: none"> • Does not impact home price • Will need to explain to potential homebuyers that the Impact Fee is offset by the tax credit 	<ul style="list-style-type: none"> • Not applicable
Mortgage Lenders	<ul style="list-style-type: none"> • Will be lending additional funds at no incremental risk (because the tax credit keeps the borrower's cash flow unchanged) 	<ul style="list-style-type: none"> • Not applicable
Businesses	<ul style="list-style-type: none"> • No impact 	<ul style="list-style-type: none"> • Not applicable

Your consideration of this proposal is very much appreciated. I am at your disposal to answer questions, perform additional research, or clarify points.

Sincerely,

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