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Development Fees and New Homes: Paying the Price in California

National surveys have shown that California leads the nation in imposing fees on new residential development, yet we know surprisingly little about the nature and effects of these fees. To fill this research gap, Marla Dresch and Steven Sheffrin conducted an econometric analysis of development fees in Contra Costa County, focusing on single-family residences constructed between 1992 and the first three months of 1996. Located in the San Francisco Bay area, Contra Costa County is the ninth most populous county in the state.

The researchers found that the fees imposed on new construction are significant, typically falling in the range of $20,000 to $30,000 per dwelling. In one community, fees and bond assessments accounted for 19 percent of the mean sales price.

This heavy reliance on development fees, particularly in California, is a relatively new phenomenon. Historically, cities and counties have used property taxes to finance infrastructure—such as roads, schools, and parks—for residential development. In turn, new residents, through their property taxes, would help finance infrastructure for others in the future.

In the wake of Proposition 13, which limits property tax to 1 percent of the assessed value, cities and counties have had to find other ways to finance infrastructure. Unless state funds are used, local governments have only two alternatives: bonds or exactions. Exactions are payments made by a developer to local governments for the right to proceed with a project. Exactions can include development fees, the dedication of public land, the construction or maintenance of public infrastructure, or the provision of public services.

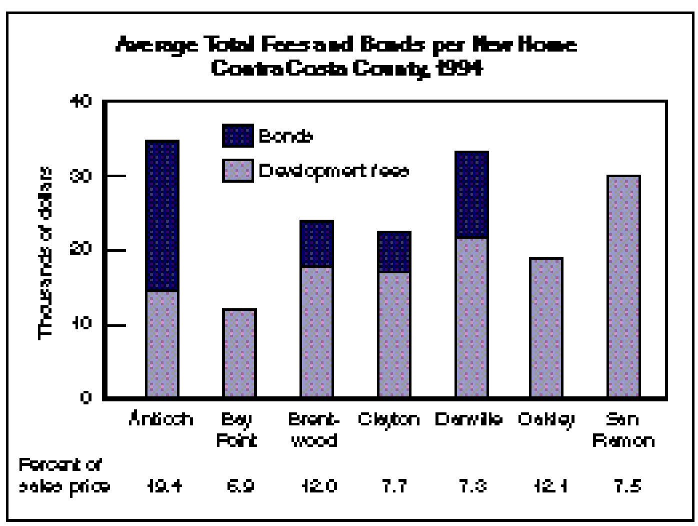
From a consumer's perspective, the difference between bonds and exactions is one of visibility. When new homeowners pay off a bond issued to finance their infrastructure, they are keenly aware of the cost, because bonds are included on property tax bills.

Exactions, however, are invisible, because the home buyer will not know what kinds of projects or fees were levied against the builder or how much of the costs have been passed on to the buyer in the form of higher home prices.

The objective of this study was to measure the size of development fees in one of California's fastest growing counties and to determine who bears the burden of the fees, the developer or the home buyer.

Methods and Findings

For their study sample, the researchers selected those cities and unincorporated areas in Contra Costa County that had the largest number of new sales and that also had available information on fees. The sample included Danville and San Ramon from the southern area of the county, and Antioch, Bay Point, Brentwood, Clayton, and Oakley from the eastern area.



Financing of infrastructure varied considerably across cities, both by type of funding and as a percentage of mean sales price.

The researchers collected information on all of the fees levied against individual homes within a tract: building permits and inspections, water and sewage, traffic, schools, parks, fire, and community development.

They integrated the data on fees into a comprehensive dataset containing the prices and characteristics of the housing, and then estimated statistical models that allowed them to determine what portion of the fees were incorporated into housing prices.

In addition to the substantial amount of the fees, one of the study's most striking findings was that the ability to pass on fees to homeowners can vary within a single county and over a single period of time. Developers in the southern part of the county passed on the full cost of the fees to the home buyer, while developers in the eastern area had to absorb about 75 percent of the fees, passing on only one-fourth of the fees to the buyer.

There are a number of reasons why a developer might not be able to pass along the full amount of the fees to home buyers. For example, if a city or county uses the fees to benefit the general community rather than to provide services that increase the value of homes in the specific development, home buyers may be unwilling to pay the fees and may prefer to purchase a home elsewhere in the community. The same would be true if the fees do not generate services valued by the homeowner.

In the case of Contra Costa County, however, the researchers determined that the difference in the effects of fees on prices was primarily due to disparate economic conditions. Although the study occurred during a declining housing market, there was much more distress in the eastern part of the county. Prices dropped continuously throughout the entire four-year period, forcing developers to absorb a significant fraction of the fees.

Policy Implications

As a result of Proposition 13, the financing of infrastructure for new homes in California is no longer shared by all property owners in a community, but is borne instead, in varying degrees, by developers and new home buyers.

Developers complain that fees and exactions in general have become excessive, increasing the risk of doing business and stifling economic growth. Local government officials argue that these levies are essential to growth: Without them, local government could not provide the infrastructure necessary for new development.

Financing for the construction of schools lies at the very heart of the current debate. Until the mid-1980s, only cities and counties could impose development fees, including school fees. In 1986, the legislature authorized school districts to impose their own fees on new construction. Although school fees were capped, based on the square footage of the new development, subsequent court decisions have ruled that the fee limits apply only to fees levied by school districts and not to those imposed by cities and counties. These legal developments raise the possibility that some communities will sharply increase their use of development fees, which in many cases are already substantial.

The authors note that cities and counties cannot be expected to reduce their reliance on development fees and exactions unless some other source of funding is provided, especially for the construction of schools.

They suggest that Californians need to decide whether it would be more equitable to spread the cost of school construction more widely across the population. Financing mechanisms that could be used to share the burden include state general fund subsidies, as well as state and local general obligation bonds.

Certainly a case could be made that there are general, statewide benefits from education that distinguish it from other infrastructure. K–12 schooling provides benefits to all Californians through a better-educated workforce and by reducing the risks of later dependence on the state. It is more difficult to make this argument with respect to other elements of the infrastructure—water, fire protection, or parks—where benefits are restricted to local residents. Because schools provide a positive good to the broader community, the financing of school construction might well be considered a broader community responsibility.

This research brief summarizes a report by Marla Dresch and Steven M. Sheffrin, Who Pays for Development Fees and Exactions? *The report may be ordered by calling (800) 232-5343 [mainland U.S.] or (415) 291-4415 [Canada, Hawaii, overseas]. A copy of the full text is also available on the Internet (www.ppic.org). The Public Policy Institute of California is a private, nonprofit organization dedicated to independent, nonpartisan research on economic, social, and political issues that affect the lives of Californians.*

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