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The Coming Crash in Impact Fees

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There's a downturn in the real estate development market. Does that mean we'll soon see cities in California cutting development impact fees as well?

The pressure is building. Development projects that made economic sense a year or two ago – even with high impact fees – don't "pencil" now because interest rates have gone up and prices have stagnated or even dropped. In many cases, the dreams of both developers and cities are now on hold.

Dreams that might move forward if fees were cut from, oh, $100,000 per unit to $80,000, or $80,000 to $40,000. At least that's what developers say, and that's what cities think. We've heard lots of rumblings around here about cities cutting fees on individual projects and considering widespread fee cuts across the board.

It's an understandable response: If we can get something going now, as opposed to later, by cutting the fees, let's do it. Lots of cities did this in the last real estate recession back in the early '90s on the theory that they could kick-start their local economy.

Impact fees are politically tricky but economically necessary for most California jurisdictions – so cutting them in an attempt to stimulate development can be tricky too. The annual "Cost of Doing Business" survey has just been released by Kosmont Companies and the Rose Institute at Claremont McKenna College.

There are not a lot of surprises in the Kosmont-Rose Survey: Philadelphia is the nation's leading "wallet-buster," while Cheyenne, Wyoming, is the least expensive place surveyed to do business. What's most interesting is Larry Kosmont's observation that cities in California don't have many choices in seeking to increase revenue: They can either increase fees and taxes or they can go after new development. It's hard to ride the wave of higher real estate values – especially when the sales market is slumping and fewer properties are turning over. That's because Proposition 13 permits reassessment of property only on sale. The longer somebody owns a piece of property, the more the property becomes a financial loser for the city.

In good times, of course, California cities can do both at the same time – they'll get more development and they can hike fees as well. In bad times, they might have to trade one for the other – lowering fees in hopes of spiking development.

It didn't work last time, largely because the bust of the '90s was created by an overall economic malaise in Los Angeles, not high fees.

This time, the bust, such as it is, appears to be the result of a hyperinflated real estate market, not an economic bust. A dozen years ago, it didn't matter how much you cut fees or other development costs. Nobody was going to build. This time around things might be different.

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