Economic Impact Statement

Montgomery County, Maryland

Expedited Bill 22-24 — Taxation - Collection of Development Impact Taxes

SUMMARY

The Office of Legislative Oversight (OLO) anticipates that Expedited Bill 22-24 would have a positive impact on economic conditions in the County in terms of the Council's priority economic indicators. By requiring development impact tax payments to be paid at the time of final inspection by the Department of Permitting Services (DPS), the Bill would extend the time certain developers have before payments are due. The additional time would likely reduce financing costs for certain development projects, which would potentially increase developers' business incomes. However, due to uncertainty about the length of this extension, OLO could not determine potential impacts on other indicators or residents.

BACKGROUND AND PURPOSE OF EXPEDITED BILL 22-24

Development impact taxes – also referred to as development impact fees or impact fees – are fees that local governments impose on new development. Localities charge impact fees to developers to help cover infrastructure and public service needs related to population growth.[1]

The County collects development impact taxes for transportation and schools. The Transportation Development Impact Tax is assessed on both residential and commercial projects and is used to fund improvements to enhance local transportation capacity. The School Development Impact Tax is assessed on residential projects only and is used to fund improvements to enhance the capacity of the public school system.[2]

Under current County law, development impact taxes and other related payments are due "6 or 12 months after the building permit is issued (depending on the type of building), or the final inspection of the building by the Department of Permitting Services (DPS), whichever is earlier."[3] If enacted, Bill 22-24 would require these payments only at final inspection of the building by DPS, regardless of building type.[4] According to the sponsoring Councilmember, the intent of Bill 22-24 is to "reduce[] the overall cost of housing construction" by reducing "higher upfront housing construction costs" associated with paying impact taxes towards the beginning of a project.[5]

The Council introduced Expedited Bill 22-24, Taxation – Collection of Development Impact Taxes, on October 15, 2024.

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[1] "Fact Sheets: Development Impact Fees."
[2] "Development Impact Taxes."
[3] Introduction Staff Report for Expedited Bill 22-24.
[4] Ibid.
[5] Memorandum from Councilmember Evan Glass to Government Operations Committee, Introduction Staff Report for Bill 22-24, circle 4

INFORMATION SOURCES, METHODOLOGIES, AND ASSUMPTIONS

Per Section 2-81B of the Montgomery County Code, the purpose of this Economic Impact Statement is to assess, both, the impacts of Expedited Bill 22-24 on residents and private organizations in terms of the Council's priority economic indicators and whether the Bill would have a net positive or negative impact on overall economic conditions in the County.[6]

No assumptions or formal methodologies are used in this analysis. OLO draws on the following sources of information to assess the economic impacts of the Bill, namely its affects on financing costs for developers:

- A 2021 report by Washington State's Joint Legislative Audit and Review Committee (JLARC) on impact fee deferral programs in the state for new single-family residential construction[7]

- A 2019 report by UC Berkeley's Tern Center for Housing Innovation on residential impact fees in California[8]

- A 2021 policy brief by the UCLA Lewis Center for Regional Policy Studies that examines the impacts of adopting impact fee deferral program for new housing construction in cities across Southern California.[9]

VARIABLES

The primary variable that would affect the economic impacts of enacting Expedited Bill 22-24 is the average time gap between building permit issuance and final inspection.

IMPACTS

WORKFORCE ▪ TAXATION POLICY ▪ PROPERTY VALUES ▪ INCOMES ▪ OPERATING COSTS ▪ PRIVATE SECTOR CAPITAL INVESTMENT ▪ ECONOMIC DEVELOPMENT ▪ COMPETITIVENESS

Businesses, Non-Profits, Other Private Organizations

OLO anticipates that Expedited Bill 22-24 would have a positive impact on certain private organizations in the County in terms of the Council's priority economic indicators.

The Bill would primarily impact property developers based in the County. Currently, unless the final inspection comes first, developers are required to pay development impact taxes:

- six months after the issuance of a building permit for single-family detached or attached residential projects, or
- one year after the issuance of a building permit for multi-family or non-residential projects.

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[6] Montgomery County Code, Sec. 2-81B.
[7] "Impact Fee Deferral Programs."
[8] Raetz, Garcia, and Decker, "Residential Impact Fees in California."
[9] Phillips, "Reducing Development Costs with Impact Fee Deferral."

The proposed policy change would delay these tax payments to the time of final inspection by DPS. For projects in which the final inspection would occur six- or 12-months after the building permit has been issued, developers would effectively have additional time before the payment is due.

However, OLO does not know how much additional time developers might receive. OLO has reached out to DPS staff for data to help answer this question but has not received a response.

Based on the above-cited reports, the additional time certain developers would have to pay the development impact taxes likely would reduce financing costs for certain developments. For developers, financing costs encompass the total amount of interest, fees, and other expenses associated with borrowing funds needed for land acquisition, construction, and other aspects of the development project. Delaying when developers are required to pay impact taxes can reduce financing costs in several ways:

- **Reduce the total amount of equity developers use to finance their projects:** As explained in the UCLA policy brief, developers finance their projects with a mix of equity and debt.[10] Equity from developers and their investors is often used to pay for early development activities, such as land acquisition, whereas debt is often used to fund subsequent activities. Due to its higher risk, equity investors often expect a higher return than the interest rate of debt. For this reason, reducing the equity share of project funding and increasing the debt share can reduce financing costs for developers.

- **Shorten the interest accrual period between the initial loan disbursement and the repayment date:** By delaying the due date for impact taxes, developers can wait longer before drawing on their loans to cover these costs. This reduces the period during which interest accrues on the loan amount used for the tax payment, as there is less time between when the loan is drawn and when it is repaid. Consequently, this shortened interest accrual period lowers the total financing costs for developers.

- **Decrease the real cost of development impact taxes over time:** Inflation erodes the purchasing power of money over time, meaning a fixed amount of money is worth less in the future than it is today. If the development impact tax is the same amount whether paid at the building permit or final inspection stage, then paying it later effectively reduces its real cost. In other words, due to inflation, the "real" value of that deferred payment is less than it would be if paid earlier. However, if the development impact tax amount is adjusted for inflation, then the real cost to developers would remain unchanged regardless of when it is paid. [11]

Importantly, the magnitude of the reduction in financing costs would depend on the amount of additional time developers would have to pay the impact tax, as well as interest rates, inflation rates, and other factors.[12] Holding all else equal, reducing financing costs for certain developments could increase developers' business incomes.

However, as noted, OLO currently lacks to estimate the average additional time developers would have to pay the development impact tax. If the financing savings are substantial, property owners could see an increase in what developers are willing to pay for land and, in turn, effectively capitalize those savings into higher property values. If this occurs, more property owners may be willing to sell, thereby increasing private sector capital development in the County.[13]

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[10] Ibid.

[11] For additional background, see Cote, "Time Value of Money (TVM)."

[12] "Impact Fee Deferral Programs."

[13] Phillips, "Reducing Development Costs with Impact Fee Deferral."

Beyond these potential impacts, OLO does not have enough information to estimate the Bill's impacts on private organizations in terms of the Council's other priority indicators.

Residents

It is uncertain whether Expedited Bill 22-24 would significantly impact residents in the County in terms of the Council's priority economic indicators. With insufficient information on the potential magnitude of reduced financing costs for developers, OLO cannot assess whether the Bill might affect developers' workforces or residential development in the County.

Net Impact

By requiring development impact tax payments to be paid at the time of final inspection by DPS, the Bill would extend the time certain developers have before payments are due. The additional time would likely reduce financing costs for certain development projects, which would potentially increase developers' business incomes. However, due to uncertainty about the length of this extension, OLO could not determine potential impacts on other indicators or residents.

DISCUSSION ITEMS

Councilmembers may wish to request additional information from DPS regarding the amount of extra time the Bill would provide developers before payments are due, as the duration of this extension could significantly affect the potential economic impacts.

WORKS CITED

Cote, Catherine. "Time Value of Money (TVM): A Primer." *Harvard Business School Online* (blog), June 16, 2022.

"Development Impact Taxes," Montgomery County Department of Permitting Services.

"Fact Sheets: Development Impact Fees," Federal Highway Administration, U.S. Department of Transportation.

"Impact Fee Deferral Programs." Joint Legislative Audit and Review Committee, Washington State, December 2021.

Montgomery County Council. Introduction Staff Report for Expedited Bill 22-24. October 15, 2024

Phillips, Shane. "Reducing Development Costs with Impact Fee Deferral." UCLA Lewis Center for Regional Policy Studies, January 27, 2021.

Raetz, Hayley, David Garcia, and Nathaniel Decker. "Residential Impact Fees in California." Terner Center for Housing Innovation, UC Berkeley, August 5, 2019.

Sec. 2-81B, Economic Impact Statements, Montgomery County Code.

CAVEATS

Two caveats to the economic analysis performed here should be noted. First, predicting the economic impacts of legislation is a challenging analytical endeavor due to data limitations, the multitude of causes of economic outcomes, economic shocks, uncertainty, and other factors. Second, the analysis performed here is intended to *inform* the legislative process, not determine whether the Council should enact legislation. Thus, any conclusion made in this statement does <u>not</u> represent OLO's endorsement of, or objection to, the Bill under consideration.

AUTHOR

Stephen Roblin (OLO) prepared this report.