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Legal Q&A

By **Tad Cleaves**, TML Legal Counsel

Access to quality, functional water, sewer and roadway infrastructure can be a powerful driver of economic development in and around a city, but sometimes financing infrastructure expansion can be difficult. One tool a city can use to finance the cost of infrastructure expansion is impact fees, which can be adopted following the procedures detailed in Chapter 395 of the Texas Local Government Code (“Chapter 395”).

Q What is an impact fee?

A An “impact fee” is defined, by statute, as “a charge or assessment imposed by a political subdivision against new development in order to generate revenue for funding or recouping the costs of capital improvements or facility expansions necessitated by and attributable to the new development.” Tex. Loc. Gov’t Code § 395.001(4). Put more simply, an impact fee is a tool that cities can use to recoup, from property developers, some of the costs that new development places on city infrastructure. Impact fees require new development to pay for the costs of new development.

Q What costs may be funded by impact fees?

A Impact fees may only be used to pay certain costs for: (1) constructing capital improvements or facility expansions for water supply, treatment, and distribution facilities; (2) wastewater collection and treatment facilities; (3) stormwater, drainage and flood control facilities; and (4) roadways. *Id.* § 395.001(1). Not all costs associated with infrastructure expansion qualify –only costs authorized under Chapter 395 are allowable. Allowable costs include the costs of facility expansion or new facility construction such as: (1) construction contract price; (2) surveying and engineering fees; and (3) land acquisition costs. *Id.* § 395.012(a). Fees paid to a non-city engineer or financial consultant related to preparing or updating the capital improvement plan can also be paid by impact fees. *Id.* § 395.012(a)(4). Additionally, certain financing charges related to permissible facilities improvements or expansions may be funded by impact fees, and impact fees may also be pledged to as security for bonds under certain circumstances. *Id.* § 395.012(d).

Q What items may not be paid for by an impact fee?

A Chapter 395 provides that impact fees may not be adopted or used to fund the following items: (1) construction, acquisition, or expansion of public facilities or assets *not identified* in the capital improvements plan; (2) repair, operation, or maintenance of existing or new capital improvements or facility expansions; (3) upgrading, updating, expanding, or replacing existing capital improvements to serve existing development in order to meet stricter safety, efficiency, environmental, or regulatory standards; (4) upgrading, updating, expanding, or replacing existing capital improvements to provide better service to existing development; (5) administrative and operating costs of the city;

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and (6) principal payments of interest or other finance charges on bonds or other indebtedness unless otherwise authorized under Chapter 395. *Id.* § 395.013.

Q Where can a city assess impact fees?

A An impact fee may be imposed within the corporate limits of a city. *Id.* § 395.011(b). Impact fees may also be imposed in the city's extraterritorial jurisdiction (ETJ), except that impact fees may not be imposed in the ETJ for roadway facilities. *Id.* § 395.011(b). The area where impact fees may be assessed is called the "Service Area." For roadway facilities, the Service Area is limited to an area within the corporate boundaries of the city, not to exceed six miles. *Id.* § 395.001(9). For storm water, drainage, and flood control facilities, the Service Area may include all or part of the land within the city or its ETJ, but shall not exceed the area actually served by the storm water, drainage, and flood control facilities designated in the capital improvements plan and shall not extend across watershed boundaries. *Id.*

In areas outside both the corporate limits and ETJ of the city, a city may only impose impact fees for capital improvements by contract (but not for roadway facilities even by contract). *Id.* § 395.011(c).

Q Are there procedural prerequisites for establishing an impact fee?

A Yes. Before a city can take final action to impose impact fees, the city must first appoint a Capital Improvements Advisory Committee and then adopt: (1) a Capital Improvements Plan; and (2) Land Use Assumptions.

Q What are Land Use Assumptions?

A Land use assumptions are essentially documentation containing a description of the Service Area and projections of changes in land uses, densities, intensities, and population in the Service Area over at least a 10-year period. *Id.* § 395.001(5).

Q What is the Capital Improvements Plan (CIP)?

A Based on the projections contained in the land use assumptions, the city also prepares a draft of a CIP detailing the capital improvements that will need to be made over the term of the plan to meet existing and projected future needs. *Id.* § 395.001(2). The CIP must be developed by qualified professionals using generally accepted engineering and planning practices. *Id.* § 395.0411. The land use assumptions and CIP are detailed documents that form the basis for calculating permissible impact fees.

Q What is the Capital Improvements Advisory Committee?

A The capital improvements advisory committee ("Committee") is an advisory committee appointed by city council to assist with the impact fee adoption and implementation process. The city council must appoint the Committee before passage of the ordinance setting the public hearing on the CIP and land use assumptions. *Id.* §

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395.058. Practically speaking, once a city has decided to consider adopting an impact fee, appointment of the Committee is the first official action. In some cities, members of the Planning and Zoning Commission also serve as the Committee.

The Committee's purpose is to: (1) advise and assist the city in adopting the land use assumptions; (2) review and file written comments on the city's CIP; (3) monitor and evaluate implementation of the CIP; (4) file semiannual reports with respect to the progress of the CIP and report to the city any perceived inequities in implementing the plan or imposing the impact fee; and (5) advise the city of the need to update or revise the land use assumptions, CIP, or impact fee. *Id.* §§ 395.058(c), 395.050. Be aware that these are not simply ad-hoc committees that disappear once an impact fee ordinance has been adopted. Due to the Committee's obligation to provide semiannual reports and advise the city council with regard to the CIP and land use assumptions, the Committee should meet on a regular basis.

Q Who may serve on the Capital Improvements Advisory Committee?

A The advisory committee must be composed of at least five members. At least 40 percent of the members of the advisory committee must be representatives of the real estate, development, or building community, and not employees or officials of the city. *Id.* § 395.058(b).

Q What is the procedure for adopting an impact fee?

A Adoption of an impact fee requires strict compliance with several detailed statutory steps, lest the city open itself up to potential legal challenge. This is a technical process with specific notice and hearing timelines, so if a city wishes to adopt impact fees or update its impact fees, it should involve its professionals early, including the city attorney and city engineer. The following is a summary of the procedural steps:

- (1) **Draft CIP and Land Use Assumptions.** The city must prepare a draft of its land use assumptions and CIP. *Id.* § 395.042. In practice, the Committee generally creates or updates these drafts in advance of the hearing described below.
- (2) **Set Hearing on CIP and Land Use Assumptions.** The council must adopt an order, resolution, or ordinance establishing a public hearing date to consider the CIP and land use assumptions. *Id.* Proper notice of the hearing must be given at least 31 days in advance of the date of the hearing. *Id.* § 395.044.
- (3) **Hold Public Hearing on CIP and Land Use Assumptions.** At the hearing, the council must allow all who desire to speak for or against the CIP or land use assumptions, or any other topic related to the upcoming impact fees, to present their views to the council. *Id.* § 395.044(c)(4).
- (4) **Vote to Adopt an Ordinance Approving the CIP and Land Use Assumptions.** After the conclusion of the hearing, the council should

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“determine whether to adopt or reject an ordinance, order, or resolution approving the land use assumptions and capital improvements plan.” *Id.* § 395.045(a). Whether this “determination” step is a distinct requirement from simply adopting the CIP and land use assumptions is debatable. Regardless, within 30 days after the hearing, the city council must adopt an ordinance, order, or resolution approving the CIP and land use assumptions. *Id.* § 395.045(b).

- (5) **Set Hearing on Impact Fees.** Assuming the city adopts the ordinance approving the CIP and land use assumptions, the city council must adopt an order or resolution setting a public hearing to consider the imposition of the impact fee. *Id.* § 395.047. Proper notice of the hearing must be given at least 31 days in advance of the date of the hearing. *Id.* § 395.049.
- (6) **Advisory Committee Comments.** At least six business days before the hearing on the imposition of impact fees, the Committee must file written comments concerning the proposed impact fees. *Id.* § 395.050.
- (7) **Hold Public Hearing on Impact Fees.** At the hearing on imposition of impact fees, the city council must allow all who desire to speak for or against the impact fees, or any other topic related to the upcoming impact fees, to present their views to the council. *Id.* § 395.049(c)(5).
- (8) **Approve Impact Fee.** Within 30 days after the hearing on the imposition of impact fees, the city council must approve or disapprove the impact fees by order, ordinance, or resolution. *Id.* § 395.051.

Q When is an ordinance, order or resolution adopting impact fees effective?

A An ordinance, order or resolution establishing an impact fee can be effective immediately upon adoption, but the validity of such ordinance, order or resolution can be challenged in court. A lawsuit to contest the validity of an impact fee must be filed within 90 days from the date of adoption of the ordinance, order or resolution. *Id.* § 395.077. To avoid refunding collected impact fees following a successful appeal, some cities delay the implementation of impact fees until after the 90-day appeal period has expired.

Q How much in impact fees may a city charge?

A An impact fee may not exceed the cost of capital improvements and facility expansions required by the new development (as calculated by a professional engineer), minus a credit in an amount equal to either: (1) the new property taxes and utility revenue generated by the development; or (2) 50 percent of total costs of the capital improvements, with that figure being divided by the total number of projected service units attributable to the new development. *Id.* § 395.015. Additionally, any construction of, contributions to, or dedications of off-site roadway facilities agreed to or required by the city as a condition of development approval shall be credited against roadway facilities impact fees otherwise due from the development. *Id.* § 395.023. It is up to the

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city, with the advice of its professionals, to determine which of the two credits above will be subtracted from the costs when calculating the impact fee.

Q What is the difference between impact fee “assessment” and “collection?”

A “Assessment” is the determination of the maximum amount of the impact fee that can be charged per service unit of development on the date when the impact fee amount is calculated as discussed below. *Id.* § 395.016(f). “Collection” is the actual payment of the assessed impact fee to the city.

Q When may an impact fee be assessed and collected from a developer?

A Generally, impact fees are assessed on development at the time the final plat of the property is recorded. *Id.* § 395.016. Impact fees are generally collected when a building permit is issued or, in some cases, when a meter is installed. *Id.* § 395.016. Keep in mind that, with certain exceptions, impact fees generally may be assessed but not collected where services are unavailable. *Id.* § 395.019. Chapter 395 provides different timeframes for assessment and collection of impact fees based on when the impact fees were adopted, so cities should carefully review Chapter 395 before taking final action. Additionally, the landowner and the city can set, by agreement, the time and method of payment of impact fees. *Id.* § 395.018.

Q When is it too late to assess an impact fee on new development?

A If an impact fee is adopted after the land being developed is platted, fees cannot be assessed on any service unit that receives its building permit within one year after adoption of the impact fee. *Id.* § 395.016(c).

Q Should a city segregate impact fee funds from other municipal funds ?

A Yes. Because impact fee funds may be spent only for the purposes for which the impact fee was imposed, mingling the funds with other city revenues can be problematic. The order, ordinance, or resolution levying an impact fee must provide that all funds collected through the adoption of an impact fee shall be deposited in interest-bearing accounts clearly identifying the category of capital improvements or facility expansions within the service area for which the fee was adopted. *Id.* § 395.024(a). Furthermore, interest earned by impact fees is subject to the same use restrictions placed on the use of impact fee funds. *Id.* § 395.024(d).

Q What fees and other development tools are not considered impact fees (and thus not subject to the procedures or restrictions under Chapter 395)?

A A number of land development costs are not considered impact fees, and thus are not subject to the detailed procedures and formulas set forth in Chapter 395, including: (1) dedication of land for public parks; (2) payment in lieu of the dedication of parks; (3) dedication of rights-of-way or easements for on-site or off-site water distribution, wastewater collection or drainage facilities, or streets, sidewalks, or curbs if the

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dedication or construction is required by a valid ordinance and is necessitated by and attributable to the new development; (4) construction or dedication of on-site or off-site water distribution, wastewater collection or drainage facilities, or streets, sidewalks, or curbs if the dedication or construction is required by a valid ordinance and is necessitated by and attributable to the new development; (5) lot or acreage fees to be placed in trust funds for the purpose of reimbursing developers for oversizing or constructing water or sewer mains or lines; and (6) other pro rata fees for reimbursement of water or sewer mains or lines extended by the political subdivision. *Id.* § 395.001(4).

Q Is a city required to review its CIP, Land Use Assumptions or impact fees after adoption?

A Yes. A city imposing impact fees must hold hearings and update its CIP and land use assumptions at least every five years. *Id.* § 395.052. Chapter 395 contains detailed procedures for hearings, review, and amendment of the CIP, which are essentially the same as the procedures for initial adoption. *Id.* §§ 395.053-395.0575. Keep in mind that the Committee is required to make semiannual reports to the city council as well as advise the council with respect to the progress of the CIP.