

SECTION 3:

IMPACT FEE ANALYSIS

3-1: Background on Water and Wastewater Impact Fees

While the City's Code of Ordinances contains a section on water and wastewater impact fees ("Impact Fees"), the City has not charged these fees for several years in an effort to encourage growth and development within the utility service area. This section of the report provides updated impact fee calculations in the event that the City would like to once again charge these fees in the future.

The purpose of impact fees is to assign the proportionate share of growth-related capital costs to new customers benefiting from such additional costs. This practice has been referred to as "growth paying its own way" without existing user cost burdens.

The initial precedent for Impact Fees in Florida was set in the Florida Supreme Court decision *Contractors and Builders Association of Pinellas Authority v. The Authority of Dunedin, Florida*. In this case, the Court's ruling found that an equitable cost recovery mechanism, such as Impact Fees, could be levied for a specific purpose by a Florida municipality as a capital charge for services. On June 14, 2006, new Impact Fee legislation became effective as Chapter 2006-218, Laws of Florida, and was later incorporated in Section 163.31801 of the Florida Statutes. These new Impact Fee laws, which were labeled as the "Florida Impact Fee Act," recognize that Impact Fees are an important source of revenue for a local government to use in funding the infrastructure necessitated by growth. The Florida Impact Fee Act has subsequently been amended in May 2009 with Florida House Bill 227, in July 2019 with Florida House Bill 207, and in June 2021 with Florida House Bill 337. The act, which is not applicable to water and wastewater impact fees as will be discussed later in this section, states that an Impact Fee adopted by ordinance of a county or municipality, or by resolution of a special district, must meet the following minimum requirements:

- The Impact Fee must be calculated based on the most recent and localized data.
- The local government must provide for accounting and reporting of Impact Fee collections and expenditures in a separate accounting fund.
- The local government must limit administrative charges for the collection of Impact Fees to actual costs.
- The local government must provide notice no less than 90 days before the effective date of an ordinance or resolution imposing a new or amended Impact Fee. However, a county or municipality is not required to wait 90 days to decrease, suspend, or eliminate an Impact Fee.
- The local government may not require payment of the Impact Fee before the date of issuance of the building permit.
- The Impact Fee must be reasonably connected to, or have a rational nexus with, the need for additional capital facilities and the increased impact generated by the construction.

- The Impact Fee must be reasonably connected to, or have a rational nexus with, the expenditures of the revenues generated and the benefits accruing to the new construction.
- The local government must specifically earmark revenues generated by the impact fees to acquire, construct, or improve capital facilities to benefit new users.
- The local government may not use revenues generated by the Impact Fees to pay existing debt or for previously approved projects unless the expenditures are reasonably connected to, or have a rational nexus with, the increased impact generated by the new construction.

The Florida Impact Fee Act also states:

"In any action challenging an impact fee, the government has the burden of proving by a preponderance of the evidence that the imposition or amount of the fee meets the requirements of state legal precedent or this section. The court may not use a deferential standard."

Florida House Bill 337 added the following Impact Fee increase limitations:

- An increase in the Impact Fee of not more than 25% must be implemented in two equal annual increments.
- An increase in the Impact Fee greater than 25% but not more than 50% must be implemented in four equal installments.
- An Impact Fee increase may not exceed 50% of the current fee.
- An Impact Fee may not be increased more than once every 4 years.

HOWEVER, a local government can increase impact fees beyond the phase-in limitations if:

- A demonstrated needs study has been completed within the past 12 months that expressly demonstrates extraordinary circumstances necessitating the need to exceed the phase-In limitations.
- The local government holds two publicly noticed workshops dedicated to the extraordinary circumstances.
- The Impact Fee increases is approved by at least a two-thirds vote of the governing body.

The Florida Impact Fee Act also states that "This section does not apply to water and sewer connection fees." Based on legal opinions that we have received, many provisions of the Florida Impact Fee Act – including the increase limitations – are not applicable to water and wastewater impact fees. According to the legal opinions:

Impact Fees have been defined as "scheduled charges applied to new development to generate revenue for the construction or expansion of capital facilities located outside the boundaries of the new development (off-site) that benefit the contributing development." Ronald H. Rosenberg, *The Changing Culture Of American Land Use Regulation: Paying For Growth With Impact Fees*, 59 S.M.U. L.Rev. 177, 206 (Winter 2006) (citing James C. Nicholas, Arthur C. Nelson & Julian C. Juergensmeyer, *A Practitioner's Guide to Development Impact Fees* 1–2 (1991)).

"Impact fees, which include connection fees, are the method by which a new user of a municipally-owned water or sewer system pays his or her fair share of the costs that the new use of the system involves." See *Contractors & Builders Ass'n v. City of Dunedin*, 329 So.2d 314 (Fla.1976).

"A connection fee is generally considered to be a type of impact fee charged by utility companies for initiating new service." See, e.g., *Save Our Septic Sys. Comm., Inc. v. Sarasota Cnty.*, 957 So.2d 671 (Fla. 2d DCA 2007); *City of Zephyrhills v. Wood*, 831 So.2d 223, 224 (Fla. 2d DCA 2002).

The Florida Impact Fee Act legislation was apparently written based upon a particular jurisdiction which referred to their water and sewer impact fees as "water and sewer connection fees" but the intent was to exempt water and sewer impact fees regardless of what they are called.

Based on Florida statutory and case law, certain conditions are required to develop a valid Impact Fee:

- 1. The Impact Fee must meet the "dual rational nexus" test.** First, Impact Fees are valid when a reasonable impact or rationale exists between the anticipated need for capital facilities and the growth in population. Second, Impact Fees are valid when a reasonable association, or rational nexus, exists between the expenditure of the Impact Fee proceeds and the benefits accruing to the development from use of those proceeds.
- 2. The system of Impact Fees and related charges should be set up so that there is not an intentional windfall to existing users.**
- 3. The Impact Fees should only cover the capital cost of construction and related costs (engineering, legal, financing, administrative, etc.) for capital expansions or other capital requirements to serve growth.** Expenses for rehabilitation or replacement of a facility benefiting the existing customers (e.g., replacement of a capital asset) or an increase in the level of service should be borne by all users of the facility (i.e., existing and future users to the extent that capacity is available in such facilities to serve growth). Similarly, increased expenses due to operation and maintenance of that facility should be borne by the existing users of the utility and are not a cost component of the derivation of the Impact Fees.
- 4. An Impact Fee resolution or ordinance should be maintained that explicitly restricts the use of Impact Fees collected and requires Impact Fee revenue to be set aside in a separate account.** Separate accounting must be made for those funds to ensure that they are used only for the lawful purposes described above.

The courts, recent legislation, and industry practices have addressed three areas associated with the development of Impact Fees. These areas include i) the "fair share" concept relating to payment of the fee by the affected property owners; ii) the "rational nexus" concept, which focuses on the expenditure or purpose of the fee; and iii) the consideration of credits that recognize appropriate fee offsets (e.g., grant-funded infrastructure).

The fair share concept addresses the fact that the fee can only be used for capital expenditures attributable to growth. The fee cannot be used to finance level of service deficiencies or the replacement of existing facilities required to provide services to the existing system users. Typical industry practices also allow for establishing different fees for different classes of customers and the ability for the payment of a reduced impact fee if applicants can demonstrate that their development will have smaller impact (or capacity need resulting in a lower allocated capital requirement) than assumed in the fee determination. Additionally, the fair share concept recognizes that the cost of facilities used by both existing customers and new growth must be apportioned between the two user groups such that the user groups are treated equally, and that one group does not intentionally subsidize the other.

The rational nexus concept requires that there be a reasonable relationship between the need for capital facilities and the benefits to be received by new development for which the fee will be expended or applied. The City's existing infrastructure and the corresponding financing and management of such infrastructure is on a system-wide basis. And as such, the Impact Fees were calculated on a System-wide basis. The second nexus condition recognizes that the property must receive a benefit from the public services for which the fee is being applied. The water and wastewater facilities are used by and are constructed on behalf of all the property within the City's service area and benefit both residential and commercial customers. As such, all new growth requesting capacity from the utility system is subject to the application of the Impact Fees.

Credit or fee offsets recognize that credits should be applied to an Impact Fee if an agency has received property in the form of cost-free capital or if there is a specific revenue (e.g., taxes) that will be used for the growth-driven capital expenditures for which the impact fee was designed. Examples of cost-free capital include grants, property contributions by developers, infrastructure funded from external sources (assessments), and other sources that provide funds toward the capital expenditures for which the impact fee was designed to recover. These credits allow for the recovery of costs to serve new development through impact fees net of such cost-free capital. The calculated water and wastewater Impact Fees recognize the above-referenced issues.

3-2: Existing Impact Fees

Before being waived by the City Commission, the City’s water and wastewater Impact Fees were imposed on a per-equivalent residential unit ("ERU") basis in accordance with the customer's estimated daily flow. These Impact Fees are summarized in the following Exhibit 3-1:

Exhibit 3-1: Former Water and Wastewater Impact Fees

Description	Inside-City
Water Impact Fee Per Equivalent Residential Unit	\$ 1,000
Wastewater Impact Fee Per Equivalent Residential Unit	<u>4,300</u>
Total	<u>\$ 5,300</u>

3-3: Level of Service Requirements

In the evaluation of the capital facility needs for providing water and wastewater utility services, it is critical that a level of service ("LOS") standard be developed. Per Section 163.3164(28) of the Florida Statutes, the "level of service" means "an indicator of the extent or degrees of service provided by, or proposed to be provided by a facility, based on and related to the operational characteristics of the facility." A level of service indicates the capacity per unit of demand for each public facility or service. Essentially, the level of service standards are established to ensure that adequate facility capacity will be provided for future development and for purposes of issuing development orders or permits pursuant to Section 163.3202(2)(g) of the Florida Statutes.

For water and wastewater service, the level of service that is commonly used in the industry is the amount of capacity (service) allocable to an ERU expressed as the amount of usage (gallons) allocated on an average daily basis. This allocation of capacity would generally represent the amount of capacity allocable to an ERU, whether or not such capacity is actually used (commonly referred to as "readiness to serve"). As previously mentioned, an ERU— sometimes known as an equivalent residential connection (ERC) or equivalent dwelling unit (EDU) – is representative of the average capacity allocated to provide service to a typical individually-metered single-family residential account. This class of users is usually the largest number of customers served by a public utility such as the City's, and such customers generally have the lowest level of usage requirements for a specifically-metered account.

Based on a review of assumptions in the City's 2019 Community Redevelopment Plan, GovRates has calculated water and wastewater impact fees assuming LOS standards of 307 gpd and 245 gpd per ERU, respectively. These LOS standards are similar to those utilized by other Florida utilities.

3-4: Existing Utility Assets in Service

In the determination of the Impact Fee associated with serving future customers, any excess capacity of the existing utility system available to serve such growth should be considered. Since this capacity is available to serve the near-term incremental growth of the utility system, it would be appropriate to evaluate the capacity availability of such facilities. In order to evaluate the availability of the existing utility assets to meet future capacity needs, the existing utility assets were reviewed and assigned to functional categories. The functionalization of the existing utility assets is necessary to identify those assets which should be included in the determination of the impact fees.

The functional cost categories are based on the purpose of the assets and the service that such assets provide. The following Exhibit 3-2 contains a summary of the functional cost categories for the utility assets considered in the impact fee analysis:

Exhibit 3-2: Utility Asset Categories

Water Service	Wastewater Service	Other Assets
Supply	Treatment	General Assets (equipment, vehicles, etc.)
Treatment, Transmission, and Storage	Effluent / Reclaimed Water	
Distribution	Transmission and Major Pumping Stations	
Fire Hydrants	Collection (includes local lift stations, manholes, and laterals)	
Meters and Services		

Generally, the costs of onsite facilities which serve a specific development or customer such as water distribution and wastewater collection lines, meters and services, and fire hydrants are usually i) donated by a developer as part of the City's utility extension program (a contribution of the plant); ii) recovered from the individual properties through an assessment program based on those properties which receive special benefit from such facilities or from the application of a main line extension fee to recover the specific cost of such facilities; or iii) funded from the customer directly (e.g., by a "front-foot" charge where the on-site lines were initially financed by the utility and then paid by the customer or an installation charge to recover the cost of a new service line and/or the meter).

The City provided GovRates with reported utility asset information that served as the basis of the functionalization of the existing utility assets. The original costs of the assets (gross book value) were adjusted based on historical changes in the ENR Construction Cost Index to derive the current value. Only assets not fully depreciated were recognized in the calculations. Table 3-1 at the end of this section provides a summary of the functionalization of the existing utility plant-in-service for the System. This information represents the most current information available relative to the assets-in-service that can serve the existing and near-term future customer base of each utility system.

3-5: Additional Capital Investment

The City's capital improvement program (CIP) through the Fiscal Year 2027, as prepared and estimated by the utility staff and its Consulting Engineers, outlines a number of capital improvements for the water and wastewater systems. These capital projects include i) expansions to accommodate new growth; ii) upgrades of existing assets to accommodate new and existing customers; and iii) replacements of existing assets or projects which generally benefit current users of the System.

Tables 3-2 and 3-3 at the end of this section show the capital costs included in the Impact Fee calculations. No amounts associated with departmental capital outlay were included. Departmental capital outlay is the ongoing replacement of vehicles, equipment, machinery, computers, furniture, and other assets that generally have relatively short average service lives (e.g., five years). These amounts are typically

considered or classified as general plant and are funded on a "pay-as-you-go" basis through the annual user rate revenues of the System.

Based on our understanding of the fair share apportionment rule identified by case law, only water production / wastewater treatment and major backbone transmission costs were recognized in the water and wastewater Impact Fee calculations. General transmission and distribution / collection project costs were not recognized because they i) generally are not system-wide costs (i.e., distribution / collection project costs tend to benefit specific customers); ii) in many instances, are funded by a specific charge applied to a customer (e.g., line extension charges, etc.); and iii) are usually contributed to the City as part of the development process (e.g., it would not be equitable for a developer who has contributed the distribution / collection assets to pay an Impact Fee which includes recovery of distribution/collection projects).

3-6: Water and Wastewater System Impact Fee Calculations

The calculated Impact Fees are shown in the following Exhibit 3-3:

Exhibit 3-3: Former and Calculated Water and Wastewater Impact Fees Per ERU

Description	Former	Calculated	Difference	Level of Service (gpd) [1]	Calculated Cost per Gallon [2]
Water	\$1,000	\$1,140	\$140	307	\$3.72
Wastewater	4,300	4,230	(70)	245	17.24
Combined	<u>\$5,300</u>	<u>\$5,370</u>	<u>\$70</u>		

ERU = Equivalent Residential Unit

gpd = gallons per day

[1] Based on assumptions in City's Community Redevelopment Plan.

[2] Proposed fee divided by level of service assumption.

As shown in the preceding table, the calculated water impact fee is higher than the former water impact fee, while the calculated wastewater impact fee is slightly lower than the former wastewater impact fee. The City now has a higher cost per unit of capacity than what was previously calculated due to inflation, new treatment technology, increased government regulations, and changing capital needs. However, the calculations recognize historical and projected grants and legislative appropriations that are offsets in the Impact Fee calculations (cannot include infrastructure costs for which the City did not pay). The costs per gallon of capacity shown in the preceding Exhibit 3-3 are comparable to those of many other Florida utilities.

An overview of the impact fee calculations is shown in Table 3-4 at the end of this section.

3-7: Impact Fee Comparisons

In order to provide additional information to the City regarding the existing and calculated Impact Fees, a comparison of the existing and calculated fees for the City with those of other Florida jurisdictions was prepared. This comparison, summarized on Table 3-5 and Figure 3-1 at the end of this section, provides a comparison of the City's former and calculated Impact Fees charged to single-family residential connections (i.e., one ERU) with the fees or comparable charges currently imposed by other "neighboring" municipal/governmental water and wastewater systems. Figure 3-1 shows a graphical representation of the comparison. It is important to note that the methods used in the development of the water and wastewater Impact Fees imposed may vary. Moreover, no analysis has been performed to determine whether 100% of the proportionate cost of new facilities is recovered from system Impact Fees, or some percentage less than 100% with the balance recovered through the user charges. Additionally, the types of capital facilities currently in service or planned for the utility may have a material effect on the impact fee charged by a local government. For example, wastewater effluent disposal utilizing a deep injection well system generally has a higher capital cost per unit of capacity than use of a surface water discharge such as an outfall to a bay or river. The capital costs associated with constructing reverse osmosis water treatment facilities, which treat brackish water, are higher than those of lime softening facilities, which treat freshwater.

Some reasons why Impact Fees differ among utilities:

- Source and quality of raw water supply.
- Proximity to source of supply.
- Type and complexity of treatment process.
- Effluent disposal method.
- Density of service area.
- Availability of grant funding to finance capital assets / CIP.
- Age of system.
- Utility life cycle (e.g., growth-oriented vs. mature).
- Level of service standards.
- Administrative policies.

As shown on Table 3-3, the average water and wastewater system Impact Fees per ERU for the 13 surveyed neighboring utilities are \$1,559 and \$2,457 (combined = \$4,016), respectively, for a single-family residences equaling one ERU. Of the surveyed utilities, Polk County has the highest combined water and wastewater fees at \$7,039. The City of Palmetto with combined fees of \$1,702 has the lowest in the group. The calculated water system Impact Fee of \$1,140 and the calculated wastewater system Impact Fee of \$4,230 (combined = \$5,370) for the City are comparable with the fees charged by the surveyed utilities. The City of Lake Wales, DeSoto County, and Polk County are the utilities represented in the comparison that currently charge higher combined water and wastewater Impact Fees than those calculated for the City.