The Unintended Consequences of Impact Fees in Baltimore County

Policy Considerations

MAY 13TH, 2019

Sage Policy Group, Inc.

Submitted to: Baltimore County Stakeholders

Table of Contents

List of Exhibits

The Unintended Consequences of Impact Fees in Baltimore County

Executive Summary

The Maryland Building Industry Association (MBIA) commissioned Sage Policy Group, Inc. (Sage) to study the economic implications of proposed impact fees on new development in Baltimore County. This is the proposed fee structure:

- $10,000 per single-family home;
- $7,500 per townhouse;
- $5,000 per apartment or condo;
- $1.50/square foot for commercial and office property; &
- $0.80/square foot for industrial property.

These fees would not be implemented in a vacuum. Also proposed are a slew of other tax/fee increases, including on cable service, cellphone accounts, hotels, and personal income. These impact fees would be imposed during a period of population decline in Baltimore County. While taxes could accelerate outmigration, impact fees would slow in-migration, accelerating the loss of taxpayers and tax base. This looks much like the trajectory Baltimore City has maintained for decades.

According to the U.S. Census Bureau, Baltimore County lost approximately 170 residents on net during a 12-month period spanning from 2017 into 2018. In terms of domestic net migration, far more people left Baltimore County than entered, which is remarkable given the large outflow of population from neighboring Baltimore City. This forms part of longer-term demographic decline. The population of adults in the prime of their careers—those aged 35 to 54—plummeted from 2010 to 2017, while the population aged 60 and older has surged. This translates into more people on fixed incomes and fewer people able to help finance school construction and other public needs in Baltimore County.

Key Findings

The Sage study team concludes the following with respect to proposed impact fees on residential and commercial development:

- They are regressive, with relatively larger impact on the price of starter homes and median-priced homes than on luxury residences;
- They will result in less multifamily and commercial development, resulting in fewer opportunities to secure housing and jobs;
- They are inconsistent with advancing the goal of housing affordability;
- They will slow the in-migration of young, professional households, including people presently living in high-priced city apartments;
- They will result in a smaller Baltimore County construction economy, with construction presently supporting approximately 7.5 percent of countywide economic activity;
- They will ultimately produce a smaller tax base, impacting income, property and transfer tax collections.

Conclusion

The unintended consequences of impact fees are concerning. Many who favor such fees argue that revenues can be used to fund much-needed infrastructure, including new school construction. While there is little question that the county requires the rebuilding of at least three high schools, we conclude that these fees will ultimately result in fewer resources to invest in public services and infrastructure.

Rather than implementing policies that will further accelerate the loss of taxpayers and tax base, Baltimore County policymakers should investigate the possible benefits of public-private partnerships. Increasingly, P3s are being utilized across the U.S. to fund public needs without requiring government to incur substantial debt.

The Unintended Consequences of Impact Fees in Baltimore County

- Significant Tax Increases & Impact Fees Proposed in Baltimore County

A community must have a tax base that is sufficient to meet its needs. These needs encompass schools, roads, public safety, parks, and a host of other quality of existence categories. Communities that are able to expand their tax base are able to invest more into these categories, all things being equal. But communities with shrinking tax bases, including because of declining population, have fewer resources to invest and also suffer greater inefficiency due to lost economies of scale in service provision (e.g. fewer people to pay for a police department or to finance the maintenance of existing parks).

Baltimore County's recently-elected Executive has recommended a number of tax increases. These include the first increase in the County's income tax rate since 1992, higher taxes on lodging, a new tax on short-term rentals (e.g., Airbnb), and fees on cell phones and cable television. By one estimate, the income tax increase, which will increase Baltimore County's rate from 2.83 percent to 3.2 percent, would result in $180 in additional income taxes for a resident earning $50,000 per year. The lodging/hotel tax is slated to rise from 8 percent to 10 percent. This tax would also be imposed on Airbnb and similar short-term rentals. The proposed cell phone tax would charge $3.50 per cell phone per month.

Prominent among the proposed new taxes and fees are the County's first impact fees on new residential and commercial development. These proposed fees envision the following:

- $10,000 per single-family home;
- $7,500 per townhouse;
- $5,000 per apartment or condo;
- $1.50 per square foot for commercial and office property; and
- $0.80 per square foot for industrial property.[1]

[1] Wilen, Holden, "Olszewski proposes raising Baltimore County income tax for first time in 28 years," Baltimore Business Journal, April 15, 2019. https://www.bizjournals.com/baltimore/news/2019/04/15/olszewski-proposes-raising-baltimore-county-income.html.

These new taxes and fees stand to impact every Baltimore County household. Of course, the total impact on a given household will vary by income level, the extent of their cell phone usage, and their consumption of cable services. At a recent Baltimore County Council hearing, one resident claimed that his family's taxes would increase by more than $700.[2]

Not only would there be impacts upon existing residents, but fees on development stand to impact those who are considering moving their household or business to Baltimore County. Impact fees can be expected to increase housing prices as developers pass along their increased costs to buyers. To the extent that fewer units are developed, Baltimore County's tax base would not expand as rapidly as it otherwise would. Fewer units might also translate into less competition for tenants, which would induce higher rents even for current residents, negatively impacting housing affordability.

Once imposed, the impact fees can be expected to increase the price of individual single-family homes by as much as $10,000, townhouses by as much as $7,500, and condominiums by as much as $5,000. For newly constructed rental units, rents would be higher as property owners seek to pass along as much development cost increase as the market will bear.

- Proposed Impact Fees are Regressive

Importantly, because the proposed impact fees are fixed as opposed to graduated, they will have a greater proportional impact on lower priced housing. Thus, for a new home priced at the $249,600 median value of owner-occupied housing in Baltimore County, a $10,000 impact fee translates into an approximately 4 percent increase in price presuming that a seller could pass along all or a significant fraction of the fee to the buyer. Alternatively, for a $1 million home, the impact represents only 1 percent of the price. In other words, to the extent that the proposed impact fees would stall development, housing targeted toward first-time buyers, including young families, would likely be the most impacted.

As prices and rents increase, the quantity demanded decreases. This means that the proposed impact fees will translate into diminished sales of homes, townhomes, and condominiums in Baltimore County. This loss of transactional volume also translates into foregone transfer tax revenue. Baltimore County charges a transfer tax rate equal to 1.5 percent of consideration.

By increasing the cost of commercial, office, and industrial space, proposed impact fees can also be expected to truncate the pace of nonresidential development. Not only will that translate into fewer

[2] Knezevich, Alison, "Baltimore County residents speak out on proposed tax increases," Baltimore Sun, April 30, 2019 https://www.baltimoresun.com/news/maryland/baltimore-county/bs-md-co-budget-hearing-20190430-story.html.

jobs available to Baltimore County residents, it will ultimately place even more pressure on the residential base to finance the consumption of services and fund debt service.

Unlike residential development that is associated with a broad range of new demands for local public services, notably schools, commercial development typically places far more limited demands on local services. As a result, new commercial development can be particularly beneficial to local government finances. Thus, reductions in commercial development as a result of higher prices for new commercial space can have disproportionately negative effects on public finances.

- Construction, a Baltimore County Economic Engine

Potential reductions in new construction of housing and commercial and industrial properties would have a direct impact on Baltimore County's construction industry. The industry contributes significantly to the county's economy both as a direct employer and indirectly through its spending multiplier effects.

Construction encompasses a varied, extensive supply chain that involves architects, engineers, suppliers of materials, general contractors, subcontractors, including minority contractors, those who manage apprenticeship programs, hardware stores, advertising and accounting services. Multiplier effects also include the household spending of construction industry workers, who generally earn high wages attached to a variety of skilled trades. The loss of that spending power impacts businesses large and small, whether restaurants, auto dealers and other retailers, or those who provide financial or other services.

One of the principal goals of this report is to quantify relevant subject matter to the extent possible. The Sage study team has sought to accomplish this by using accepted statistical techniques on publicly available data.

IMPLAN is a nationally recognized source of economic data including the interrelationships between the output of specific industries such as the construction of new housing and new office buildings and the myriad industries that provide inputs to the establishments in the construction industry. These data are available for all counties in America.[3]

Exhibit 1 summarizes IMPLAN estimates of key variables for the Baltimore County economy and for the construction industry in particular. Direct impacts of the construction industry comprise the employees of construction companies, proprietors of construction companies, the income and other

---

[3] IMPLAN is the industry standard source of economic and econometric data and software that enables economic impact analysis. The data provided in Exhibit 1 are the most current data available and are estimates of the Baltimore County economy in 2017. www.implan.com.

compensation of these workers, and the business sales of those companies. Secondary impacts include the workers, income, and business sales of the supply chain that are dependent on the construction industry's activities in Baltimore County. Also included in the secondary impacts are the benefits to county businesses and their employees that are generated by local spending of workers supported directly and indirect by construction activity.

As indicated, in total the construction industry accounts for 7.6 percent of all jobs located in Baltimore County once multiplier effects are considered. These jobs support 7.4 percent of the income earned by those employed in Baltimore County and 7.5 percent of total Baltimore County business sales. Roughly two-thirds of these total impacts are attributable to the construction industry itself (direct jobs) with the remaining jobs attributable to the secondary impacts of the construction industry. The jobs created directly by the construction industry are well-paid, averaging 6 percent more than the average compensation for all jobs in Baltimore County.

Exhibit 1. The Construction Industry as an Economic Engine of Baltimore County

Category of industry	*Employment*		*Income*		*Business Sales*	
	Number	Share of total	Number	Share of total	Number	Share of total
All industries	518,037	100.0%	$29,162	100.0%	$79,141	100.0%
Construction industry						
Direct impacts	24,530	4.7%	$1,440	4.9%	$3,969	5.0%
Secondary impacts	15,092	2.9%	$721	2.5%	$1,998	2.5%
Total impacts	39,622	7.6%	$2,161	7.4%	$5,967	7.5%

Source: Sage; IMPLAN

- Baltimore County is Already in Demographic Decline, at least along Certain Dimensions

The loss of construction jobs, the impact of higher living costs on households, the expanded tax burdens of families, and diminished growth in the county's commercial tax base would be more palatable if Baltimore County were operating from a position of strength. It isn't. Baltimore County is already experiencing demographic decline along key dimensions.

Population change is largely defined as natural increase — the difference between the number of births and deaths — and net migration — the difference between the number of those moving into and out of jurisdictions. Net migration also distinguishes between international migration — primarily movements of the foreign born[4] — and domestic migration — which primarily reflects the movement of native-born persons.

Exhibit 2. Trends in the Components of Population Change[5]

Time period	Total Population Change (1)	Natural Increase	Vital Events		Net Migration		
			Births	Deaths	Total	Int'l	Domestic
2017-2018							
Baltimore County	-172	1,030	9,579	8,549	-1,202	2,614	-3,816
Baltimore City	-7,346	1,037	7,965	6,928	-8,381	1,989	-10,370
2016-2017							
Baltimore County	-13	1,201	9,775	8,574	-1,210	2,654	-3,864
Baltimore City	-6,008	1,283	8,140	6,857	-7,278	1,947	-9,225
2015-2016							
Baltimore County	1,145	1,670	9,895	8,225	-508	2,481	-2,989
Baltimore City	-6,301	2,115	8,598	6,483	-8,428	1,814	-10,242
2014-2015							
Baltimore County	2,465	1,943	10,071	8,128	596	3,190	-2,594
Baltimore City	-1,015	2,617	8,930	6,313	-3,609	2,278	-5,887
2013-2014							
Baltimore County	2,768	2,204	9,852	7,648	661	2,829	-2,168
Baltimore City	668	2,571	8,744	6,173	-1,810	1,945	-3,755
2012-2013							
Baltimore County	4,215	1,695	9,539	7,844	2,644	2,625	19
Baltimore City	-476	2,600	9,009	6,409	-3,040	1,651	-4,691

Source: U.S. Census Bureau; Maryland State Data Center. Note: 1. Total population change includes a residual. This residual represents the change in population that cannot be attributed to any specific demographic component.

[4] While international migration is most commonly associated with the foreign born, the Census Bureau also includes the net migration between the United States and Puerto Rico, the net migration of natives to and from the United States, and the net movement of the Armed Forces population between the United States and overseas. Net international migration for Puerto Rico includes the migration of native and foreign-born populations between the United States and Puerto Rico.

[5] U.S. Census Bureau, Population Division, "Estimates of the Components of Resident Population Change: April 1, 2010 to July 1, 2018" at Maryland State Data Center. https://planning.maryland.gov/MSDC/Pages/s2_estimate.aspx.

A more granular assessment of the manner by which Baltimore County's population has changed since 2010 reveals patterns suggesting that Baltimore County and Baltimore City are experiencing surprisingly similar trends in population, though the city's demographic shifts remain more extreme. Natural increases in population have declined in both jurisdictions in recent years. From 2017 to 2018, the natural increase in population in both jurisdictions was approximately 1,030, down from approximately 2,200 in Baltimore County four years earlier and from approximately 2,600 in Baltimore City three years earlier.

Net migration has been negative for Baltimore County for the past three years, a phenomenon that has been true of Baltimore City for even longer. Since 2016, the extent of net out-migration in Baltimore County has been large enough to overcome the natural increase in population. This loss of population has been driven by the out-migration of native-born persons. If not for the increase in population from international immigration, the loss of Baltimore County's population would have been substantially greater. See Exhibit 2 for relevant statistical detail.

The impact of these shifts is broad-based, including on demand for County services. While international migration renders Baltimore County a more interesting place in which to live, it also generates a need to adjust to emerging realities, including financially.

A recent report noted that more than half of new students enrolling in County schools spoke English as a second language and that students in the school system now speak nearly 100 different languages.[6] Many would view this as making a great county even greater. The Sage study team does not disagree. However, teaching students who speak English as a second language is a decidedly more expensive endeavor. The Maryland Commission on Education, Finance Equity, and excellence, otherwise known as the Thornton Commission, concluded that "it costs twice as much to teach an LEP (limited English proficiency) student as it does an English speaking student."[7]

[6] Bowie, Liz, "Baltimore County schools are rapidly adding students. More than half are immigrants or speak another language," The Baltimore Sun, February 7, 2019. https://www.baltimoresun.com/news/maryland/baltimore-county/bs-md-co-immigrant-enrollment-20190204-story.html.

[7] "Calculation of the Cost of an Adequate Education in Maryland in 1999-2000 Using Two Different Analytic Approaches," prepared for the Maryland Commission on Education Finance, Equity, and Excellence (Thornton Commission), John Augenblick.

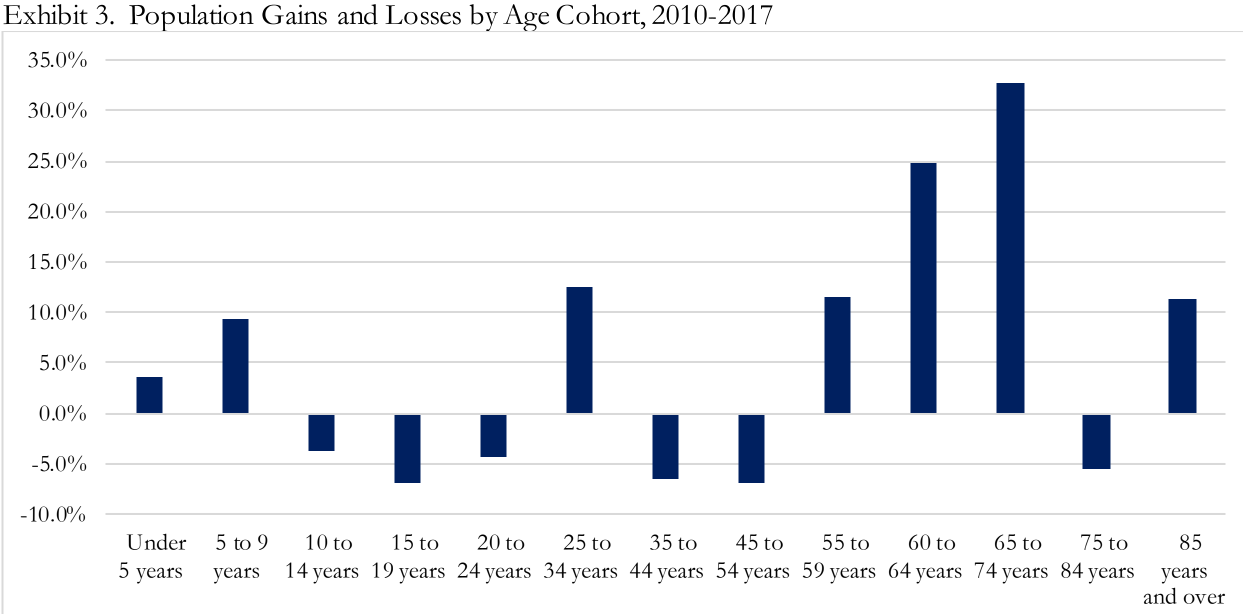
- Population Changes by Age Cohort are also Revealing[8]

Baltimore County's shifting mix of ages also suggests that the imposition of significant impact fees could be more problematic than initially meets the eye. Since 2010, the largest percentage increases in population are associated with those aged 60 to 74 years. This is primarily a function of demographics as the large Baby Boomer generation moves into and beyond ages associated with the onset of retirement. Meanwhile, the largest decreases have been among older teenagers (15 to 19 years) and those who comprise the heart of workforce (35 to 54 years).

The population of college age residents and young adults (20 to 24 years) has also declined, while the population of young children, those aged 9 years and under, has increased. This is the group that among other things is associated with substantial numbers of limited English proficiency students.

The overall picture is of a county that is aging. Although the cohort that encompasses the youngest residents has experienced population increases, these increases are much smaller than the increases associated with those in their 60s and early 70s and those 85 and older. This is reflected in Exhibit 3. This apparent greying is also evident in the steady increase in the county's median age, from 38.2 years in 2010 to 39.2 years by 2017 according to American Community Survey estimates.

Exhibit 3. Population Gains and Losses by Age Cohort, 2010-2017



Source: U.S. Census Bureau

[8] U.S. Census Bureau, American Community Survey, "DP05: ACS Demographic and Housing Estimates". Data represent changes from the 2006-2010 American Community Survey to the 2013-2017 American Community Survey.

Exhibit 4 supplies additional detail regarding population trends by age cohort. As indicated, between 2010 and 2017, Baltimore County's population aged 9 years and under expanded by 6,074 while the population aged 55 years and over increased 34,260. The population of younger adults (25 to 34 years) increased by 12,698, but this increase was sandwiched between population losses in the immediately younger (10 to 24 years) and older demographic categories (35 to 54 years), which experienced population losses of 8,221 and 15,369, respectively.

Exhibit 4. Trends in Population Change by Age Cohort, 2010-2017

Age cohort	Number	Percentage
Under 5 years	1,727	3.6%
5 to 9 years	4,347	9.3%
10 to 14 years	(1,917)	-3.8%
15 to 19 years	(3,901)	-6.8%
20 to 24 years	(2,403)	-4.3%
25 to 34 years	12,698	12.4%
35 to 44 years	(6,985)	-6.5%
45 to 54 years	(8,384)	-6.9%
55 to 59 years	6,106	11.6%
60 to 64 years	10,561	24.9%
65 to 74 years	17,837	32.7%
75 to 84 years	(2,384)	-5.6%
85 years and over	2,140	11.4%

Source: U.S. Census Bureau

Given the expanding population of very young people, Baltimore County can expect to face significant educational costs going forward, both in terms of instruction and the need to invest in its aging facilities, including a number of high schools that remain in poor physical condition. At the same time, the population of those on fixed incomes continues to climb, putting additional pressure on the heart of the tax base to generate funds for both operations and capital.

The way to balance the need for tax revenues and the capacity of taxpayers is to expand the tax base, including by adding more young professional families. However, with many of these young professionals still paying down student debt, affordability and value proposition represent major considerations. A Federal Reserve study indicates that every $1,000 in student debt delays homeownership by 2.5 months. For the class of 2017, student debt averaged approximately

$40,000.[9] That translates into a delay exceeding 8 years in homeownership according to the Federal Reserve's estimates.

In general and in the context of student debt, impact fees on new development would render it less likely that the county can capture sufficient numbers of young families. The result could very well be a population increasingly characterized by fixed income retirees and a simultaneous and growing need to finance schools. The associated dynamic would likely be associated with serial increases in tax rates, including in property tax rates, resulting in more taxpayer outmigration and increasingly tenuous County finances.

Rather than imposing barriers to in-migration of those who could add to the tax base and rebalance Baltimore County's demographics along the dimension of age, the County should strive to create an environment as amenable to budding professionals as possible.

As is well known, Baltimore City has been a hotbed for Millennials renting apartments, which are often part of new construction associated with lofty rents. As these renters continue to progress in their careers and form households, Baltimore County will emerge as a natural option for many of them.

What is remarkable is that Baltimore City's large-scale population losses are no longer associated with Baltimore County's population gain. Both jurisdictions are now associated with significant out-migration and population declines.

As is well known, Baltimore City has been losing population for decades, with especially large losses registered since the turmoil of 2015. Since that fateful year, the city has experienced the departure of approximately 10,000 domestic migrants on net each year.

---

[9] Yale, Aly, "Student Loans Keeping You From Buying A Home? Think Again," Forbes, January 14, 2019. https://www.forbes.com/sites/alyyale/2019/01/14/student-loans-keeping-you-from-buying-a-home-think-again/#7b6127671d08.

- The Fiscal Implications of Population Gains and Losses

There are some who make the claim that new development represents a fiscal drag on communities – that existing residents end up subsidizing new ones. This contention simply fails tests of common sense. Since 1950, the City of Baltimore has lost nearly 350,000 residents. If new residents represent a drag on community finances, the loss of residents should represent a boon to fiscal health. According to the City's Department of Finance, Moody's rates Baltimore City's general obligation bonds Aa2, which is hardly terrible, but falls short of a triple A rating. By contrast, Montgomery County, MD, which has added nearly 900,000 people since 1950, maintains a AAA bond rating.

One can view this from the perspective of the Great Recession as well. Prior to the housing collapse, Baltimore County, which hadn't raised taxes in many years, was running large-scale surpluses. In FY2006, the County finished the year with a $280 million surplus, $25 million more than anticipated "thanks to a robust real estate market."[10]

When the housing market buckled during the global financial crisis, construction activity slowed and County finances deteriorated. In fashioning its FY2011 budget, County policymakers were forced to address an estimated $164 million revenue shortfall, including by delaying capital improvements. As indicated by the *Baltimore* Sun, that budget was associated with what then-County Executive James Smith said "were the fewest capital projects in several years."[11] Many projects had been postponed "because of the fiscal realities in which we live."[12] In fact, a robust real estate dynamic associated with new construction, including of single-family homes, townhomes, and apartments for professionals represent sources of fiscal well-being.

---

[10] The Baltimore Sun. "County ends fiscal year with $280 million surplus". October 27, 2006. https://www.baltimoresun.com/news/bs-xpm-2006-10-27-0610270136-story.html.
[11] The Baltimore Sun. "Baltimore County executive unveils 2011 budget". By Mary Gail Hale. April 15, 2010. https://www.baltimoresun.com/news/maryland/baltimore-county/bs-xpm-2010-04-15-bs-md-co-baltimore-county-announces-budge20100415-story.html.
[12] Id.

- County Could Trigger Faster Population Losses with Impact Fees

Even in the absence of proposed tax and fee increases, Baltimore County's population has been shrinking and aging. Census Bureau data indicate that the county's population peaked in 2016 and has been declining since. Among Central Maryland counties, Baltimore County has experienced the slowest overall growth in population since 2010, increasing at half the regional rate. As reflected in Exhibit 5, other Central Maryland counties have continued to experience meaningful population growth, including Howard County, the region's pace-setter. Since 2010, Baltimore City's population has declined by a bit more than 18,500 people.[13]

Exhibit 5. Annual Estimates of the Resident Population on July 1: 2010 to 2018

	Baltimore City	Baltimore County	Anne Arundel County	Harford County	Howard County	Counties Surrounding Baltimore City	Maryland State Total
2010	621,005	806,560	539,277	245,235	288,628	1,879,700	5,788,642
2011	620,442	812,797	544,744	246,704	293,579	1,897,824	5,838,991
2012	622,973	818,023	550,311	248,556	299,213	1,916,103	5,887,072
2013	622,497	822,238	555,438	248,892	303,583	1,930,151	5,923,704
2014	623,165	825,006	559,691	249,330	306,998	1,941,025	5,958,165
2015	622,150	827,471	563,502	249,589	311,449	1,952,011	5,986,717
2016	615,849	828,616	567,665	250,361	315,619	1,962,261	6,004,692
2017	609,841	828,603	571,592	251,890	319,374	1,971,459	6,024,891
2018	602,495	828,431	576,031	253,956	323,196	1,981,614	6,042,718
2010-2018							
Net Chg.	-18,510	21,871	36,754	8,721	34,568	101,914	254,076
% Chg.	-3.0%	2.7%	6.8%	3.6%	12.0%	5.4%	4.4%

Source: U.S. Census Bureau

[13] U.S. Census Bureau, Population Division, "Annual Estimates of the Resident Population: April 1, 2010 to July 1, 2018" at Maryland State Data Center. https://planning.maryland.gov/MSDC/Pages/s2_estimate.aspx.

- P3s as a Preferred Alternative

Rather than adopt policies that truncate future tax base, Baltimore County must create a value proposition that is as appealing as possible to emerging households, including those comprised by professionals. While Sage researchers are perfectly well aware that the County has massive needs for infrastructure funding, including a need to eventually replace Lansdowne, Towson, and Dulaney high schools, the study team's research also indicates that hemorrhaging taxpayers does not represent a path to fiscal sustainability and optimized quality of life.

There are other ways to fund much need infrastructure, including new school construction. At the top of the list are public-private partnerships (P3s), which use private capital to help finance public investment requirements.

A 2016 study conducted by Syracuse University concluded that there is a significantly higher likelihood of meeting cost and schedule objectives under P3 models compared with traditional public sector project delivery where a project is owned, managed, and financed by government.[14] Based on published studies regarding the design, construction and maintenance of social infrastructure projects, such as schools and clinics, McKinsey Consulting concluded that the P3 approach can diminish life cycle cost by as much as 20 percent relative to traditional approaches. Accordingly, we recommend that before Baltimore County adopt and implement broadly-crafted impact fees on a slew of private investment, the County consider P3s as a mechanism by which to finance much-needed infrastructure.

Conclusion

Baltimore County has an opportunity to appeal to young professional families, including people who presently live in high-rent city apartments. That would expand the county's tax base, stimulate commercial activity, and help rebalance the county demographically.

However, proposed tax and development fee increases could induce many young people to opt for residences in other counties. That would serve to limit Baltimore County's tax base growth, and hurt the local construction industry, local retailers and other commercial enterprises.

Proposed impact fees would also potentially impact the pace of commercial development, resulting in even more burden placed on shrinking numbers of prime age workers/households. Such outcomes would be inconsistent with long-term investment in infrastructure, including schools.

[14] McKinsey & Company. "The rising advantage of public-private partnerships". By Michael Della Rocca. July 2017. https://www.mckinsey.com/industries/capital-projects-and-infrastructure/our-insights/the-rising-advantage-of-public-private-partnerships.