Montgomery County Council Hearing
On the Subdivision Staging Policy

September 15, 2020

Written Testimony of David Murray, Montgomery County Resident

The Planning Board is asking the County Council to impose new taxes on affordable housing development, increase taxes on home sales by more than 20 percent, and gamble with the MCPS capital budget so that the County can give developers and institutional investors a 50 percent tax break. The Council should reject these proposals and develop its own.

We all agree that housing is too expensive and there is not enough of it. Unfortunately, the Planning Board's take on trickle down economics only guarantees a windfall for developers, not more housing.

To hear the Planning Board tell it, school impact fees are driving housing prices. It is worth questioning that assertion, because the record tells a different story. Developers have repeatedly asked the Planning Board to allow them to scale down projects. Developers are not worried about a housing shortage. They are worried that a shortage of customers will force them to settle for lower prices, so they ration supply.

The Planning Board is also asking the Council to take on fiscal risks. Under the proposal, if new home construction increases, and sales of existing homes fail to increase at a similar rate, the County would see an influx of students without enough money to build classrooms for them. In this scenario, the Council could become so cash strapped that it would have no choice but to impose construction moratoria while it finds money for schools.

Indeed, under the Planning Board's proposal, new construction would fund much less than the cost of its impact on schools. The Planning Board is asking the Council to take money from Montgomery County Public Schools (MCPS) and give it to developers. Adopting the Planning Board's proposal would ensure that the County would lose money almost every time a developer puts a shovel in the ground. Families throughout the County would bear these costs.

In light of the flaws in the Planning Board's proposals, the Council should reject them. Instead, the Council should consider leaving recordation taxes unchanged and adopting school impact fees that recover costs only when the County will incur a cost while also promoting affordable housing.

Flawed Analysis

The Planning Board has done a disservice to the Council by putting forward a series of maximalist proposals based on flawed analysis. The growth policy claims that one variable — impact fees — is driving housing supply and housing costs. However, the growth policy fails to substantiate this assertion, and it fails to examine any other factors affecting housing supply and costs. As a result, the growth policy fails to include any recommendations for policies that would discourage excessive project staging and downsizing in prime locations. The Planning Board ignored evidence that school impact fees are not the sole or primary variable driving housing supply and prices. The growth policy's analysis appears to be designed to influence rather than inform, making a strained case to reduce impact fees but delivering little else while failing to consider alternative explanations for the County's growth patterns.

- During the hearings on the growth policy, the Planing Board received testimony from County Budget officials and the public that made clear that there has been no historical relationship between impact fee rates and the volume of residential development in the County. The Planning Board ignored this testimony and did not even note the data that contradict the growth policy's primary thesis.
- The Planning Board's analysis also ignored a growing body of evidence that developers are rationing supply to keep prices high. So far this year, the Planning Board has approved developers' applications to delay residential projects, downsize residential projects, and to convert parts of residential projects from apartments to hotel rooms. Developers seeking these approvals have claimed that they are concerned about a lack of demand.
- During the hearings on the growth policy, the best rationale that the Planning Board could provide for reducing impact fees was that it "stands to reason" that reducing impact fees would increase supply and reduce prices. This argument flows from trickle down economic theory, which a substantial body of literature shows has exacerbated inequality rather than reducing it. The Planning Board's argument also does not account for other incentives for developers to limit supply, such as a desire to maintain high prices throughout their housing inventory, including in older buildings.

More thorough analysis would have included a comprehensive analysis of the housing industry in the County to identify the multiple drivers of housing development patterns and to inform better recommendations for driving growth. The Council should insist on more comprehensive analysis before overhauling the impact and recordation tax schedules.

- Comprehensive analysis would reveal why more developers have not taken advantage of fee exemptions for building affordable housing.
- Comprehensive analysis would identify the factors that developers consider when they decide whether to start a project, how big a project should be, and the target market for a project.

Fiscal Risks

The draft growth policy would jeopardize the County's fiscal health, without any safeguards to ensure that the proposed tax breaks for developers would result in more housing or lower prices for customers. In contrast, the current impact fee and recordation tax schedule limits the county's downside fiscal risk because impacts are closely linked to revenue streams that address the costs of those impacts.

Importantly, developers of new housing already receive a subsidy from the county's other taxpayers. According to the Planning Board, new housing's share of enrollment growth is three times its share of the MCPS capital budget. The remainder of the capital budget is funded by the rest of the County's taxpayers, either directly or through taxes paid to the state, which finances part of the MCPS capital budget.

The Planning Board's proposals are unlikely to be fiscally neutral unless they fail to deliver an increase in new housing development. Impact fees cannot be analyzed based solely on how much revenue they generate. Impact fees must be analyzed on a net basis: revenue minus the cost of building classrooms for the students generated by new residential development. Optimally, impact fees collected minus construction costs net to zero.

- The Planning Board has asked the Council to increase recordation tax rates to subsidize construction of market rate housing units. If new housing development increases, but turnover of existing housing stays the same or decreases, the County would face a budget shortfall because new housing and turnover would not generate enough revenue to fund the necessary new classrooms. The revenue shortfall could be so severe that the Council would have no choice but to impose a moratoria, a risk that is heightened by separate fiscal stressors arising from the pandemic.

- The Planning Board claims — without evidence — that cutting impact taxes would increase new development. If that claim is correct, then the County would face a revenue shortfall unless turnover of existing housing increased at a similar rate despite the Planning Board's recordation tax increase. Under the Planning Board's proposal, whether the County has sufficient funding to build new classrooms required by new housing would be almost entirely dependent on the health of the market for existing homes.

- The Planning Board's recordation tax estimate is based on a year with a near-record setting number of home sales. The projected revenue increase would have been smaller if the Planning Board had based its estimates on a year with fewer transactions. The Planning Board has not provided public estimates of how much its impact fee cuts would cost the County.

Current Impact Fee and Recordation Schedule Ensure School Funding

Currently, impacts are linked to revenue, although new construction pays slightly less in impact fees than the County spends to build classrooms for the students that new construction generates.

Proposed Rates	New Housing Growth	Turnover Growth	Total Revenue Growth	New Classrooms Needed	Net Revenue
Scenario 1	↔	↔	↔	↔	↔
Scenario 2	↑	↑	↑	↑	↔
Scenario 3	↑	↓	↓	↓	↔
Scenario 4	↓	↑	↑	↑	↔
Scenario 5	↓	↓	↓	↓	↔

The complexity of the Planning Board's proposal amplifies the County's downside fiscal risks. The proposal suggests that seven separate rate areas replace the current countywide rates, making forecasting and rate setting more complex and increasing the likelihood of errors.

- The areas proposed to have the lowest rates are the areas where recent new housing is already concentrated and that are best positioned for near-term growth because many projects have already cleared approval hurdles.
- Setting impact fee rates at cost recovery levels for each of the areas described in the Planning Board's proposal would require consistently accurate forecasting of student generation rates among these areas. The County has struggled to forecast development impacts even under the current, simpler fee regime, and the new regime would require much more precision. The Planning Board's proposal to exclude older units from student generation rate formulas increases the risk of error because the sample size would be smaller and units that have never been sold or leased would make up a greater percentage of total units, which would cause measured generation rates to be artificially low.
- The pandemic has made forecasting more difficult. Developers build what consumers demand. It is unclear what type of housing will be most appealing to consumers 12 months from now, let alone in 2024.

Planning Board's Proposal Threatens School Funding

Under the Planning Board's proposal, recordation taxes collected on sales of existing homes would subsidize developers who are building market rate housing. As a result, fiscal stability would be overly reliant on the market for existing homes. Falling prices for existing homes or a sales slowdown would result in budget shortfalls. The Planning Board's desired scenario — an increase in new housing — would result in a revenue loss to the County unless sales of existing homes increased at a similar rate.

Proposed Rates	New Housing Growth	Turnover Growth	Total Revenue Growth	New Classrooms Needed	Net Revenue
Scenario 1	↔	↔	↔	↔	↔
Scenario 2	↑	↑	↑	↑	↔
Scenario 3	↑	↓	↓	↑	↓
Scenario 4	↓	↑	↑	↑	↑
Scenario 5	↑	↔	↓	↑	↓

Alternative Proposal

The Planning Board's proposal is so flawed that the Council should scrap it. The Planning Board's proposal recommends a large tax break for developers — at the expense of the County's other taxpayers — and fails to make the case that the tax break will generate any more housing units than the regime currently in place. The Planning Board has also failed to propose any measures that would penalize developers who would pocket the tax breaks as profit instead of building more housing. The proposal is all carrot and no stick. In addition, the Planning Board's proposal threatens socioeconomic diversity by imposing new impact fees on affordable housing development in some neighborhoods but not in others. Furthermore, the draft fails to assess the impact that these recommendations would have on the County's ability to fund capital improvement projects, affordable housing initiatives, and government services.

- The Proposal's base case takes at face value developers' claims that regulations and fees are the only barriers to delivering more housing units and largely ignores the high levels of multifamily housing development in infill areas during the past 10 years, under the current impact fee program.
- The Proposal does not assess whether there are any other factors that would compel developers to continue to limit supply even if the County were to loosen regulations and reduce fees. Moreover, the Proposal does not put forward any recommendations that would make the delivery of more affordable housing units a more certain outcome.
- The Proposal would impose thousands of dollars in new impact fees on affordable housing development in some neighborhoods but not in others. The Planning Board appears to be relying on revenue from the new taxes on affordable to fund its subsidy for market rate housing in some of the County's hottest neighborhoods.

The Council should reject the Planning Board's proposal and adopt a simpler plan instead. A simpler plan would benefit developers by making the fee schedule easier to understand and anticipate, and it would benefit the County by limiting fiscal risks. A simpler plan would also leave recordation taxes unchanged. The County's school impact fee schedule should be based on two principles: generating revenue sufficient to cover the cost of the new classrooms that new housing requires and promoting affordable housing.

Notional School Impact Fee Schedule

School impact fees are imposed to cover the cost of building classrooms for students in new housing development. Impact fees should not be used to pay for renovations of existing classrooms, because those expenses are more appropriately paid for by existing residents through property and recordation taxes.

School Utilization (After accounting for new development)	Rate (% cost of each seat)
Less than or equal to 100 percent countywide	0%
Greater than 100 percent countywide, in any year over next five years	100%
Greater than 100 percent countywide, in any year over next three years	120%

First, the County should only charge impact fees when it actually incurs a cost for building new classrooms. If, on a countywide basis, elementary, middle, and high schools are forecast to have spare capacity for the entirety of the next five years, school impact fees should be set at zero. According to the Planning Board, the County will soon achieve this goal at the elementary and middle school levels, and it is close to achieving this goal at the high school level on a countywide basis. If, however, a project would require the County to add school capacity, then the project would be required to pay impact fees with the rate escalating the sooner that schools would cross the 100 percent threshold.

This impact fee schedule would provide growth incentives when the County has the infrastructure necessary to support growth but would ensure money is available for construction when the County needs to add classrooms, without ever prohibiting development because of school overcrowding. These impact fee holidays would spur development by offering developers hundreds of thousands of dollars in savings for limited times while helping the County's budget by increasing utilization of existing infrastructure and spreading the cost of maintaining existing infrastructure over a wider tax base. Such a system would reduce the risk that slow growth would force the County to close schools, as it did in the late 1970s and early 1980s.

By measuring utilization on a countywide basis, the County would eliminate the need to conduct utilization tests on a school-by-school basis when considering development applications. This would provide more certainty to developers, because countywide utilization is less volatile than the utilization of particular schools. MCPS could periodically adjust boundaries to achieve its optimal utilization at every school. In some cases, this would mean that students in new housing would not attend the closest school until a comprehensive boundary review occurs, so that MCPS could preserve continuity for students who are already enrolled.

The County's impact fee schedule also should promote affordable housing development so that all of our neighborhoods are diverse. Even when schools are overcapacity, the impact fee schedule should preserve the existing exemptions for affordable housing.

In addition, the Council should explore other ways to drive growth. It is clear from developers' recent requests to delay and downsize residential projects that they are staging and scaling their projects to avoid producing so much housing that prices fall. To promote affordable housing, the Council should consider:

- Imposing affordable housing impact taxes annually on properties that received approval to downsize;
- Imposing affordable housing impact taxes annually on properties that have approved plans for increased residential density that are more than five years old, and that escalate the longer an approved plan sits on the shelf; and
- Imposing affordable housing impact taxes on short-term rental units contained within multifamily residential properties.

Together, the revenue from these affordable housing impact taxes would equip the County to address housing needs at all income levels. These affordable housing impact taxes also would properly allocate the costs that developers' decisions to delay and downsize impose on society. The County already imposes an affordable housing tax on high-end residential transactions. It should do the same on market rate projects that are scoped and timed to keep prices high, because decisions to downsize and delay large projects have a far greater impact on housing affordable housing than one expensive single family home.

Debunking Myths About Impact Fees

The Planning Board has muddied the discussion about impact fees with misleading claims about impact fees.

Myth	Fact
Future impact fees will alleviate current overcrowding, and moratoria deprive the County of revenue it needs to address current overcrowding.	**Moratoria have no net impact on the County's bottom line, because every time the County collects an impact fee, it is also incurring a cost.** The County does not currently break even on impact fees. New housing funds just 8 percent of the MCPS capital budget but accounts for 23 percent of the student growth. Chasing impact fee revenue as a salve for school overcrowding is akin to a business losing money on every transaction but claiming to make up the difference on volume. The math does not work.
Montgomery County's impact fees are unreasonable.	**Montgomery County's impact fees are carefully calculated.** Montgomery County's impact fees are based on school construction costs and expected student generation. Our impact fees are high because our school construction costs are high, and they do not even account for the full cost of impact because they do not cover the cost of portable classrooms or site preparation.
Impact fees are holding back housing production and resulting in higher housing prices.	**Impact fees do not drive housing production or housing prices.** The Planning Board claims that impact fee reductions will promote new development and result in lower prices, but the Planning Board is unable to substantiate either claim with evidence. Loudoun County's impact fees are even higher than Montgomery County's fees, and Loudoun County is growing faster. Developers are limited in their ability to pass impact fees onto renters and buyers because, according to the County's Department of Housing and Community Affairs, household incomes drive pricing, not impact fees. Developers charge what people are willing to pay, rather than basing prices on cost plus desired profit. Recent applications to delay or reduce the size of projects express concerns about a shortage of buyers and tenants, not a shortage of housing.