



## THE HOUSING BOTTOM LINE:

# Fiscal Impact of New Home Construction on California Governments

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## Abstract

This study examines the fiscal impact of new housing on California governments. Specifically, we looked at both one-time and new ongoing revenues and expenditures at the city, county, and state levels. We estimated costs and revenues using an average, per-household-based approach in which the total costs or revenues associated with current residents were divided by the number of current households to arrive at an average per-household cost or revenue calculation. The per-household figure for current households was applied to new households to estimate future revenues and costs. In certain cases, we adjusted this per-household method to incorporate differences between new and current residents based on socioeconomic characteristics of a typical new household, such as the likelihood that a new household has a school-age child, the projected spending of the new household members on taxable goods, and the probability of utilizing government-supported social service or health programs. Ultimately, we found that for a new, median-priced house, the ongoing fiscal impact is positive, at \$771, \$190, and \$3,498 at the city, county, and state levels, respectively. In addition, one-time net revenues are on average positive, producing an additional \$3,017, \$1,706, and \$15,858 for cities, counties, and the state, respectively, each year. In sum, new housing construction has a substantial net fiscal benefit to the state and local governments in California.

## Executive Summary

The purpose of this analysis is to estimate the fiscal impact of new housing in California. Specifically, our analysis seeks to answer the question: What is the fiscal impact on city, county, and state government budgets when a new house is built? This analysis examines both the one-time costs and revenues associated with the construction of a new, occupied dwelling, as well as the ongoing service costs and revenue effects of new housing,

Housing has long been recognized as a significant component of the state's economy. Numerous studies and experts have documented the impact of new housing on job creation and overall economic growth. The fiscal impact of housing, however, has been the subject of far less analytical examination. Although many consulting firms and university researchers have looked at the fiscal effects of a specific development project on one city or one county, we found no previous study that examines the overall fiscal effects of housing at the state level or looks at multiple cities or counties (let alone all the municipalities in California, as we have in this analysis).

Lacking this analytical work, many local officials and researchers operate under the belief that new residential construction does not "pay its own way." However, it is possible that new residential development is more fiscally beneficial than conventional wisdom holds. For example, because actual housing values are going up much faster than the assessed values of existing homes, new houses (initially assessed at market value) will generate substantially more property tax revenues than homes of equal value that have not been on the market for several years.

The current body of research on the fiscal impact of housing does not include a multi jurisdiction analysis of whether or not new housing pays its own way. This study seeks to fill the gap in the existing literature by analyzing this question in detail.

## **Methodology**

Most of the available work examining the fiscal impact of housing in California has been done by consultants hired by local jurisdictions to set the level of a "fiscal impact fee." Impact fees are generally paid by developers to cover the cost of government services or infrastructure required to serve a new home. A major difference between these studies and the analysis done for this report is that, while the other studies look at the impact of a specific proposed development project, we are considering the fiscal impact of housing in general terms, focusing on the impact of the "next house" to be built.

The most common method for land-use fiscal impact analysis is the per-capita average cost method (also known as the per-capita multiplier method). Using the average cost method, costs and revenues for a new population are estimated based on the average costs and revenues for current residents. That is, the method estimates the costs to serve a new resident as being equal to the total costs for serving existing residents divided by the total number of existing residents receiving a particular service. A similar method is employed to estimate the revenues generated by new residents. To arrive at a per-household estimate of net impact, the net per-capita estimate (new per-capita revenues less new per-capita costs) is multiplied by the household size.

The basic unit of analysis in this study is the "new house." In other words, we sought to answer the question: What is the effect on government revenues and expenditures each time a new house is built? We looked at houses priced at the median value for the local housing market. Our analysis examined the ongoing effects once a new house is occupied as well as the one-time fiscal effects that occur during the construction phase.

Our analysis looks primarily at operating expenditures and revenues of general purpose governments, and does not include special-fund supported programs or local enterprise activities. This is because, for the most part, these activities have no net fiscal effect. Fees collected pay for the service provided.

This study also does not include a separate analysis of capital outlay expenditures and revenues, but does include debt service payments that are used to support current and future capital facilities. The implicit assumption of this approach is that the current level of spending on debt service will, in combination with other capital financing sources such as Mello Roos bonds, and development exactions, provide an adequate funding stream for the needed capital expenditures resulting from new housing.

Finally, when possible, we used a conservative assumption or relied on a conservative estimate so as to not overstate the fiscal benefit of housing.

## **The Impact of Business Growth Related to New Housing**

Without the construction of new housing, economic growth would undoubtedly slow as a result of increasing home prices, crowding, and other factors. Similarly, it is not likely that much in the way of new housing would be constructed without employed residents to occupy the new dwellings. And while there may be periods during which the rate of growth of one group exceeds the other, in the long run, population growth and economic growth occur together. For this reason, we have estimated the costs and revenues associated both with a new house itself, as well as with the new business activity that is likely to accompany this new house.

### **Construction Phase Impacts**

Some of the fiscal impacts associated with new housing are tied directly to construction of the new house (and should not, therefore, be estimated on a per-capita basis). These costs include, for example, that portion of building inspection and planning and zoning activities that are not covered by fees and charges paid by developers. We estimated these fiscal effects on a per-new-house basis as opposed to a per-capita basis.

There are also revenues specifically associated with the building of a new house, such as the sales taxes paid on the sale of construction materials and the income or corporation tax paid on the on builder's profits. We also estimated the amount of revenues from the local property transfer tax, which is levied when a piece of property changes hands, including when it is first sold from the contractor or developer to its first occupants.

### **City and County Analysis**

For most of the revenue and expenditure categories analyzed, cities and counties were treated in the same way. However, because counties provide services both to all county residents and to residents of unincorporated areas (i.e. areas that are not part of a city), we separately estimated the impact of those costs and revenues that differ based on the location within the county, such as sales taxes and property transfer taxes, and law enforcement and fire protection services.

City and county property tax revenue from new construction was determined by estimating the value of the house and then subtracting the value of the land prior to construction. We then applied the relevant property tax rate (taking into account the impact of the homeowner's exemption) to the added value from the construction.

Sales tax revenues were determined using an estimate of household spending on taxable goods as a function of the income of the residents based upon the purchase price of the house. Then, the local sales tax rate for the relevant jurisdiction was applied to the estimated taxable expenditures.

In order to determine both the amount of county health and social services program subvention revenue and expenditures per household, we determined each household's probability of participating in subvention-supported health or social service programs compared to the overall participation rate as a function of household income.

Utility user tax revenues and other local tax revenues were calculated on a per-household basis.

On the local government expenditure side of the equation, we estimated all local government expenditures, except for construction-related spending and spending on health and social services programs, on a per-household basis.

### **State Analysis**

Our analysis of the state-level fiscal effects of new housing construction was conducted using a method analogous to the method used for cities and counties. Revenues and expenditures were calculated on a per-

household basis, except in cases where the new households were not likely to resemble the average current household.

We estimated revenues in three categories: personal income tax, sales tax, and all other revenue sources. In addition, we estimated the school share of the property tax generated by a new home, and included this amount as an offset to state general fund costs for K-12 schools and community colleges. In terms of expenditures, we prepared estimates for K-12 education, higher education, health and social services, corrections, and all other programs.

For income taxes, we calculated average personal income tax rates by income brackets and estimated personal income tax revenues based upon the projected income of the new households as a function of the purchase price of the home. For the sales tax, as with cities and counties, we estimated likely taxable sales activity as a function of income based on home price and applied the state sales tax rate. All other revenues were calculated on a per-household basis.

In terms of state expenditures, we estimated the state's obligation to K-12 schools for a new household by determining the expected number of new students in an average new household. We then estimated the total per-student expenditures (based on funding from both state general fund and local property tax sources). Finally, we estimated the amount of new property taxes that the new house would generate and applied the resulting amount as an offset to the state's costs.

To estimate the new housing-related state general fund costs for each of the three segments of public higher education in California (California Community College, California State University, and University of California), we determined the probability, based on income, of attending one of these public higher education institutions, estimated the number of college-age students in a household, and multiplied by the state general fund cost per student.

For corrections costs, we estimated the probability that someone residing in a new house would be incarcerated based on the income of the household and applied that probability to the per-inmate cost of housing inmates in state prison. Similarly, for health and human services costs, we estimated the likelihood that someone in a new household would receive health or social services benefits based on household income and multiplied that rate by the cost per recipient of these services.

Finally, we estimated the cost of all other state expenditures on a per-household basis.

## **Results**

The results of our analysis indicate that, on average, construction of a new house provides substantial fiscal benefits for all levels of government in California. Specifically, we found that when a median-priced house is built, the state receives an ongoing fiscal benefit of \$3,498 and a one-time benefit of \$15,858. The average city receives an ongoing fiscal benefit of \$771 and a one-time benefit of \$3,017. The fiscal impact of new housing on counties depends on the location in the county in which the new construction occurs. Construction of a median-priced home in the incorporated portion of the county yields an ongoing fiscal benefit of \$571 as compared to a \$266 annual cost for houses built in the unincorporated area of counties. The one-time county-level fiscal impacts are positive for houses regardless of where in the county the house is built, at \$1,332 for houses built in the incorporated portion of the county and \$2,323 for houses built in the unincorporated portion of the county. The average dwelling built in a county produces a one-time fiscal benefit of \$1,706 and an ongoing benefit of \$190.