

Audit Report – Impact Fees

To: Michael Smith, Chief Financial Officer; Richard Hall, Land Use General Manager

Audit Conclusions and Reportable Items

Overall, we believe that adequate internal controls exist in all material respects over New Castle County's assessment, collection, and administration of impact fees.

Opportunities for improvement are included in the "Opportunities for Improvement" section of this report, beginning on page 14. We also have a General Comment regarding performing a review of impact fees as required by County Code Section 40.14.220. See page 8. We are also issuing a separate memorandum to the Executive Office regarding the possibility of assessing impact fees to developers in the incorporated municipalities.

Overview – Impact Fees

Delaware Code Title 29, Chapter 91, Section 9124 gives the County Government the authority to charge impact fees for services for which the County will bear increased costs of development.

New Castle County adopted the Unified Development Code (UDC) in Fiscal Year 1998. (The UDC is Chapter 40 of New Castle County Code). To help reduce the need for (1) the issuance of General Obligation Bonds and (2) property tax increases, the UDC has provisions to allow the County to charge development impact fees to be used for future infrastructure needs of the County. Impact fees are one-time payments used to fund future capital improvements that become necessary as a result of increased demand for County services (including libraries, fire services, emergency medical services, law enforcement, County facilities, and parks) due to growth and new development in the County.

Impact fees are covered in the UDC's Article 14. In particular, Section 40.14.010 outlines the services for which the County may require new development to provide impact fees, Section 40.14.210 outlines the impact fee amounts by service and different development categories, and Section 40.14.260 states how impact fee funds should be administered.

Prior to July 31, 2006, County Code allowed for the assessment of sewer impact fees for development in the Southern Sewer Service Area (SSSA), i.e., the area of New Castle County south

of the C & D Canal. Sewer impact fees were removed from the Code by Substitute No. 1 to Ordinance No. 06-042 and replaced by capital recovery fees. However, there are still some sewer impact fees being collected for land use development agreements entered into before the effective date of that ordinance. We did not include sewer impact fees in the scope of our testing.

In FY 2019, the County collected approximately \$1.5 million in impact fees. Table 1 gives the estimated account balances for the various general ledger impact fee accounts as of 6/30/2019.

A portion of the impact fees collected is used to service debt in the operating budget (\$400,000 for FY 2020), while most is used for capital projects (\$1.2 million Southern Park for FY 2020).

Table 1: Ending Balances of Impact Fee accounts, 6/30/2019

| Parks - North C & D | | | | Parks - South C & D | | | |
|--|----|--|--------------|--|----|--|--------------|
| Balance 6/30/2018 | \$ | | 57,935.34 | Balance 6/30/2018 | \$ | | 1,064,845.73 |
| Revenue | | | 143,590.83 | Revenue | | | 184,869.34 |
| Expenditures | | | (150,000.00) | Expenditures | | | (328.00) |
| Balance 6/30/2019 | \$ | | 51,526.17 | Balance 6/30/2019 | \$ | | 1,249,387.07 |
| Libraries - North C & D | | | | Libraries - South C & D | | | |
| Balance 6/30/2018 | \$ | | 19,174.12 | Balance 6/30/2018 | \$ | | 348,387.13 |
| Revenue | | | 59,403.02 | Revenue | | | 76,181.04 |
| Expenditures | | | (50,000.00) | Expenditures | | | (138.00) |
| Balance 6/30/2019 | \$ | | 28,577.14 | Balance 6/30/2019 | \$ | | 424,430.17 |
| Emergency Medical Services - North C & D | | | | Emergency Medical Services - South C & D | | | |
| Balance 6/30/2018 | \$ | | 4,943.67 | Balance 6/30/2018 | \$ | | 2,989.95 |
| Revenue | | | 8,845.77 | Revenue | | | 3,827.61 |
| Expenditures | | | (10,834.49) | Expenditures | | | (3,443.39) |
| Balance 6/30/2019 | \$ | | 2,954.95 | Balance 6/30/2019 | \$ | | 3,374.17 |
| Law Enforcement - North C & D | | | | Law Enforcement - South C & D | | | |
| Balance 6/30/2018 | \$ | | 28,005.50 | Balance 6/30/2018 | \$ | | 47,888.53 |
| Revenue | | | 44,087.25 | Revenue | | | 32,915.68 |
| Expenditures | | | (56,529.87) | Expenditures | | | (62.00) |
| Balance 6/30/2019 | \$ | | 15,562.88 | Balance 6/30/2019 | \$ | | 80,742.21 |
| Fire Service | | | | County Facilities | | | |
| Balance 6/30/2018 | \$ | | 374,227.65 | Balance 6/30/2018 | \$ | | 67,122.89 |
| Revenue | | | 630,813.64 | Revenue | | | 204,591.35 |
| Expenditures | | | (562,470.24) | Expenditures | | | (204,594.15) |
| Balance 6/30/2019 | \$ | | 442,571.05 | Balance 6/30/2019 | \$ | | 67,120.09 |
| Sewer - North C & D | | | | Sewer - South C & D | | | |
| Balance 6/30/2018 | \$ | | - | Balance 6/30/2018 | \$ | | 1,195,412.09 |
| Revenue | | | | Revenue | | | 85,801.41 |
| Expenditures | | | | Expenditures | | | (17,460.07) |
| Balance 6/30/2019 | \$ | | - | Balance 6/30/2019 | \$ | | 1,263,753.43 |

Source: Comprehensive Annual Budget Summary, FY 2020

Audit Objectives, Methodology and Scope

This audit was a “performance audit” of New Castle County’s processes for assessing, collecting and administering impact fees. Performance audits, as defined by Generally Accepted Governmental Auditing Standards, are audits that provide findings and conclusions based on an evaluation of sufficient, appropriate evidence against criteria. The overall performance audit objectives for this audit were:

- Internal Control: An assessment of the County’s system of internal control over impact fees that is designed to provide reasonable assurance of achieving efficient and effective operations, reliable financial and performance reporting, and compliance with applicable laws and regulations.
- Compliance: An assessment of the County’s compliance with criteria, related to impact fees, established by provisions of laws, formal policies and procedures, and other requirements.
- Program effectiveness, economy, and efficiency: An assessment of the extent to which the County is achieving its goals and objectives related to the assessment, collection and administration of impact fees.

Our performance audit, and its scope and methodology, encompassed the following:

1. Documented and evaluated the internal controls over the processes for assessing, collecting, and administering impact fees.
 - Our evaluation revealed the need for the Department of Land Use to develop written policies and procedures for all aspects of assessing impact fees. See Comment #3 on page 18.
 - Our evaluation revealed the need for the Department of Land Use to develop written policies and procedures for the evaluation of fire & rescue impact fee funding requests and the distribution of funds. See Comment #4 on page 21.
2. Tested that the amounts for the six residential impact fee categories were assessed correctly per Table 40.14.210 in the UDC: We requested a report of all residential building permits, except for residential additions¹, processed in June 2019. The report contained 85 building permits – 46 detached single-family residences, 35 townhouses and 4 duplex/twin homes.
 - Our testing revealed no exceptions.
3. For the residential impact fees in Step #2, tested (in accordance with County Code Section 40.14.260B) that such fees were appropriately allocated to the North and South of the C & D Canal. (For four of the six residential impact fee categories, there are North and South general ledger accounts.)

¹ The County collects impact fees only for new residential developments, not additions to existing structures. The accuracy of building permit classification is the subject of another audit.

- Our testing revealed no exceptions.
4. We requested a report of all commercial building permits processed during July 2017 through December 2019. The report contained 219 commercial new (P-NEW) and addition (P-ADDN, P-RVAD) building permits and 1,340 commercial fit-out permits. (Note: Impact fees are only assessed on commercial fit-outs when there has been a change of use.) Audit testing performed was as follows:
- a. Commercial New (P-NEW) and Addition (P-ADDN, P-RVAD) Building Permits: For the period July 2017 through December 2019, we tested whether impact fees had been assessed in all situations where they should have been. For testing the accuracy of the impact fee amounts per Table 40.14.210 in the UDC, we selected the commercial building permits issued between January and June 2019 (44 total); this enabled us to test the accuracy of the impact fee calculations for the four impact fee services for the following development categories: Commercial/shopping center (less than 60,000 sq. ft GFA), Office/institutional (less than 10,000 sq. ft. GFA), Office/institutional (10,000 sq. ft. to 50,000 sq. ft. GFA), Business Park, Light Industrial, and Warehousing.
- Assessment of Impact Fees: Our testing revealed:
 - Five exceptions on the P-NEW building permits. We do not believe these exceptions to be material. See comment #3 on page 18.
 - No exceptions on the P-ADDN building permits.
 - Eight exceptions on commercial building permits involving both renovations & additions (P-RVADs). We do not believe these exceptions to be material. See Comment #2 on page 16.
 - Accuracy of Impact Fees: Our testing did not reveal any exceptions on the P-NEWs and the P-ADDNs. Our testing did reveal exceptions on the accuracy of impact fees for two of the four P-RVADs where impact fees were assessed. We do not believe these exceptions to be material. See Comment #2 on page 16.
- b. Commercial Fit-Out Permits (P-FIT): There were 26 commercial fit-out permits on the report which had “Y” (Yes) for Change of Use.
- Our testing revealed one immaterial exception on commercial fit-out permits involving a change of use, as well as a few situations where the Change of Use box was checked in Hansen when it shouldn’t have been. As a result of this testing, we also began to question whether impact fees should be assessed at all in commercial fit-out change of use situations. See Comment #1 on page 14.
5. Commercial and Residential Building Permits: If the impact fees had not yet been collected for any of the building permits issued from January 2019 through June 2019, we tested whether a Certificate of Occupancy had been issued and, therefore, whether impact fees should have already been collected. We performed this same step for the residential building permits from our testing in Step 2 above.

- Our testing revealed no exceptions.
6. Traced impact fees received by Land Use for two dates in June 2019 from the Hansen system to the County's financial system and to the County's consolidated cash bank account. Then traced the weekly transfers (encompassing these dates) of impact fees from the consolidated cash bank account to the impact fees bank account. (Note: This is done to comply with County Code Section 40.14.260A, which requires the impact fees to be deposited into separate interest-bearing funds.)
 - Our testing revealed no exceptions.
 7. Tested, for the month of June 2019, whether the interest income in the impact fees bank account was properly allocated to the various impact fee general ledger accounts (in accordance with County Code Section 40.14.260A).
 - Our testing revealed no material exceptions.
 8. Reviewed the Office of Finance's May 2019 reconciliation of the impact fee bank account balance to the total of all impact fee general ledger account balances, with a particular emphasis on determining the validity of the bank account's reimbursement to the County's consolidated cash account for impact fee disbursements made from such account.
 - Our testing revealed no exceptions.
 9. For fire & rescue impact fees, selected the three volunteer fire companies to which the highest dollar amounts of impact fees were disbursed in FY 2019 and:
 - a. Tested that the projects to which the disbursements relate were properly approved by the Department of Land Use and the County Executive, and that the New Castle County Fire and Ambulance Advisory Board provided sufficient documentation to the County to justify such approvals (i.e., whether the request for funding was for "capital facilities and equipment" as per Code). This testing encompassed five projects.
 - Our testing revealed no exceptions.
 - b. Tested that sufficient funds existed in the applicable impact fee general ledger account at the time of disbursement. The disbursements pertained to five approved projects.
 - Our testing revealed no exceptions.

In general, our testing involves audit sampling. We evaluate the results of the tests and use professional judgment, based on the number of exceptions and/or the materiality of such exceptions, whether to include exceptions in the audit report. In some cases, we perform additional testing to help us obtain additional audit evidence in making such evaluation and determination.

If our audit work reveals an item which we believe is significant in the context of one or more audit objectives, we include this in an "Areas of Particular Concern" section of the audit report. An Area of Particular Concern is an item (such as a deficiency in internal control or noncompliance

with a particular law) which we believe has or could have a significant adverse impact upon the County's ability to accomplish a major objective and, therefore, warrants management's immediate attention. All other reportable items are included in an "Opportunities for Improvement" section of the audit report.

Because the scope of an audit does not allow us to examine every single function and transaction performed by an area, an audit would not necessarily disclose all matters that might be reportable items.

Generally Accepted Government Auditing Standards

Except as discussed in the following paragraph, we conducted our audit in accordance with Generally Accepted Government Auditing Standards (GAGAS) promulgated by the United States General Accounting Office. These standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

We have not met the requirement of Section 3.96 of GAGAS that requires an audit organization performing audits in accordance with GAGAS to have an external review every three years. In Fiscal Year 2021, we plan to have the Association of Local Government Auditors perform a peer review of the County Auditor's Office.

Views of Responsible Officials

Management's responses are included after each of the report's recommendations.

Also, the Department of Land Use stated the following:

Based on numerous interactions with the Auditor's Office, the Department can state that the efforts by the Auditor have been open and transparent with a consensus goal by both offices to ensure compliance with the adopted Unified Development Code (UDC).

Appreciation of Cooperation

We sincerely appreciate the cooperation of the Office of Finance and the Department of Land Use in their willingness to work together with us in determining constructive improvements to the assessment, collection, and administration of impact fees.

Cc:

Matthew Meyer, County Executive

Vanessa Phillips, Chief Administrative Officer

Brian Boyle, Policy Director

Wilson Davis, County Attorney

Karen Sullivan, County Solicitor

George Haggerty, Assistant Land Use Manager

David Holston, Department of Land Use Licensing Manager

Antoni Sekowski, Department of Land Use Planning Manager

Michele Davis, Land Use Administrator

Nicole Racine, Senior Budget & Procedures Analyst, Department of Land Use

Brian Merritt, Assistant County Attorney

Richard Piekarski, Senior Budget & Procedures Analyst, Office of Finance

Patricia Kastner, Senior Budget & Procedures Analyst, Office of Finance

General Comment

Perform evaluation of impact fees as required by County Code Section 40.14.220.

Background

Impact fees were implemented upon County Council's adoption of the Unified Development Code (UDC) on December 31, 1997. However, several service impact fees were left out of Table 40.14.210 until a comprehensive study of impact fees for such services could be performed. This study, completed by Tischler & Associates (now TischlerBise), was completed in June 1998. On January 12, 1999, County Council adopted legislation which updated Table 40.14.210 based upon the results of the study.

County Code Section 40.14.230, "Other necessary adjustments", states:

"All costs in the impact fee calculations are given in current dollars with no assumed inflation rate over time. Necessary cost adjustments will be made as part of the periodic evaluation and update of impact fees. Impact fees will be adjusted for inflation in construction costs as reflected in the Engineering News Record (ENR) index and upon approval by County Council ..."²

Since 1999, however, the only impact fees which have been adjusted have been the fire & rescue impact fees. County Council adopted legislation in August 2006 raising these fees based upon another study performed by TischlerBise earlier in 2006. Thus, the impact fees for Parks, Libraries, County Facilities, EMS, and Law Enforcement have not been adjusted for over 20 years – while, undoubtedly, there have been increases in the costs of construction over that timeframe.

The County did engage TischlerBise in Fiscal Year 2010 to perform another impact fee study. (This study did not include fire & rescue impact fees because these had been covered in the 2006 study.) However, impact fees were not raised as a result of the study, most likely due to the downturn in the economy at that time. Recommendations in a draft of this study³, dated December 28, 2009, included:

² Note: Prior to the January 12, 1999 legislation, the wording in this Section of the Code required annual adjustments, i.e., "The fees hereby imposed shall be adjusted annually by the Departments of Land Use and Finance to reflect any change in the cost-of-living over the prior year. The amount of change shall be determined by comparing the cost of living index (consumer price index) for all items, as published by the United States Department of Labor for this region of the country, as of January 1st of each year, with the same index for the same date in the previous year." We do not know the reason why County Council changed this wording.

³ See Appendix A. Note: We do not know if this study was ever finalized. Nor do we know if it was ever presented to County Council.

- Fees for single-family units should increase with unit size, measured in square feet of living space. “Under the current, one-size-fits-all approach, large single-family units, which have on average more people and more vehicles available, are being subsidized by smaller, more affordable housing.”
- The study proposed increases for both residential and non-residential (except for industrial) impact fees, with the largest increases being for residential structures.

Engineering News Record (ENR) Construction Cost Index⁴

The Engineering News Record (ENR) Construction Cost Index was 6,000 in January 1999 (when the County Code’s Table 40.14.210 was updated based on the 1998 impact fee study). As of October 2019, it was 11,326, which means it has almost doubled in 20 years. Obviously, if the County had been making impact fee cost adjustments over the years, the amount of impact fees collected by the County – and the amount available to defray capital-related costs related to new development – would have been significantly higher.

Other Jurisdictions that Require Adjustments

More than a dozen Maryland counties impose impact fees. Also, it appears that most municipalities in the State of Arizona evaluate their impact fee rates on a regular basis (i.e., every five years). We looked at a few of these jurisdictions and found the following:

- Frederick County MD: This county makes an annual adjustment to its library impact fee per the below Code language:

“On July 1, 2019, and on July 1 of each year thereafter in which the library development impact fee is in effect, the amount of the library development impact fee, per dwelling unit, shall be adjusted as follows:

(A) On or before January 15, 2019, and on or before January 15 of each year thereafter, the County Executive shall provide to the County Council a report which proposes an annual adjustment to the library development impact fee. The adjustment shall be calculated by taking into account the most recent data from the Engineering News Record Construction Cost Index, and changes to other factors and data components in the library development impact fee calculations.

(B) The proposed annual adjustment shall automatically take effect on July 1, the first day of the fiscal year immediately following receipt of the report, unless the

⁴ A Construction Cost Index is an indicator of the average cost movement over time of a fixed basket of representative goods and services related to the Construction Industry. The Engineering News Record (ENR) publishes its own Construction Cost Index.

County Council enacts a bill that takes effect on or before June 30 of the same year as the report, to change or maintain the library development impact fee.”

Frederick County’s current residential library impact fees, per housing unit, for single-family detached and single-family attached are \$768 and \$695, respectively, compared to New Castle County’s rates of \$138 and \$129.

- Flat versus Variable Fee for Residential Construction: Baltimore County charges an impact fee as a percentage of the sales price of the home. Howard County⁵ and Anne Arundel County charge a dollar amount per square foot of the project. New Castle County charges a fixed fee per housing unit, thus having a higher proportional impact upon lower-priced housing. (For nonresidential construction, New Castle County charges a dollar amount based on the square footage of the project.)
- State of Arizona: Arizona State Code allows for the assessing of development fees (essentially impact fees). Before a municipality may do so, however, it must adopt a “land use assumptions and infrastructure improvements plan” (upon which there must be a public hearing before adoption). Such plan includes the land use assumptions, the time period of the projections, a description of the necessary public services included in the infrastructure improvements plan, and a map of the service area to which the land use assumptions apply. For each necessary public service that is the subject of development fees, the plan must include certain information which supports the fee, e.g., “the projected demand for necessary public services or facility expansion required by new service units for a period of not more than ten years.” The “land use assumptions and infrastructure improvements plan” must then be updated every five years. Thus, in Arizona, it appears that decisions on updating impact fees are made every five years.
- City of Tucson, AZ: This municipality recently engaged a consultant to review impact fees and is proposing new rates.⁶ Tucson has three impact fee categories that are the same as New Castle County: Parks, Police, Fire. Although we know there are many variables involved with determining proposed rates and such variables may be entirely different between the City of

⁵ Note: In Howard County, it is not called an impact fee; it is called a building excise tax.

⁶ Note: We also found recent impact fee studies performed for the cities of Phoenix and Tucson, AZ. All these studies seem consistent with the State of Arizona’s requirement to update the municipality’s “land use assumptions and infrastructure improvements plan” every five years.

Tucson and New Castle County⁷, we noticed the following regarding Tucson’s proposed rates and New Castle County’s current rates:

- Tucson’s proposed impact fees for parks and police are significantly higher than New Castle County’s. This makes sense given the County has not raised these rates in 20 years.
- Tucson is proposing residential impact fees to be based upon square footage. New Castle County assesses impact fees based upon the type of housing unit, i.e., single-family detached, single-family attached, “all other housing” (e.g., single-wide mobile homes).
- Unlike New Castle County, Tucson assesses parks impact fees for nonresidential facilities.

County’s Comprehensive Development Plan

The County is currently embarking on efforts to update its Comprehensive Development Plan (Comprehensive Plan), which was last updated in 2012.

Arizona’s “land use assumptions and infrastructure improvements plan” appears similar to the County’s Comprehensive Plan. As municipalities in Arizona tie increases in development fees to the 5-year update of the “land use assumptions and infrastructure improvements plan”, and include information in the plan which supports such increases, we believe now (with the County embarking on efforts to update the Comprehensive Plan) is a good time for the County to evaluate its impact fees. Perhaps this could be done in conjunction with the Comprehensive Plan update and the County could include information in the Plan which supports changes in impact fees.

Disclaimer

It is not the responsibility of the County Auditor’s Office to provide an opinion on whether impact fees should be raised. However, it is the responsibility of our Office to determine whether internal controls exist to ensure compliance with relevant laws, regulations, and policies. Given the language in County Code about “the periodic evaluation and update of impact fees”, we do believe the Department of Land Use, the Office of Finance, and the Executive Office need to perform an evaluation as to whether the rates currently being charged are, as stated in the “Purpose” language of Article 14, sufficient to “ensure that new development contributes adequate funds to enable the County to provide these facilities⁸ in a timely manner and at established levels of service.”

⁷ New Castle County used the Incremental Expansion methodology for determining the impact fees currently in the County Code. Tucson has also been using the Incremental Expansion methodology but is proposing using the Plan-Based methodology.

⁸ Division 40.14.000, “Purpose”, states “This Article addresses facilities and services that New Castle County provides which are impacted by population growth and new development.”

In determining whether impact fees should be raised, obviously there are many considerations the County needs to take into account such as (1) the extent to which, in the past, impact fees have been sufficient to accommodate new facilities and services which have been impacted by new development, (2) the likelihood that developers would pass fee increases on to buyers, thus making housing less affordable and having a negative impact on the property tax base, and (3) the effect on the construction industry and the jobs it creates.

Recommendation – Department of Land Use, Office of Finance, Executive Office

In accordance with County Code Section 40.14.230, we recommend that the Department of Land Use, Office of Finance, and Executive Office perform an evaluation of impact fees to determine whether the County is assessing sufficient fees to enable it to fund capital improvements necessary to accommodate new development. A good starting point for performing this evaluation would be the draft TischlerBise study dated December 28, 2009. Perhaps this evaluation could be done in conjunction with the Comprehensive Plan update and the County could include information in the Plan which supports impact fee changes.

Management’s Response – Executive Office

The report makes clear that most impact fees have not been updated in more than 20 years. The report recommends evaluating impact fees in conjunction with the Comprehensive Plan update. We believe such an evaluation is appropriate. An impact fee evaluation could consider issues such as:

- current collections, balances, and how impact fees are expended;
- the utility of a flat vs variable impact fee in helping advance the county’s policy goals including encouraging affordable housing, discouraging sprawl, and achieving community reinvestment goals; and
- how changes to impact fees could impact economic development in the current economic climate.

We value the work of the Auditor’s office to provide background and recommendations regarding the county’s impact fees. We look forward to continued collaboration to protect the public trust.

Management’s Response – Department of Land Use

Regarding the general comment, the Department generally agrees with the premise that studies should be reviewed on a routine basis to ensure their content is current and valid. With that

being said, this general comment further references a need to verify if sufficient fees are being collected to fund capital improvements. While these fees are collected by Department staff, the management of such funds are handled solely by the Office of Finance who would be in the best position to speak to whether adequate funding is being received.

Opportunities for Improvement

1. Evaluate whether County Code allows for additional impact fees to be assessed for a change of use and, if so, the mechanism for doing so.

Background

County Code Section 40.14.010 states “New Castle County may require that new development provide impact fees for the following services:” (It then lists the services.) County Code Section 40.14.110 states “Impact fees are one (1) time payments used to fund system improvements needed to accommodate development.”

Regarding fit-outs to nonresidential buildings, the Department of Land Use informed us at the beginning of the audit that additional impact fees may be assessed if there has been a “change of use” to the development category in Table 40.14.210 of the Code and such change of use results in a higher impact fee level than was originally assessed to the building. For example, if a building was originally assessed impact fees in the Warehouse category, and the gross floor area of the building is being fitted for a school, impact fees would be assessed based on this change of use from Warehouse to Office/Institutional.

New Castle County Code does not include any specific language about assessing additional impact fees if there has been a change of use, nor does it specify the mechanism (e.g., NAICS codes⁹, ITE land use codes¹⁰) to be utilized in determining whether there has been a change of use.

Audit Testing

In the report we requested of all commercial building permits processed during July 2017 through December 2019, there were 26 commercial fit-out permits which had “Y” (Yes) for Change of Use. Our audit testing revealed:

⁹ In determining whether there has been a “change of use”, Land Use informed us that they look at the first three digits of the NAICS (North America Industry Classification System) code for the new use and compare it to the first three digits of the NAICS code for the original use. If these don’t match, then there has been a “change of use.”

¹⁰ The nonresidential development categories in County Code, Table 40.14.210 (See https://library.municode.com/de/new_castle_county/codes/code_of_ordinances?nodeId=CH40UNDECO_ART14I_MFE_S40.14.210IMFE) were established based upon the original TischlerBise (then called Tischler & Associates) study in 1998. These categories remained the same in TischlerBise’s 2009 study. These categories are based upon the Land Use Codes in the “Trip Generation Manual” published by the Institute of Transportation Engineers (ITE). Thus, the categories are established based upon the ability to ascertain trip data.

- One situation where one of the four impact fee service categories (fire & rescue) was not assessed for a commercial fit-out where there was a change of use; however, the exception is not material.
- 14 situations where the applicant checked off a Change of Use on the permit application, causing a change of use checkbox to be displayed in the Hansen system where the change of use was a building change of use, not a change of use in the development category in Table 40.14.210 of the UDC. When a change of use checkbox is displayed in Hansen, this serves as a flag for staff to review for a UDC zoning change of use. In these 14 situations, it was determined that a zoning change of use was not applicable and the employee correctly did not assess impact fees; however, the change of use box remained checked. It should be noted that a Land Use Administrator has now unchecked the Change of Use box for these permits.

These situations were primarily attributable to the manual nature of the process and, sometimes, a lack of clear understanding on the part of the permit applicant and Land Use employees on how to handle commercial fit-out change of use situations. It should be noted that the Land Use Administrator we dealt with was very helpful to us in answering all of our questions. This Land Use Administrator has now provided additional training to the Land Use employees assessing impact fees. It should also be noted that situations where there is a change of use for a commercial fit-out do not occur very often.

Recommendations – Department of Land Use

We recommend that management:

- Make the determination as to whether the County should continue to assess additional impact fees in certain change of use situations.¹¹
- If the County is going to continue to assess additional impact fees for certain change of use situations:
 - Determine the proper mechanism for doing so, i.e., NAICS codes or ITE codes. And, if this mechanism is determined to be NAICS codes, consider changing the categories in Code Section 40.14.210 to be consistent with the NAICS Codes and the Use Definitions in County Code Division 40.33.200.
 - Develop written policies and procedures for what constitutes a change of use and how to handle the calculation of impact fees in such situations. (Also, see Comment #3 on page 18.)

¹¹ Note: Even if the Department of Land Use makes the decision to no longer assess additional impact fees in certain change of use situations, it may want to consider still doing so if the change of use occurs before the Certificate of Occupancy is issued and the change of use is significant.

Management's Response – Department of Land Use

Regarding Opportunity for Improvement 1., the Department is in general agreement with the recommendations. We plan to engage Department staff, specifically the Planning and Licensing Divisions, and the Office of Law to review current change of use situations involving fit-out applications as it relates to the UDC. This review will warrant a legal interpretation which will be documented in writing. A timeline for such action will occur prior to July 1, 2020.

2. For commercial building permits involving both renovations and additions, where impact fees were not assessed, determine if impact fees can be assessed now.

Background

Land Use's Licensing Division assesses all impact fees, including impact fees on commercial building permits. Generally, impact fees are applicable on commercial building permits when there is an increase in the Gross Floor Area (GFA)¹² greater than 1,000 square feet. Hence, for commercial building permits, impact fees are due on brand new structures as well as on additions made to existing structures.¹³ [Note: Impact fees may also be assessed if there is a change of use of a property in a commercial fit-out from one development category to another (e.g., from Warehousing to Office/Institutional). However, see Comment #1 on page 14.]

When we started our audit testing, the Hansen system was automatically loading the impact fees due on commercial building permits based on the type of work (P-NEW or P-ADDN). However, we found that Hansen was not loading impact fees due to increased GFA for commercial building permits that involved an addition along with a renovation (i.e., when Work Type was P-RVAD).

Audit Testing

During our audit testing, we requested a list of all commercial building permits processed between July 2017 and December 2019. The report contained 1,559 commercial permits – 219 commercial building permits and 1,340 commercial fit-outs. Table 2 gives the different Work Types within these types of commercial permits.

¹² The General Definitions section in Article 33 of the Unified Development Code (Chapter 40, New Castle County Code) gives the definition of Gross Floor Area (GFA).

¹³ Note: For residential building permits, since impact fees are applied to the type of housing unit (e.g., Single Family Attached), not to the square feet, impact fees are not assessed for additions to existing residential buildings.

Table 2: Commercial Permits by Work Types, July 2017 – December 2019

| Permit Type | Work Type | Work Type Description | # of Permits |
|-------------------|-----------|--------------------------------|--------------|
| COMMBLDG | P-NEW | New Building | 173 |
| | P-ADDN | Building Addition | 25 |
| | P-RVAD | Building Renovation & Addition | 20 |
| | BLANKS | | 1 |
| | | Total | 219 |
| COMMFITOUT | P-FIT | Tenant Fitout | 1293 |
| | P-RENV | Building Renovation | 17 |
| | P-ADDN | Building Addition | 12 |
| | P-NEW | New Building | 3 |
| | BLANKS | | 15 |
| | | Total | 1340 |

Our testing revealed that impact fees had not been assessed for eight Building Renovation and Addition (P-RVAD) Work Types even though the work done had resulted in an increase in GFA of greater than 1,000 square feet and they were non-exempt properties.¹⁴ Also, when impact fees were assessed on P-RVAD Work Types, the amounts were not always accurately calculated.¹⁵ Land Use management informed us that the Work Type “P-RVAD” was created a few years back; however, not everyone assessing impact fees in Land Use was made aware of it, nor was Hansen’s programming code updated to look for P-RVADs while loading impact fees on commercial building permits.

Land Use management informed us that the non-assessed impact fees in the above situations are not, collectively, a material amount.

Going forward, Land Use management has changed Hansen’s programming code to load impact fees on commercial building permits associated with a Building Renovation and Addition (P-RVAD) whenever there is an increase in GFA (greater than 1,000 feet). This ensures that all impact fees due on commercial building permits for increased GFA would be assessed.

Recommendation – Department of Land Use

We recommend that management determine if any of the non-assessed impact fees in the above situations could still be assessed and collected.

¹⁴ Per UDC Section 40.05.050 H, public facilities that are needed to support development such as schools, parks on government land, etc. are exempt from impact fees.

¹⁵ For two of the four P-RVAD building permits where impact fees were assessed, the fees were not assessed at the correct amount.

Management’s Response – Department of Land Use

Regarding Opportunity for Improvement 2., the Department is in general agreement with the recommendation. As referenced in the report, the Department already took immediate action once it became apparent that applications containing additions and interior fit-outs weren’t loading with the appropriate impact fees. We have taken the steps to insert impact fees on all open applications to ensure payment prior to the issuance of any certificate of occupancy. No timeline for corrective action is necessary as steps to address this opportunity for improvement are complete.

3. Develop written policies and procedures for the various aspects of assessing impact fees.

For the most part, impact fees are automatically assessed. However, there are situations where such fees have to be manually assessed or the impact fees assessed automatically need to be overridden. Such situations point to the need for Land Use to have written policies and procedures governing all aspects of impact fees. Such situations include:

- Impact fee amounts are assessed based on the impact fee categories in UDC’s Table 40.14.210. The nonresidential impact fee categories were established based upon the original TischlerBise study in 1998. These categories are based upon the Land Use Codes in the “Trip Generation Manual” published by the Institute of Transportation Engineers (ITE). The impact fee categories from the Trip Generation Manual are not contained in the UDC; therefore, when classifying building permit applications to these categories, Land Use staff refer to the use definitions given in UDC Division 40.33.200.
 - Note that the assignment of permit applications to Table 40.14.210’s Warehousing and Business Park impact fee categories requires some analysis and elaboration. When we asked the Department of Land Use about how they assign permit applications to the Warehousing and Business Park impact fee categories, they informed us that they classify a use having NAICS code 493 with a maximum GFA of 50,000 square feet as Warehousing¹⁶, whereas a use having NAICS code 493 with GFA greater than 50,000 is classified as Light Industrial. Also, since Business Park is not defined in the UDC, the Department of Land Use classifies a use defined as “office park” (UDC 40.33.300 O) as a Business Park.

¹⁶ Please note that the UDC sets NAICS code 493 at either Commercial Use (Heavy Retail and Service) if it is less than 50,000 SF (40.33.240) or Industrial Use (Light Industry) if larger (40.33.270).

UDC Division 40.33.200 states: “The uses found in Table 40.03.110 are defined in this Division. Specific uses may be further defined in Division 40.33.300. If a use is not enumerated in either of these Divisions, see Section 40.31.520 for interpretations.”

UDC Section 40.31.520 states: “... when a proposed use is not listed in Table 40.03.110, the Department shall provide a written interpretation.”

Hence, we believe that the Department of Land Use should include its interpretations of Warehousing and Business Park in written policies and procedures.

- The Department of Land Use informed us of the difference between NAICS codes 6111 and 6115 for determining which impact fee category a trade school should be assigned to. NAICS 6111 is related to schools that serve a dual function of teaching academics and a trade; such schools would be classified as an Institutional Use (UDC Section 40.33.230). On the other hand, NAICS 6115 is related to schools that are solely for the purposes of teaching a trade (e.g., truck driving school); such schools would be classified as Commercial Use (UDC Section 40.33.240). We believe that it would be helpful to capture such nuances in written policies and procedures.
- A new commercial building or an addition to an existing building may not meet the definition of gross floor area (GFA) because of the definition of GFA in Article 33 of the Unified Development Code (UDC), e.g., parking structures do not count towards GFA.
- Note: Our testing of P-NEW and P-ADDN building permits issued between July 2017 and December 2019 revealed that some staff were under the impression that unoccupied/unconditioned structures were not subject to impact fees. Hence, impact fees on five car washes and pole storage buildings were overridden. The confusion was based on letter E in the Gross Floor Area definition (Article 40.33.300) which states:

“Unheated structures or buildings, not fully enclosed whether temporary or permanent and exposed to the elements through the absence of walls on at least twenty-five (25) percent of its perimeter shall not be counted as GFA.”

However, since car washes and pole buildings generally have walls on over 75% of their perimeter, they are subject to impact fees. Upon reviewing the five exceptions caused by a lack of clarity on this clause, Land Use updated the impact fee category, placed log notes within each permit in Hansen, and added the impact fee for payment on the one permit currently open. Land Use is also training its Permits staff on this.

The above situation shows that the definition of GFA, as well as examples of typical situations not counted as GFA, should be included in the Department of Land Use's written policies and procedures.

- A new commercial building or an addition to an existing building may not be assessed impact fees because it is exempt under Section 40.05.050 H of the UDC dealing with public facilities. An explanation of this Code Section should be included in written policies and procedures.
- The mechanism of determining whether there has been a change of use in the development categories in Section 40.14.210 of the UDC.
- The methodology for calculating the additional impact fees to be assessed if there has been a change of use, i.e., the comparison of the impact fees assessed for the original development category to the impact fees applicable to the new development category for the portion of the structure having the change of use, and the calculation of the difference.
- How to assess impact fees for mixed use facilities.

In general, written policies and procedures provide standards for an organization's operations and provide clear and consistent communication of expectations. Well written policies and procedures describe how and when tasks should be completed, as well as who should complete them. Written policies and procedures are also helpful to:

- Ensure consistency in the performance of management's directives.
- Serve as a training tool for new employees or to existing employees performing new job functions.

Also, we know that the Licensing Division has a goal of pursuing accreditation credentials (as a Building Department) through the International Accreditation Service (IAS), and that one of the items the IAS looks at is policies and procedures.

Once written policies and procedures have been developed, management should have a system of reviewing them periodically for updates and communicating any necessary revisions to relevant personnel.

Recommendation – Department of Land Use

We recommend the Department develop written policies and procedures for the various aspects of assessing impact fees, taking into account the particular areas addressed in this comment.

Management’s Response – Department of Land Use

Regarding Opportunity for Improvement 3., the Department is in general agreement with the recommendations. We plan to engage Department staff, especially the Planning and Licensing Divisions, to review our current practices related to impact fees, and document those practices while ensuring we meet the obligations outlined in the adopted UDC. Such written documentation will be shared amongst Department staff as part of an ongoing training opportunity. A timeline for such action will occur prior to July 1, 2020.

4. Develop written procedures for the evaluation of fire & rescue impact fee funding requests and the distribution of funds.

Background

Fire & rescue impact fees are collected by the Department of Land Use through the building permitting process and in accordance with the Table in County Code Section 40.14.210. These fees are posted to the subsidiary general ledger accounts which exist for each of New Castle County’s volunteer fire companies.

Per County Code Section 40.14.110B, funds may be transferred from the subsidiary general ledger accounts to the volunteer fire companies “as needed for growth-related capital facilities and equipment.” A volunteer fire company makes a request for funds through the Impact Fee Committee of the New Castle County Fire and Ambulance Advisory Board. The Department of Land Use and the County Executive’s Office review the request to determine whether the request represents a qualifying purchase per Code. If so, the County Executive’s Office sends an approval letter to the Impact Fee Committee and the Land Use Fiscal area establishes a schedule for the disbursement of funds.

County Code Section 40.14.260G, “Disclosure requirements for recipients of fire impact fees”, states: “Fire and rescue impact fees shall be distributed contingent upon the recipient fire company filing an annual financial statement on a form provided by the County in accordance with procedures established by the County. At a minimum, financial data shall be provided to the extent necessary for the County to determine that impact fees were utilized to supplement, not supplant, existing funding ...”

Audit Evaluation and Testing

In our evaluation and testing of the processes for the evaluation of impact fee requests and the distribution of funds, we believe the processes are working effectively to ensure funds are only

being requested and distributed for “growth-related capital facilities and equipment.” We do have the following observations:

- The Department of Land Use does not have any written procedures for how the processes work, nor has it developed a formal application the Impact Fee Committee is required to submit. Since Code Section 40.14.260G mentions “procedures developed by the County”, we believe Land Use should (1) formally document its procedures and (2) develop an application form making it clear the information and documents the fire companies are required to provide in requesting funds.
- Fire companies requesting impact fees are not always required, as per Code, to provide an annual financial statement or other financial data necessary for the County to determine that the impact fees will be supplementing – not supplanting – existing funding.¹⁷ Apparently, fire companies are only required to submit documentation supporting the cost of the item(s) for which funds are being requested. We believe it would be practical to have a formal application with a question/statement in which the fire company is required to attest that the request for funding is supplementing – not supplanting – any other funding the company has received (or will be receiving) for the same purpose.
- The Land Use Planner, who reviews the request to determine whether the request represents a qualifying purchase per Code, documents his/her approval by preparing the approval letter to be signed by the County Executive and by emailing such letter to the Land Use Fiscal Unit. This is fine; however, we do feel the approval could be better documented by having an application form (as referred to in the previous two bullets) with a line for the Planner to affix his/her approval signature.

Recommendations – Department of Land Use

We recommend that management:

- Develop written procedures for the processes concerning the evaluation of impact fee funding requests and the distribution of funds.
- Develop a formal application, with instructions, for the Impact Fee Committee to submit. The instructions for the form should specify exactly what the Impact Fee Committee is required to submit and the form itself should have:
 - Signature approval lines for the President of the Impact Fee Committee, the Land Use Planner, and the County Executive’s Office.

¹⁷ Note: In our opinion, the submission of a financial statement would not necessarily be sufficient to determine whether the request for impact fees is supplementing – not supplanting – existing funding. If a fire company had secured a grant for the same purpose for which it is requesting funds from the County, this would probably not be specified in the financial statements.

- A question/statement in which the fire company is required to attest that the request for funding is supplementing – not supplanting – existing funding.

Management’s Response – Department of Land Use

Regarding Opportunity for Improvement 4., the Department is in general agreement with the recommendations. The Department has consistently followed a process for which to review fire and rescue impact fee request and the distribution of funds. This process can be enhanced, and we plan to engage Department staff, specifically the Planning Division and Senior Budget and Procedure Analyst, to review our current practices and develop a standardized application. A timeline for such action will occur prior to July 1, 2020.