Developer Funding of Affordable and Work Force Housing Through Impact Fees and Land Value Recapture: A Comparison of American and Spanish Approaches

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DEVELOPER FUNDING OF AFFORDABLE AND WORK FORCE HOUSING THROUGH IMPACT FEES AND LAND VALUE RECAPTURE: A COMPARISON OF AMERICAN AND SPANISH APPROACHES.

By JULIAN CONRAD JURGENSMEYER

SUMMARY

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ABSTRACT

This article explores the differences, similarities, comparative advantages and disadvantages between developer funding requirements for Affordable and Work Force Housing in the United States and Spain. Emphasis is placed on impact fees as a revenue source in the United States and value recapture requirements in Spain and in Catalonia in particular. The author concludes that American impact fees provide a broader base for developer funding requirement but that Spanish land value recapture programs offer greater flexibility to planning officials when they are applicable.

Key words: Affordable housing; Work Force Housing; Impact Fees; Land Value Recapture; Developer Infrastructure Funding Requirements

I. An Introduction to the Funding of Affordable and Work Force Housing in the USA and Spain

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Revista de Derecho Urbanístico y Medio Ambiente
ISSN 1139-4978, number 297 BIS. Madrid. April-May (2015), pages 131-144
The need for affordable housing in all countries is not in doubt and data as well as personal observation strongly supports that need in the United States and Spain. The need is not debated. The debate in both countries is how affordable housing can and should be financed. The purpose of this article is to focus on potential funding of affordable housing through financial obligations placed on developers in the development approval process of the two countries. Although such programs often are and frequently need to be combined with public financing of various types, an examination of such programs is left to the works of other authors included in this collection.

II. An American View

A. Developer Funding Programs in General

How can developers be required to provide or finance affordable housing? Developer funding or provision of infrastructure as a condition which must be met in order to obtain development permission has a long history in the United States stretching back nearly a century and first appeared in the form of required dedications for plat approval in subdivision regulation law. Required dedications are still used in affordable housing programs in the form of set asides and inclusionary requirements – or inclusionary zoning, as it is often labeled. For example, a commonly encountered approach to developer funding of affordable housing is to require a residential developer, for example, to set aside land within his development for the construction of affordable units and even to include construction of such units on site and sell or rent them at below free market value.

Required dedications which first related only to infrastructure within subdivisions have evolved into impact fees or development fees as they are labeled in some jurisdictions. In one form or another, impact fees now exist in

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3 Several of the articles published as part of this Study Space publication explore these issues in detail and the reader is referred to them.
nearly all states and are a common technique used to generate revenue for capital funding necessitated by new development. To date, approximately 27 states have enacted impact fee enabling legislation and in most other states impact fees are enacted pursuant to home rule powers or pursuant to individual local government enablement. Impact fees are charges levied by local governments on new developments in order to pay a proportionate share of the capital costs of providing public infrastructure to those developments. In the Georgia Development Impact Fee Act, a leading impact fee enabling statute, an “impact fee” is defined as “a payment of money imposed upon development as a condition of development approval to pay for a proportionate share of the cost of system improvements needed to serve new growth and development.” Impact fees play an increasingly important role in the efforts of local governments to cope with the economic burdens of population growth such as the need for new parks, roads, schools, jails, public buildings, libraries, sewer, water treatment and storm water facilities, and public safety buildings and equipment.

The essential legal principle that governs the validity of impact fees is the rational nexus test. Since impact fees are enacted pursuant to a governmental unit’s land use control power it is police power based and consequently must satisfy a reasonableness test. This test for the validity of impact fees is usually expressed as the dual rational nexus test. Simply stated, the rational nexus test, i.e., the dual rational nexus test, has two components: (1) Impact fees may be no more than the government’s infrastructure costs which are reasonably attributable to the new development, i.e. that development’s proportionate share, and (2) The new development required to pay impact fees must benefit from the expenditure of those fees.

Considerable attention has been given in many American jurisdictions to giving modest subsidies to affordable housing by providing certain exemptions or special treatment from impact fees for infrastructure items such as roads, parks, and public building for affordable housing projects. Being exempted

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7 Georgia Development Impact Fee Act, Ga. Code Ann. § 36-71-2(8). System improvements, also called non-site related improvements, are to be distinguished from project improvements, also called site related improvements.
9 Id at 549.
from all or a portion of the impact fees that the affordable housing project would otherwise have to pay decreases their construction cost. Such subsidies are generally rather minor and therefore the more important question is whether there can be impact fee programs designed to fund affordable housing. Without doubt, impact fees are a possible funding source for the construction of affordable housing even though the vast majority of impact fee programs found in the United States at the present time focus on so-called “hard infrastructure” for example, roads, parks, schools, public buildings, libraries, and public safety facilities. The seminal case in this regard is Holmdel Builders Ass’n v. Township of Holmdel, in which the New Jersey Supreme Court upheld the imposition of fees on commercial and non-inclusionary residential developments for the construction of low income housing. The court examined two substantive issues 1.) If there was statutory authority under the municipality’s police power to impose affordable housing development fees as a condition for development approval and 2.) If affordable housing development fees are an unconstitutional form of taxation. 

The Holmdel Township ordinance imposed a mandatory development fee on all new commercial and residential development as a condition for receiving a certificate of occupancy with the funds collected dedicated to an affordable housing trust fund. In exchange, the development received a density bonus. The ordinance linked community-housing goals with real estate development to address the lower income-housing crisis. Linkage strategies relate the housing and infrastructure needs created by new development to a requirement that the entity generating the need provide the resources to pay for the impacts of the development. The Court found that providing lower income housing is one of the purposes of police power eligible zoning authority incorporated by reference into New Jersey’s Zoning and Enabling Act. The “real and substantial” relationship between development fee measures affects “the nature and extent of the uses of land and buildings and structures thereon” and is not an impermissible exaction. In overturning the Appellate Division’s opinion, the Court found that affordable housing development fee ordinances must bear a reasonable relationship, not a “stringent nexus”, between commercial construction and the need for affordable housing; ultimately concluding that the dual rational nexus test is too stringent to be appropriate in determining the relationship between development fees and affordable housing.

In regard to constitutionality, New Jersey’s Fair Housing Act (FHA) does not expressly authorize a municipality to impose development fees. The statute’s language does confer broad powers on a municipality - including authority “to provide for its share of low and moderate income housing by means of any technique or combination of techniques which provide a realistic opportunity for the provision of its fair share” 14. In interpreting the FHA’s language, the Court deemed authority to require development fees to be supported by the FHA while leaving open the question if development fees must always be compensated with density bonuses. 14 The decision lends authority to the proposition that affordable housing development fee ordinances are permissible land use regulations and not excessive and unconstitutional exactions but the Court’s indication that a less strict standard of review than the dual rational nexus test applies is not necessarily a position that should be expected from courts in other jurisdictions.

The California Supreme Court recently held in Sterling Park, L.P. v. City of Palo Alto that an affordable housing requirement of ten out of 96 residential units and a payment of a fee of approximately 5% of the sales value of the market rate units both constituted exactions rather than land use regulations. 15 Without deciding if the imposed requirements were constitutional, the decision placed future affordable housing requirements under a higher scrutiny by requiring municipalities to demonstrate a nexus and rough proportionality between the affordable housing requirement and the impact it is intended to address. 16 The California Supreme Court has granted review to address the applicable standard for affordable housing requirements in California Building Industry Ass’n v. City of San Jose. 17 The City of San Jose adopted an affordable housing ordinance requiring a fraction of all new development to be dedicated to low to moderate income housing. 18 The California Building Industry Association challenged the decision, arguing the city failed to show a “reasonable relationship” between the requirements and a public need for affordable housing. 19 In upholding the ordinance, the Appellate Court found the ordinance to be a land use regulation rather than an exaction and thus reviewable

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16 Id. at 1205
18 Id. at 816.
19 Id. at 817

Revista de Derecho Urbanístico y Medio Ambiente
ISSN 1139-4078, number 297 BIS. Madrid, April–May (2015), pages 131-144

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as an exercise of police power rather than the strict scrutiny applicable to exactions.²⁰

Even though the Holmdel program and the California programs just discussed focused on funding the construction of "affordable housing," there may be advantages under American law to make a distinction between affordable housing and workforce housing.

B. Workforce Housing vs. Affordable Housing

Despite frequently being used interchangeably, affordable housing and workforce housing have different meanings. Fundamentally, workforce housing is a subset of affordable housing that ties moderately priced housing to a community’s middle and lower middle income working citizens. Politically, due to its association with middle rather than low income households, workforce housing is a more palatable form of affordable housing in high income communities where low income housing is associated with socioeconomic class bias. Legally, inclusionary zoning encompasses workforce housing, with many municipal ordinances requiring linkage fees to spur workforce housing development.²¹

Affordable housing fees are often referred to as "linkage fees" on the theory that because of their social importance they should be entitled to less stringent scrutiny from courts. As discussed above, the Holmdel ²² court took this position. In most jurisdictions, however, they are considered a form of exaction and thus subject to the "essential nexus" takings test of Nollan.²³ Where there is no evidence of a nexus between the development and the problem an exaction seeks to address, the exaction may not be upheld.²⁴ In finding a constitutional

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²⁰ Id. at 824. See also Home Builders Ass’n of Northern California v. City of Napa, 90 Cal. App. 4th 188, 108 Cal. Rptr. 2d 60, 31 Envtl. L. Rep. 20800, 22 A.L.R.6th 785 (1st Dist. 2001), as modified, (July 2, 2001), cert. denied 122 S. Ct. 1356 (2002) (Nollan and Dolan held not applicable to inclusionary zoning ordinance which was generally applicable to all development in the city.).
²² It is interesting to note that in France there can be made a distinction between work force housing and affordable housing, because since 1943 there is a mechanism for funding housing for the work force paid by companies called "participation des employeurs à l'effort de construction" also known as "1% logement". Further information can be obtained at http://fr.wikipedia.org/wiki/Participation_des_employeurs_%2A_1%_logement.
²³ Commercial Builders of N. California v. City of Sacramento, 941 F.2d 872, 875 (9th Cir. 1991)
²⁴ Id.
essential nexus existed, the Ninth Circuit *Commercial Builders* court examined a study produced by the city connecting the exactions required of the developer with the need for low income housing and the effect of nonresidential development on the demand for such housing.\(^{25}\)

While courts have disagreed over applying strict scrutiny to workforce housing ordinances, they have consistently required a reasonable relationship between the fee assessed and the housing need generated directly by the development.\(^{26}\) Thorough and detailed studies of workforce jobs required and generated by the proposed commercial development, calculating precise fees, and exchanging density bonus or other benefits offer a direct route to establishing an essential nexus.\(^{27}\)

The major legal hurdle confronted in the defense of an affordable housing impact fee is of course satisfying the dual rational nexus test – i.e. establishing that the proposed development will create a need for and be benefitted by affordable housing. Since not all courts will be willing to relax the dual rational nexus test as did the New Jersey Supreme court, it would seem that concentrating on work force housing will be more likely to pass judicial scrutiny. An innovative developer funding based workforce housing program proposed for but not yet adopted by a Florida local government will be used as a model for discussion purposes. The dilemma faced by the City of Destin, Florida, a prosperous and popular resort community is that housing costs have exceeded the ability of the local workforce – construction workers, service personnel, public school teachers, firemen, police men and paramedics to afford and therefore is preventing them from living in the community. The Report prepared by Professor James C. Nicholas, City of Destin Attainable Workforce Housing Study\(^{28}\) explains this dilemma:

"Housing prices in Destin have risen to the point that there are concerns about the ability of a substantial portion of the workforce to find adequate housing. Although prices have abated, they are still matters of concern. Such an inability could have serious implications for the Destin economy and for Destin’s society. The median price of the existing home in Destin now stands at $415,000, 75%
higher than the statewide average of $237,800 and 86% higher than the national average of $223,000."

"The continuing development of Destin is a major factor leading to the increased prices of Destin homes. Each new building adds to the need for construction workers and then, after construction, to the need for employees that will operate and maintain those structures. Many of the employees needed to serve Destin’s economic growth will not be able to afford adequate housing within Destin. Labor shortages that may result will lessen the economic attractiveness of Destin as a place for business location or expansion.

The construction and operation of residential and non-residential developments will demand additional employees and those employees, in turn, will require housing. The first impact is the actual construction of buildings. Destin construction workers earn $33,073 and their households have $45,739, given more than one wage-earner per household. A household with this income can afford to pay $144,832 for housing. This income does not provide sufficient resources for construction workforce households in Destin to afford market housing in or around Destin.

Once residences are built they must be operated and maintained, thus creating the need for continuing employees and their housing. The typical residential operational and maintenance employee earns $39,271, with the household income of that employee being $51,937. These employees can afford to pay $164,457 for housing and thus will need housing assistance in order to afford adequate workforce housing in Destin, which is priced at $165,873 for these employees. Therefore the data show that the construction, operation and maintenance of residential structures do result in net unmet workforce housing needs."

The report proceeds to establish a formula for the workforce housing needs created by commercial and residential development so as to assign the workforce housing obligation which needs to be fulfilled as a prerequisite for the granting of development permission. The formula takes into account the difference in workforce demand created by residential units designed to be occupied full time from those intended to be occupied part time (vacation homes). For example the Report provides:

"Once a residence has been constructed it must be operated and maintained. Some people do much of the operational and maintenance activities themselves while others do not. The residential survey conducted by RRC,
Developer finding of affordable and workforce housing through impact fees and land value...

Associates, Incorporated, found that the average number of full time equivalent employees (FTE) per residential unit in Destin was 0.0854. With an estimated 86,539 dwelling units for Okaloosa County in 2006, total operational and maintenance employment would be 7,390. This is 177 person-hours per residence per year devoted to operations and maintenance by employed persons.”

The Ordinance imposes an obligation on developers to provide “affordable workforce housing units” which are defined as “a dwelling unit which is provided for a person employed in the City of Destin and their families, either through sale or rent, at prices that are restricted to ensure the unit is maintained as affordable to persons employed in the City.” The draft ordinance innovatively gives the developer several choices in regard to fulfillment of the workforce housing obligation.

The choices, subject to approval by the City in a Workforce Housing Mitigation Plan entered into by it and the developer are as follow:

1. To build the requisite number of workforce housing units on site or off site. If the developer chooses this option then the units must be deed restricted when sold so as to maintain their character as affordable units.
2. Developer can convert the requisite number of free market housing units to workforce/affordable units. As with the case of the construction of workforce units restrictions are imposed designed to “keep” the units affordable.
3. Developer can contract with nonprofit organizations (a good example would be the Habitat for Humanity) to provide the workforce units on the developer’s behalf and
4. The developer can pay an in lieu fee (similar to an impact fee) into the City’s Affordable Workforce Housing Trust Account. The amount of the fee would be determined as the cost of building the requisite number of workforce units and the money paid to the City must be spent for the construction or conversion of affordable housing units.
5. The developer, with the City’s approval may convey land to the City which it can use as the site for construction for workforce housing or sell and transfer the proceeds to the Trust Account.

The developer, with the City’s permission may also combine two or more of these methods. The purpose of providing for so many options is not only

29 City of Destin Florida, Draft Ordinance on Affordable Workforce Housing Mitigation (2007). The author of this article was a consultant to the City in regard to the preparation of the report and the drafting of the Ordinance.
to give considerable flexibility to the developer but to enhance the potential judicial view of the reasonableness of the Program.

III. Land Value capture as a source of funding for affordable housing in Spain

An important source of revenue for affordable housing in many Spanish regions is land value capture:

"Value capture refers to the recovery by the public of the land value increments (unearned income...) generated by the actions other than the landowner’s direct investments,... Although all such increments are essentially unearned income, value capture policies focus primarily on the increment generated by public investments and administrative actions, such as granting permission for the development of specific land uses and densities. The objective is to draw on publicly generated land value increments to enable local administrations to improve the performance of land use management and to fund urban infrastructure and service provisions. The notion is that benefits provided by governments to private landowners should be shared fairly among all residents." 30

The use of land value capture in Spain in general and in Catalonia in particular is complicated and a detailed discussion of it is definitely beyond the possible scope of this article. It is examined in detail in the inclusionary housing context in a book chapter written by Professor Nico Calavita and others. 31 Before giving an overview of the use of land value recapture to finance affordable housing, Calavita emphasizes the need to consider the somewhat

31 Calavita, Clusa, Mur & Wiener, Spain’s Constitutional Mandates: The Right to Housing, Land Value Recapture, and Inclusionary Housing, Chapter 7 in Calavita & Mallach, INCLUSIONARY HOUSING IN INTERNATIONAL PERSPECTIVE: AFFORDABLE HOUSING, SOCIAL INCLUSION, AND LAND VALUE RECAPTURE (Lincoln Institute of Land Policy, 2010). [The Book Chapter is hereinafter cited as CALAVITA.] Similar issues and examples of inclusionary housing issues in Catalonia are explored in Janice Griffith, BARCELONA, SPAIN AS A MODEL FOR THE CREATION OF INNOVATION DISTRICTS AND SUSTAINABLE SOCIAL HOUSING WITHOUT SPATIAL SEGREGATION at page ___ in the present collection of Barcelona Study Space papers.
unique Spanish statutory and constitutional context in which the program occurs, starting with Spain's 1956 Planning Act.

"Departing from a tradition in which property rights were sacrosanct and local government paid for all infrastructure costs, a drastic new approach was devised, founded on four main principles.

1. Social function of property. The right to land ownership and development is accompanied by obligations and duties.
2. Distributive equity. The increases in land values resulting from plan designations for development are to be shared equally among property owners.
3. Discretionary power of law. Urban planning is a public function expressed through the municipal (or, rarely, multijurisdictional) general plan, which distinguishes three juridical categories of property; urbanized, urbanizing, and nondevelopable, each with its own rights and duties.
4. Juridical security of administrative acts. Arbitrary acts by the public sector are limited, and future land values are ensured through the systematic assignment of uses, values, rights, and duties. In exchange, property owners are responsible for the urban infrastructure and public facilities."

Reforms in 1975 required land owners to provide the public facilities needed per the comprehensive plan for new developments, including parkland.

"The 1975 legislation also required a donation to the municipality of land equivalent in value to 10 percent of the profit from the development. This requirement was increased to 15 percent in 1990, but reflecting the shift from a socialist to a conservative government, returned to 10 percent in 1996. The donation can be seen as a betterment tax on the benefits of urban development."

In regard to current Spanish constitutional provisions relevant to the use of land value capture and related techniques as the source of funding for affordable housing, the two most important are Sections 33 and 47. The former which adopts the social function theory of ownership which subjects land owners to responsibilities as well as rights and subjects land ownership to obligations to serve a social and not just a private role.

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33 Calavita 242.
“Section 33 1. The right to private property and inheritance is recognized. 2. The social function of these rights shall determine the limits of their content in accordance with the law. 3. No one may be deprived of his or her property and rights, except on justified grounds of public utility or social interest and with a proper compensation in accordance with the law.”

The second is Section 47

“Section 47. All Spaniards have the right to enjoy decent and adequate housing. The public authorities shall promote the necessary conditions and establish appropriate standards in order to make this right effective, regulating land use in accordance with the general interest in order to prevent speculation. The community shall have a share in the benefits accruing from the town-planning policies of public bodies.”

Although the relevant laws have undergone changes in recent years and differ in the different autonomous regions of Spain, the process by which land value capture provides land or funds for affordable housing can be summarized as follows. The burdens placed on the landowners are compensation to the public for the (private) benefits they realize after doing an urban transformation operations, such as the ability to build and sell houses, etc. So, the Public Administration allows a land transformation that increases the wealth of the land owner through the Planning Gain, “aprovechamiento urbanístico”, which obligates the land owner to give something back to the public interest.

That obligation includes:

1.- Obligation for the land owner to deliver for free to the Public Administration the land for urban endowments/public utilities, and
2.- Obligation for the land owner to assign for free a percentage of the Planning Gain to the Public Administration.

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34 The minimum parameters are set by the State (currently by the Royal Legislative Decree 2/2008 of 20 June, approving the Land Act).
35 The author is deeply indebted to Rafael Fernández Bautista for the explanation that follows. Any inaccuracies must be attributed to me.
36 Planning Gain is calculated based on the Floor Area Ratio, uses and intensity of uses allowed on the land. Planning Gain capture applies to different kind of uses (commercial, industrial, residential).
37 The State (within the above mentioned Royal Legislative Decree 2/2008 of 20 June, approving the Land Act), establishes that the assignation of the Planning Gain that each Autonomous Community has to obligate (through its specific legislation) to the land owner, to
In the case of Catalonia, the Legislative Decree 1/2010 of 3 August, of Urbanism, states that Urban-land-owners of not fully developed land have to deliver for free 10% of the Planning Gain and the owners of developable land have to deliver for free a percentage that soars to 15%. Finally, this Planning Gain can be delivered (i) in kind (plot of land suitable to fit the percentage given) or, in some cases (but it is restrictive), (ii) in cash (amount equivalent to the value of the land that would be given).

The Public Administration destinies the land based on this percentage of the Planning Gain given (or its monetization) to the Public Land and Housing Heritage. The purposes of the Public Land and Housing Heritage are according to Section 160.5 of the Legislative Decree 1/2010 of 3 August, of Urbanism of Catalonia: (a) to anticipate expanding populations and improving their quality of life. (b) to create affordable housing, (c) to intervene in the housing market to lower prices, and (d) to create reserves of undeveloped land.

IV. Comparison and Evaluation of American and Spanish Approaches

At first blush it would appear that American impact fees and Spanish value recapture programs proceed from very different approaches to developer funding requirements. Impact fees are based on the theory that new development and not existing residents should bear the cost of providing new infrastructure. The Spanish land value capture approach addresses the much discussed but seldom implemented, in the US, idea of using windfalls38 landowners receive from obtaining development permission to mitigate the wipeouts suffered by landowners negatively affected by new development or the denial of development permission or negative consequences suffered by society in general. There has been much emphasis in the U.S in recent years on programs designed to compensate landowners negatively affected by land use controls but virtually no attention has been paid to the question of capturing for the public any portion of the gains conferred on landowners by virtue of public improvements and government regulations. Those few who have considered the equity – or lack thereof – involved in granting windfalls but not compensating for wipeouts often cite the writings of Henry George’s classic work Progress and Poverty and the late 19th century publications of one of America’s best known land use control

give for free to the Public Administration, has to be between 5% and 15% like a general rule (sometimes it is possible to reduce/increase this percentage).

law scholars, Donald Hagman. In 1978 Professor Hagman and Dean Misczynski published through the American Planning Association a collection of essays titled *Windfalls for Wipeouts: Land Value Capture and Compensation.*\(^3^9\) Professor Hagman was more concerned with using windfall recapture as a source of wipeout mitigation than he was with using value recapture to fund public projects but he nonetheless noted that under such a program the community is only asking for a return of a portion of the wealth it creates.

It is interesting to note as a leading authority on Land Value Capture describes U.S. impact fees as a land value capture approach.\(^4^0\) So perhaps the Spanish and the U.S. approach are not that different in theory or result. However, whatever the philosophical relationship of the two, current American impact fee practice seems considerably more flexible. Although conceptually Spain could designate value recapture for purposes other than affordable housing, its current confinement to that purpose requires other ways of paying for roads, parks, schools, libraries, public buildings, public safety facilities, etc. Although in Spain the developer has to pay and deliver to the administration all the development works and the infrastructure that connect with the general services. Also collection of impact fees is not confined to major development projects since it is collected as a precondition for building permit issuance and can therefore be collected for the construction of a single dwelling or commercial unit as well as when there is redevelopment. Although the value capture approach is flexible in the sense that there may be an arbitrary percentage of planning gain -- 5%, 10%, etc., the impact fee must be precisely proportionate to the cost of providing infrastructure for new development and the money collected must be spent in a way to benefit those who pay the fees and not just to provide a general benefit to the public. Of course the serious negative to the American approach in the affordable housing context is that relatively few jurisdictions have thus far recognized that impact fees can be used to raise funds for affordable or work force housing. From that standpoint the Spanish value recapture approach and the certainty of its legality has a definitive edge.