Coates' Canons Blog: Assessing and Collecting System Development Fees (SDFs): It's All About the Timing

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As detailed in previous posts (**here**, **here**, and **here**), the General Assembly has granted local government utilities (including municipalities, counties, water and sewer authorities, sanitary districts, county water and sewer districts, metropolitan water districts, metropolitan sewerage districts, metropolitan water and sewerage districts, and local government water and wastewater providers established pursuant to G.S. 160, Art. 20 or local act of the General Assembly, collectively "local utility") explicit authority to charge capacity fees, referred to as system development fees, on "new development" to fund certain water and wastewater capital. *See* **G.S. 162A, Art. 8.** As more local utilities adopt and implement system development fees (SDFs), issues have arisen related to when the fees apply and when they must be collected. The difficulties are partially due to the fact that, by law, the fees are collected at a different time than they are assessed. But there are also questions about triggers for SDFs. This blog post walks through the circumstances under which SDFs may be assessed and when they must be collected. It also discusses what happens when the SDF law does not apply. The post incorporates recent legislative changes from **S.L. 2020-61**.

Triggers for Assessing SDFs

The SDF law allows a local utility to assess a system development fee on "new development to fund costs of capital improvements necessitated by and attributable to such new development, to recoup costs of existing facilities which serve such new development, or a combination of those costs…." **G.S. 162A-201(9);** *see also***G.S. 162A-203(a).** The law defines "new development" in a way that is both broader and narrower than its common understanding. Specifically, there are three definitions of new development, resulting in three different potential triggers for assessing SDFs (although if an SDF is assessed based on one trigger, it may not also be assessed based on another trigger unless there is a change in capacity needs).

The three definitions of "new development" (aka three triggers) are:

- Subdivision of land.
- Construction, reconstruction, redevelopment, conversion, structural alteration, relocation, or enlargement of any structure which increases the number of service units. (Service units are a unit of measure for capacity need. They are typically expressed as an equivalent residential unit.)
- Any use or extension of the use of land which increases the number of service units.

Most SDFs will be assessed based on trigger (1). Triggers (2) or (3) typically will apply to additions or other modifications to existing structures such as adding bedrooms or bathrooms, or changes to use of land such as adding additional agricultural development resulting in increased irrigation needs. Triggers (2) and/or (3) also apply when there is new construction on previously undeveloped or underdeveloped land or when there is a wholesale change to the use of land or structures, such as a partial or complete redevelopment. SDFs may only be assessed for triggers (2) and (3) based on the increase in service unit needs necessitated by the change (not total service unit needs). And, as discussed below, a local utility may not double assess SDFs. If they are assessed based on trigger (1), they not also be assessed based on triggers (2) or (3) unless there is an increase in service unit needs.

New development triggers that occur before SDF ordinance adopted

What about "new development" that occurred before a local utility adopted its SDF ordinance? For new development, as defined above, the law allows a short look-back period. If one of the three triggers occurs after the local utility begins its written analysis process, pursuant to G.S. 162A-205, and no more than 1 year prior to the adoption of the SDFs, a local

utility may assess the SDFs as if the trigger occurred after the adoption of the SDFs. The local utility should identify the date that its written analysis begins in order to track any “new development” that occurs within the year before it adopts the final SDF schedule.

A related question is what happens if the subdivision of land occurred outside (before) the lookback window, but if actual construction does not occur until after the SDF ordinance is adopted? Sometimes subdivision of land occurs long before actual development and development takes time, such that there may be a significant lag period between the development of the first and last parcel of land. May a local utility assess SDFs under triggers (2) or (3) when actual development of the land begins? The answer to this question is probably yes, but it is not entirely clear. As detailed below, however, even if the answer is no, a local utility likely may accomplish the same purpose through another means.

First, let’s look at the arguments for assessing SDFs under one of the other two triggers if the SDF ordinance is adopted after the land is subdivided (and outside the lookback window). Recall that triggers (2) and (3) occur when there is some change to structures or land use that cause an increased need for service units. Arguably, when there is actual construction on previously subdivided, but undeveloped, land, it will almost always involve an increase in service units from zero to whatever is necessary to serve the new construction. And trigger (2) includes original “construction,” not just additions, renovations, or reconstructions. The argument may be even stronger if the local utility legally does not commit any service units until building permits are pulled, or some other time after the final plat is recorded. (See more below on “commitment of service” timing.) Assessing the SDFs at this stage also appears consistent with the law’s intent that properties that will be newly connecting to the water and/or sewer system, or increasing their capacity needs of these systems, pay a proportional share of the infrastructure costs necessitated to provide and maintain that service capacity.

A potential counterargument might arise if the recorded plat (at the subdivision stage) indicates the number of service units needed and that number does not change when service is committed or when construction begins. In that case, it is possible that triggers (2) or (3) would not apply. One might also argue that the whole purpose of the lookback window was to grant a brief (but not unlimited) time for a local government to assess SDFs on properties that were subdivided before the local government adopted the fee schedule. And **G.S. 162A-215** mandates a narrow interpretation of the SDF law’s provisions.

Capacity fees when SDF law does not apply

The issue may be moot, though. That’s because if a particular property parcel does not meet the definition of “new development” for purpose of the SDF law, all that means is that the SDF law does not apply. A local utility is still free to assess fees and charges under its general rate-setting authority. And state law allows most local utilities to adopt “schedules of rents, rates, fees, charges, and penalties for the use of *or the services furnished or to be furnished* by any public enterprise.” *See* G.S. 160A-314 (municipalities); G.S. 153A-277 (counties); G.S. 162A-9 (water and sewer authorities); G.S. 162A-49 (metropolitan water districts); G.S. 162A-72 (metropolitan sewerage districts); G.S. 162A-85.13 (metropolitan water and sewerage districts); 162A-88 (county water districts). The general rate authority may be used to assess capacity fees, on a rational and proportional basis, on property that does not fall under the SDF law. *See generally Mc*Neill v. Harnett County, 327 N.C. 552 (1990). This authority also may be used to impose capacity fees on properties located outside the local utility’s territorial jurisdiction (which likely are not covered by the SDF law).

Collecting SDFs

The law also strictly prescribes when SDFs must be collected. The timing depends on the trigger for the SDF assessment.

For trigger (1), subdivision of land, the local utility **must** collect the SDFs either (1) at the time of the application for a building permit or (2) when water or wastewater service is committed by the local government utility, *whichever occurs later* . (Note that **S.L. 2020-61** changed the collection timing, effective as of January 1, 2021.) As per below, the amount of the SDF fees is likely set when the final plat is recorded (unless there is an increase in capacity needs after this date), but the fees are not actually collected until the latter of application for building permit or commitment of water/wastewater services.

For triggers (2), change in structures on land that cause a need for increased service units, or (3), change in use of land that cause a need for increased service units, the utility **must** collect the SDFs at either (1) the application for connection of the individual unit of development to the service or facilities; or (2) when the water or wastewater service is committed by the local utility, *whichever occurs sooner*.

Collection Timing is Exact

The first thing to note is that the collection timing is exact. The law does not afford a local utility any wiggle room to set a different time for collection, even upon agreement with the affected property owner/developer. Some units have expressed an interest in offering a developer a payment plan for the SDFs. The challenge with this approach is that the local utility likely will not have the ability to enforce collection of amounts owed after the statutory collection date has passed. That is a financial risk to the local utility.

Committing Water & Wastewater Services

The collection timing also raises the issue of when, and what it means, for the local utility to legally commit water or wastewater service. Committing service means that a local utility has reserved sufficient water/wastewater capacity to serve the “new development” that is subject to the SDFs, or that the utility is obliged to add/obtain sufficient capacity when it is needed by the new development.

In the past, many local government utilities did not address this issue directly. And, as a practical matter, there may be different understandings about when the service is actually committed. Does it occur when the final subdivision plat is recorded? Or when a developer agrees to construct water and wastewater infrastructure within the subdivision that will be deeded to the local government? Or when the building permits are pulled? Or when that infrastructure is actually deeded to the local government? Or not until there is an actual application for the installation of a meter/connection to the water or wastewater system? Before the SDF law, the exact timing might not have mattered in most cases (unless there was competition for limited capacity). But now a local utility must specify when it legally commits water and wastewater service. Clearly the law envisions that the commitment of service, recordation of plat, application for building permit, and application for connection of individual unit to system, all could occur at different times. And it is possible that service commitment will occur at different times in different situations. The law leaves it up to the discretion of the local utility to make this determination, consistent with any development agreements or other contracts with property owners or developers. When service will be deemed legally committed under the different circumstances should be specified in the utility’s water or wastewater ordinance.

Different Government Assesses SDFs than Grants Building Permit

What if a different local government assesses the SDFs than issues the building permits? An amendment to G.S. 162A-213, effective as of January 1, 2021, addresses this issue. It states that if the “local governmental unit that charges or assesses the system development fee is different from the local governmental unit that issues the building permit, the local governmental unit issuing the building permit shall require proof of collection of the system development fee prior to issuance of the building permit.” A local utility will need to coordinate the collection and transfer of SDFs with the local government that issues the building permit.

Change in Capacity Needs between Subdivision and Building Permit

If the trigger for SDFs is subdivision of land, what happens when there is a change in capacity needs between when the final plat is recorded and when the application for the building permit is submitted?

S.L. 2020-61 enacted G.S. 162A-213(d), which states that no SDF may be assessed at the building permit stage if it has already “been collected at the time of plat recordation” and the amount of needed capacity has not increased between plat recordation and the application of the building permit. If, however, “the amount of capacity is increased at the time of application for a building permit, then a [SDF] may be charged for the difference in the amount of the increased capacity minus the system development fee previously paid….” This provision does not make any sense because that same law makes clear that no SDFs may be collected at the time of plat recordation. This is likely a drafting oversight, with the intent to measure capacity differences between when the SDF is assessed (at the subdivision stage) and when it is collected (at

the building permit stage). Although as written, this provision technically does not apply, it seems reasonable to follow the intent. That means that a local utility may not collect additional SDFs when a building permit is pulled than what it originally assessed when the land was subdivided unless there has been a change to the building plans that would require an increase in service units. (Of course, because this provision technically does not apply, a local utility should consult its attorney for advice on how to proceed.)

Change in SDF Schedule Between Subdivision and Building Permit

It also likely means that if a local utility increases its SDF amounts between the time that land is subdivided (when the SDFs are triggered) and the application of the building permit (when the SDFs are collected), the utility must collect the fee based on the SDF schedule in place at the time the land was subdivided. It may not alter the amount actually collected based on the new SDF schedule. (The law requires a local utility to update its SDF analysis at least every 5 years, and a utility may do it more often in its discretion.)

Links

- www.ncleg.net/enactedlegislation/statutes/html/bychapter/chapter_162a.html
- www.ncleg.gov/Sessions/2019/Bills/House/PDF/H873v7.pdf
- www.ncleg.gov/EnactedLegislation/Statutes/PDF/BySection/Chapter_162A/GS_162A-201.pdf
- www.ncleg.gov/EnactedLegislation/Statutes/PDF/BySection/Chapter_162A/GS_162A-203.pdf
- www.ncleg.gov/EnactedLegislation/Statutes/PDF/BySection/Chapter_162A/GS_162A-215.pdf