

---

## **Coates' Canons Blog: Municipalities (and Counties) Not Authorized to Charge Certain Impact (aka Capacity, System Development) Fees**

By Kara Millonzi

Article: <https://canons.sog.unc.edu/updated-municipalities-counties-not-authorized-charge-certain-impact-aka-capacity-system-development-fees/>

This entry was posted on September 14, 2016 and is filed under Community & Economic Development, Development Fees, Development Finance, Development Finance, Finance & Tax, Public Enterprise / Utility Finance

---

**UPDATE 4 August 2018: Overruling the court of appeals, the North Carolina Supreme Court held that the Town of Carthage's liability to refund the unlawful impact fee revenue was subject to a 3-year statute of limitations. See Quality Built Homes Inc. v. Town of Carthage, No. 315PA15-2 (May 11, 2018).**

**UPDATE 3 September 2017: The legislature enacted a comprehensive system development fee law granting local government utilities specific authority to charge certain upfront fees for water and sewer services. For more information, [clickhere](#).**

**UPDATE 2 January 2017: The North Carolina Court of Appeals held that the Town of Carthage's liability to refund the unlawful impact fee revenue was subject to a ten-year statute of limitations. See Quality Built Homes, Inc. v. Town of Carthage, COA15-115-2 (Dec. 30, 2016).**

**UPDATE 1 December 2016: For more prospective guidance on calculating and assessing upfront charges for water and sewer utilities [clickhere](#).**

The North Carolina Supreme Court recently invalidated water and sewer impact fees assessed on new development by the Town of Carthage, holding that a municipality lacks the authority under general law to assess such fees. See **Quality Built Homes Inc. v. Town of Carthage, No. 315PA15, \_\_\_ N.C. \_\_\_ (Aug. 19, 2016)**. The case could have significant revenue implications for other municipalities and counties who currently assess similar fees. (Local units sometimes refer to these fees by other names, including capacity fees and system development fees) This post summarizes the court's opinion and provides guidance to municipalities and counties as to the types of water and sewer fees that are now prohibited and those that are still allowed. It then briefly discusses the potential liability of a municipality or county that has assessed an unauthorized fee. A future post will apply the new water and sewer fee framework to common scenarios involving both new and existing development.

Note that this post only addresses municipal and, by analogy, county fee authority. A previous **post** analyzed a water and sewer district's authority (and, by analogy, a water and sewer authority's, metropolitan water district's, metropolitan sewer district's metropolitan water and sewerage district's authority) to assess impact fees for water and sewer services.

### **What is an Impact Fee?**

An impact fee is a charge assessed on new (or sometimes existing) development to fund current and future public infrastructure expenditures that are (or may be) necessitated by the development. It is a form of targeted revenue generation, the rationale for which is based on the benefit principle. According to that principle, those who most directly benefit from public projects or services should pay for those projects or services. An impact fee is typically, but not always, imposed in advance of the completion of a development project—sometimes as early as the plat approval stage. And paying the fee is often a condition of receiving a building permit or certificate of occupancy.

### **Lack of Impact Fee Authority for General Government Purposes**

The most widespread use of these fees nationally is for sewer and water facilities, parks, roads, and schools. North Carolina local governments have more limited authority than those in many other states. Counties and municipalities in this state have specific statutory authority to require subdivision developers to pay fees in lieu for certain road and

---

recreational land infrastructure projects that benefit the new development. See G.S. 160A-372 (municipalities); G.S. 153A-331 (counties). *But see* China Grove 152, LLC v Town of China Grove, \_\_\_ N.C. App. \_\_\_, COA14-972 (July 7, 2015). There is no specific authority to charge general impact fees, though. (A handful of units have local act authority to assess impact fees for certain purposes.) And North Carolina courts have repeatedly refused to hold that impact fee authority is implied from a unit's regulatory powers, at least when the revenues are used to fund general government infrastructure or services. See, e.g., Lanvale Properties, LLC v. County of Cabarrus, 366 N.C. 142 (2012); Union Land Owners Ass'n v. County of Union, 201 N.C. App. 374 (2009), *disc. rev. den'd*, 364 N.C. 442 (2010); Amward Homes, Inc. v. Town of Cary, 206 N.C. App. 38 (2010), *aff'd by an equally divided court*, 365 N.C. 305 (2011).

### **Questionable Impact Fee Authority for Water and Sewer Purposes**

It has been an open question whether or not counties, municipalities, and other special purpose governments (such as water and sewer authorities and county water districts) have authority to assess impact fees for water and sewer purposes. Relying on a federal district court case from the late 1980's, *South Shell Investment v. Town of Wrightsville Beach*, 703 F.Supp. 1192 (1988), many local government entities have assumed that there is implied authority to assess impact fees to mitigate the impact of development on their water and/or sewer system(s) under their applicable public enterprise fee statutes (G.S. 160A-314 (municipalities) G.S. 153A-277 (counties); G.S. 162A-9 (water and sewer authorities); G.S. 162A-88 (water and sewer districts); G.S. 162A-49 (metropolitan water districts); G.S. 162A-72 (metropolitan sewerage districts); G.S. 162A-85.13 (metropolitan water and sewerage districts)). As discussed **here** and **here**, there were several reasons to question the (continued) validity of the court's holding in that case, at least with respect to municipalities and counties. The North Carolina Supreme Court has now provided some clarity on this issue.

### **Town of Carthage Case**

#### *Town's Impact Fees*

In order to place the court's holding in proper context, it is important to fully understand the impact fee programs at issue in *Quality Built Homes*. The town had two impact fee ordinances—one for water and one for sewer.

According to the water ordinance, an impact fee was imposed on all new development “that is to be served by the town's water system.” The fee ordinance provided for some exceptions—those who contracted for bulk water purchases, those who provided water services to the public for temporary or emergency services, and those who installed service solely for fire protection—were not required to pay the fee. The amount of the fee was based on the projected water meter size needed to serve the new development. In recent years, it ranged from \$1,000 to \$30,000 per connection. The fee was triggered off of final plat approval and generally due either upon payment of the tap fee or upon issuance of the development permit, whichever occurred first. According to the ordinance, the fee revenue was to be placed in a capital reserve fund and “used to cover the cost of expanding the water system. The costs of expansion are water treatment plant expansion, elevated storage expansion, and transmission mains.” See Carthage, N.C. Code Sect. 51.076 (2015) (full text **here**).

The town also imposed a sewer impact fee on new development, based on the size of the water meter. The fee was assessed upon final plat approval, and, as with the water impact fee, due in full at the earlier of payment of the tap fee or issuance of the development permit. There was an exception for property owners whose water services were only for fire protection. The revenue generated from the sewer impact fee was used “to cover the cost of expanding the sewer system. The costs of expansion include gravity mains, force mains, and lift stations.” See Carthage, N.C. Code Sect. 51.096 (2015) (full text **here**).

#### *Court's Analysis and Holding*

In 2013, two developers who had paid a total of \$123,000 in water and sewer impact fees to the Town of Carthage, sued claiming that the town lacked the authority to assess the fees. The trial court granted summary judgment in favor of the town, which was affirmed by the court of appeals. As stated above, the North Carolina Supreme Court reversed, holding that the town lacked statutory authority to assess the impact fees.

In so holding, the court determined that the plain language of the fee authorizing statute allows a municipality “to charge for the contemporaneous use of its water and sewer systems . . . .” *Id.* at 8. The statute, however, “fails to empower [a

---

municipality] to impose impact fees for future services.” *Id.* The statute provides that “[a] city may establish and revise from time to time schedules of rents, rates, fees, charges, and penalties for the *use of or the services furnished by* any public enterprise.” G.S. 160A-314 (emphasis added). The court compared this statutory grant of authority with that applicable to county water and sewer districts, in G.S. 162A-88. The latter statute provides that a county water and sewer district “may establish and revise a schedule of rates, fees, and other charges for the *use of and for the services furnished or to be furnished by* any sanitary sewer system, water system or sanitary sewer and water system of the district.” G.S. 162A-88 (emphasis added). In *McNeill v. Harnett County*, 327 N.C. 552 (1990), the court held that this fee statute authorizes a county water and sewer district to charge for prospective services, which are “not limited to the financing of maintenance and improvements of existing customers.” *Id.* at 570. (Note that although the *Quality Built Homes* court referred to G.S. 162A-88 as the “county” enabling statute, it actually is the enabling statute for a county water and sewer district. The county fee statute has identical fee language to the municipal fee statute. See G.S. 153A-277. A county water and sewer district is a separate legal entity from a county, governed by a separate board. By statute, however, a county board of commissioners serves as the district’s board. G.S. 162A-89.)

The *Quality Built Homes* court found the absence of the phrase “to be furnished” in the municipal fee statute significant. Unlike county water and sewer districts (and other local government entities) “[a] municipality’s ability to ‘establish and revise’ its various ‘fees’ is limited to ‘the use of’ or ‘the services furnished by’ the enterprise, which provisions are operative in the present tense.” *Id.* at 9.

Thus there were two problems with the impact fees assessed by Carthage. The first was the timing of the fee—assessed before the property was connected, or even contracting to connect, to the water and sewer systems. The second was how the fee was calculated—to fund costs associated with future maintenance and expansions of the system(s). In some cases, a fee will be unlawful even if it has only one of these problems.

### **Authorized Water and Sewer Charges**

Not all water and sewer charges assessed for capital purposes are unlawful, though. It may be easier to identify the contours of the fee authority by looking at the types of fees and charges that are authorized.

#### *Connection / Tap Fees*

The *Quality Built Homes* court reaffirmed municipal authority, and, again, by analogy, county authority, to charge tap fees. *Id.* at 11 (“Furthermore, Carthage has the authority to charge tap fees . . .”). A tap (or connection) fee is assessed to cover the costs of connecting a property with the public water and/or sewer systems, including the costs of installing a tap, service line, and meter, as well as any excavation or boring costs, paving costs, etc.

Arguably, a tap fee could be calculated to also cover the proportional share of past costs incurred by the local government that were necessary to provide the water and/or sewer services to the property. For example, if the local unit had previously invested in an extension of water and/or sewer infrastructure to enable service to the property, it could require the property owner to pay a proportional share of the costs of the extension, as a condition of connecting to the system(s). In *Atlantic Construction Company v. City of Raleigh*, 230 N.C. 365 (1949), the court held that a municipality has authority to charge reasonable connection (tap) fees and to otherwise “fix the terms upon which the service may be rendered and its facilities used.” *Id.* at 369. A local government likely may not calculate a tap fee to include the proportional share of estimated future maintenance, upgrade, or expansion costs to the water and/or sewer system(s) due to the addition of the property, though.

#### *User Fees*

The *Quality Built Homes* court also reaffirmed municipal (and county) authority to set water and sewer customer user fees so as to cover “necessary improvements and maintain services” and to handle any expansion needs. *Id.* at 11. User fees are charges for the actual use of the water and sewer services. A user fee generally has two components – a fixed “overhead” charge and a variable charge based on metered or calculated usage.

The court had previously recognized a local government’s power to set water and sewer customer user fees so as to cover the customer’s proportional share of past, current, and future capital costs associated with providing continued water and sewer services to the property. See *Town of Spring Hope v. Bisette*, 305 N.C. 248 (1982). Past costs include capital

---

investments that were necessary to serve the property, such as expanding system capacity and installing water and sewer lines. Current costs include the proportional share of construction, maintenance, and upgrade expenses incurred this fiscal year, as well as the proportional share of debt service payments for previous infrastructure projects. Future costs could include the proportional share of anticipated future year maintenance, upgrade, or expansion projects that are necessary to maintain the level and type of services currently being provided to water and/or sewer customer.

The challenge in *Bissette* was to a town's practice of periodically increasing its water and sewer rates to finance the construction, operation, and maintenance of an upgraded water treatment plant. The new plant was required to maintain the town's permit to discharge treated water. The fee at issue was assessed on all current customers of the water and sewer system. An owner of a laundrette refused to pay the increased fee, claiming that the town exceeded its authority in charging for "services to be furnished" as opposed to "services furnished" by the public enterprise. The *Bissette* court disagreed, holding instead that the fee was assessed for a service that the customer currently received. According to the court, the upgrade "was not intended to, nor did it result in, providing a new or higher level of service to the sewer system's customers." *Id.* at 251-252. When the new plant went into operation, "the customers received nothing they had not received before," thus, the rate "did not reflect any service yet to be furnished." *Id.* To the contrary, it "represented the cost of a necessary improvement to the already existing sewer system without which the Town could not continue to provide sewer service." *Id.* The town was free to set the fee amount above the level necessary to cover current operating costs. It could also factor in the costs of upgrading the water treatment plant.

#### *Contractual Payments for Extending Water and Sewer Infrastructure*

Although not specifically addressed in *Quality Built Homes*, a local government also has authority to enter into a development agreement, or other contractual arrangement, to extend water or sewer lines, or undertake other water and sewer system infrastructure projects necessary to serve a particular development or property. In some instances, the developer or property owner will construct the necessary infrastructure. In many cases, though, a municipality or county undertakes at least a portion of the capital projects itself. In those cases, the local government may charge the developer, or individual property owner, the proportional share of the past and current capital costs incurred to make the water and sewer services available to the property. There is no authority to charge for future maintenance, upgrade, or expansion utility projects at this stage of the process.

#### *Availability Fees*

A municipality and county may require the owner of developed property (with one or more residential or commercial structures), that is located within the municipality or county, and within a reasonable distance of the municipality's or county's water and/or sewer lines, to connect the property to the public water and/or sewer system. G.S. 160A-317 (municipalities); G.S. 153A-284 (counties). The local government may "fix the charges for these connections." In other words, if a local government requires a property to connect to its water and/or sewer system, it may charge the property owner the tap fee described above. (A unit may not require connection to its water system, however, if the property owner is served by a drinking water well, pursuant to a valid permit.)

In lieu of requiring connection, a municipal board may instead assess an *availability fee* on the property's owner. The amount of the availability fee may not exceed the fixed component of the periodic user fee assessed to the unit's water and/or sewer customers. The availability fee is often calculated in the same manner as the fixed "overhead" charge, and may be set to cover the property's proportional share of past, current, and future capital costs associated with operating the water and/or sewer system(s). See G.S. 160A-317.

A county's authority to impose an availability fee, however, is more limited than a municipality's. G.S. 153A-284 provides that:

[i]n the case of improved property that would qualify for the issuance of a building permit for the construction of one or more residential dwelling units or commercial establishments and where the county has installed water or sewer lines or a combination thereof directly available to the property, the county may require payment of a periodic availability charge, not to exceed the minimum periodic service charge for properties that are connected.

This provision was added to G.S. 153A-284 in 1995. S.L. 1995-511. It seems to limit a county's availability fee authority to those situations where the county's water or sewer lines are directly available to property that has been improved to the

extent that it would qualify for the issuance of a residential or commercial building permit, but where no structures actually have been constructed. Once a building permit is issued, though, the county's only option is to force the property owner to connect to its water or sewer systems.

### *Assessments and Special Taxing Districts*

Finally, there are a few other financing methods available to municipalities and counties to fund water and sewer infrastructure projects. Under certain circumstances, a municipality may impose a special assessment or critical infrastructure assessment on property owners whose properties directly benefit from the water and/or sewer project. The assessment methods only allow a unit to charge for costs of undertaking the particular capital project—not past or future expenses. Alternatively, a county may establish a county service district (special taxing district) to fund water and sewer systems, and a municipality may establish a municipal service district to fund sewer systems. A unit may use special taxing district proceeds to cover both current and future capital and operating costs.

### **Guidance for Municipalities Currently Charging Unauthorized Fees**

Municipal and county officials should work with their local unit's attorney to review all of their water and sewer fees and cease charging any water and sewer fees that lack statutory authority. Specifically, a unit should look both at the timing of when a fee is imposed and how the fee is calculated. (And remember that what the fee is called does not matter. For example, a "capacity fee" or "tap fee" that is imposed on new development to fund future capital maintenance, upgrade, and expansion projects is unlawful. On the other hand, an "impact fee" that is assessed when a property connects to the unit's water and/or sewer system, and is calculated to cover the proportional share of costs incurred to extend the infrastructure to the property, is allowed.)

Must a unit refund unauthorized fee revenue that it has already collected? The answer to this question likely is yes, at least upon request of the individual or entity that paid the fee. If a local government is found to have "illegally exacted a tax, fee, or monetary contribution for development or a development permit not specifically authorized by law, the [local unit] shall return the tax, fee, or monetary contribution plus interest of six percent (6%) per annum." G.S. 160A-363(e). Additionally, if a court determines that a local government acts outside its legal authority, it "may award reasonable attorneys' fees and costs to the party who successfully challenged" the unit's action. G.S. 6-21.7. A court must award attorneys' fees and costs if it finds that a unit's action constituted an abuse of discretion. *Id.*

How far back does the refund obligation extend? In a recent case involving a similar dispute (lack of authority to impose impact fees), the court of appeals held that the applicable statute of limitations was 10 years, pursuant to G.S. 1-56. See *Point South Properties, LLC v. Cape Fear Public Utility Authority*, COA15-374, \_\_\_ N.C. App. \_\_\_, (Oct. 20, 2015). That could translate into a significant liability for some municipalities and counties. In *Quality Built Homes*, the court remanded the litigation to the court of appeals to address this issue in the context of this case, as well as the issue of whether or not the plaintiffs are entitled to an award of attorney's fees and costs, under G.S. 6-21.7. We will have to await final guidance from that court on this issue.

## **Links**

- [caselaw.findlaw.com/nc-supreme-court/1895752.html](http://caselaw.findlaw.com/nc-supreme-court/1895752.html)
- [appellate.nccourts.org/opinions/?c=2&pdf=35099](http://appellate.nccourts.org/opinions/?c=2&pdf=35099)
- [ced.sog.unc.edu/upfront-charges-for-local-government-water-and-sewer-capital/](http://ced.sog.unc.edu/upfront-charges-for-local-government-water-and-sewer-capital/)
- [appellate.nccourts.org/opinions/?c=1&pdf=34625](http://appellate.nccourts.org/opinions/?c=1&pdf=34625)
- [canons.sog.unc.edu/water-and-sewer-districts-impact-fee-powers/](http://canons.sog.unc.edu/water-and-sewer-districts-impact-fee-powers/)
- [canons.sog.unc.edu/local-government-impact-fee-authority-for-public-enterprises-revisited/](http://canons.sog.unc.edu/local-government-impact-fee-authority-for-public-enterprises-revisited/)
- [canons.sog.unc.edu/do-north-carolina-local-governments-have-authority-to-assess-impact-fees-for-water-and-sewer-public-enterprises/](http://canons.sog.unc.edu/do-north-carolina-local-governments-have-authority-to-assess-impact-fees-for-water-and-sewer-public-enterprises/)
- [canons.sog.unc.edu/wp-content/uploads/2016/09/Town-of-Carthage-Water-Impact-Fee-2015.docx](http://canons.sog.unc.edu/wp-content/uploads/2016/09/Town-of-Carthage-Water-Impact-Fee-2015.docx)
- [canons.sog.unc.edu/wp-content/uploads/2016/09/Town-of-Carthage-Sewer-Impact-Fee-2015.docx](http://canons.sog.unc.edu/wp-content/uploads/2016/09/Town-of-Carthage-Sewer-Impact-Fee-2015.docx)