Coates' Canons Blog: Water and Sewer Extensions "At No Cost" – Analyzing the New Annexation Law

By Frayda Bluestein

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As summarized in this **post**, the new annexation reform law requires cities to extend water and sewer services to annexed areas if the owners of a majority of properties in the area request service. The law requires the city to offer to each eligible owner of real property the opportunity to obtain water or sewer service, or both, "at no cost other than periodic user fees." **G.S. 160A-58.56(b)**. The new law also restricts the amount that may be charged to property owners who request service after the annexation occurs (assuming that the city extends water and sewer to the area either voluntarily or as mandated when a majority requests it). G.S. 160A-58.56(d). During our recent legislative webinars, there were several questions about what can be charged under these new provisions. This post addresses those questions.

Can cities charge impact fees, tap fees, connection fees, special assessments or other fees to customers who have requested service during the annexation process?

The new annexation law, in G.S. 160A-58.56(h)(1), defines "at not cost other than periodic user fees" as follows:

"The municipality may not charge the property owner who responded favorably under subdivision (b)(3) of this section [owners who request service during the annexation process] for any costs associated with the installation of the water or sewer system. "

Based on this definition, my conclusion is that a city can't charge any fee (regardless of what it's called) that is designed to recover the costs of extending services to property owners who request service during the annexation process. It's important to note that local government utilities use various names for fees they change, and the names don't necessarily describe the purpose of the fee. A 2009 survey conducted by the School of Government's **Environmental Finance Center** and the **North Carolina League of Municipalities** analyzed the types of fees charged by North Carolina local government utilities. The study notes, "Generally, utilities use three major types of upfront fees and charges in North Carolina: tap fees, system development charges and special assessments." Special assessments are specifically authorized as a mechanism to recover costs of construction. Other fees are established under more general authority to impose fees for utilities. The names for these fees include, according to the survey, "Impact Fee, System/Capacity Development Charges, Capacity Use Fee, Capacity Depletion Fee, Capital Facilities Fee, Capital Investment Fee, Capital Recovery Fee, Capital Reserve Fee, Connection Fees, Development and Technology Fee, Tap Fee, Acreage Fee, Privilege Fee, Initial Hook-up Fee, and the list goes on."

So how does the limitation in the new law affect imposition of these fees? For customers who requested service during the annexation process, any charge that is designed to pay for or offset any part of the cost of the "installation of the water or sewer system" is prohibited. It could be argued that this limitation only applies to fees designed to recover the cost of the initial extension of services to the annexed properties, and that fees designed to provide for future system-wide needs might be allowed. G.S. 160A-58.55(3)(b), which describes the obligation to provide services under the new law, requires construction of "the mains, outfalls and lines *necessary to extend water and sewer services to each lot or parcel*," (emphasis added), might provide support for notion that the limitation is as to the initial improvements only. However, even if this interpretation is correct, fees designed to fund future system needs could only be charged if they are incorporated into or otherwise considered to be "periodic user fees."

What can cities charge to property owners who request services after the annexation has occurred?

The new law is very specific about what can be charged to property owners who request service within five years after annexation has occurred. As set forth in G.S. 160A-58.56(h), property owners who later request service can be charged a percentage of the "average installation of a connection for a residential lot." The percentages range from 50% to 90%, depending upon how many years have elapsed when the application for service is made. The term "average installation of a connection for a residential lot" is defined in G.S. 160A-58.56(h)(2) as follows:

"The average of the cost for residential installations from curb to residence, including connection and tap fees, in the area described in the annexation ordinance."

This definition describes the total amount to which the percentage is applied in order to determine the amount that may be charged to customers who request service after the annexation under subsection (d). Unlike the provision that applies to property owners who request during the annexation process, this provision specifically includes connection and tap fees (these terms are not defined in this, or in any other statute, as far as I know) and it does not prohibit charges that include the cost of the initial extension. So it's possible that the connection or tap fee for these customers could include an allocated portion of installation costs beyond the cost from curb to residence.

Another challenge in determining the amount that may be charged to this category of customers, is that the definition describes an "average" installation cost, but it does not identify or define the set of installations to be used to generate the average. One possible interpretation is that it is the average of extensions that were constructed for those property owners who requested service during the annexation process. If so, this means that the city would have to maintain records of these costs in order to calculate the average amount. It's not clear whether the city would then be required to update the figure as it continues to make extensions over time.

As I noted in my **original summary,** for customers who request service five years after the annexation, the new statute allows a city to charge the full amount under its existing policy. In this context, it might be of interest to note that the annexation reform law repeals G.S. 160A-47.1, which restricted a city's authority to substantially diminish its financial participation in the construction of water or sewer facilities prior to an annexation.

Can cities apply a mandatory connection policy to property owners in annexed areas who have not requested service?

The answer to this question appears to be "no." A provision in the new law, G.S. 160A-58.56(e), prohibits the city from charging, for any reason, any property owner within the annexed area for the installation or use of the water or sewer system unless the property owner is, or has requested to become, a customer of the system. Indeed, this limitation appears to be permanent with respect to the annexed property and does not include any exception for public health and safety reasons that might exist or develop. The limitation might also conflict with existing grant agreements or bond covenants that require the city to require connections or collect minimum fees.

Links

- canons.sog.unc.edu/?p=4494
- www.ncga.state.nc.us/Sessions/2011/Bills/House/PDF/H845v7.pdf
- www.efc.unc.edu/
- www.nclm.org/Pages/default.aspx