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Public Law Update: New Law Prohibits Local Agencies from Charging Certain Development-related Fees and Charges Until After a Certificate of Occupancy is Issued

On September 19, 2024, Governor Gavin Newsom signed into law Senate Bill 937 ("SB 937"), which amended Government Code section 66007 of the Mitigation Fee Act (the "Act"). The Act regulates fees for residential development projects, fees for specific purposes, including water and sewer connection fees, and fees for solar energy systems, among others. Most notably, SB 937 prohibits local agencies from collecting certain development-related fees and charges until a certificate of occupancy is issued. This constitutes a significant change, as public agencies currently charge most of these fees at or prior to issuance of building permits. Proponents of SB 937 argue that it will assist in reducing housing costs by decreasing initial costs, therefore decreasing developer reliance on high-interest construction loans. However, SB 937 creates uncertainty for public agencies and poses logistical and financing challenges for accommodating new development.

Changes Under SB 937

General Rule: Under the amended Government Code section 66007(a), local agencies shall not require payment of fees or charges "for the construction of public improvements or facilities" for residential developments[1] until the date of the final inspection or the date the certificate of occupancy ("COO") is issued, whichever occurs first.

Exceptions: Public agencies may require the payment of fees/charges earlier if:

1) The fees/charges are to reimburse the agency for expenditures previously made

2) If the local agency has established an account and has appropriated funds for public improvements or facilities related to provision of the following services to the residential development: water service; sewer or wastewater service; fire, public safety, and emergency services; roads, sidewalks, or other improvements for transportation; or construction and rehabilitations of school facilities.

**Exceptions 1 and 2 do not apply to units reserved for lower income households in a residential development in which at least 49 percent of total units are reserved for lower income households at an affordable rent.*[2]

3) Utility service fees related to connections may be collected at the time an application for service is received. However, connection fees may not exceed the costs incurred by the utility provider resulting from connection activities.

4) If construction of a *designated* residential development does not begin within five years after the building permit is issued, the fees may be charged earlier.

5) SB 937 does not apply to fees collected to cover the cost of code enforcement or inspection services.

Additional Requirements and Provisions:

Local agencies cannot charge interest or other fees on any amount of fees deferred pursuant to this law.

If the development contains more than one dwelling, the local agency may determine whether the fees or charges described shall be paid on a pro rata basis for each dwelling, when a certain percentage of the dwellings have received their COOs, or on a lump-sum basis when all the dwellings receive their COO.

A local agency may withhold a COO or a temporary COO until payment of the relevant fees or charges are received.

If the local agency does not issue COOs for residential developments, the final inspection shall serve as the certificate of occupancy for the purposes of section 66007.

Impacts and Significance of SB 937

Public agencies have expressed concern with the scheme imposed by SB 937. Fees such as connection and capacity fees are typically collected at the time of permit issuance to ensure the revenue necessary to support improvements to sustain and connect the development exists prior to construction. SB 937's reimbursement type model is concerning because it will shift initial costs to public agencies for new development, and risk increasing costs to existing utility customers to cover capacity upgrade costs and administrative costs for tracking COOs for each development project.

SB 937 provides in 66007(C)(1)(A)(ii) that, "utility service fees related to connections may be collected at the time an application for service is received, provided that those fees do not exceed the costs incurred

by the utility provider resulting from the connection activities." While this section clearly applies to connection fees, it is unclear if it applies to capacity charges, creating significant uncertainty. Capacity charges are defined as a charge for "public facilities in existence at the time a charge is imposed or charges for new public facilities to be acquired or constructed in the future that are of proportional benefit to the person or property being charged…." (Gov. Code § 66013(b)(3).) Thus, it is not clear that capacity charges fit within the category of fees "related to connections" under SB 937, especially because the bill purports to change the timing of charges on "public improvements or facilities."

In the short term, upon the effective date of SB 937 which is January 1, 2025, public agencies may risk exposure to legal challenges if they continue to collect capacity charges at the time of permit issuance. In the long term, public agencies will face a multitude of challenges, such as finding ways to cover the cost of capacity upgrades which are often incurred prior to the issuance of COOs. Additionally, if capacity charges are precluded until the issuance of a COO, public agencies will face substantial logistical challenges. Coordinating recovery of the capacity charge after the fact will likely be difficult for agencies that provide utilities and particularly for special districts, which are not land use agencies because those districts do not issue COOs, are not privy to individual determinations, and often serve multiple cities in their service areas. These entities will thus have to track individual projects on a development-by-development basis to determine when to initiate collection of the capacity charge. This in and of itself could be burdensome and resource intensive, increasing general costs for provision of utility services which will likely have to be subsidized, at least in part, by existing customers.

Public agencies should become familiar with SB 937 and its exceptions, and develop plans for implementation, including plans for inter-agency coordination where appropriate.

[1] This includes "designated residential developments" which are projects that meet one of the seven criteria listed in 66007(c)(4).

[2] For these low-income units, a developer may guarantee payment of certain fees or charges by posting a performance bond or a letter of credit from a federally insured, recognized depository institution. If the developer does not elect to do so, the city, county, or city and county may collect certain fees or charges in accordance with a specified procedure.

Attorneys at Burke regularly advise clients on legal matters related to the Mitigation Fee Act.

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