



Community and Economic Development in North Carolina and Beyond Blog: Changes to Municipal Service District (MSD) Authority

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[UPDATE: Additional changes were made in 2016. Those changes are summarized here: [2016 Changes to Municipal Service District \(MSD\) Authority](#)]

In the state budget bill, **S.L. 2015-241**, the legislature made a few changes to municipal service district (MSD) authority. An MSD is a defined area within a municipality in which the unit's governing board levies an additional property tax in order to provide projects or extra services that benefit the properties in the district. (Counties have similar authority, referred to as county service districts.) A service district is not a separate government. It is simply a mechanism whereby a local government may raise money to pay for services or projects from those property owners that most directly benefit from the services or projects. (Click [here](#) for more information on MSDs.)

Under general law, a municipality may define one or more service districts for any of the following functions:

- Beach erosion control and flood and hurricane protection works
- Downtown revitalization projects
- Urban revitalization projects
- Transit-oriented development projects
- Drainage projects
- Sewage collection and disposal systems
- Off-street parking facilities
- Watershed improvement, drainage, and water resources development projects

(There are a few additional authorized purposes for certain municipalities. See **G.S. 160A-536**.)

The most common municipal service districts are established for downtown or urban area revitalization. A municipality may establish one or more downtown revitalization districts in its central downtown area. It may form an urban area revitalization district in an area that meets any one of these criteria: (1) it is the central business district of the municipality; (2) it consists primarily of existing or redeveloping concentrations of industrial, retail, wholesale, office, or other significant employment-generating uses; (3) it is located in or along a major transportation corridor (with certain restrictions); or (4) it is centered or focused around a major concentration of public or institutional uses.

Downtown and urban area revitalization districts are commonly referred to as business improvement districts or BIDs. Establishing a BID allows a municipality to levy an additional property tax on real and personal properties within its central downtown, or other commercial area, to fund a variety of downtown projects and services, such as street and sidewalk improvements, promotional and marketing efforts, increased security, additional trash collection, and building façade improvements. (Click [here](#) for more information on BIDs.)

Section 15.16B of S.L. 2015-241 (state budget) imposes limitations on a municipal board's authority to levy an MSD tax for any of the authorized purposes. It also mandates that a municipality follow certain procedures before entering into a contract with a private entity to provide services within certain types of MSDs—namely those established for downtown or urban area revitalization. Finally, the new law designates a study commission to look at the feasibility of allowing property owners to opt out of an MSD.

New Tax Rate Limitations

Before establishing an MSD, a municipality's governing board must determine that the proposed district is in need of one



or more of the authorized projects or services “to a demonstrably greater extent” than other areas in the municipality. **G.S. 160A-536(a)**. The board then must follow a statutory process to establish the district. (Click here for more information on the process requirements.) Generally, a new district must take effect at the beginning of a fiscal year. **G.S. 160A-537(d)**.

After an MSD is established, the unit’s governing board may levy an MSD tax each fiscal year against all taxable property in the district (real and personal). There is one exception—the personal property of public service corporations is exempted from the MSD tax.

Effective with the adoption of the FY2016-2017 annual budget ordinance, a municipal board is limited to setting a tax rate such that there is “no accumulation of excess funds beyond that necessary to meet current needs, fund long-range plans and goals, and maintain a reasonable fund balance.” The new limitation does not prohibit a municipality from carrying over MSD tax proceeds from year-to-year, but it does force the municipal board to determine the specific needs of the district and be mindful not to set the MSD tax rate to high so as to produce excess revenue beyond what is estimated to meet the current and future needs of the district. The intent of the new provision is to limit a unit’s ability to impose an MSD tax without a clear sense of the need or purpose for the tax proceeds.

New Contracting Rules

General Contracting Authority

Once a unit levies an MSD tax, it must “provide, maintain, or let contracts for the services for which the residents of the district are being taxed within a reasonable time, not to exceed one year, after the effective date of the definition of the district.” **G.S. 160A-540**. In addition to MSD tax proceeds (and in some cases in lieu of MSD tax proceeds) a unit may appropriate any other unrestricted revenues to the district to fund the services or projects undertaken in the district. **G.S. 160A-542**.

A municipality has broad authority to “provide services, facilities, functions, or promotional and developmental activities in a service district with its own forces, through a contract with another governmental agency, through a contract with a private agency, or by any combination thereof.” **G.S. 160A-536(d)**. Any time a municipality enters into a contract to provide services, facilities, functions, or promotional and developmental activities in an MSD, whether it be with a management company or any other governmental or private entity, the contract must:

- specify the purposes for which municipal funds will be used; and
- require an appropriate accounting of the moneys paid out under the contract at the end of the fiscal year (or other appropriate period of time). See **G.S. 160A-536(d)**.

These requirements facilitate a municipal board’s ability to engage in proper management and oversight over the expenditure of public funds by the contracting party.

Most units contract with outside entities for major construction projects in an MSD. And some units contract for the provision of certain services within an MSD. Larger municipalities, in particular, often utilize private organizations to manage their downtown or urban area revitalization districts (management companies). The management company serves as a liaison between the downtown property owners and the municipality. It works with the property owners in the district to identify needs, prioritize projects, and manage initiatives. It also may engage in branding and marketing efforts on the part of the downtown. And, in some instances, the management company raises private monies to fund downtown initiatives.

New Contracting Requirements for Downtown Revitalization and Urban Area Revitalization Districts

As of October 1, 2015, municipalities are subject to additional requirements when contracting with private entities to provide services, facilities, functions, or promotional and developmental activities in certain types of MSDs. The additional requirements only apply to contracts entered into with private entities relating to MSDs for downtown or urban area revitalization. (They also apply to the few jurisdictions that have MSDs for certain projects in an historic district. See **G.S. 160A-536(a)(1a)**.) The apparent intent of the legislation was to target general service provision contracts with



management companies.

Specifically, the new law amends G.S. 160A-536 to require that a municipality do all of the following before entering into a contract with the private entity to “provide services, facilities, functions, or promotional and developmental activities in a service district:”

Solicit input from the residents and property owners as to the needs of the service district. The statute leaves it up to the municipality to determine the best way to obtain meaningful input from both property owners and residents. A unit could hold one or more public hearings, but this process is not necessary and may not be sufficient in some cases. A unit might also conduct written surveys or hold focus group discussions with affected residents and property owners. In some municipalities, the governing board may be able to simply request comments from those who live or own property in the district. A unit may have to use different information gathering methods for property owners, who likely are more actively engaged in the district, than for residents.

Use a bid process to select the private entity that is contracting to provide services or undertake projects in the MSD. Generally, a local government must use an authorized bid process for purchase and construction and repair contracts over a certain dollar amount. (Click [here](#) for information on bid thresholds and requirements.) A local unit is not required to bid service contracts, though, unless the unit itself has an internal policy requiring it to do so. The new law now requires a municipality to use a bid process to select a private entity to provide services, facilities, functions, or promotional and developmental activities in a downtown or urban area revitalization MSD, regardless of the amount or nature of the contract. The requirement applies to new contracts and to renewals of existing contracts. Thus, if a municipality enters into yearly contracts with a management company, it will need to undertake a bid process each year to select the company.

What is a bid process? The new law states that the municipality “shall determine criteria for selection of the private agency and shall select a private agency in accordance with those criteria.” I consulted with my colleagues, Norma Houston and Frayda Bluestein, who both have expertise in purchasing and contracting, and they concur that the law does not require that the municipality use one of the competitive bid processes prescribed by Article 8 of Chapter 143 of the General Statutes. A unit may use one of these processes, but it is also free to create its own bid process.

The following sets out the basic process a unit should follow in creating and implementing the bid process (thanks to Norma for this framework!):

1. Identify criteria for selecting a private entity to perform the needed services in the downtown or urban area MSD. The unit’s governing board is free to select whatever criteria it deems appropriate given the particular needs of the MSD. The unit likely should identify the criteria after obtaining input from residents and property owners about the needs of the district.
2. Publicize that unit is soliciting proposals from private entities to perform the specified services in the downtown or urban area MSD. The announcement or advertisement should specify the criteria that the unit will use to select the winning bid. (Formal bid advertising is not specifically required, but inherent in a bid process is some form of public notice that the unit is seeking proposals.) The unit likely will want to set a deadline for receiving proposals.
3. Evaluate the proposals received. The proposals must be judged based on the criteria established in Step 1 and publicized in Step 2.
4. Select the private entity whose proposal “is best suited to achieve the needs of the service district.” This is a very broad standard of award. The unit may take into consideration cost, but it is not required to make its contract award decision on that basis. Instead, the unit must determine which entity satisfies the criteria specified in Step 1 and is best suited to meet the needs of the district.

Hold a public hearing before entering into the contract. The governing board must hold the public hearing in the district, and it must publish notice of the public hearing in a newspaper of general circulation for at least two consecutive weeks before the date of the public hearing. The exact timing of the hearing is unclear, though. It is possible that if the unit chooses to hold one or more public hearings to initially solicit input from residents and property owners that this specific “public hearing” requirement also will be satisfied. The statute lists the requirements separately, though. In fact, it lists the public hearing requirement after that for a bid process. It seems likely that the legislature intended for a unit to hold the



public hearing after it has identified a contracting entity but before the contract is actually executed. If a unit holds the public hearing earlier in the process, it should, at a minimum, outline the basic contract parameters at or before the hearing.

Require the contracting entity to report annually to the municipality. The report must be in writing to the municipal board and must identify the “needs of the service district, completed projects, and pending projects” Before submitting the report; the contracting entity must seek input from property owners and residents in the district about the district’s needs for the upcoming year. A municipality may request that the private entity document its efforts to obtain and consider this input.

Specify the scope of the services to be provided by the private entity in the contract. It will no longer be sufficient to enter into an open-ended management contract with a private entity. Instead, the unit must contract for the private entity to perform specific projects and services in the district. The municipal board must approve any amendments to the scope of the services.

Limit the contract to five years or less. A municipality may enter into a multi-year contract with a private entity to provide services or projects in a downtown or urban area MSD. The contract period may not exceed five years.

Legislative Study Commission

Section 15.16B of S.L. 2015-241 also directs the Legislative Research Commission to study the “feasibility of authorizing property owners within a municipal service district to petition for removal” from the district. The Commission must report its findings and recommendations to the 2016 Regular Session of the 2015 General Assembly. So stay tuned, there may be further modifications to the MSD statutes in the coming years.