Submit a revitalization project for UNC-Chapel Hill graduate students enrolled in Community Revitalization course

Graduate students enrolled in the Community Revitalization course and working with the School of Government's Development Finance Initiative (DFI) are current professional degree students in business (MBA), planning (MCRP), and public administration (MPA), among others. Under the supervision of faculty and staff, students conduct market research, feasibility analysis, and financial modeling to **help communities understand how they can attract *private* investment into community revitalization projects** across North Carolina. Students work in multi-disciplinary teams over the course of a semester **at no charge to the local government**.

We invite you to submit your community revitalization projects for consideration by students in the course. The projects to be performed by student teams are selected by students themselves, so please provide details that will make your project appealing. The best projects tend to be located in the heart of a downtown or other significant community space and focus on important structures that the community wants to preserve. The local government or a civic-oriented nonprofit must own the property or have a clear path to obtaining site control (e.g., owner intends to sell or donate the property to the local government). In addition, **please provide the name of a local government staff member to serve as liaison to the students** who is accessible, enthusiastic, and in a position to help the assigned student team secure the information that is required for the analysis, such as land use and planning documents, building inspection records, and interviews with key stakeholders. Importantly, *the liaison must assist students with obtaining comprehensive tax parcel data and GIS shapefiles at the beginning of the semester*.

To apply for a student project to be performed in your community, fill out and return this form to Marcia Perritt (mperritt@sog.unc.edu) and/or Tyler Mulligan (mulligan@sog.unc.edu), **or submit this information online using the link on the CED Blog home page at ced.sog.unc.edu**. If you have questions, contact Marcia Perritt at (919) 538-1545.

1. **Local Government Liaison Name/Job Title**:
2. **City/County**:
3. **Tel**:
4. **Email**:
5. **Building/area targeted for redevelopment (e.g., historic theater, school, mill, etc.) and status of site control (e.g., local government has clear path to ownership/control of site)**:

6. **Redevelopment project summary and anticipated local government role** (up to 5-6 sentences to describe project, needs, and any special circumstances—feel free to provide maps or pictures to better convey project and make it more appealing to students):

Some Legal Provisions Related to Economic Development Incentives

A. Constitutional Limitations

1. Article I, section 32 of the state constitution provides that no person "is entitled to exclusive or separate emoluments or privileges from the community but in consideration of public services."

2. Article V, section 2(1) states that the power of taxation "shall be exercised in a just and equitable manner, for public purposes only . . . ."

3. Article V, sections 2(2) and 2(3) provide that only the General Assembly may classify or exempt property for property tax purposes, and the General Assembly must do so on a statewide basis.

4. Article V, section 4(3) prohibits any local government from "giving or lending its credit in aid of any person, association, or corporation," except for public purposes and with the approval of the voters. A loan of credit occurs whenever a local government guarantees the debts of another.

B. Local Development Act of 1925: G.S. 158-7.1 (with 2015 edits)

(a) "Each county and city … is authorized to make appropriations for economic development purposes. ~~aiding and encouraging the location of manufacturing enterprises … and locating industrial and commercial plants … or other purposes which, in the discretion of~~ Those appropriations must be determined by the governing body … to increase the population, taxable property, agricultural industries, employment, industrial output, ~~and~~ or business prospects of ~~any~~ the city or county."

(b) Cities and counties may [listing in (b) not to limit authority provided by (a) above]:

- Acquire and develop land for an industrial park
- Acquire, assemble, and hold for resale property that is suitable for industrial or commercial use
- Acquire options for … property that is suitable for industrial or commercial use
- Acquire, construct, convey, or lease a building suitable for industrial or commercial use
- Construct or extend … utilities to industrial property or facilities, public or private
- Engage in site preparation for industrial property or facilities, public or private
- Make grants or loans for the rehabilitation of commercial or noncommercial historic structures whether the structure is publicly or privately owned.

(c) Any appropriation or expenditure pursuant to this section … must be approved by the … governing body after a public hearing.

(d) A county or city may lease or convey interests in real property held or acquired pursuant to subsection (b) … by private negotiation and [subject to conditions]… after a public hearing. … The consideration for the conveyance may not be less than the [fair market value].

(d2) In arriving at the amount of consideration … the Board may take into account … prospective tax revenues or income … over the next 10 years as a result of the conveyance or lease provided:

1. the conveyance … will stimulate the local economy, promote business, and **result in the creation of a substantial number of jobs** … that pay at or above the median average wage….
2. contractually bind the purchaser of the property **to construct … improvements … that will generate the tax revenue taken into account** in arriving at the consideration….

(h) "Each economic development agreement … **shall [require] the recapture of sums** appropriated or expended by the city or county upon the occurrence of events specified in the agreement. Events that would require the city or county to recapture funds would include the **creation of fewer jobs** than specified in the agreement, a **lower capital investment** than specified in the agreement, and **failing to maintain operations** at a specified level for a period of time specified in the agreement."

C. Accounting for Economic Development Expenditures: G.S. 158-7.2

In the event funds appropriated for the purposes of this Article are turned over to any agency or organization other than the county or city for expenditure, no such expenditure shall be made until the county or city has approved the same, and all such expenditures shall be accounted for by the agency or organization at the end of the fiscal year for which they were appropriated.

D. Closed Sessions: G.S. 143-318.11

(a) Permitted Purposes. … A public body may hold a closed session and exclude the public only when a closed session is required…

(4) To discuss matters relating to the location or expansion of industries or other businesses in the area served by the public body, including agreement on a tentative list of economic development incentives that may be offered by the public body in negotiations. The action approving the signing of an economic development contract … authorizing the payment of economic development expenditures, shall be taken in an open session.

(5) To establish, or to instruct the public body's staff or negotiating agents concerning the position to be taken by or on behalf of the public body in negotiating (i) the price and other material terms of a contract or proposed contract for the acquisition of real property by purchase, option, exchange, or lease….

E. Public Records: G.S. Chapter 132

§ 132-1.11. Economic development incentives.

(a) Assumptions and Methodologies. … [W]henever a public agency … performs a cost-benefit analysis or similar assessment … the agency … must describe in detail the assumptions and methodologies used in completing the analysis or assessment. This description is a public record….

(b) Disclosure of Public Records Requirements. – Whenever an agency … first proposes, negotiates, or accepts an application for economic development incentives with respect to a specific industrial or business project, the agency or subdivision must disclose … laws regarding disclosure of public records. In addition, the agency or subdivision must fully and accurately describe the instances in which confidential information may be withheld from disclosure, the types of information that qualify as confidential information, and the methods for ensuring that confidential information is not disclosed.

§ 132-6. Inspection and examination of records.

(a) Every custodian of public records shall permit any record in the custodian's custody to be inspected and examined….

(d) … [P]ublic records relating to the proposed expansion or location of specific business or industrial projects may be withheld so long as their inspection … would frustrate the purpose for which such public records were created.… Once the provisions of this subsection no longer apply, the agency shall disclose as soon as practicable, and within 25 business days, public records requested for the announced project that are not otherwise made confidential by law….

What is "parallel" to *Maready v. Winston-Salem*?

Incentives must "primarily benefit the public" & ensure "net public benefit"

Allowable means for incentives	**Consideration** in exchange for incentives	**Procedural requirements** for approval of incentives
• "even the most innovative activities … are constitutional *so long as they primarily benefit the public* and not a private party." • "While private actors will necessarily benefit … [it] is merely incidental."	• "ensure a net public benefit" 1. Jobs for "displaced workers" 2. "better paying" jobs 3. Tax base (recoup incent. w/in "three to seven years") 4. Diversify the economy • Competition with "other states" (3X)	• "strict procedural requirements" prevent abuse • "Typical procedures" 1. Necessity ["but for"] determination 2. Written policy or guideline 3. Notice & hearing 4. Paid as reimbursement 5. Written agreement

"Strict Procedural Requirements" for Economic Development Incentives by Local Governments: G.S. Chapter 158 and *Maready v. City of Winston-Salem*

Every appropriation for economic development must be approved following a public hearing, properly noticed (G.S. 158-7.1(c)), and a determination by governing board that appropriation will "increase the population, taxable property, agricultural industries, employment, industrial output, or business prospects of the city or county" (G.S. 158-7.1(a)). Appropriations related to improving real property—*as virtually all economic development incentives to create jobs and increase the tax base are*—involve additional procedures described below.

Activity	Required Procedure	Citation
Initial disclosure re: confidential information and public records rules	Disclose public records rules upon "first" proposing, negotiating, or accepting application for incentives for a "specific industrial or business project"	G.S. 132-1.11(b)
Government acquisition and improvement of property	Notice and hearing prior to final approval of appropriation. *Notes:* *- Closed session allowed only for negotiation w/ specific business* *- Failure to provide notice and hold hearing means the property was acquired pursuant to G.S. 160A-457 or 153A-377, which require Article 12 competitive bidding procedures upon sale*	G.S. 158-7.1(b)(1)-(4), (c) G.S. 143-318.11(4) G.S. 160A-457/ 153A-377
Hold closed sessions to discuss business location matters and incentives	Closed session to "discuss" and develop "tentative list of economic development incentives"—final approval in open session	G.S. 143-318.11(a)(4)
Construction of improvements that government owns (NO SUBSIDY)	Notice and public hearing prior to final approval of appropriation	G.S. 158-7.1(b)(1), (5)-(8), (c)
Convey/lease interest in real property to private entity for fair market value (NO SUBSIDY) or make secured loan at market interest rate (NO SUBSIDY)	1. Issue notice of hearing in form required by G.S. 158-7.1(d) 2. Determine probable average hourly wage of workers on site 3. Determine fair market value of interest, subject to covenants and restrictions imposed by board 4. Hold public hearing prior to final approval	G.S. 158-7.1(b)(1)-(4), (d)
Provide *subsidy/incentive* (grant or loan) to induce business to create jobs and improve property to increase the tax base: - Construction of improvements owned by private entity to increase tax base - Convey/lease gov't interest in real property below fair market value	1. Issue notice of hearing in form required by G.S. 158-7.1(c) - (d) 2. Make necessity ["but for"] determination (competitive?) 3. Make G.S. 158-7.1(d2)(1) job creation and wage determination 4. Apply written policy to determine maximum incentive 5. Use reimbursements to comply with G.S. 158-7.2 accounting 6. Hold public hearing prior to final approval 7. Written agreement complies with G.S. 158-7.1(d2) and (h)	G.S. 158-7.1(b)(1)-(8), (d)-(d2), (h); G.S. 158-7.2; N.C. Constitution; and *Maready* "typical procedures" for incentives
Final approval of any incentive	Final approval "shall be taken in an open session." In addition, board must make G.S. 158-7.1(a) determination for appropriation.	G.S. 143-318.11(a)(4) G.S. 158-7.1(a)
Release public records	Public records exception expires following announcement	G.S. 132-6(d)

STATUTORY AUTHORITY FOR CONVEYING REAL PROPERTY TO PRIVATE ENTITY

North Carolina law requires *real* property be disposed *without conditions on buyers* through one of three competitive bidding procedures—Sealed Bid (G.S. 160A-268), Upset Bid (G.S. 160A-269), or Public Auction (G.S. 160A-270)—*unless another method of conveyance is specifically authorized*.

Authority for Conveyance	Competitive Bidding Sale	Private Sale for *Fair Market Value*	Private Sale - *Non-Monetary Consideration*	Allowable Covenants/ Conditions	Notes
Economic Development G.S. 158-7.1	✓	✓	✓	Construct w/in 5 yrs or reverts to local gov't, plus any other desired conditions	G.S. 158-7.1(d2) allows next 10 years of local government revenue to count as consideration if purchaser creates "substantial number of jobs" paying above average wage and comply with *Maready*.
Urban Redevelopment Law G.S. 160A-514(c) Boards exercise powers directly: G.S. 160A-456, G.S. 153A-376	✓			In URA consistent with approved plan, as Redev. Comm'n deems necessary	Within formally designated urban redevelopment area (URA) consistent with redev plan; conveyance must comply with Art. 12 competitive bidding procedures.
Disposition for redevelopment by private developer G.S. 160A-457 (cities) G.S. 153A-377 (counties)	✓	(cities only, in CD area only, in accord with CD plan)		Only cities in CD areas in accord with CD plan; any unit may in URA, G.S. 160A-514	Acquire/convey blighted or inappropriately developed property. Cities: private sale only in commun. develop. (CD) areas (to remove blight or assist low-income), price no less than "appraised value."
Housing Authorities Law G.S. 157-9 Boards exercise powers directly: G.S. 160A-456, G.S. 153A-376	✓	✓	✓	Covenants and restrictions to ensure housing serves LMI persons	Exempt from disposition rules, but disposal must fit within statutory authority and serve constitutional public purpose (housing project for low and moderate income (LMI) persons, G.S. 157-3(12) and 157-9.4).
Conveyance to Historic Preservation Organizations G.S. 160A-266(b)	✓	✓		Historic covenants, limits on further sale	Historic covenants affect appraised value, but does not allow for conveyance for less than appraised. Also G.S. 160A-400.8.
Conveyance to Entities Carrying Out Public Purpose G.S. 160A-279 (cities and counties only)	✓	✓	✓	Ensure *recipient* puts property to public use, no subsequent sale	City or county must be authorized to appropriate funds to entity. No conveyance to a for-profit corporation.
Downtown Dev Projects (DDP) G.S. 160A-458.3 **P3 for construction** G.S. 143-128.1C	✓	✓		Any	Public facility part of private development. Private sale if public facility <50% total project cost/financ. P3: Must use RFQ.

CED in NC Blog: When May NC Local Governments Pay an Economic Development Incentive?

By Tyler Mulligan

Article: https://ced.sog.unc.edu/when-may-nc-local-governments-pay-an-economic-development-incentive/

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News outlets regularly report about the latest company that was lured to North Carolina through the payment of a cash economic development incentive by a local government and the state. Local government cash incentives often take the form of an annual cash payment to a company that is contingent on the company's creation of jobs, investment in taxable property in the jurisdiction, and timely payment of property taxes, among other conditions. The statutory authority for making the incentive payment is supplied by G.S. 158-7.1, and the local government is required to approve and account for how the incentive payment is expended by the recipient company pursuant to G.S. 158-7.2. The accounting of payments is accomplished through an incentive agreement in which the recipient company agrees, typically, to create jobs at a facility that involves leasing or purchasing land, constructing a building, and/or installing equipment in the jurisdiction.

For most of the last century, however, North Carolina local governments were not permitted to make such incentive payments. It wasn't until 1996, following the loss of economic development projects to other states, that the North Carolina Supreme Court finally decided that economic development incentives serve a constitutionally-permitted public purpose—*under certain conditions*. These conditions continue to impose limitations on incentives today, so this post reviews the relevant limitations and summarizes the conclusions of a 2013 North Carolina Law Review article entitled, *Economic Development Incentives and North Carolina Local Governments: A Framework for Analysis*.

NC Constitution: Exclusive Emoluments and Public Purpose

As a threshold matter, local governments are not permitted to provide "exclusive emoluments"—in other words, gifts of public property—to private entities (Section 32 of Article I of the North Carolina Constitution). Exclusive emoluments are permitted only "in consideration of public services." That is, the public must get something in return—known as "consideration" in contract law—for a payment to a private entity. A separate set of constitutional provisions requires that expenditures by local governments and contractual payments to private entities must serve a public purpose (Section 2 of Article V of the North Carolina Constitution). As long as a payment or expenditure serves a valid public purpose, it not only satisfies the constitutional provisions regarding public purpose, but also the exclusive emoluments provision as well. The courts alone—not the legislature, not statutes—decide what is a valid public purpose under the constitution.

G.S. 158-7.1: Broad Statutory Language and Procedural Requirements

Local governments may act only pursuant to statutory authority. In the economic development context, statutory authority for offering incentive payments to companies is found within the remarkably broad language of the Local Development Act of 1925 (G.S. 158-7.1 et seq.). When local governments make economic development expenditures involving the purchase or improvement of property (G.S. 158-7.1(b)), strict procedural requirements are imposed by statute, such as notice and hearing requirements (G.S. 158-7.1(c)). When a local government turns funds over to a company for expenditure (such as an incentive payment), those same procedural requirements are imposed. Additionally, the

expenditures must be approved and accounted by the local government (G.S. 158-7.2) and the funds made subject to recapture in an incentive agreement (G.S. 158-7.1(h)). If the local government turns funds over to a company for the purchase or improvement of property, and the company keeps the property rather than returning the local government's interest, then this is the economic equivalent of transferring the local government's interest in property to the company, and additional requirements are imposed regarding job creation and wages (G.S. 158-7.1(d)-(d2)). Professor David Lawrence makes this "economic equivalent" argument on p. 107 of his text on economic development law.

The restrictions imposed by statute, however, are not the final word. Economic development incentives involve payments of *public* funds to *private* entities in service of a mix of public and private purposes, thereby colliding with the constitutional provisions regarding exclusive emoluments and public purpose. This makes economic development different from other *purely public* activities of local governments and results in far more constitutional scrutiny from the courts. For this reason, the statute alone cannot be our guide—it is necessary to look closely at case law to determine the extent of a local government's authority to offer economic development incentives.

Case Law on Economic Development Incentives:*Maready* and Progeny

If we assume that a local government has adequate statutory authority for offering a particular incentive (an assumption that in practice should not be taken lightly), how do we determine whether it also serves a public purpose and avoids running afoul of the state constitution? The answer is found in the seminal case on economic development incentives, *Maready v. City of Winston-Salem*, 342 N.C. 708, 467 S.E.2d 615 (1996), and in subsequent cases decided by the North Carolina Court of Appeals. Those cases examined dozens of economic development incentives provided by local governments to private companies pursuant to G.S. 158-7.1. In *Maready*, the court opined that economic development incentives authorized by G.S. 158-7.1 are constitutional "so long as they primarily benefit the public and not a private party." The requisite "net public benefit," according to the court, is generated by providing jobs, increasing the tax base, and diversifying the economy. Furthermore, the court was comforted by the "strict procedural requirements" of G.S. 158-7.1. As pointed out in the law review article, the court essentially assumed that cash payments to companies for the purchase or improvement of property were subject to the same procedural requirements as if the local government engaged in those activities directly (supporting the economic equivalent argument).

Additionally, the incentives in *Maready* are particularly important, because in subsequent cases at the North Carolina Court of Appeals, the court has refused to strike down incentives that are "parallel" to those approved in *Maready.* As described in the law review article, the key characteristics of the *Maready* incentives can be summarized as follows:

Consideration Obtained by Local Government in Exchange for Incentive

- *Job creation*: Every incentive approved by *Maready* and subsequent cases involved the creation of a substantial number of permanent jobs. Additionally, cases outside of North Carolina, on which the *Maready* court explicitly relied, referred to job creation more than any other factor as a basis for finding that incentives serve a public purpose.
- *Increasing the tax base*: Every incentive in *Maready* was designed such that the increase in the tax base and resultant tax revenue would pay for the incentive within three to seven years.

Procedural Requirements for Approval of Incentives

- An initial "but for" or necessity determination is made that the incentive is required for a project to go forward, typically in a competitive situation.
- A written guideline or policy is applied to determine the maximum amount of incentive that can be given to the receiving company.
- Expenditures take the form of reimbursements, not unrestricted cash payments.
- Final approval is made at a public meeting, properly noticed.
- A written agreement governs implementation.

Secondary Characteristics

- *Diversifying the economy*: The *Maready* court listed diversification of the economy alongside job creation and increasing the tax base as an indicator of "net public benefit" arising from an incentive, and subsequent case law

has included this factor in its public purpose analysis, but no further elaboration of the term's meaning has been supplied. The absence of further explanation makes it difficult to determine the relative importance of this factor. In cases outside of North Carolina on which the *Maready* court explicitly relied, "diversification of the economy" has referred to significant impacts on sectors of the economy, such as locating an advanced automobile manufacturing plant, or improving the state's aviation system, or making a port more attractive to seaborne commerce.

- *Winning an interstate competition*: A driving force behind the *Maready* decision was the sense that, without incentives, job-creating facilities would be "lost to other states." The court openly fretted about "the actions of other states" and "inducements … offered in other jurisdictions." There was, therefore, an underlying assumption that all of the incentives in *Maready* involved interstate competition. The North Carolina Court of Appeals was asked to assess the importance of interstate competition directly in the 2010 case, *Haugh v. County of Durham*, but the court was not forced to decide the issue for reasons explained in my law review article and this blog post about interstate competition. Interstate competition has been taken seriously by the courts, but the lack of specific guidance in the statutes or case law relegates this factor to a secondary characteristic.

Conclusion

We know that the North Carolina Court of Appeals will uphold incentives that are "parallel" to the incentives approved in *Maready.* At a minimum, this involves following the strict procedural requirements described above and ensuring that incentives attain adequate jobs and increase the tax base. A conservative approach would also ensure that the secondary characteristics—diversification of the economy and interstate competition—are present. The *Maready* case represents an expansion of public purpose into an area that has long been off-limits in North Carolina, so incentives venturing beyond the boundaries of *Maready* would invite a new assessment by the courts as to public purpose.

For projects that do not offer sufficient jobs or other forms of consideration mentioned above, there may be alternative sources of statutory authority in pursuit of different public purposes. Alternatives are explored in the law review article and in blog posts here and here.

Links

- www.ncga.state.nc.us/EnactedLegislation/Statutes/HTML/ByChapter/Chapter_158.html
- scholarship.law.unc.edu/nclr/vol91/iss6/5/
- www.ncga.state.nc.us/legislation/constitution/ncconstitution.html
- shopping.netsuite.com/s.nl/c.433425/it.A/id.4135/.f

CED in NC Blog: Notice and Hearing Requirements for Economic Development Appropriations

By Tyler Mulligan

Article: http://ced.sog.unc.edu/notice-and-hearing-requirements-for-economic-development-appropriations/

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As discussed in a prior post, Session Law 2015-277 requires North Carolina local governments to issue notice and hold a public hearing prior to approval of *any appropriation* for economic development pursuant to North Carolina General Statutes Chapter 158, Article 1, "The Local Development Act of 1925." Local governments have held public hearings pursuant to that act for decades, but previously such hearings were required only when an economic development appropriation was related to real property or to an incentive payment for a private business. Now local governments must issue notice and hold a public hearing prior to approving *any* appropriation for economic development—even when the appropriation has nothing to do with incentives or real property. In fact, the bill summary written by legislative staff states "The bill standardizes the treatment of appropriations for economic development by: Making all appropriations subject to the public hearing requirement of G.S. 158-7.1(c)." Unfortunately, S.L. 2015-277 provides no guidance on the form of notice for the new set of required hearings. This post proposes a framework for understanding and complying with the old and new notice and hearing requirements under G.S. 158-7.1.

A Framework for Notice and Hearing Requirements for Economic Development Appropriations

The revised notice and hearing requirements for economic development appropriations can be understood using a basic two-step framework. The two-step framework will first be described, and then a more detailed explanation of the component steps will be provided.

STEP 1: Is the appropriation most correctly described as being "for economic development purposes?"

- **If yes**, then hold a public hearing at least 10 days after publishing notice of hearing **as described in STEP 2 below**.
- **If some other statute is more appropriate**, then follow the procedures directed by that other statute.

STEP 2: What is the nature of the economic development appropriation?

- **If the appropriation is for an activity related to real property or for a business location incentive**, then publish a notice of hearing as prescribed by G.S. 158-7.1(c) or (d) that describes the specific property-related activities being undertaken by the local government or the subsidized activities being undertaken by the induced business, and hold a public hearing prior to approval of the appropriation. The governing board must determine that the appropriation will "increase the population, taxable property, agricultural industries, employment, industrial output, or business prospects of the city or county."
- **If the appropriation is for some other economic development purpose**, then publish a notice of hearing describing the general nature of the appropriation and hold a public hearing prior to approval of the appropriation. The governing board must determine that the appropriation will "increase the population, taxable property, agricultural industries, employment, industrial output, or business prospects of the city or county."

What are "appropriations for economic development purposes?"

G.S. 158-7.1(a) authorizes local governments "to make appropriations for economic development purposes." As explained in a prior post, the term "economic development" is a general term imbued with little specific meaning. The term encompasses activities ranging from workforce training, to marketing the local jurisdiction in trade publications, to hiring a staff of development professionals, to constructing shell buildings in industrial parks. The statute requires a governing board to determine that each appropriation will, at a minimum, "increase the population, taxable property, agricultural industries, employment, industrial output, or business prospects of the city or county." Unfortunately, this broad language offers little help in determining what is or is not an economic development appropriation. Case law provides no assistance either. The North Carolina Supreme Court, in the seminal economic development case, *Maready v. City of Winston-Salem* , 342 N.C. 708 (1996), looked at essentially the same language in an earlier version of the statute and dismissed it as being merely the "self-proclaimed end" of the statute.

We must therefore conclude that the General Assembly intended for the term "economic development" to remain ambiguous and general in nature. This has an important implication for determining when an appropriation is "for economic development purposes." The North Carolina Supreme Court has stated, "When two statutes apparently overlap, it is well established that the statute special and particular shall control over the statute general in nature, even if the general statute is more recent, unless it clearly appears that the legislature intended the general statute to control." *Trustees of Rowan Tech. Coll. v. J. Hyatt Hammond Associates, Inc.*, 313 N.C. 230, 238 (1985).

The economic development statute, being "general in nature," therefore will not control when other statutes overlap, such as urban redevelopment law (G.S. Chapter 160A, Article 22), community development programs and activities (G.S. 153A-376, G.S. 160A-456), downtown revitalization districts (G.S. 160A-536), acquisition and disposition for redevelopment (G.S. 153A-377, G.S. 160A-457), and historic preservation (G.S. 160A-400.1 *et seq*.). Thus, when a local government appropriates funds for purposes described by those other statutes, the activity arguably is not "for economic development purposes" and the notice and hearing requirements of G.S. 158-7.1 will not apply unless the local government specifically elects to appropriate funds pursuant to G.S. 158-7.1.

Once it has been determined that a local government intends to appropriate funds "for economic development purposes," G.S. 158-7.1 requires the local government to publish notice and hold a public hearing prior to approving the appropriation. The notice must be published in a publication meeting the standard set forth in **G.S. 1-597** and **G.S. 1-599.** The specific information to be provided in the published notice is determined through the second step of the two-step framework: What is the nature of the economic development appropriation? If the appropriation is made for an activity related to real property or for a business location incentive, then very particular information must be included in the notice of hearing as prescribed by G.S. 158-7.1(c) and (d). Accordingly, it is necessary to explore when an appropriation is made for those purposes.

When is an economic development appropriation related to real property or for a business location incentive?

Determining when an appropriation is related to real property or a business location incentive is not as simple as it may first appear, primarily because there is case law involved. As background, certain kinds of economic development appropriations have long been subject to specific notice and hearing requirements pursuant to G.S. 158-7.1(c) and (d). Before 2015, subsection (c) read as follows: "Any appropriation or expenditure *pursuant to subsection (b)* of [G.S. 158-7.1] must be approved by the county or city governing body after a public hearing." (S.L. 2015-277 removed the reference to subsection (b), thereby making all economic development appropriations subject to the notice and hearing requirement.) Subsection (d) imposes a notice and hearing requirement for conveyance of property held or acquired *pursuant to subsection (b)*.

The explicit references to subsection (b) were important: the original notice and hearing requirements applied *only to subsection (b) activities*, all of which pertain to acquiring, improving, or conveying real property. Examples of those enumerated subsection (b) activities include developing an industrial park, acquiring and holding commercial property for resale, constructing industrial shell buildings, extending utilities, and conducting site preparation for industrial development (and more recently, rehabilitating historic structures). Thus, the statute was unambiguous in instances when a local government engaged *directly* in subsection (b)'s enumerated activities: the local government was required to publish notice and hold a public hearing prior to approving the appropriation.

The same result would occur whenever a local government engaged in those property-related activities *indirectly* by appropriating funds to induce a *private business* to engage in those activities. As a general rule, *this meant that all business location incentives were subject to the notice and hearing requirement.*

The logic was straight forward. G.S. 158-7.2 requires a local government to approve and account for all expenditures of its economic development funds by another entity. Incentives can only be paid lawfully to a business when that business promises to create jobs and increase the property tax base (as explained in this blog post), and essentially the only way for a business to accomplish that end is by making taxable improvements to real property. Further, the payment of a business location incentive is essentially the same as acquiring an interest in the business' property and then conveying that interest to the business for less than fair market value, mandating adherence with subsection (d) and subsection (d2) procedural requirements. (As explained in this prior post, Professor David Lawrence refers to this as the "economic equivalent" of engaging in those activities directly on page 107 of his book on economic development law.)

Even installation of machinery or related equipment, typically classified as personal property, involves improvements to real property to accommodate the equipment, particularly when the installation is significant enough to warrant a competitive business location incentive. Thus, paying a business location incentive is essentially the same as engaging in property-related activities directly, thereby implicating the notice and hearing requirements of subsections (c) and (d).

Furthermore, the notice and hearing for business location incentives was imbued with constitutional significance in *Maready*. The *Maready* court reviewed 24 cash incentives offered to private companies by the City of Winston-Salem and Forsyth County. All of the incentives were paid in cash, so the local governments did not engage *directly* in any of the real estate development activities of subsection (b). Nonetheless, the *Maready* trial court (quoted approvingly by the supreme court) specifically found that incentives "made pursuant to the provisions of N.C.G.S. 158-7.1(b) through (f) were approved … following publication of a notice of a public hearing … as provided in said statute." Thus, the local governments were following all of the procedural requirements as if cash business location incentives were the same as engaging in property related activities directly. The fact that all of the incentives took the form of cash payments was irrelevant in the court's view. And the court went further, stating that adherence to those "strict procedural requirements" was part of the constitutional public purpose rationale for incentives. As a result, local governments have long published notice and held a public hearing prior to approving any business location incentive.

Enactment of S.L. 2015-277 does not change this constitutional imperative. Local governments are advised to continue the practice of publishing notice and holding hearings pursuant to subsections (c) and (d) for all business location incentives as if they were engaging in property-related activities directly. The constitutional public purpose analysis of the court remains in effect regardless of how the underlying statute is modified by the General Assembly.

Accordingly, appropriations for activities related to real property (whether or not connected to a business location incentive), as well as appropriations for any lawful business location incentive, involve subsection (b) activities that require notice and hearing under subsection (c) or (d). The specific information to provide in a compliant subsection (c) or (d) notice of hearing is described in the next section.

What information must be included in the notice of hearing for an appropriation related to real property or a business location incentive?

G.S. 158-7.1(c) and (d) require publication of a notice of hearing at least 10 days prior to the hearing. The information to publish in the notice is determined according to the activity being funded.

For an activity involving acquisition of an interest in real property (or the economic equivalent), the notice shall describe:

- interest to be acquired
- the proposed acquisition cost of such interest
- the governing body's intention to approve the acquisition
- the source of funding for the acquisition
- and *such other information needed to reasonably describe the acquisition*.

For an activity involving the improvement of privately owned property (or the economic equivalent) by site preparation or by the extension of water and sewer lines to the property, the notice shall describe:

- the improvements to be made
- the proposed cost of making the improvements
- the source of funding for the improvements
- the public benefit to be derived from making the improvements
- and *any other information needed to reasonably describe the improvements and their purpose*.

For an activity involving the lease or conveyance of real property (or the economic equivalent), the notice shall describe:

- the interest to be conveyed or leased
- the value of the interest
- the proposed consideration for the conveyance or lease,
- and the governing body's intention to approve the conveyance or lease.

Sometimes a business location incentive does not fit neatly within one of the categories above. A notice of hearing should nevertheless be published to remain consistent with the "strict procedural requirements" that factored into the court's public purpose rationale in *Maready*. There are several common elements in the above notice provisions that should be included in any notice of public hearing for business location incentives that don't otherwise appear to fit:

- **a description of the incentives to be granted and their value**
    - *consistent with: G.S. 158-7.1(c) notice shall describe "interest to be acquired" and "the proposed acquisition cost"; "improvements to be made" and the "proposed cost of making the improvements" and G.S. 158-7.1(d) notice shall describe "interest to be conveyed or leased" and "value of the interest"*
- **the public benefit or consideration to be derived from granting the incentives**
    - *consistent with: G.S. 158-7.1(c) notice shall describe "public benefit to be derived from making the improvements" and G.S. 158-7.1(d) notice shall describe "proposed consideration for the conveyance or lease"*
- **and such other information needed "to reasonably describe" the incentives.**
    - *consistent with: G.S. 158-7.1(c) notice shall describe "such other information needed to reasonably describe the acquisition" and "any other information needed to reasonably describe the improvements and their purpose"*

[NOTE: Business location incentive agreements often involve multiple appropriations over a span of years. A single notice and hearing prior to approving a multi-year incentive agreement can satisfy the G.S. 158-7.1 requirement for all subsequent appropriations pursuant to the agreement, provided the initial notice adequately describes the future appropriations and their purpose and they are not later modified in a material way after the public hearing.]

Experienced local government officials will recognize immediately that they have been following the procedures above for years. Nothing discussed above is new. However, S.L. 2015-277 expanded the notice and hearing requirement further such that all appropriations—even those that have nothing to do with real property or business location incentives—may be approved only after issuing notice and holding a public hearing. The requirements for those appropriations are discussed in the next section.

What procedures should be followed for other economic development appropriations that are<u>not</u> related to real property or business location incentives?

Local governments regularly appropriate funds for economic development activities that have nothing to do with real property or incentives. For example, local governments may appropriate funds to pay for an advertisement about the local business environment, to hire professional economic development staff, or to contract with the local Chamber of Commerce for networking and small business support services. Prior to 2015, there was no statutory imperative to hold a public hearing prior to approving such appropriations. As already noted, however, S.L. 2015-277 altered the statute to require a local government to hold a properly-noticed public hearing for *every appropriation* under the statute—regardless of whether or not it is connected to an incentive or improving real property.

Unfortunately, the statute provides no guidance on the form of notice for these miscellaneous appropriations. The statute requires notice and a public hearing prior to approving "any appropriation or expenditure pursuant to [G.S. 158-7.1]." Each appropriation or expenditure should be "reasonably" described—as opposed to merely declaring that a single lump sum will be appropriated for "economic development purposes" without further elaboration—for two reasons. First, the fact that the statute imposes the notice and hearing requirement for "*any* appropriation or expenditure" suggests that each appropriation or expenditure is individually subject to the requirement and must demonstrate compliance. Second, the new notice and hearing requirement is derived directly from the original statutory language, which has always required the notice "to reasonably describe" the activity being funded. In the absence of further guidance, however, presumably local governments may simply describe the activity to be funded in general terms, such as "$30,000 for small business support services."

Likewise, a single appropriation to a third party, such as Chamber of Commerce or a nonprofit economic development corporation (EDC), that contemplates expenditures for multiple activities, probably cannot be described merely by reference to the recipient entity, such as "$50,000 for nonprofit EDC." It is probably necessary for the notice to describe the activities to be performed by the third party. Keep in mind that G.S. 158-7.2 requires a local government to approve and account for all expenditures by a third party pursuant to G.S. 158-7.1. The mandatory G.S. 158-7.2 approval of expenditures by third parties, when coupled with the new G.S. 158-7.1 notice and hearing requirement, suggests that the notice should, at a minimum, describe the general nature of each activity to be funded.

Does the notice and hearing for the annual budget approval process meet the G.S. 158-7.1 notice requirements?

Prior to approving an annual budget, The Local Government Budget and Fiscal Control Act, **G.S. Chapter 159, Article 3**, requires a local government to provide notice to the public of its proposed budget and to hold a public hearing on the budget. Can the notice and hearing for the budget ordinance satisfy the notice and hearing requirement for G.S. 158-7.1? The answer is "probably not" for appropriations related to real property or business incentives, unless all of the required information is available for the budget approval process. However, it might be possible for other miscellaneous economic development appropriations, with some important caveats. Those caveats are discussed below.

The notice and hearing for G.S. 158-7.1 can probably be executed *in parallel* to the budget approval process, but public officials must be aware that the budget approval process (see Kara Millonzi's blog post on the process) does not automatically comply with the requirements of G.S. 158-7.1. First, the minimum notice requirements of the budget approval process do not precisely match the notice requirements of G.S. 158-7.1, which requires that notice be provided at least 10 days prior to the public hearing. Second, a budget ordinance is a summary document and does not incorporate specific line-item expenditures, so it may not provide an adequate description of the economic development activities to be funded. Third, under the budget approval process, the budget ordinance may be modified by the governing board following notice to the public, which means that an economic development appropriation might inadvertently be added to the budget or increased without complying with the notice provisions of G.S. 158-7.1. Economic development appropriations, due to the strict notice requirements and constitutional implications of following the procedures, should not exceed the amount listed in the notice—otherwise a new notice and public hearing is required for the excess amount.

Due the fact that the two approval processes are not identical, local governments are advised to keep the processes separate even if they run them in parallel. Publish a separate notice for economic development appropriations, even if it is published at the same time as the notice for the annual budget. Additionally, if the board holds the public hearing for the annual budget and the public hearing for economic development appropriations at the same meeting, be sure to separate the two hearings procedurally by closing the budget hearing before opening the hearing for economic development

appropriations. Public officials will need to use care when attempting to run these two approval processes in parallel to ensure that any modifications to the budget do not run afoul of the procedural requirements of G.S. 158-7.1.

Links

- www.ncga.state.nc.us/Sessions/2015/Bills/Senate/PDF/S472v3.pdf
- www.ncga.state.nc.us/EnactedLegislation/Statutes/HTML/ByChapter/Chapter_158.html
- ncleg.net/Applications/Dashboard/Chamber/Services/BillSummary.aspx?sSessionCode=2015&sBarcode=S472-SMTM-96%28e1%29
- www.ncga.state.nc.us/EnactedLegislation/Statutes/HTML/ByArticle/Chapter_160A/Article_22.html
- www.ncga.state.nc.us/EnactedLegislation/Statutes/HTML/BySection/Chapter_153A/GS_153A-376.html
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- shopping.netsuite.com/s.nl/c.433425/it.A/id.4135/.f
- www.ncleg.net/EnactedLegislation/Statutes/HTML/ByArticle/Chapter_159/Article_3.html
- canons.sog.unc.edu/?p=8103

Coates' Canons Blog: Conveyance of Local Government Property to Nonprofit EDC for Industrial Park

By Tyler Mulligan

Article: http://canons.sog.unc.edu/?p=8037

This entry was posted on March 17, 2015 and is filed under Development Finance, Development Finance, Disposal Of Property / Surplus Property, Economic Development

Ray Kinsella leads the nonprofit economic development corporation (the "EDC") that was jointly formed by the county and its largest city in the early 2000s, and that is now governed by an independent board of directors. Ray has heard some optimistic forecasts of "re-shoring" of manufacturing facilities to the United States, and he has a plan to take advantage of the possible trend. He proposes for the EDC to build a new industrial park with the help of the county and city. Upon completion of the park, Ray believes the available land with new infrastructure will attract manufacturing facilities to the local area.

The EDC hasn't amassed enough privately-raised capital to undertake the project on its own, and private developers and investors don't have an appetite for the project, so Ray's plan depends on direct local government support. Ray proposes for the county to contribute the land for the park by conveying a 500-acre tract of land, which the county already owns, to the EDC *for one dollar*. The tract lies outside of city limits, but Ray thinks he can convince the city to provide water and sewer. Ray plans to market the tract to manufacturing companies, and when a company decides to locate in the park, the EDC will sell the required land to the company. Ray hopes the EDC can keep the proceeds from any sale, and then the EDC would use those retained proceeds for future economic development activities.

Is the EDC's proposed structure allowable? In a word, no. Specifically, the property conveyances are problematic unless subject to very specific conditions, and the EDC cannot retain the proceeds from the sale of county land to businesses. This post describes some of the legal issues involved with the EDC's proposal and explains how the EDC and the county can execute the project lawfully.

General background on disposal of local government property for economic development

As explained in a prior post, we start with the general rule that, unless an exception is authorized by statute, North Carolina local governments *are required* to dispose of real property through competitive bidding procedures: sealed bid (G.S. 160A-268), upset bid (G.S. 160A-269), or public auction (G.S. 160A-270). In addition, case law generally prohibits local governments from placing conditions on conveyances of property that will depress the price that a buyer would pay (*Puett v. Gaston County*).

Economic development, however, is an exception to those general rules. So long as certain public benefits are secured, G.S. 158-7.1(d) permits local governments to convey property for commercial or industrial use at *private sale* (see G.S. 160A-267), meaning the local government may select the buyer of its choice without undergoing a public bidding process. Furthermore, G.S. 158-7.1(d) permits the local government to impose covenants and restrictions on the conveyance in order to secure the public benefits required by the statute, such as job creation and increasing the tax base.

The authority to convey property by private sale does not mean that the property can be given away for one dollar. In fact, G.S. 158-7.1(d) states that the price paid by businesses for land "may not be less than" the "fair market value" of the property. In addition, there is a constitutional requirement to consider: gifts of public money or assets are not permitted under Article 1, Section 32 of the North Carolina Constitution (for further legal analysis of that constitutional provision, see a blog post on the topic by my colleague Frayda Bluestein).

Disposal for less than fair market value

In rare instances, some statutes permit a local government to sell property for less than fair market value, provided some other lawful form of consideration or "payment" is provided. In the economic development context, G.S. 158-7.1(d2) allows "prospective tax revenues or income" coming to the local government "over the next 10 years as a result of the conveyance" to be counted toward the payment for the land. However, prospective tax revenues alone *are not sufficient*. Other public benefits must be secured as well, such as the creation of a "substantial number of jobs" that pay at least the average wage in the county. The statute also requires local governments to "contractually bind the purchaser" to construct improvements within five years that will generate the tax revenue that was counted toward the company's payment.

In addition, when economic development property is sold to a private entity for less than fair market value, the government-subsidized sale amounts to an economic development incentive—a transfer of public funds over to a private company—which triggers constitutional public purpose concerns. For most of the last century, North Carolina courts held that such incentives were not permitted, because they violated the state constitution's public purpose clause. It wasn't until 1996, following the loss of economic development projects to other states, that the North Carolina Supreme Court finally decided in *Maready v. City of Winston-Salem* that economic development incentives serve a constitutionally-permitted public purpose—*under certain conditions*.

The conditions under which incentives are permitted are described in more detail in a separate blog post, When May NC Local Governments Pay an Economic Development Incentive? To boil it down, *Maready* approved incentives that adhered to the "strict procedural requirements" of G.S. 158-7.1 and that obtained the following public benefits: (1) substantial job creation, (2) new tax revenue that paid back the incentive within 3-7 years, and (3) the incentive was "necessary" to cause the company to locate in the jurisdiction (to prevent it from being "lost to other states"). Lower courts have stated that they will uphold incentives that are "parallel" to the incentives approved in *Maready*.

Evaluating the subsidized conveyance by the county to the EDC

Returning to the EDC scenario, Ray's proposed price of one dollar for 500 acres is certainly below fair market value. Can the property be conveyed to the EDC at that price? Not likely. There are two possible sources of statutory authority for a below-market sale to the EDC. Each will be evaluated and ultimately rejected.

1. Conveyance for economic development (G.S. 158-7.1)

   As already explained above, subsection (d2) of G.S. 158-7.1 specifically permits a local government to convey land at a price below fair market value, provided the conveyance will "result in the creation of a substantial number of jobs in the county" and the local government "contractually bind[s] *the purchaser*" to construct improvements within five years that will generate sufficient tax revenue to make up the difference between fair market value and the subsidized price. Any related land purchase contract would also trigger G.S. 158-7.1(h), which requires economic development agreements to include recapture provisions in case the company fails to create the promised jobs, fails to make the promised capital investment, or fails to maintain operations for a specified period of time.

With that background, it becomes clear that there are at least three problems with using G.S. 158-7.1 for the proposed conveyance.

First, the EDC, as the purchaser, cannot be "contractually bound" to construct improvements to generate tax revenue, because it has no intention of constructing those improvements itself. Rather, the EDC plans to sell the land to businesses, and those businesses are supposed to construct the improvements. But even if we assume that the EDC is prepared to make a capital investment itself, the EDC is a nonprofit and might not generate any (or enough) property tax revenue to pay back the incentive. The most the EDC could promise is that it will use best efforts to find a business to purchase the land and construct improvements—but best efforts do not satisfy subsection (d2)'s job creation and tax revenue standards.

Second, subsection (h) recapture requirements related to job creation, capital investment, and maintaining operations, pose a problem. A purchase contract for conveyance of land to the EDC for less than fair market value would be an economic development agreement for purposes of subsection (h) and would therefore need to contain the enumerated recapture provisions. However, in this scenario, the EDC cannot make promises related to job creation and capital investment, because the EDC has no way of knowing whether and how much job creation and capital investment will be generated in the park, nor can the EDC make promises pertaining to maintaining business operations related to those jobs and investments.

Third, a conveyance for less than fair market value would amount to an incentive for the EDC and therefore would fall within the purview of the NC Supreme Court's analysis in *Maready* (discussed previously). As already explained, courts will uphold incentives that are "parallel" to the incentives approved in *Maready*, but the EDC's transaction doesn't fit the *Maready* model. Not only is the EDC unable to promise to create the jobs and tax-generating investment that were promised by the companies receiving incentives in *Maready*, but also the incentive to the EDC is not "necessary" to attract the EDC to the county—there is no competition with other jurisdictions for the EDC to locate at the site.

Accordingly, the EDC cannot rely on G.S. 158-7.1 as authority for its proposed transaction.

2. Conveyance to entities carrying out a public purpose (G.S. 160A-279)

Whenever a local government is permitted to appropriate funds to a not-for-profit entity for carrying out a public purpose, G.S. 160A-279 permits the local government to convey property to that entity "in lieu of or in addition to the appropriation of funds." In other words, the local government may make a conveyance of property for less than fair market value just as it would make an appropriation through its general fund. The statute requires the conveyance to be subject to covenants ensuring that the property will be "put to a public use *by the recipient entity.*" In the EDC scenario, the EDC is a nonprofit entity working on behalf of the county, but this particular statute does not work for the EDC's proposal for two reasons.

First, although the EDC will initially own the property and put it to a public use by creating an industrial park as authorized under G.S. 158-7.1(b)(1), the EDC intends to sell the property to private for-profit companies. Such a use is specifically prohibited by G.S. 160A-279, which states that "no such conveyance may be made to a for-profit corporation." The EDC cannot get around this requirement—if local governments could simply pass property through a nonprofit in order to sell it to a for-profit at a discount, it would elevate form over substance and evade the clear intent of the property disposition statutes.

Second, a G.S. 160A-279 conveyance must attach covenants or restrictions to ensure the property will be "put to a public use *by the recipient entity*." The EDC is "the recipient entity," but the EDC does not intend to retain the property. Therefore, if the county were to proceed to convey the property to the EDC under G.S. 160A-279, then at the time the EDC attempted to sell the property to a business, the covenants would be activated and would likely lead to a reversion of the property back to the county. Bottom line: The county, not the EDC, would handle the ultimate sale to a company and would retain any proceeds from the sale.

In summary, the statutory and constitutional limitations make it difficult or impossible to execute the transaction as proposed by the EDC.

Can a local government just give cash to the EDC to purchase the property?

After the county rejected the EDC's proposal, Ray went to the city instead. He proposed for the city to make a cash grant to the EDC in an amount sufficient for the EDC to purchase a similar tract in another location. Ray hopes that this will get around all of the G.S. 158-7.1 requirements, because he hopes the city can simply appropriate funds to the EDC for economic development and allow the EDC to decide how to spend those funds. Is Ray's proposition to the city permitted under the law? The answer is no.

The explanation begins with G.S. 158-7.2, which states that whenever appropriated economic development funds "are turned over to any agency or organization other than the county or city for expenditure, no such expenditure shall be made until the county or city has approved the same, and all such expenditures shall be accounted for … at the end of the fiscal year." This requirement applies to the EDC, which is independent of the city and county, so the city must approve every expenditure by the EDC that uses city funds. In our scenario, that means the city must formally approve the purchase of the land if city funds are used.

The city's specific approval of the land purchase thereby triggers all related procedures as if the city was purchasing the land itself. Professor David Lawrence explains in his book on economic development law that the city is undertaking the "economic equivalent" of an activity when it provides funds to another entity to conduct that activity. Any other result would evade the procedural requirements of G.S. 158-7.1 and -7.2, and would run afoul of *Maready*'s emphasis on following the "strict procedural requirements" of G.S. 158-7.1. Accordingly, the city must issue the appropriate notices and hold a public hearing for the acquisition of real property as required by G.S. 158-7.1 when its funds are used by the EDC to purchase land. To secure its interest in the property, it would be advisable for the city to place a lien on the property in the amount of its contribution.

Adherence to the "strict procedural requirements" of the statute would also involve two consequences upon *sale* of the property by the EDC. First, any land sale by the EDC to a private company should comply with all procedures as if the city were selling the land itself—including obtaining fair market value for the land under G.S. 158-7.1(d) unless a subsidized sale is permitted under G.S. 158-7.1(d2). In either case, the city must approve the sale and will retain any proceeds from the sale (the lien mentioned above is helpful in this regard). If the EDC were permitted to retain the proceeds from the sale of land rather than returning it to the local government, it would be equivalent to the city making an appropriation to the EDC without following the approval mandated by G.S. 158-7.2, and it would amount to an unconstitutional gift of property to the EDC because there would be no contractual requirement for the EDC to use the funds for public benefit.

As a result, the EDC cannot use an appropriation from the city to accomplish what it could not with the county. To suggest that the city could avoid all of the constitutional and statutory requirements associated with appropriations and conveyances for economic development, simply by making a cash grant to the EDC, would elevate form over substance and undermine the overriding purpose of the law's procedural requirements.

Lawful Alternatives to the EDC's Proposals

The root cause for the failure of the EDC's various proposals is that they fail to respect all of the procedures related to appropriations and land conveyances for economic development. Is it possible to identify lawful alternatives that accomplish the EDC's economic development goals without forfeiting the accountability demanded by the statutes and constitution? Finally, we can answer "yes." There are at least three lawful alternatives to the EDC proposal: (1) make a loan to the EDC secured by a deed of trust, (2) grant an option on the property rather than fee simple conveyance, and (3) execute a conditional G.S. 160A-279 conveyance.

1. Make a loan to the EDC secured by a deed of trust

   If it is helpful for the EDC to own the land (for example, if EDC ownership facilitates joint development of the park with private investors), the city or county could make a loan to the EDC for the land purchase and then secure that loan with a deed of trust on the land. The loan would be an appropriation under G.S. 158-7.1 and would require

compliance with the procedural requirements for such appropriations. Furthermore, the loan should be offered on typical market terms, not for a below-market interest rate—otherwise the loan becomes an incentive and implicates the *Maready* constitutional analysis for incentives as described previously (a bar the EDC has trouble clearing). A market rate loan involves not only an appropriate interest rate that would be offered in the market, but also standard equity requirements and the recordation of a deed of trust. Through a deed of trust, a local government is able to retain its interest in the property and could ensure that all procedural requirements are met. In the event of a future sale to a private company, the loan could either be paid back in full, thereby resulting in no subsidy (a G.S. 158-7.1(d) transaction), or the local government could authorize a subsidy by forgiving the loan to facilitate a conveyance to a job-creating business when permitted under G.S. 158-7.1(d2). Also see a prior post on making a loan instead of a grant.

2. Grant an option on the property rather than fee simple conveyance

   Rather than conveying the property to the EDC in fee simple, the county could instead grant the EDC an option (or options) to purchase the land at fair market value. The option could be assignable under specific conditions—namely, assignable to a company that qualifies for an unsubsidized conveyance under G.S. 158-7.1(d) or a subsidized conveyance under G.S. 158-7.1(d2). An option still allows the EDC to exercise positive site control over the land, thereby ensuring that the property will remain available for economic development during the term of the option. Another benefit of this approach is that the option could be granted to the EDC for no monetary consideration, because the EDC would put that option to public use. At the time that the EDC was ready to sell some of the land to a private company, the EDC could assign the pertinent option(s) over to the company, and then the company would exercise those option(s) and purchase the property directly from the county. This ensures that proceeds from any sale are returned to the local government, or, if a subsidized conveyance is appropriate, that the proper procedural requirements are followed.

3. Execute a conditional G.S. 160A-279 conveyance

   Although this option is cumbersome, the county could convey the property to the EDC for no monetary consideration under the typical G.S. 160A-279 requirement that the EDC put the property to a public use. The EDC would be in compliance with the public use requirement of G.S. 160A-279 for so long as it was holding and marketing the property. Once the EDC found a private company to locate in the park, the property to be sold would be returned to the county because the EDC no longer intends to put it to a public use. In this way, the county makes the actual conveyance to the private company, retains the proceeds from the sale, and can ensure compliance with all procedures.

Whatever method the county selects for granting the EDC control over the property, whether by making a loan, granting an option, or making a conditional conveyance under G.S. 160A-279, the county will receive most or all of the proceeds from the later sale of land to a business. Once the county receives the sale proceeds, it may at that time appropriate some of the proceeds of the sale to the EDC. Of course, in appropriating funds to the EDC, the county would be required to follow all procedural requirements for the appropriation, such as G.S. 158-7.2 approval of expenditures by entities other than the county, and G.S. 158-7.1(c) notice and hearing requirements. The key to compliance with the procedural requirements is thinking about the conveyance of land as separate from any appropriation to the EDC, even if they happen nearly simultaneously.

All three of the alternatives above allow the EDC to be in control of the industrial park property while concurrently ensuring that the local governments comply with the “strict procedural requirements” of the economic development statutes and case law. As a final comment, it should be noted that many local governments avoid all of these issues by simply keeping industrial park property titled in a city’s or county’s name at all times while the local EDC markets the property to businesses.

Now that a legal path for the EDC has been laid out, only one question remains. If Ray builds it, will they come?

Links

- www.forbes.com/sites/billconerly/2014/09/02/reshoring-or-offshoring-u-s-manufacturing-forecast-2015-2016/

- ced.sog.unc.edu/mega-sites-part-ii-luring-the-big-fish/
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Coates' Canons Blog: Cash Grants for Real Estate Developers without Competition for Jobs—A Constitutional Quandary

By Tyler Mulligan

Article: http://canons.sog.unc.edu/?p=8221

This entry was posted on September 15, 2015 and is filed under Community Development & Redevelopment, Development Finance, Development Finance, Downtown Revitalization, Downtown Revitalization, Economic Development, Special Taxing Districts

A local real estate developer, Al Czervik, proposes to construct a mixed-use development with residential, office, and retail space. The city council likes the development plan because it is consistent with the council's vision for the area. Czervik, seeing incentives being offered to convince companies to locate in North Carolina rather than other states, misses the significance of the competition element of those incentives and thinks his development, too, should receive incentives. He requests a $1 million cash grant ($100,000 per year for 10 years) from the city to "make the project work." Czervik is unwilling to promise jobs, of course—because it is the tenants who will provide jobs, not his development—but he is confident that tenants with jobs will locate in the development and therefore he seeks a subsidy nonetheless. Czervik's request gets the attention of the city attorney, who is well aware that this request rests on very shaky legal ground (as explained in this blog post and this law review article). How might the city attorney frame the legal issues for city council members, who are initially receptive to Czervik's request?

Background: Constitutional and Statutory Considerations

We start with a foundational principle of the North Carolina constitution. Local governments are not permitted to make gifts of public money or assets "but in consideration of [*i.e.*, in exchange for] public services," according to Article 1, Section 32 of the North Carolina Constitution (for further legal analysis of that constitutional provision, also known as the exclusive emoluments clause, see a blog post on the topic by my colleague Frayda Bluestein). Further, the state constitution permits local governments to expend funds "for public purposes only." It wouldn't matter, for example, whether the General Assembly enacted a statute empowering local governments to make a cash gift to every private company with the letter "A" in its name—a local government would still be unable to make the gift expenditure unless it served a constitutional public purpose. The constitution is the supreme law of the land—it trumps statutes enacted by the General Assembly when those statutes conflict with it.

This is not to diminish the importance of statutes. Statutory authority is required for every action undertaken by a North Carolina local government. The North Carolina Constitution, Article VII, Section 1, makes local governments creatures of the state, declaring that the General Assembly "may give such powers and duties to counties, cities, and towns … as it may deem advisable." If a local government cannot identify a statute that authorizes the activity it wishes to undertake, then the local government cannot engage in that activity.

Returning to our scenario, in order for the local government to make an incentive payment to Czervik, there must be both (1) an authorizing statute for such a payment and (2) a constitutional public purpose for the payment. The remainder of this post reviews several possible statutes and applicable case law.

Economic Development

The statutory language of the Local Development Act of 1925, G.S. Chapter 158, Article 1, provides North Carolina local governments with extraordinary authority to engage in economic development activities. Although G.S. 158-7.1 is broadly written, it is the oldest of the development statutes reviewed in this post. It was enacted at a time when incentive payments were clearly impermissible under the constitution and there was no thought of making cash payments to private companies as an incentive. It wasn't until 1996, in *Maready v. City of Winston-Salem*, 342 N.C. 708 (1996), that the North Carolina Supreme Court decided for the first time that incentive payments, under certain conditions, could serve a constitutional public purpose. The question is whether Czervik's request fits the conditions described in the *Maready* case.

As discussed in this blog post about the *Maready* requirements, the primary motivation for the court to permit incentives was interstate competition—the court was particularly interested in allowing incentives that could attract companies which "might otherwise be lost to other states"—and all of the incentives approved by the court involved both substantial job creation and new tax revenue that paid back the incentives within 3-7 years. In addition, the court was satisfied that "strict procedural requirements" would prevent abuse of this new incentive authority. Indeed, the court laid out the following incentive approval procedures as "typical," even though none of them could be found within the statutory language of G.S. 158-7.1 at the time:

- An initial necessity determination is made that the incentive is required for a project to go forward (necessity is easily proven in a competitive situation, where a company "might otherwise be lost to other states").
- A written guideline or policy is applied to determine the maximum amount of incentive that can be given to the receiving company.
- Expenditures take the form of reimbursements, not unrestricted cash payments.
- Final approval is made at a public meeting, properly noticed.
- A written agreement governs implementation.

Lower courts have stated that they will uphold incentives that are "parallel" to the incentives approved in *Maready*. Unfortunately for Czervik, his development project cannot be called "parallel" to the *Maready* standard. He cannot promise job creation, which is the primary form of public benefit described in *Maready*, and just as important, he cannot demonstrate that an incentive is "necessary" for his project to go forward in the community. Indeed, most real estate development projects do not involve interstate competition and cannot demonstrate that a subsidy is "necessary." Without a showing of necessity—always elusive in the context of a real estate development project—an incentive payment becomes an unconstitutional gift, regardless of whether G.S. 158-7.1 appears to authorize the payment. Accordingly, absent promised job creation and a showing of necessity, Czervik's requested incentive cannot be paid under G.S. 158-7.1.

Urban Redevelopment Areas

North Carolina's Urban Redevelopment Law (G.S. Chapter 160A, Article 22) authorizes a local government to exercise special statutory powers within a designated geographic area called a "redevelopment area." The designated area must be classified as blighted—meaning the growth of the area is impaired by the presence of dilapidated or obsolete buildings, overcrowding, or other unsafe conditions—or in danger of becoming blighted. See this blog post on urban redevelopment areas for more information on the establishment of redevelopment commissions, redevelopment plans, and redevelopment areas.

One of the powers that may be exercised in a redevelopment area is engaging in "programs of assistance and financing, including the making of loans, for rehabilitation, repair, construction, acquisition, or reconditioning of residential units and commercial and industrial facilities in a redevelopment area." In other words, a local government possesses authority to offer "programs of assistance and financing," presumably including grants, to developers who agree to construct or rehabilitate buildings in a redevelopment area. The exercise of redevelopment powers has been found to serve a public purpose (Redevelopment Comm'n of Greensboro v. Sec. Nat'l Bank, 252 N.C. 595 (1960)), and the *Maready* case relied on redevelopment case law to support its decision to allow incentives for economic development.

The difference between financial assistance offered pursuant to the Urban Redevelopment Law and incentives offered under G.S. 158-7.1 is the form of public benefit obtained by the local government in return. In the context of urban

redevelopment, the public benefit is derived not from job creation and increasing the tax base, but in attracting development to a blighted area. The law may therefore permit a local government to provide a financial subsidy to a developer where construction in a designated redevelopment area is promised as consideration.

Czervik's development, however, is not located in a statutory redevelopment area, so the Urban Redevelopment Law does not provide authority for his requested incentive payment.

Community Development and Affordable Housing

Local governments in North Carolina have long possessed statutory authority to assist private entities with construction of affordable housing for low and moderate income persons (G.S. Chapter 157) and to rehab private structures as part of a community development program for the benefit of low and moderate income persons (G.S. 153A-376, G.S. 160A-456). Case law has also found these activities to serve a constitutional public purpose. See, for example, *In re* Housing Bonds, 307 N.C. 52 (1980), regarding the public purpose of undertaking programs for the benefit of low and moderate income persons.

In the case of affordable housing and community development programs, the public benefit to be received in exchange for a payment is the rehabilitation or construction of structures for the benefit of low and moderate income persons. A conservative test for such assistance would examine whether the grant or other financial assistance would be permitted under requirements of the federal Community Development Block Grant (CDBG) program. In Czervik's case, there is no intent to benefit low and moderate income persons, so this authority does not apply to his request.

Municipal Service District for Downtown Revitalization

The final possible source of statutory authority for an incentive payment to Czervik is a municipal service district ("MSD") for downtown revitalization (G.S. Chapter 160A, Article 23), also known as a Business Improvement District, or "BID." An MSD for downtown revitalization is a special taxing district that municipalities (not counties) can establish to fund, among other services or functions, "downtown revitalization projects." My colleague Kara Millonzi describes the process for establishing such districts in her blog post on BIDs in North Carolina.

The statute authorizing MSDs for downtown revitalization, much like the statute for economic development, is broad in its scope. The statute describes downtown revitalization projects as services, functions, and developmental activities intended to further the economic well-being of the downtown area, and it offers a non-exclusive list of examples of downtown revitalization, such as "promoting business investment in the downtown area." The only explicit limits imposed by the statute, it appears, are the geographic boundaries of the district. Thus, the MSD statute presents a similar situation to G.S. 158-7.1, in which constitutional limitations may be more important than the statutory language.

However, North Carolina courts have not yet had an opportunity to evaluate the downtown revitalization statute or the public purpose of cash grants offered pursuant to the statute. In addition, a review of case law across the nation offers no support for such grants—no cases were identified that supported the grant of public subsidies to private developers outside of the instances already mentioned above: economic development with competition for jobs, urban renewal of blighted areas, and projects primarily for the benefit of low and moderate income persons. To the contrary, the Arizona Supreme Court, en banc in 2010, held that cash payments to the developer of a mixed-use development—much like Czervik—were an unconstitutional gift because tax revenues alone were not valid consideration under that state's gift clause. *Turken v. Gordon*, 224 P.3d 158 (Ariz. 2010). The holding in Arizona, while possibly influential, is not controlling in North Carolina, so the question remains unresolved here.

Accordingly, there is legal risk associated with relying on North Carolina's MSD statute to make incentive payments to private developers. For those local governments that wish to take advantage of the ambiguity in North Carolina to offer such incentives anyway, it is recommended that they mitigate their risk somewhat in two ways: (1) follow the procedural requirements described in *Maready* that were not explicitly required by G.S. 158-7.1, and (2) attempt to determine "necessity" as described below.

***Maready* Procedures Not Found in G.S. 158-7.1 and the Necessity Challenge**

Recall from the earlier discussion of *Maready* that the court listed the following approval procedures for incentives, even

though the listed procedures were not required by the authorizing statute, G.S. 158-7.1:

- Necessity determination.
- Applying a written guideline or policy to determine the maximum amount of incentive that can be given to the receiving company.
- Expenditures take the form of reimbursements, not unrestricted cash payments.
- Final approval is made at a public meeting, properly noticed.
- A written agreement governs implementation.

A local government seeking to provide incentives for Czervik's development through an established MSD would have no difficulty complying with these procedures, with one notable exception: the necessity determination.

It should be recognized at the outset that determining that a public subsidy is "necessary" for a private development, in the absence of a genuine competitive situation, is challenging. In our work with local governments through the Development Finance Initiative (DFI) here at the School of Government, our goal is to maximize the public benefits and achieve public interests while minimizing the public expense associated with any particular development project. To accomplish this goal, we conduct independent financial feasibility analysis of the development project and examine public involvement through a tiered approach, as an approximation of necessity, as follows:

1. **Public ownership**: Are there public infrastructure elements of the project that a local government could acquire directly from the developer through a public-private partnership for construction (G.S. 143A-128.1C, G.S. 160A-458.3) as described in a blog post by my colleague Norma Houston, or a reimbursement agreement (G.S. 153A-451, G.S. 160A-499), thus relieving the developer of some of the costs of development by buying a portion of the development for a "reasonable" price? Parking facilities, sidewalks, government offices, and parks and recreation space are common candidates for acquisition by the local government. See this blog post on DFI's project in Wilmington as an example. If feasibility is achieved, stop here, because a grant cannot be "necessary." By stopping before making a grant, a local government avoids the constitutional concern entirely because no subsidy is provided to a private entity.
2. **Unsubsidized loan**: Would feasibility be achieved through subordinated debt at a market rate of interest (approximately 5% higher than the interest rate of the primary loan) as described in this blog post on mezzanine debt and this post on the legal procedures for a loan? A loan is often sufficient to make a development project feasible, as explained in this blog post about the impact of a loan on a development project. If feasibility is achieved by an unsubsidized loan, stop here, because a grant cannot be "necessary." Here again, the legal risk associated with a grant is avoided entirely.
3. **Subsidized loan**: Would feasibility be achieved through subsidized subordinated debt, such as a lower-than-market interest rate or deferred interest and principal with a balloon payment upon sale? A subsidized loan is essentially a loan that sits alongside a grant—the grant portion buys down the interest rate or the payments on the loan as described in this blog post on legal procedures for a loan. Notice, however, that the legal risk associated with subsidizing a private entity through an MSD resurfaces, because this loan contains a grant or subsidy. If feasibility is achieved by this loan, stop here, because any further grant cannot be "necessary."
4. **Grant**: Finally, if none of the above measures achieves feasibility for the project, then a grant may be "necessary" to make the project go forward in the developer's proposed form. Note, however, that the constitutional concerns remain. Why must the development take the form proposed by the developer? Is the rate of return for investors in the project being subsidized by the public, and if so, is that rate of return justified? What public benefit will be achieved by the project, beyond increasing the tax base?

Perhaps Czervik could receive assistance if his project is located in an established MSD. However, even if a local government follows the tiered approach to determining "necessity" described above and follows the other procedures described in *Maready* when approving an incentive, there remains a real risk that a court could strike down such payment as an unconstitutional gift or as failing to achieve a public purpose. However, the steps outlined above may mitigate the risk, and at the very least, may lead to the discovery that offering a loan to a developer provides adequate assistance—and that making a grant is not even *necessary*.

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CED in NC Blog: Legal and Business Reasons Why Downtown Development Programs Should Involve Secured Loans—Not Grants

By Tyler Mulligan

Article: https://ced.sog.unc.edu/legal-and-business-reasons-why-downtown-development-programs-should-involve-secured-loans-not-grants/

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Dr. Blaine Beeper is a retired hospital administrator who was recently elected to council in the Town of Bushwood. Dr. Beeper thinks he has figured out how to jumpstart revitalization of Bushwood's historic downtown. He proposes for the Town to offer annual cash grants to any owner who redevelops a commercial property within the downtown. Dr. Beeper reasons that redeveloped properties will carry a higher tax assessed value, and the additional tax revenue can be "granted back" to the owners in the form of cash grants for five years, calculated as some percentage of the additional property taxes received by the Town. When Dr. Beeper floats this idea, he runs into resistance from the Town Attorney and the Economic Development Director, each for different reasons. The Town Attorney raises serious concerns about the legality of such a program, while the Economic Development Director says it doesn't make good business sense and a loan program would better address owners' financing needs. This post explains the legal and business reasons why Dr. Beeper's proposed grant program should be scrapped in favor of a loan program.

The Legal Reasons

When state constitutions across the nation were written, they included "gift clauses" to ensure that state and local governments did not make gifts to private entities (see this law review article). In North Carolina, a local government isn't even allowed to make a donation to a charitable nonprofit entity. See my faculty colleague Frayda Bluestein's blog post on the topic here. A local government can enter into a contract and pay a reasonable price for a valuable public service (such as a contract to manage a homeless shelter), but the government cannot make a donation.

Dr. Beeper, however, believes his proposed grant program for private owners is legally authorized because he thinks certain statutes allow it. For example, the Town long ago established a municipal service district (MSD) for downtown revitalization, and the statutory powers granted to the Town within that MSD include "promoting business investment in the downtown area." In addition, he points to the economic development statute, G.S. 158-7.1, which seems to offer boundless authority to local governments to encourage development.

The Town Attorney explains to Dr. Beeper that those statutes are limited by the state constitution. For example, the economic development statute has existed in essentially the same form since 1925, but for decades after it was enacted, it was unconstitutional to offer economic development grants. The constitution always constrained the statute's scope. Then, in the 1996 case *Maready v. City of Winston-Salem*, the North Carolina Supreme Court decided for the first time that incentive grants were allowable—but only in very limited circumstances in order to compete with "neighboring states." The court reasoned that incentive grants serve a constitutional public purpose (and therefore are not unconstitutional gifts) so long as they are "necessary" to obtain significant jobs and tax base that "might otherwise be lost to other states." (For more details, see a law review article on the topic, with the major points summarized in this blog post: When May NC Local Governments Pay an Economic Development Incentive?

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In addition, multiple development statutes express the rule that local governments must receive “fair market value” when conveying property, reflecting the same prohibition on making gifts to developers. For example, the economic development statute mandates that the price received for property “may not be less than” the fair market value (G.S. 158-7.1(d)). In blighted redevelopment areas, competitive bidding processes must be used, and even conveyances to charitable nonprofit entities “shall not be less than the fair market value” (G.S. 160A-514). For conveyance of property for redevelopment, the price received for negotiated sale “shall not be less than the appraised value.” (G.S. 160A-457) The mere authorization to convey property by private negotiated sale does not mean that the price can be reduced below fair market value. See blog posts about conveyances for economic development, historic rehabilitation, downtown development projects, and affordable housing.

Dr. Beeper protests, saying he’s pretty sure that the City of Nearby has enacted a program similar to the one he is proposing. The Town Attorney is aware of the program in Nearby City and says he believes that Nearby’s program violates the state constitution. The Town Attorney recalls that Nearby implemented its program before a recent set of NC Court of Appeals cases clarified the state’s incentives law. Initially, some local governments interpreted the case law broadly and enacted their downtown development programs based on that understanding. In subsequent cases (e.g., *Blinson*, *Haugh*), courts have maintained that incentive grants will be upheld so long as they are “parallel” to the incentives approved in the *Maready* case. Downtown redevelopment projects—which typically cannot promise new high-paying jobs, fail to diversify the economy, and aren’t competitive with “other states”—don’t even come close.

In light of the statutes and constitutional law, the Town Attorney suggests that Dr. Beeper explore alternatives that don’t involve gifts to private entities. Creativity is permitted so long as the local government does not attempt to give a gift to a private developer. Some creative and legally permissible approaches include the following:

1. Construct publicly-owned infrastructure to support private development	Examples include lighting, public parking, and street improvements. Public parking spaces can be leased to private businesses, subject to some limitations.
2. Enter into a public-private partnership (P3) with the developer	A P3 involves the developer constructing public infrastructure and the Town buying it for a reasonable price (see blog posts about public-private partnerships here and here and reimbursement agreements here).
3. For historic buildings, pay the owner a fair price for a preservation easement on the building façade.	The local government can pay to acquire an historic preservation easement on the building façade, enabling the Town to repair the historic façade if the owner fails to do so. G.S. 160A-400.8(3)
4. Designate an historic structure as an historic landmark.	Designated landmarks receive favorable tax treatment as described here.
5. Offer loans with appropriate market rate terms (no gifts)	Loans offered by a local government should be secured and carry an appropriate risk-adjusted rate of interest.

None of the alternatives above (also discussed here and here) involves an unconstitutional gift to the owner. The Town Attorney recommends that Dr. Beeper talk with the Economic Development Director about her ideas on the last item in the list: a loan program.

The Business Reasons

The Economic Development Director is a sophisticated real estate development professional. She wants to implement a loan program because she knows it will be more helpful to a downtown redevelopment project than Dr. Beeper's proposed grant program, and a loan program better preserves the Town's resources—which means more projects can be assisted over time. She outlines her downtown redevelopment loan program and the rationale for Dr. Beeper:

1. **The Town should offer a "mezzanine loan" program for redevelopment of downtown buildings.**

Redeveloping buildings is expensive, and developers typically obtain a commercial bank loan for each project. Private bank financing should continue to be the primary source of financing in her view, but the Town could offer a loan that supplements, rather than replaces, the bank loan. Thus, the Town loan would be the second or "mezzanine" loan. The main advantage of requiring a developer to secure a bank loan first is that the Town will know that a bank has underwritten the redevelopment project. It should give the Town some comfort to know that a business-minded lender is paying attention to the project.

2. **The interest rate on the Town's loan should be several points higher than the interest rate of the primary bank loan on the project. In current conditions, this would put the Town's rate in the range of 8% to 10%, depending on the risk of the loan. The riskier and more unconventional the loan, the higher the interest rate.**

The bank will require the Town's loan to be subordinated to the bank's loan. That is, the bank will hold a lien on the property in *first position*, meaning the bank is first in line at foreclosure should the borrower fail to pay. The Town's loan will be subordinate—in *second position*—so the Town will be second in line, making the Town's loan a bit riskier. Market pricing for loans is based on risk. Since the Town's loan is riskier than the bank loan, it should carry a higher interest rate than the bank loan.

Offering a low-interest loan (lower even than the bank loan rate) would be counter-productive and inconsistent with sound development finance principles. To illustrate the point, say that a borrower eventually earns enough income to pay off some principal on its loans. A rational borrower would choose to pay off the highest interest loan first. If the Town's loan carries a lower interest rate than the bank loan, then a rational borrower would pay off the bank loan first. The Town, however, actually wants to have the opposite effect: that is, for the borrower to maximize the (private) bank loan and take no more (public) Town loan than is absolutely required to make the redevelopment project feasible.

3. **Even with a higher interest rate, a mezzanine loan program is still potentially more helpful to a redevelopment project than Dr. Beeper's original grant proposal, for several reasons.**

Redevelopment projects need financing up front to cover the costs of development. When a developer says a project has a financing "gap," it means the project needs up front financing to make the project work. Dr. Beeper's annual grants would be paid only after the redevelopment was complete, so the grants do not address the "gap." Furthermore, because Dr. Beeper's proposed grants would be paid after the project is complete, the grants cannot be "necessary" to make the project feasible (a legally significant point). A mezzanine loan does not suffer from the same deficiencies in part due to its risk-adjusted rate of interest. When a developer takes out a mezzanine loan, the developer accepts added cost and complexity, so the Town can be fairly certain that the loan is necessary to the success of the project. The interest rate also ensures that the developer will maximize the bank loan and borrow no more from the Town than the project requires.

A mezzanine loan—even at 10% interest—is less expensive than equity provided by investors, who often expect high rates of return (sometimes well above 10%). A mezzanine loan provides up front capital to a project in the 8% to 10% interest range. While this rate is more expensive than a conventional bank loan, it is still cheaper than capital provided by an equity investor, who may demand a 12% to 15% return or more, depending on project risk. The Town improves the feasibility of the redevelopment project by replacing high cost equity with a mezzanine loan.

When a mezzanine loan replaces high-cost equity, this creates "leverage" that increases returns for the equity investor. When a mezzanine loan replaces high cost equity, this means that less up-front cash is required from an investor. Because the investor provides less cash up front, the project's overall returns are larger in comparison to the investor's (now smaller) cash investment. This effect is called "leverage."

4. **A mezzanine loan is intended to be paid back, generating revenue for the local government over time that can be put toward other projects.**

Mezzanine loans are secured loans that, with proper underwriting, are expected to be paid back with interest. This generates revenue for the local government above and beyond property tax revenue—revenue that can be revolved back into other projects. However, it must be acknowledged that mezzanine loans involve risk of loss because they are secured by a lien in "second position" behind the bank loan. That is, in the event of default by a borrower, the bank loan takes precedence. Although a mezzanine loan involves risk of loss, it still compares favorably with Dr. Beeper's annual grant program, which fails to generate any income and results in lower net revenue for the Town.

5. **A mezzanine loan program is flexible and the loan structure can be modified to avoid causing cash flow problems for a redevelopment project with thin margins.**

What if a project's operating income is not sufficient to make the loan payments on a mezzanine loan (because the project is already burdened by the debt service for the primary bank loan)? Mezzanine loans are flexible financial instruments that can be structured to meet the needs of the project.

For example, a mezzanine loan could be amortized over a long period of time, such as 30 years, to make payments manageable. Or a loan could be structured as interest only with a balloon payment upon sale or refinancing. For the most difficult projects, a government could even consider deferring all principal and interest payments until sale or refinancing. If deferral of that sort fails to make a project work, then the viability of the project should be seriously questioned.

When structuring a mezzanine loan, it is important to evaluate the effect of different terms on investor returns. In addition, the relative riskiness of the loan should be reflected in the interest rate charged to the borrower. To see an example of different loan structures and their comparative effect on investor returns (e.g., equity multiple), see a mezzanine loan pro forma illustration from an actual revitalization project in North Carolina here.* (Readers are also challenged to calculate the effect of Dr. Beeper's proposed grant program on developer returns and see for themselves why his grants are less effective.)

Finally, if a developer insists that a project cannot accommodate even the most flexible mezzanine loan, that doesn't mean the Town must make a grant or gift to the developer. The Town could consider making an equity investment (through a limited liability vehicle) that results in ownership on the same terms as any other owner or investor. (The Town Attorney can confirm that local governments possess statutory authority to acquire interests in real property and to hold and lease that property for economic development, provided statutory procedures are followed.)

For an example of a North Carolina municipality that built public-owned infrastructure and offered a loan (not a grant) to assist a developer, see this post: Multiplex in Morganton: The Mimosa Theatre.

The mezzanine loans described in this post can help a redevelopment project earn higher returns while potentially preserving a local government's resources—without running afoul of the North Carolina Constitution. This and other related topics are covered in greater detail in a course for public officials held at the School of Government called the Development Finance Toolbox.

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* Sarah Odio and Andrew Trump, Project Managers with the School's Development Finance Initiative, created the mezzanine loan pro forma illustration.

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Coates' Canons Blog: Local Government Economic Development Powers "Clarified"

By Tyler Mulligan

Article: http://canons.sog.unc.edu/?p=8273

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On October 20, 2015, the Governor signed Session Law (S.L.) 2015-277, placing into effect several "clarifications" to the primary economic development statute used by local governments, G.S. Chapter 158, Article 1, "The Local Development Act of 1925." The modifications fall into three categories: first, broad discretionary language was removed; second, new procedural requirements were imposed; and third, historic rehabilitation was explicitly included within the penumbra of allowable economic development activities, subject to the same limitations that have long been imposed on such activities by the statute and the North Carolina Constitution. Each will be addressed in turn.

Discretionary Language in G.S. 158-7.1(a) Removed

G.S. 158-7.1, up until S.L. 2015-277 became law, contained fascinating language in subsection (a) that can be traced back to the original language enacted in 1925, at a time when economic development incentives weren't permitted (incentives wouldn't be approved by the North Carolina Supreme Court until the seminal 1996 case, *Maready v. Winston-Salem*, 342 N.C. 708). The pre-2015 language did not contain the term "economic development," but it described activities that conveyed a similar meaning:

> "Each county and city in this State is authorized to make appropriations for the purposes of aiding and encouraging the location of manufacturing enterprises, making industrial surveys and locating industrial and commercial plants in or near such city or in the county; encouraging the building of railroads or *other purposes which, in the discretion of the governing body* of the city or of the county commissioners of the county, will increase the population, taxable property, agricultural industries and business prospects of any city or county."

The italicized language, in particular, appeared to grant remarkable discretion to governing boards—leading me to write in a law review article about economic development incentives that "it is difficult to say what appropriations are *not* permitted under the catch-all provision [subsection (a)]." Indeed, that article concludes that the most important limitations on economic development incentives are imposed not by the broadly written statute, but by the North Carolina Constitution. That's still the case—more on that later in the post.

S.L. 2015-277 removed the broad, discretionary language quoted above and replaced it with a simpler formulation:

> "Each county and city in this State is authorized to make appropriations for economic development purposes."

The new language could be read as narrower because the broad discretionary language (italicized above) has been removed. In my opinion, however, the scope is probably roughly the same with the new language as it was under the original formulation, for two reasons.

First, the term "economic development" is a general term imbued with little specific meaning. My colleague Jonathan Morgan writes in the introduction to his Economic Development Handbook that economic development is "both a process and a set of desired outcomes." The term encompasses activities ranging from workforce training, to marketing the local jurisdiction in trade publications, to hiring a staff of development professionals, to constructing shell buildings in industrial parks. The term itself resists being bounded.

Second, in *Maready*, the North Carolina Supreme Court itself used shorthand similar to the new formulation when it

summarized the statute this way: “Section 158-7.1 allows local governments to appropriate funds for the purpose of economic development.” The court was more concerned about the evil that local governments were addressing with the statute—competition from other states for jobs and investment—than it was about the specific boundaries of the statute.

New Procedural Requirements Imposed

The North Carolina Supreme Court in *Maready*, when it decided in 1996 that economic development incentives offered pursuant to G.S. 158-7.1 are constitutional, asserted that the “strict procedural requirements” of G.S. 158-7.1 would prevent abuse of this new incentive power. As support for its assertion, the *Maready* court pointed out that the local governments in the case all adhered to the G.S. 158-7.1 procedures, including issuing notice and holding public hearings, prior to approving each incentive.

However, as a technical matter, the pre-2015 statute only required a local government to issue notice and hold a hearing for activities related to improving real property listed in G.S. 158-7.1(b). Of course, this included all incentives anyway, because incentives can only be paid when a company promises to create jobs and increase the property tax base—and essentially the only way to do that is to make taxable improvements to real property.

But local governments were also appropriating funds for economic development purposes that had nothing to do with incentives—or improving real property for that matter—such as paying for an advertisement about the local industrial park, or contracting with the local Chamber of Commerce for networking and small business support services. In the pre-2015 statute, there was no statutory imperative to hold a public hearing prior to approving such appropriations.

That has changed with S.L. 2015-277, which adds a new notice and hearing requirement. By deleting some words in G.S. 158-7.1(c) that tied the public hearing requirement only to property-related activities described in subsection (b), the statute now mandates notice and public hearing for *every appropriation* under the statute regardless of whether or not it is connected to an incentive or improving real property. It seems clear from the bill summary that the General Assembly intended this result.

Unfortunately, the statute imposes this new notice and hearing requirement but fails to provide guidance on the form of notice to be issued. The form of notice for *incentives* should continue to follow the specific requirements of G.S. 158-7.1(c) and (d) for activities involving improving real property. For other (not incentive or property related) expenditures, in the absence of other guidance, presumably local governments may simply describe the general nature of the activity to be funded by the appropriation.

In addition to imposing the new notice and hearing requirement described above, S.L. 2015-277 also requires governing boards to make a specific finding prior to approving any appropriation for economic development, regardless of whether or not the appropriation is connected to an incentive. Specifically, the governing body must determine that the appropriation will “increase the population, taxable property, agricultural industries, employment, industrial output, or business prospects of the city or county.” The vast majority of typical economic development expenditures will meet this standard, so making this finding is not anticipated to be much of a hurdle for local economic development efforts.

Historic Rehabilitation as an Economic Development Expenditure

Local governments have long possessed authority to make expenditures for historic rehabilitation. Historic preservation commissions, after being established by a city (G.S. 160A-400.7) or a county (G.S. 160A-400.2), are empowered to acquire, hold, restore, and manage historic properties, and to convey historic property "subject to covenants or other legally binding restrictions which will secure appropriate rights of public access and promote the preservation of the property" (G.S. 160A-400.8). All local governments are also permitted to acquire real property "for the preservation or restoration of historic sites" (G.S. 160A-457(1)(d) and G.S. 153A-377(1)(d)), and they may rehabilitate buildings so acquired (G.S. 160A-457(2) and G.S. 153A-377(2)). Subsequently the local governments may sell those properties through competitive bidding procedures outlined in Article 12 of G.S. Chapter 160A, or they may select their buyer through special private sale procedures for historic properties (G.S. 160A-266(b)). These statutes do not authorize a local government to sell property for less than fair market value nor to give gifts of cash or property for historic rehabilitation projects. Rather, they allow local governments to make investments in historic rehabilitation that result in some form of ownership or control for the local government.

Even if those statutes above were to authorize making outright grants to private entities for historic rehabilitation, the state constitution's prohibition on gifts of property would step in. A grant may be paid only if the local government receives valid consideration (such as partial ownership or delivery of a service) in exchange for the appropriation. See posts here and here regarding the North Carolina Constitution's prohibition on making gifts to private entities and the requirement that all expenditures serve a constitutional *public* purpose. The courts alone—not the legislature, not statutes—determine what is a constitutional public purpose, and enactments by the General Assembly cannot override this constitutional imperative. The concern is particularly acute when the entity requesting a grant is a for-profit development firm or a nonprofit working with for-profit partners, as is the case when historic preservation is accomplished for private ownership or control (such as a privately owned apartment building) rather than for a public facility (such as a museum).

If a developer requests financial assistance from a local government for historic preservation, then the local government should act like any other investor and insist that its appropriation be treated as an equity investment that results in some public ownership of the structure. The form of public ownership can be flexible. For example, the public ownership could come in the form of a historic preservation easement. Some local governments have even acquired ownership over the façade of a building. Other local governments have purchased a specific portion of a development, such as a share of the parking spaces. Whatever form the public ownership takes, however, the price paid for the public's ownership should reflect market value. An overpayment is an unconstitutional gift. The same applies to loans, which should be offered under the same terms and with the same level of security as similar loans offered in the market, as described in this post.

There are three instances, however, in which the North Carolina Supreme Court arguably has approved the payment of cash subsidies for rehabilitation of privately owned or controlled historic structures without requiring an equivalent ownership stake in return (see also this post):

1. Community Development and Affordable Housing: S. 153A-376 and G.S. 160A-456 authorize local governments, as part of community development programs for the benefit of low and moderate income persons, to make appropriations "for the restoration or preservation of older neighborhoods or properties," to include "the making of grants or loans." Rehabilitation of historic properties arguably fits under the statute and serves a constitutional public purpose when it is undertaken *primarily for the benefit of low and moderate income persons*, such as affordable housing. See *In re* Housing Bonds, 307 N.C. 52 (1980).
2. Urban Redevelopment of Blighted Areas: Local governments may designate urban redevelopment areas (URAs) in which they exercise special development powers as described in this blog post on URAs. An area may be designated as a URA only after it is determined to be blighted—meaning the growth of the area is impaired by the presence of dilapidated or obsolete buildings, overcrowding, or other unsafe conditions—or in danger of becoming blighted. The powers include "programs of assistance and financing," possibly including grants, for "rehabilitation … of residential units and commercial and industrial facilities in a redevelopment area." Rehabilitation of historic properties within a URA arguably could be supported, and the exercise of redevelopment powers within a designated URA serves a public purpose. Redevelopment Comm'n of Greensboro v. Sec. Nat'l Bank, 252 N.C. 595 (1960).
3. Economic Development: As explained in this post, G.S. 158-7.1 authorizes local governments to make cash incentive payments to companies that promise to create jobs and make taxable investments that "might otherwise be lost to other states." *Maready v. Winston-Salem*, 342 N.C. 708 (1996). The broadly written pre-2015 language in subsection (a) of G.S. 158-7.1, which was eliminated by S.L. 2015-277 as explained above, arguably always

> included implied authority to engage in historic preservation when all other statutory and constitutional requirements for economic development grants were met. However, two concerns caused some jurisdictions to question whether rehabilitation was a proper activity under the pre-2015 statute. First, the property-related activities listed in G.S. 158-7.1(b) included acquiring, holding, and constructing buildings suitable for commercial use, but *rehabilitation* was not specifically listed. Second, historic rehabilitation often includes a mix of commercial and residential uses, and there was some question whether the noncommercial portions of a mixed-use rehabilitation project could be "counted" as part of the capital investment by a company.

To clear up the confusion about historic rehabilitation, S.L. 2015-277 added the following *within subsection (b) of G.S. 158-7.1* as an allowable economic development activity:

> "A county or city may make grants or loans for the rehabilitation of commercial or noncommercial historic structures, whether the structure is publicly or privately owned."

By placing this new historic rehabilitation provision *within subsection (b)* of G.S. 158-7.1, along with other property-related activities, the General Assembly ensured that any appropriations pursuant to the provision would fit within the existing legal framework for economic development. That existing framework is explained in great detail in my law review article—a summary of the statutory and constitutional requirements is provided below.

Statutory requirements for grants for historic preservation under G.S. 158-7.1

Under G.S. 158-7.1(b), a local government may acquire an interest in property, invest in improvements to the property, and then sell its interest at private sale for a price that "may not be less than" the fair market value of the interest (G.S. 158-7.1(d)). The governing body must determine the probable average hourly wage to be paid by the business to be located on the property, but so long as the interest in property is sold for fair market value, no minimum number of jobs is required. If, however, the local government's interest is sold for *less* than fair market value, then the buyer must comply with G.S. 158-7.1(d2), which requires creation of a "substantial number jobs" and construction of taxable improvements that will generate tax revenue such that the local government will recoup the discount on the sale price.

As explained in Professor David Lawrence's text on economic development law and my law review article, paying a grant for rehabilitation of historic real property in this context is the "economic equivalent" (to quote Professor Lawrence) of acquiring an interest in historic property, improving the property, and then selling the local government interest for less than fair market value. The sale of the government's equity stake for less than fair market value—the grant—triggers all of the statutory requirements of G.S. 158-7.1(d2), including creation of a substantial number of jobs paying above the average wage and the requirement that the local government recoup its grant from revenue generated by improvements to the property. The jobs requirement means that a purely residential project would not qualify for an incentive payment under G.S. 158-7.1—there must be a commercial business component.

Maready constitutional requirements for grants for historic preservation under G.S. 158-7.1

In addition to complying with the statutory requirements outlined above, any incentive grant for historic rehabilitation under G.S. 158-7.1 should also comply with *Maready*'s constitutional public purpose analysis. The Court of Appeals has said that it will uphold incentives that are "parallel" to the incentives approved in the *Maready* case. An examination of the incentives approved by *Maready* reveals some additional, constitution-based procedures. For incentive appropriations to be "parallel" to *Maready*, they should adhere to the following *Maready* requirements as well.

The primary motivation for the *Maready* court to permit incentives under G.S. 158-7.1 was interstate competition—the court was particularly interested in allowing incentives that could attract companies which "might otherwise be lost to other states"—and all of the incentives approved by the court involved both substantial job creation and new tax revenues to recoup the incentives "within three to seven years." Jobs and tax base are therefore constitutionally required for any economic development incentive under G.S. 158-7.1. In addition, the court was satisfied that "strict procedural requirements" would prevent abuse of this new incentive authority. In fact, the court laid out the following incentive approval procedures as "typical," even though none of them could be found within the statutory language of G.S. 158-7.1 at the time:

- An initial necessity determination is made that the incentive is required for a project to go forward (necessity is

easily proven in a competitive situation, where a company "might otherwise be lost to other states," but necessity is highly suspect for mixed-use development projects as explained in this post and this law review article).
- A written guideline or policy is applied to determine the maximum amount of incentive that can be given to the receiving company.
- Expenditures take the form of reimbursements, not unrestricted cash payments.
- Final approval is made at a public meeting, properly noticed.
- A written agreement governs implementation.

The above-listed procedures are now imbued with constitutional significance, as explained in this law review article and in several blog posts (e.g., here and here). Even if the General Assembly were to attempt to eliminate these procedures through legislation, local governments would still be advised to follow the procedures, as they are now an integral part of the constitutional public purpose rationale for incentives. Any local government failing to adhere to the above standards for economic development incentives, regardless of the language in the statute, would no longer be "parallel" to *Maready* and would therefore invite the courts to reassess the constitutionality of those incentives.

Links

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Coates' Canons Blog: Sale of Historic Structures by NC Local Governments for Redevelopment

By Tyler Mulligan

Article: http://canons.sog.unc.edu/?p=7939

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Almost ten years ago, in the town of Bushwood, North Carolina, the “generous” owner of the historic textile mill building just off Main Street donated the property to the town (it was difficult to maintain and the owner didn’t want to pay property taxes on it any more). The town accepted the property, hoping that it would be able to find a new private owner who would redevelop the property and retain the historic character of the building. Some potential buyers have kicked the tires on the building, but no one has made an offer. Due to the value of the land and the excellent location of the parcel, the property appraises for $300,000.

The town recognizes that it needs to market the building more actively—and that it may need the help of experts. “Old Mills R Us,” a regional historic preservation nonprofit with a mission to preserve historic mill buildings, has a proposal for the town:

- The town will sell the mill to the nonprofit for one dollar.
- Old Mills R Us (OMRU) will market the property and sell the mill to a private developer who will redevelop the property while retaining the historic features.
- Rather than charging a broker fee, OMRU will simply keep the proceeds from the sale at whatever price OMRU can get.

Can the town enter into this transaction with OMRU? Short answer: not on these terms. This post explains why and suggests some alternatives.

General Background on Disposal of Local Government Property

We start with the general rule that, unless an exception is authorized by statute, North Carolina local governments *are required* to dispose of real property through competitive bidding procedures. Three procedures are available: sealed bid (G.S. 160A-268), upset bid (G.S. 160A-269), or public auction (G.S. 160A-270). These bidding procedures are fair to the public in the sense that anyone with the means can submit a bid—there are no back-room deals. The procedures are assumed to be favorable to the government because theoretically, the process should yield the highest possible price. The law assumes that price is the most important factor to local governments; indeed, case law generally prohibits local governments from placing conditions on conveyances of property that will depress the price that a buyer would pay (*Puett v. Gaston County*).

However, from time to time, compelling and overriding public interests have led the General Assembly to enact exceptions to the competitive bidding requirement. Historic preservation is one of those exceptions. In such instances, the statutes

permit local governments to engage in a *private sale* (as described in G.S. 160A-267)—that is, the local government may select the buyer of its choice without following a public bidding process and, when allowed by statute, may impose covenants and restrictions on the conveyance.

The authority to convey property by private sale does not mean that the property can be given away for nothing. Rather, the property is to be sold at or near fair market value, because gifts of public money or assets to private persons are not permitted under Article 1, Section 32 of the North Carolina Constitution (for further legal analysis of that constitutional provision, see a blog post on the topic by my colleague Frayda Bluestein). Note, however, that when a statute permits a local government to impose covenants or restrictions on a conveyance, the law recognizes that the property's value may be impaired by those restrictions and appraisers may take the restrictions into account when calculating fair market value.

In rare instances, the statutes may even permit a local government to sell property for less than full fair market value, provided some other allowable form of consideration or "payment" is provided. For example, whenever a local government is permitted to appropriate funds to a nonprofit entity for carrying out a public purpose, it may also convey property to that entity "in lieu of or in addition to the appropriation of funds." In other words, the local government may make a conveyance of property for less than fair market value just as it would make an appropriation through its general fund. In that case, the conveyance must be subject to covenants ensuring that the property will be "*put to a public use by the recipient entity*" (G.S. 160A-279).

The next section examines how and whether these exceptions apply to the sale of historic property.

Private Sale of Historic Property

There is specific statutory authority for the sale of historic property. G.S. 160A-266(b) authorizes local governments to convey historic property by private sale—meaning, the unit gets to pick its buyer and impose covenants and restrictions to preserve the historic property. Notably, the local government may use this private sale authority only for conveyance to a nonprofit or trust whose purpose is to conserve or preserve historic property, and the deed must be subject to a conservation agreement as defined by G.S. 121-35. The preservation nonprofit, after it purchases the property under G.S. 160A-266, is permitted to turn around and sell the property subject to covenants that promote the preservation or conservation of the historic property.

In addition, if the local government has established a statutory historic preservation commission (G.S. 160A-400.7), then the commission actually possesses greater authority than the governing board. A governing board is limited to using private sale only when selling to a nonprofit with a historic preservation mission, but a statutory commission is empowered to purchase historic properties and then convey at private sale to any party, subject to covenants that will "secure appropriate rights of public access and promote the preservation of the property." It is not surprising that the General Assembly granted more authority to statutory commissions, because, after all, a majority of the members of a commission must have special interest or expertise in fields related to historic preservation (G.S. 160A-400.7), so presumably they will act knowledgably when selling historic assets without the aid of a historic preservation nonprofit.

Let's return to our scenario involving OMRU and the historic mill property. OMRU is a nonprofit with a historic preservation mission, so the private sale procedures of G.S. 160A-266 are available. Accordingly, the local government may sell the historic mill to OMRU through private sale, provided a conservation agreement is placed in the deed. If the local government has formed a historic preservation commission, then that commission could exercise essentially the same powers and sell the property to OMRU—and it could even sell the property directly to a private developer—subject to preservation covenants and restrictions (G.S. 160A-400.8(3)).

However, there is a still a wrinkle to resolve. OMRU wants to purchase the property for only one dollar—far below the fair market value. Is such a low price permissible?

Consideration to be Paid in Sale of Historic Property

Recall the constitutional prohibition against making gifts of public assets that was mentioned previously. In a sale of public property, the buyer must either participate in a public bidding process (where the winning bid is assumed to be fair market value) or, if private sale is authorized, pay fair market value. There are only two ways that the property could be sold to

OMRU for less than fair market value:

1. **Fair market value is reduced as a result of the covenants and restrictions imposed pursuant to G.S. 160A-266(b)**. The value of commercial property is typically reflective of the income potential of the property. If the income potential is high, then the value of the property will be high. When a property is subject to historic preservation restrictions that limit how the property may be redeveloped, the additional costs and lost revenues associated with complying with the restrictions could reduce the income potential of the property and therefore reduce its value. However, the additional costs associated with historic preservation are mitigated by the use of long-term debt, historic tax credits and other subsidies, and rent premiums that redeveloped historic structures command in the market. As long as there is adequate market demand for space in a redeveloped historic structure, it is essentially inconceivable that the value of the property would be reduced to one dollar by historic preservation covenants. The School of Government's Development Finance Initiative can help local governments assess the market potential for redeveloped historic properties, and a property appraiser could assess the value of the property after factoring in the effect of historic preservation covenants.

2. **OMRU agrees to put the property to public use *and* the local government is permitted to appropriate funds to OMRU for that purpose pursuant to G.S. 160A-279**. A private sale pursuant to G.S. 160A-279 is not related to the historic character of the property. As mentioned earlier, G.S. 160A-279 allows conveyance by private sale provided there are covenants and restrictions to assure the property is *put to a public use by the recipient entity* (OMRU in this case). A public use might include using the space as, for example, a museum, or police sub-station. OMRU could certainly promise to put the property to a public use, but in this case, OMRU intends to sell the property to a for-profit private developer (G.S. 160A-279 specifically prohibits conveyances to a for-profit corporation), and the intended use is not a public use. Additionally, in order to avail itself of the private sale procedures of G.S. 160A-279, the local government must be authorized to appropriate funds to OMRU. Local governments are permitted to establish statutory historic preservation commissions and to appropriate funds to those commissions (G.S. 160A-400.12), but OMRU is not such a commission and therefore it is questionable whether a local government possesses authority to appropriate funds directly to OMRU.

Accordingly, in our scenario, it appears that the local government cannot reduce the sale price below fair market value.

This conclusion makes even more sense when placed in context with other, similar authorities. The most similar situation involves local government authority to convey property for redevelopment. When a local government employs the vast powers of a redevelopment commission (as described here), private sale is not permitted at all—competitive bidding procedures must be used. A set of alternative redevelopment statutes, G.S. 160A-457(3) (cities) and G.S. 153A-377(3) (counties), may be used to convey property for redevelopment when a redevelopment commission is not available. Under those statutes as well, competitive bidding procedures must be used. Private sale is available only in very limited circumstances when cities are following a community development plan for the benefit of low and moderate income persons, and even in that case, the property must be sold for the appraised value of the property. Likewise, in the economic development context, G.S. 158-7.1(d) permits local governments to convey property by private sale to a business that will employ workers at the site, but the sale price must be no less than the "fair market value" (note there is an exception under G.S. 158-7.1(d2) for competitive economic development projects when a substantial number of jobs and new tax revenue will result). Reading these statutes together, and in the absence of specific statutory authority allowing local governments to reduce the price of historic property, it seems clear that the authority to convey historic properties for redevelopment does not include the power to accept payment of less than fair market value.

No discount on sale price—but alternatives?

Having determined that the local government must sell the property to OMRU for fair market value (after accounting for the effect of any historic preservation restrictions)—not for one dollar as OMRU proposed—are there lawful alternatives that might compensate OMRU for its assistance with selling the mill property? There are a few options, but they are not as lucrative for OMRU as its original proposal. One possibility is for the local government to purchase a preservation easement on the property and to pay a fee to OMRU for assisting with monitoring and compliance (a local historic preservation commission is empowered to purchase easements and manage them pursuant to G.S. 160A-400.8(3)). Another possibility is that the unit could pay OMRU a customary broker's fee for marketing the property and for identifying a high-quality developer to buy the property.

Options without OMRU in the deal

Keep in mind, too, that there are other options that don't involve OMRU at all. For example, G.S. 160A-400.8(3) empowers a historic preservation commission to restore, preserve, hold, and manage historic properties, so a commission could rehabilitate the property on its own. In addition, local governments, regardless of whether they have an active statutory preservation commission, possess authority to construct and lease out commercial space for economic development pursuant to G.S. 158-7.1(b)(4), or, if the property is well-suited for residential units, to construct and manage housing for low- and moderate-income persons (G.S. Chapter 157, G.S. 160A-456, G.S. 153A-376). Finally, the local government could even engage a developer directly for the rehabilitation as part of a public-private partnership for construction (P3), provided the local government intends to include a public facility (such as public staff offices) as part of the project. For an example of a historic mill redevelopment accomplished through a P3 led by a North Carolina town, see this post on the School's Community and Economic Development blog. See this post for more information about local government legal authority to enter into a P3 for construction of public facilities.

Links

- www.ncga.state.nc.us/EnactedLegislation/Statutes/HTML/BySection/Chapter_160A/GS_160A-268.html
- www.ncga.state.nc.us/EnactedLegislation/Statutes/HTML/BySection/Chapter_160A/GS_160A-269.html
- www.ncga.state.nc.us/EnactedLegislation/Statutes/HTML/BySection/Chapter_160A/GS_160A-270.html
- www.ncga.state.nc.us/EnactedLegislation/Statutes/HTML/BySection/Chapter_160A/GS_160A-267.html
- www.ncga.state.nc.us/legislation/constitution/ncconstitution.html
- www.ncga.state.nc.us/EnactedLegislation/Statutes/HTML/BySection/Chapter_160A/GS_160A-279.html
- www.ncga.state.nc.us/EnactedLegislation/Statutes/HTML/BySection/Chapter_160A/GS_160A-266.html
- www.ncga.state.nc.us/gascripts/statutes/statutelookup.pl?statute=121-35
- www.ncga.state.nc.us/EnactedLegislation/Statutes/HTML/BySection/Chapter_160A/GS_160A-400.7.html
- www.ncga.state.nc.us/EnactedLegislation/Statutes/HTML/BySection/Chapter_160A/GS_160A-400.8.html
- ced.sog.unc.edu/category/development-finance-initiative/
- www.ncga.state.nc.us/EnactedLegislation/Statutes/HTML/BySection/Chapter_160A/GS_160A-400.12.html
- ced.sog.unc.edu/using-a-redevelopment-area-to-attract-private-investment/
- www.ncga.state.nc.us/EnactedLegislation/Statutes/HTML/BySection/Chapter_160A/GS_160A-457.html
- www.ncga.state.nc.us/gascripts/statutes/statutelookup.pl?statute=153A-377
- www.ncga.state.nc.us/EnactedLegislation/Statutes/HTML/ByChapter/Chapter_158.html
- www.ncga.state.nc.us/gascripts/Statutes/StatutesTOC.pl?Chapter=0157
- www.ncga.state.nc.us/gascripts/statutes/statutelookup.pl?statute=160A-456
- www.ncga.state.nc.us/gascripts/statutes/statutelookup.pl?statute=153A-376
- www.ncga.state.nc.us/gascripts/statutes/statutelookup.pl?statute=143-128.1C
- ced.sog.unc.edu/redevelopment-of-historic-mill-properties-the-morganton-trading-company/
- ced.sog.unc.edu/new-construction-delivery-methods-public-private-partnerships-p3/

GENERAL ASSEMBLY OF NORTH CAROLINA
SESSION 2015

SESSION LAW 2015-277
SENATE BILL 472

AN ACT TO AUTHORIZE LOCAL GOVERNMENTS TO APPROPRIATE MONEY FOR HISTORIC REHABILITATION AND TO CLARIFY AND STANDARDIZE THE REQUIREMENTS FOR APPROPRIATING FUNDS FOR LOCAL ECONOMIC DEVELOPMENT.

The General Assembly of North Carolina enacts:

SECTION 1. G.S. 158-7.1 reads as rewritten:

"**§ 158-7.1. Local development.**

(a) Economic Development. – Each county and city in this State is authorized to make appropriations for ~~the purposes of aiding and encouraging the location of manufacturing enterprises, making industrial surveys and locating industrial and commercial plants in or near such city or in the county; encouraging the building of railroads or other purposes which, in the discretion of~~ economic development purposes. These appropriations must be determined by the governing body of the city or ~~of the~~ county ~~commissioners of the county, will~~ to increase the population, taxable property, agricultural ~~industries and~~ industries, employment, industrial output, or business prospects of ~~any~~ the city or county. These appropriations may be funded by the levy of property taxes pursuant to G.S. 153A-149 and 160A-209 and by the allocation of other revenues whose use is not otherwise restricted by law. The specific activities listed in subsection (b) of this section are not intended to limit the grant of authority provided by this section.

(b) Specific Activities. – A county or city may undertake any of the following specific economic development ~~activities. (This listing is not intended to limit by implication or otherwise the grant of authority set out in subsection (a) of this section). The activities listed in this subsection may be funded by the levy of property taxes pursuant to G.S. 153A-149 and G.S. 160A-209 and by the allocation of other revenues whose use is not otherwise restricted by law.~~activities under this section:

(1) A county or city may acquire and develop land for an industrial park, to be used for manufacturing, assembly, fabrication, processing, warehousing, research and development, office use, or similar industrial or commercial purposes. A county may acquire land anywhere in the county, including inside of cities, for an industrial park, while a city may acquire land anywhere in the county or counties in which it is located. A county or city may develop the land by installing utilities, drainage facilities, street and transportation facilities, street lighting, and similar facilities; may demolish or rehabilitate existing structures; and may prepare the site for industrial or commercial uses. A county or city may convey property located in an industrial park pursuant to subsection (d) of this section.

(2) A county or city may acquire, assemble, and hold for resale property that is suitable for industrial or commercial use. A county may acquire such property anywhere in the county, including inside of cities, while a city may acquire such property inside the city or, if the property will be used by a business that will provide jobs to city residents, anywhere in the county or counties in which it is located. A county or city may convey property acquired or assembled under this subdivision pursuant to subsection (d) of this section.

(3) A county or city may acquire options for the acquisition of property that is suitable for industrial or commercial use. The county or city may assign such

an option, following such procedures, for such consideration, and subject to such terms and conditions as the county or city deems desirable.

(4) A county or city may acquire, construct, convey, or lease a building suitable for industrial or commercial use.

(5) A county or city may construct, extend or own utility facilities or may provide for or assist in the extension of utility services to be furnished to an industrial facility, whether the utility is publicly or privately owned.

(6) A county or city may extend or may provide for or assist in the extension of water and sewer lines to industrial properties or facilities, whether the industrial property or facility is publicly or privately owned.

(7) A county or city may engage in site preparation for industrial properties or facilities, whether the industrial property or facility is publicly or privately owned.

(8) A county or city may make grants or loans for the rehabilitation of commercial or noncommercial historic structures, whether the structure is publicly or privately owned.

(c) Public Hearing. – Any appropriation or expenditure pursuant to ~~subsection (b) of~~ this section must be approved by the county or city governing body after a public hearing. The county or city shall publish notice of the public hearing at least 10 days before the hearing is held. If the appropriation or expenditure is for the acquisition of an interest in real property, the notice shall describe the interest to be acquired, the proposed acquisition cost of such interest, the governing body's intention to approve the acquisition, the source of funding for the acquisition and such other information needed to reasonably describe the acquisition. If the appropriation or expenditure is for the improvement of privately owned property by site preparation or by the extension of water and sewer lines to the property, the notice shall describe the improvements to be made, the proposed cost of making the improvements, the source of funding for the improvements, the public benefit to be derived from making the improvements, and any other information needed to reasonably describe the improvements and their purpose.

(d) Interests in Real Property. – A county or city may lease or convey interests in real property held or acquired pursuant to subsection (b) of this section in accordance with the procedures of this subsection. A county or city may convey or lease interests in property by private negotiation and may subject the property to such covenants, conditions, and restrictions as the county or city deems to be in the public interest or necessary to carry out the purposes of this section. Any such conveyance or lease must be approved by the county or city governing body, after a public hearing. The county or city shall publish notice of the public hearing at least 10 days before the hearing is held; the notice shall describe the interest to be conveyed or leased, the value of the interest, the proposed consideration for the conveyance or lease, and the governing body's intention to approve the conveyance or lease. Before such an interest may be conveyed, the county or city governing body shall determine the probable average hourly wage to be paid to workers by the business to be located at the property to be conveyed and the fair market value of the interest, subject to whatever covenants, conditions, and restrictions the county or city proposes to subject it to. The consideration for the conveyance may not be less than the value so determined.

(d1) Repealed by Session Laws 1993, c. 497, s. 22.

(d2) Calculation of Consideration. – In arriving at the amount of consideration that it receives, the Board may take into account prospective tax revenues from improvements to be constructed on the property, prospective sales tax revenues to be generated in the area, as well as any other prospective tax revenues or income coming to the county or city over the next 10 years as a result of the conveyance or lease provided the following conditions are met:

(1) The governing board of the county or city shall determine that the conveyance of the property will stimulate the local economy, promote business, and result in the creation of a substantial number of jobs in the county or city that pay at or above the median average wage in the county or, for a city, in the county where the city is located. A city that spans more than one county is considered to be located in the county where the greatest population of the city resides. For the purpose of this subdivision, the median average wage in a county is the median average wage for all insured industries in the county as computed by the Department of Commerce,

Division of Employment Security, for the most recent period for which data is available.

(2) The governing board of the county or city shall contractually bind the purchaser of the property to construct, within a specified period of time not to exceed five years, improvements on the property that will generate the tax revenue taken into account in arriving at the consideration. Upon failure to construct the improvements specified in the contract, the purchaser shall reconvey the property back to the county or city.

(e) Local Government Budget and Fiscal Control Act. – All appropriations and expenditures pursuant to ~~subsections (b) and (c) of~~ this section shall be subject to the provisions of the Local Government Budget and Fiscal Control Acts of the North Carolina General Statutes, respectively, for cities and counties and shall be listed in the annual financial report the county or city submits to the Local Government Commission. The budget format for each such governing body shall make such disclosures in such detail as the Local Government Commission may by rule and regulation direct.

(f) Limitation. – At the end of each fiscal year, the total of the following for each county and city may not exceed one-half of one percent (0.5%) of the outstanding assessed property tax valuation for the county or city as of January 1 preceding the beginning of the fiscal year:

(1) The investment in property acquired at any time under subdivisions (b)(1) through (b)(4) of this section and owned at the end of the fiscal year.

(2) The amount expended during the fiscal year under subdivisions (b)(5) and (b)(7) of this section.

(3) The amount of tax revenue that was taken into account under subsection (d2) of this section and was expected to be received during the fiscal year.

The Local Government Commission shall review the annual financial reports filed by counties and cities to determine if any county or city has exceeded the limit set by this subsection. If the Commission finds that a county or city has exceeded this limit, it shall notify the county or city. A county or city that receives a notice from the Commission under this subsection must submit to the Commission for its review and approval any appropriation or expenditure the county or city proposes to make under this section during the next three fiscal years. The Commission shall not approve an appropriation or expenditure that would cause a county or city to exceed the limit set by this subsection.

(g) Repealed by Session Laws 1989, c. 374, s. 1.

(h) Economic Development Agreement. – Each economic development agreement entered into between a private enterprise and a city or county shall clearly state their respective responsibilities under the agreement. Each agreement shall contain provisions regarding remedies for a breach of those responsibilities on the part of the private enterprise. These provisions shall include a provision requiring the recapture of sums appropriated or expended by the city or county upon the occurrence of events specified in the agreement. Events that would require the city or county to recapture funds would include the creation of fewer jobs than specified in the agreement, a lower capital investment than specified in the agreement, and failing to maintain operations at a specified level for a period of time specified in the agreement."

SECTION 2. This act is effective when it becomes law.

In the General Assembly read three times and ratified this the 23rd day of September, 2015.

s/ Daniel J. Forest
President of the Senate

s/ Tim Moore
Speaker of the House of Representatives

s/ Pat McCrory
Governor

Approved 10:34 a.m. this 20th day of October, 2015

INTRODUCTION TO

Local Government Finance

Fourth Edition 2018

UNC SCHOOL OF GOVERNMENT

Edited by
KARA A. MILLONZI

The School of Government at the University of North Carolina at Chapel Hill works to improve the lives of North Carolinians by engaging in practical scholarship that helps public officials and citizens understand and improve state and local government. Established in 1931 as the Institute of Government, the School provides educational, advisory, and research services for state and local governments. The School of Government is also home to a nationally ranked Master of Public Administration program, the North Carolina Judicial College, and specialized centers focused on community and economic development, information technology, and environmental finance.

As the largest university-based local government training, advisory, and research organization in the United States, the School of Government offers up to 200 courses, webinars, and specialized conferences for more than 12,000 public officials each year. In addition, faculty members annually publish approximately 50 books, manuals, reports, articles, bulletins, and other print and online content related to state and local government. The School also produces the *Daily Bulletin Online* each day the General Assembly is in session, reporting on activities for members of the legislature and others who need to follow the course of legislation.

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Preface

Finance is a cornerstone of local government operations. Issues related to finance cut across multiple departments within a unit and delimit the duties of many local government officials and employees. North Carolina local governments derive all of their financial authority from the General Assembly, including the power to raise revenue, budget and manage that revenue, and expend the revenue to support activities and projects that benefit the unit's citizens. The legal rules governing finance establish the framework within which fiscal and program decisions are made and implemented, authorize and sometimes restrict the financial resources available to local governments, and define the sorts of activities in which local governments may participate.

This book provides an introduction to these legal rules as well as to basic principles of revenue forecasting, budgeting, accounting, and financial management. It serves as the textbook for "Introduction to Local Government Finance," the foundational course of the School of Government's finance curriculum. Intended for local government officials and employees who manage, supervise, or oversee any aspect of local government finance, the course is particularly recommended for new finance officers and other finance personnel, managers, budget officers, purchasers, tax collectors and other tax office personnel as well as local government attorneys. The course provides a survey of the statutory, strategic, and practical limits of local government finance and financial management. Areas of instruction include the basic legal authority and requirements relating to local government revenues, budgeting processes, cash management, purchasing and contracting, expenditure control, conflicts of interest, fund accounting, and financial reporting. It also covers special public records laws relating to local government finance records and information.

The text, like the course, is a collaborative effort among the School's local government finance faculty members. It is divided into four sections. Section I, Legal Framework, begins with a discussion of the constitutional public purpose clause. It then provides a brief overview of the Local Government Budget and Fiscal Control Act (LGBFCA), which comprises the set of statutes that govern budgeting, accounting, and financial management of local public funds in North Carolina. Section II, Budgeting and Revenues, surveys the various revenues and other funding mechanisms available to local governments and details the budgeting processes for operating and

capital expenditures. Section III, Financial Management, delves into several of the specific statutory processes and requirements of the LGBFCA—namely, cash management and investments, expenditure control, and accounting and financial reporting. It also covers purchasing and contracting and conflicts of interest. Finally, Section IV, Select Expenditure Categories, highlights the financing authority and processes for a few major local government functions—public enterprises, public schools, and community and economic development. The appendix compiles the statutes that constitute the LGBFCA. Unless otherwise indicated in a specific chapter, the text reflects statutory provisions and case law through the 2018 legislative session, which concluded on July 1, 2018.

The authors wish to thank our colleagues and clients who reviewed each chapter and provided many helpful suggestions for improvement. We are extremely grateful also to Leslie Watkins, Kevin Justice, Daniel Soileau, and other members of the School's publications team for the invaluable work of designing, editing, and producing the text. Finally, this text has profited greatly from our continuing association with the people for whom it is intended—local and state officials in North Carolina. Their questions and suggestions have done much to shape the book as well as the introductory course.

Kara A. Millonzi
Professor of Public Law and Government
Summer 2018

Chapter 14

Financing and Public-Private Partnerships for Community Economic Development

by C. Tyler Mulligan

Community Economic Development (CED) refers to efforts to stimulate markets in low-income communities in order to attract private investment in job-creating businesses, downtown revitalization, affordable housing, and other public benefits.[1] These efforts occur at the intersection of the related fields of community development and economic development. Community development programs include improving the appearance of neglected neighborhoods or commercial areas, constructing housing that is affordable to low-income workers, and alleviating problems associated

This chapter reflects the law through July 1, 2018.

1. "The premise is that the markets in low-income communities do not work well; accordingly, the remedy is to stimulate them." Roger A. Clay Jr. and Susan R. Jones, eds., *Building Healthy Communities: A Guide to Community Economic Development for Advocates, Lawyers, and Policy-Makers* (Chicago: ABA Publishing, 2009), 11. *See also* William H. Simon, *The Community Economic Development Movement: Law, Business, and the New Social Policy* (Durham, N.C.: Duke University Press, 2001).

with unemployment and underemployment.[2] Economic development programs often include place-based development activities, such as downtown revitalization and promotion of tourism, to complement their business recruitment, retention, and entrepreneurship efforts.[3] The hope is that improving the built environment and leveraging the natural attributes, cultural heritage, and distinctive character of a place will encourage investment and growth.[4] Some CED projects are *publicly* owned and can be financed through traditional public financing mechanisms discussed in earlier chapters of this book. The focus of this chapter, however, is local government authority to use financing mechanisms to induce or participate directly in *private* development in furtherance of CED goals, typically through creative public-private partnerships.

This chapter proceeds in three parts. The first part articulates the rationale for local government involvement in the revitalization or redevelopment of a community's built environment—a primary focus of CED efforts. The second part describes federal and state programs that support such CED efforts. Finally, the third part explains local government legal authority for the use of financing mechanisms and public-private partnerships to attract private investment for CED purposes.

Revitalization and Redevelopment of the Built Environment

The built environment of a community—the buildings (houses, retail stores, manufacturing facilities) and infrastructure (roads, water and sewer, telecommunications)—is essential to attracting private investment, and the implications of absent or inadequate built assets can be far-reaching. Water and sewer infrastructure is almost always a prerequisite for economic development and job creation.[5] Access to broadband contributes to both economic development and access to education and health care.[6] A well-maintained historic downtown—even in a rural area—confers

2. C. Tyler Mulligan, "Community Development and Affordable Housing," in *County and Municipal Government in North Carolina*, 2nd ed., edited by Frayda S. Bluestein (Chapel Hill: UNC School of Government, 2014).

3. Jonathan Q. Morgan and C. Tyler Mulligan, "Economic Development," in *County and Municipal Government in North Carolina*, 2nd ed., edited by Frayda S. Bluestein (Chapel Hill: UNC School of Government, 2014).

4. *See* William Lambe and C. Tyler Mulligan, introduction to "Local Innovation in Community and Economic Development: Stories from Asheville, Edenton, Kannapolis, Wilson and Winston-Salem," *Carolina Planning* 34 (2009): 16–19.

5. Faqir S. Bagi, "Economic Impact of Water/Sewer Facilities on Rural and Urban Communities," *Rural America* 17 (Winter 2002): 44, 45–46.

6. Peter Stenberg and Sarah A. Low, *Rural Broadband at a Glance, 2009 Edition*, Economic Information Bulletin No. 47 (Washington, D.C.: Economic Research Service, U.S. Department of Agriculture, Feb. 2009), https://www.ers.usda.gov/publications/pub-details/?pubid=44324; Peter Stenberg, Mitch Morehart, Stephen Vogel, John Cromartie, Vince Breneman, and Dennis Brown, *Broadband Internet's Value for Rural America*, Economic Research Report No. 78 (Washington, D.C.: Economic Research Service, U.S. Department of Agriculture, Aug. 2009), https://www.ers.usda.gov/publications/

benefits on the wider community.[7] In addition, there is evidence of a link between the built environment in a community and public health outcomes because residents who live in a thriving "walkable" neighborhood or have convenient access to full-service grocers are more likely to engage in greater physical activity and consume a healthier diet.[8] Furthermore—and of great significance to local governments—the financial health of a community is often dependent on the amount of private investment in built assets because such assets make up the bulk of the tax base on which local governments rely to finance public priorities. For these reasons, among others, local governments typically seek to preserve and revitalize existing built assets.[9]

Attracting and Influencing Private Investment

Communities often seek to influence private investment decisions in order to achieve local development goals, such as creating jobs and increasing the tax base. Traditionally, local governments have attempted to influence private development and investment decisions through the use of zoning and through the construction of streets, water and wastewater facilities, schools, and other public infrastructure. Under that traditional model, areas that received appropriate zoning and public infrastructure would also experience an influx of private investment and development. These traditional public mechanisms, which are described in earlier chapters and are still widely used by local governments across North Carolina, typically do not involve direct public subsidies or direct participation by local governments in private development. In recent years, however, local governments increasingly have begun participating in private development directly through the offer of subsidies or other inducements. Without commenting on the wisdom of such endeavors, this chapter describes the limited circumstances under which such direct subsidies or inducements are permitted by North Carolina law. It should also be noted that financial incentives are but one factor considered by investors among several others, such as accessibility to transportation,

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pub-details/?pubid=46215. North Carolina's efforts are led by the Broadband Infrastructure Office, a division of the North Carolina Department of Commerce. *See "About the Broadband Infrastructure Office,"* N.C. Department of Information Technology website, https://ncbroadband.gov/about-broadbandio.

7. Dagney Faulk, "The Process and Practice of Downtown Revitalization," *Review of Policy Research* 23 (Mar. 2006): 625, 629.

8. The Prevention Institute has profiled eleven examples of predominantly low-income communities that have been transformed by changes in the built environment, particularly in terms of health outcomes. *See* Manal J. Aboelata, *The Built Environment and Health: 11 Profiles of Neighborhood Transformation* (Oakland, Cal.: Prevention Institute, July 2004), http://www.preventioninstitute.org/publications/the-built-environment-and-health-11-profiles-of-neighborhood-transformation.

9. For more on historic preservation, see Richard D. Ducker, "Community Planning, Land Use, and Development," in *County and Municipal Government in North Carolina*, 2nd ed., edited by Frayda S. Bluestein (Chapel Hill: UNC School of Government, 2014).

accessibility to skilled labor, energy availability and costs, and quality of life—many of which are beyond the control of individual counties and municipalities.[10]

Counties and municipalities enjoy broad statutory and constitutional authority to engage in CED activities in general, but they possess more limited authority when it comes to offering incentives. Before describing local government authority in this area, it is first helpful to set the context by summarizing federal and state programs.

Federal Programs

The federal government typically does not get directly involved in state and local development efforts. However, it can be a source of funding for certain types of projects. This section describes federal grant and tax credit programs that are commonly used to finance CED projects.[11]

Community Development Block Grants

The Community Development Block Grant (CDBG) program is the largest and most flexible source of federal community development funds. Created in 1974 as an offshoot of several different existing community development programs, the CDBG program operates in furtherance of three objectives: (1) to benefit low- and moderate-income persons, (2) to help prevent or eliminate slums or blight, and (3) to meet urgent needs.

North Carolina communities have devoted CDBG funds to a wide range of activities, including the creation of affordable housing, improvements in infrastructure, promoting economic development, and the enhancement of community facilities and services. Notwithstanding the program's flexibility—the program's funds may be used to support a wide range of activities—Congress and the U.S. Department of Housing and Urban Development have mandated that, at a minimum, no less than 70 percent of all CDBG funds must be used for activities that directly benefit low- and moderate-income persons. When CDBG funds are used to provide financing for private development projects, local governments must conduct underwriting to determine (1) that private contributions in equity and debt are appropriate, (2) that federal funds are necessary to make the project go forward, and (3) that the project, which was infeasible without the federal assistance, will attain long-term feasibility and achieve the approved public purpose after the subsidy is provided.[12]

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10. As used in this book, the term "municipality" is synonymous with "city," "town," and "village."

11. The description of federal and state programs contained in this chapter draws heavily from similar descriptions contained in Mulligan, *supra* note 2, and Morgan and Mulligan, *supra* note 3.

12. Guidelines and Objectives for Evaluating Project Costs and Financial Requirements, 24 C.F.R. Pt. 570, App. A (Community Development Block Grant underwriting guidelines to ensure public aid is necessary).

The amount of CDBG funds distributed annually is determined by a formula that comprises several measures of community need, including population, housing overcrowding, age of housing, population growth lag in relationship to other metropolitan areas, and the extent of poverty.[13]

The CDBG program is divided into two parts, the Entitlement Program (for large municipalities and urban counties) and the Small Cities Program (for small municipalities and rural areas). Communities that are eligible for Entitlement Program CDBG funds are generally municipalities that have fifty thousand or more residents and urban counties. In North Carolina, twenty-four municipalities and four counties participate in the CDBG Entitlement Program.[14] Several cities and one county have been added to the ranks of these entitlement communities since 2010. Together, all North Carolina entitlement communities received a total of approximately $27 million in fiscal year 2017, and that total is down from more than $28 million in fiscal year 2010, even though fewer entitlement communities were designated at that time.

The Small Cities Program provides North Carolina (and other states) with annual direct grants, which the state in turn awards to local governments in small communities and rural areas. States receive CDBG funds as an annual block grant, and then each state develops a method of distributing funds to eligible local governments. To ensure that Small Cities Program funds are used appropriately and distributed in amounts that are large enough to have an impact, most states (including North Carolina) hold annual funding competitions for non-entitlement communities. States may reflect statewide priorities by earmarking funds for specific activities (e.g., housing rehabilitation or economic development). States also may keep a small percentage to cover administrative costs and to provide technical assistance to local governments and nonprofit organizations. North Carolina received approximately $43 million in CDBG funds for the Small Cities Program in fiscal year 2017, down from almost $49 million in fiscal year 2010. The North Carolina Department of Commerce administers the portion of the state's CDBG funds designated by the General Assembly for economic development and revitalization projects, and the Department of Environmental Quality administers the portion designated for water and wastewater infrastructure.

The HOME Investment Partnerships Program

HOME is a federal program designed to increase the supply of housing for low-income persons. HOME provides funds to states and local governments to implement local housing strategies, which may include tenant-based rental assistance, assistance

13. *See* U.S. Department of Housing and Urban Development, Community Development Block Grant Program—CDBG, http://portal.hud.gov/hudportal/HUD?src=/program_offices/comm_planning/communitydevelopment/programs.

14. The entitlement counties are Cumberland, Mecklenburg, Union, and Wake; the entitlement cities are Asheville, Burlington, Cary, Chapel Hill, Charlotte, Concord, Durham, Fayetteville, Gastonia, Goldsboro, Greensboro, Greenville, Hickory, High Point, Jacksonville, Kannapolis, Lenoir, Morganton, New Bern, Raleigh, Rocky Mount, Salisbury, Wilmington, and Winston-Salem.

to homebuyers, property acquisition, new construction, rehabilitation, site improvements, demolition, relocation, and administrative costs. After certain mandated set-asides, the balance of HOME funds is allocated by formula between qualified municipalities, urban counties, consortia (contiguous units of local government), and states. In North Carolina, the state portion is then reallocated to remaining jurisdictions by the North Carolina Housing Finance Agency. In fiscal year 2017, the federal government allocated over $13 million in HOME funds directly to qualified local jurisdictions (down from $20 million in fiscal year 2010). Over $12 million went to the Housing Finance Agency for use statewide (down from $21 million in fiscal year 2010). The statewide funds are allocated based on each region's housing needs and are available through both competitive and noncompetitive funding programs.

Other Federal Grant Programs

The Economic Development Administration (EDA) provides funding for local governments to engage in economic development planning and implement projects. EDA targets its funding to economically distressed communities and regions by making grants for projects focusing on public works (infrastructure), technical assistance, economic and trade adjustment assistance, and planning. Other federal agencies administer and fund various types of loan guarantees for private lenders, support revolving loan programs, and provide funding for community facilities. These agencies include the Small Business Administration, the U.S. Department of Agriculture, and the U.S. Treasury Department.

Federal Tax Credit Programs

Three federal tax credit programs are designed to induce private investment for CED purposes: the New Markets Tax Credit, the Low-Income Housing Tax Credit, and the Historic Rehabilitation Tax Credit. The New Markets Tax Credit (NMTC) was enacted as part of the federal Community Renewal Tax Relief Act of 2000. Designed to stimulate billions of dollars of new investment in distressed areas, the NMTC allows taxpayers to receive a credit against their federal income taxes for investing in commercial and economic activities in low-income communities. The Low-Income Housing Tax Credit provides tax credits to private investors who develop housing with set-asides for persons earning 60 percent or less of the area median income.[15] The Historic Tax Credit provides tax credits to taxpayers who invest in the rehabilitation of historic structures. North Carolina has also offered complementary state tax credits for investments in historic rehabilitation projects and affordable housing,

15. Federal Low-Income Housing Tax Credits (LIHTC) are awarded to affordable housing developers in North Carolina through a competitive process administered by the North Carolina Housing Finance Agency (NCHFA). Each year, NCHFA promulgates the Qualified Allocation Plan, which explains how projects will be selected to receive an award of tax credits. A 2018 change in federal law allows for "income averaging" within LIHTC properties; that is, properties may accept residents with higher average median incomes as long as the overall average of tenants in the project does not exceed 60 percent of the area median income.

and when combined with federal tax credits, eligible projects are even more attractive to private investors.

Most real estate developers cannot use all of those tax credits themselves, so they sell investment interests in their projects (through a tax credit intermediary or "syndicator") to persons or companies with large tax liabilities. When those entities with large tax liabilities invest in a project in order to receive tax credits, the investment provides an infusion of capital (or equity) into the project. When tax credits are valuable, a developer can attract more equity for a project, making the project more financially feasible. When tax credit values are reduced, developers cannot obtain as much equity for a project, thereby making it more difficult to finance.

Local governments do not typically get involved with tax credit syndication, but they must understand how tax credits work in order to evaluate the necessity of local government participation in a private project.[16] In addition, due to the fact that tax credits help make private development projects possible, local governments are usually active partners in seeking to have projects and qualified areas of their communities designated for special tax treatment.

State Programs

The state's community economic development programs are centered in the Department of Commerce. Statewide economic development efforts are coordinated through the Department of Commerce and its associated nonprofit arm, the Economic Development Partnership of North Carolina.[17] These entities are often the initial points of contact for prospective businesses seeking financial incentives to locate or expand a facility in the state. The Department of Commerce also administers grants and loans for CED projects in rural or distressed communities through its Rural Economic Development Division.[18]

16. A determination of necessity for public aid to private enterprise is legally significant. See C. Tyler Mulligan, *Economic Development Incentives Must Be "Necessary": A Framework for Evaluating the Constitutionality of Public Aid for Private Development Projects*, 11 Harv. L. & Pol'y Rev. S13 (2017). *See also* C. Tyler Mulligan, *Legal and Business Reasons Why Downtown Development Programs Should Involve Secured Loans—Not Grants,* Coates' Canons: NC Loc. Gov't L. blog (Sept. 19, 2017), https://www.sog.unc.edu/blogs/coates-canons/legal-and-business-reasons-why-downtown-development-programs-should-involve-secured-loans%E2%80%94not-grants; Andrew Trump, *How a Local Government Loan Can Make a Revitalization Project Possible*, CED in NC blog (Sept. 4, 2015), https://ced.sog.unc.edu/how-a-local-government-loan-can-make-a-revitalization-project-possible.

17. Section 143B-431.01 of the North Carolina General Statutes (hereinafter G.S.).

18. G.S. 143B-472.126.

Approval for Industrial Revenue Bonds

Industrial Revenue Bonds (IRBs) are a potential source of financing that businesses can use for land, building, and equipment purchases as well as for facility construction. The interest paid to bondholders is exempt from federal and state income taxes, making it possible to offer loans to firms at below-market rates. Only manufacturing companies are eligible to receive IRB funds, and the maximum issuance for a single company in a jurisdiction is related to job creation. IRB issues must be backed by a letter of credit from a bank, so most IRB transactions are completed in partnership with a bank that issues the letter of credit and places the bonds. Counties are authorized to create financing authorities[19] to issue the bonds after approval has been obtained from the county, the secretary of the Department of Commerce, and the Local Government Commission.[20] Although government approvals are part of the process, no government guarantees the bonds. The bonds are secured only by the credit of the company. The approval process for IRBs entails additional transactional costs, so the Department of Commerce advises that in order to be cost-effective, issuances should amount to at least $1.5 million.[21]

Discretionary Incentive Grants for Competitive Projects

At the state level, the two primary discretionary grant programs are the Job Development Investment Grant (JDIG) and the One North Carolina Fund. The JDIG program provides discretionary grants directly to new and expanding companies to induce them to increase employment in North Carolina rather than another state. The grant amount is based on some percentage of withholding taxes paid for each eligible position created over a period of time, with higher amounts awarded for higher levels of capital investment and job creation.[22] The terms of the grant are specified in an agreement that requires the company to comply with certain standards regarding employee health insurance, workplace safety, and wages paid. The grant agreement must include a clawback provision to recapture funds in the event that the company relocates or closes before a specified period of time.

The One North Carolina Fund awards grants to local governments to secure commitments from private companies to locate or expand within the local government's jurisdiction. The grants must be used to install or purchase new equipment; make structural repairs, improvements, or renovations of existing buildings in order to expand operations; construct or improve existing water, sewer, gas or electric utility distribution lines; or equip buildings.[23] Applications for the grants are submitted according to guidelines promulgated by the Department of Commerce, with grants being awarded on the basis of the strategic importance of the industry, the quality of jobs to be created, and the quality of the particular project. The local government must provide matching funds for any award made by the State.

19. G.S. 159C-4.
20. G.S. 159C-7 and -8.
21. Smaller issuances may be possible through a composite bond program.
22. G.S. 143B-437.52.
23. G.S. 143B-437.71.

Tax Credits, Benefits, and Exemptions by County Tier

The state's tax system has long been used to encourage development, and several different types of tax credits are available to companies meeting specified criteria. As already mentioned, the state has its own tax credit programs for historic rehabilitation projects and low-income housing developments that are designed to complement the parallel federal tax credits. The state has, at various times, also supported tax credits and various exemptions for companies that create jobs and invest in facilities and equipment in the state. Benefits and credit amounts under state programs are often based on the relative distress of the county in which the project is located, as signified by a county tier designation assigned by the Department of Commerce. For example, the tier designation system employed in 2017 assigned the forty most distressed counties to tier one, the next forty as tier two, and the twenty least-distressed counties as tier three. The most generous benefits and tax credits are reserved for projects located in tier one counties, with lower benefit amounts offered in higher tiers.

Industrial Development Fund Utility Account for Infrastructure

The Industrial Development Fund Utility Account (Utility Account) provides funds to local governments in the most economically distressed counties for infrastructure projects that are reasonably anticipated to result in job creation.[24] Utility Account funds may not be used for any retail, entertainment, or sports projects. Eligible public infrastructure projects include construction or improvement of water, sewer, gas, telecommunications, high-speed broadband, electrical utility facilities, or transportation infrastructure.

Local Government Authority for Development Incentives

Local governments have broad authority to engage in CED-related activities. Most of these activities involve traditional public functions. These include such economic development activities as employing agents to meet and negotiate with and assist companies interested in locating or expanding within the community, developing strategic plans for economic development, administering unsubsidized revolving loan funds, and advertising the community in industrial development publications and elsewhere. They also include such community development endeavors as forming redevelopment commissions to purchase and improve blighted areas, offering homebuyer counseling to first-time homebuyers, developing community development plans, applying for grants, and managing community facilities.

In addition, counties and municipalities may construct public facilities for CED purposes, such as by extending utility lines, expanding water supply and treatment facilities and sewage treatment facilities, building publicly owned affordable housing, and constructing road improvements. Publicly owned improvements can be financed

24. G.S. 143B-437.01.

by local governments through traditional public financing mechanisms discussed in earlier chapters of this book.

However, North Carolina local governments are increasingly being asked to subsidize or otherwise participate directly in *private* development in furtherance of CED goals. This section describes the limited circumstances under North Carolina law when such participation is permitted.

As a threshold matter, local governments are not permitted to provide "exclusive emoluments"—in other words, gifts of public property—to private entities (Section 32 of Article I of the North Carolina Constitution).[25] Exclusive emoluments are permitted only "in consideration of public services." That is, the public must get something in return—known as "consideration" in contract law—for a payment to a private entity. A separate set of constitutional provisions requires that expenditures by local governments and contractual payments to private entities must serve a public purpose (Section 2 of Article V of the North Carolina Constitution). As long as a payment or expenditure serves a valid public purpose, it satisfies not only the constitutional provisions regarding public purpose, but the exclusive emoluments provision as well. The courts alone—not the legislature, not statutes—decide what is a valid public purpose under the constitution.

An additional constitutional requirement is that North Carolina local governments are authorized to make expenditures only as specifically permitted by statute.[26] In the context of CED projects, there are several different statutes that permit a local government to subsidize development in pursuit of CED goals. Without commenting on the relative merits of offering such subsidies, the discussion below describes the legal authority for entering into a public-private partnership or offering a subsidy or incentive payment in order to induce private development.

First Pursue Partnership Options that Involve No Subsidy to Private Entities

As explained above, the exclusive emoluments clause of the North Carolina Constitution prohibits local governments from making gifts to private entities. There are many options for providing support to a private CED project—options that improve project feasibility—without providing a subsidy (or gift) to the project. If the non-subsidy options make a project financially feasible, then a subsidy must be unnecessary and therefore would amount to an unconstitutional gift. Creativity is permitted so long as the local government follows procedural requirements and does not attempt to give a gift to a private developer. Some effective and legally permissible approaches include the following:

- Construct *publicly owned* infrastructure to support private development. Examples include lighting, public parking, and street improvements.

25. The exclusive emoluments clause of the North Carolina Constitution, which prohibits government gifts to private entities, is consistent with gift clauses found in most state constitutions across the nation. *See* Mulligan, *Economic Development Incentives Must Be "Necessary*, *supra* note 16.

26. N.C. Const. art. VII, § 1 ("The General Assembly . . . may give such powers and duties to counties, cities, and towns, and other governmental subdivisions as it may deem advisable.").

Public parking spaces can be leased to private businesses, subject to some limitations.

- Enter into a public-private partnership (P3)[27] or reimbursement agreement[28] with the developer. A P3 or reimbursement agreement involves the developer constructing *public* facilities and, following construction, the local government buying the public facilities from the developer for a reasonable price.
- For historic buildings, pay the owner a fair price for a preservation easement on the building façade[29] or consider designating the property as a historic landmark to confer a perpetual property tax exemption.[30]
- Offer loans with appropriate market rate terms based on the risk profile of the loan (loan forgiveness and below-market interest rates are typically impermissible gifts).[31]

In the vast majority of development projects—even difficult projects in distressed areas—the above options are sufficient to make a project feasible.

Form of Subsidy: Permissible Cash Payments and Impermissible Tax Abatements

There are limited situations in which it is necessary for a local government to provide a direct subsidy to a project. The most common examples are business location competitions in which significant jobs and capital investment will be "lost to other states" if the subsidy is awarded and affordable housing for low-income persons in which deep subsidization is necessary to make a project feasible.[32] In these cases, provided statutory procedures are followed, it may be permissible to provide the required subsidy.

In other states, such subsidies from local governments can come in the form of special property tax breaks or tax abatements. The tax abatements do not violate those states' constitutional gift clauses because they occur through an adjustment to taxes, not as an expenditure of public funds.[33] In North Carolina, local governments have almost no authority to offer such tax abatements. Under Article V, Section 2, of the state constitution, property tax exemptions and classifications may be made

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27. G.S. 143-128.1C; G.S. 160A-458.3.

28. *See* Adam Lovelady, *Reimbursement Agreements*, Coates' Canons: NC Loc. Gov't L. blog (Jan. 19, 2016), https://www.sog.unc.edu/blogs/coates-canons/reimbursement-agreements.

29. G.S. 160A-400.8.

30. G.S. 105-278.

31. *See* Mulligan, *Legal and Business Reasons Why Downtown Development Programs Should Involve Secured Loans—Not Grants, supra* note 16.

32. For further discussion of affordable housing, see C. Tyler Mulligan, *Local Government Support for Privately Constructed Affordable Housing,* Coates' Canons: NC Loc. Gov't L. blog (June 21, 2016), https://www.sog.unc.edu/blogs/coates-canons/local-government-support-privately-constructed-affordable-housing.

33. Osborne M. Reynolds Jr., Local Government Law 129 (4th ed. 2015) ("Although taxes may not be levied for private (as opposed to public) benefit, *exemptions* from property taxes may validly be authorized by state law except as such exemptions are prohibited by state constitutions.").

only by the General Assembly and then only on a statewide basis. In other words, a local government may not constitutionally offer a special tax classification to a property owner unless that classification is available statewide. An example of one such statewide special classification is the tax exclusion for property designated as a historic landmark by a local government.[34] Unless the legislature has enacted such a special classification for a particular type of development, local officials cannot alter tax rates or offer tax abatements.

However, a number of municipalities and counties have developed a cash grant incentive policy that very much resembles tax abatements. These policies follow a common pattern: the local government offers to make annual cash grants over a number of years (typically five) to businesses that make investments of certain minimum amounts in the county or municipality. (The investment might be either a new facility or the expansion of an existing facility.) The grant reimburses a business for qualifying investments, but the amount of the cash grant is explicitly tied to the amount of property taxes paid by the business. For example, a company that made an investment of at least $5 million might be eligible for a cash grant in an amount up to 50 percent of the property taxes it paid on the resulting facility; larger investments would make the company eligible for a grant that represented a larger percentage of the property taxes paid. These policies closely approach tax abatements but with two important differences: the company receiving the cash incentives pays its property taxes first, and the grant payment is contingent not solely on payment of property taxes, but also on performance of some public purpose or benefit approved in case law, such as job creation that might be lost to other states or construction of affordable housing. One note of caution: no court has directly addressed whether this tax-calculated grant is an unconstitutional attempt to enact a tax abatement or whether it is simply a constitutionally permitted cash grant.[35] With that background established, the following sections describe the various statutes that permit a local government to subsidize development in pursuit of CED goals.

Economic Development

In the economic development context, statutory authority for offering incentive payments to companies is found within the remarkably broad language of Section 158-7.1 of the Local Development Act of 1925.[36] Local governments are authorized to undertake economic development activities and to fund those activities by the levy of property taxes.[37] When a North Carolina local government turns funds over to a private entity for expenditure (through an incentive payment), the local government must give prior approval to how the funds will be expended by the private entity,

34. G.S. 105-278. *See also* Michelle Audette-Bauman, *Designating Local Historic Landmarks in North Carolina*, CED IN NC blog (Sept. 11, 2014), http://ced.sog.unc.edu/designating-local-historic-landmarks-in-north-carolina.

35. *See* Blinson v. State, 186 N.C. App. 328, 335 (2007) (dismissing plaintiff's claim for lack of standing on the constitutional issue of uniformity of taxation).

36. G.S. Chapter 158, Article 1.

37. G.S. 158-7.1(a); G.S. 153A-149(c)(10b) (counties); G.S. 160A-209(c)(10b) (municipalities).

and "all such expenditures shall be accounted for" at the end of the fiscal year.[38] Furthermore, the funds must be made subject to recapture in an incentive agreement in which the private entity promises to create a certain number of jobs, exceed some minimum level of capital investment, and maintain operations throughout a defined compliance period.[39] Additional procedural requirements are imposed when the expenditure involves the purchase or improvement of property, which is almost always the case for an economic development incentive that is contingent on making investments that increase the property tax base.[40]

The restrictions imposed by statute, however, are not the final word. Economic development incentives involve payments of *public* funds to *private* entities in service of a mix of public and private purposes, thereby colliding with the constitutional provisions described above regarding exclusive emoluments and public purpose. This makes economic development different from other *purely public* activities of local governments and results in far more constitutional scrutiny from the courts. For this reason, it is necessary to look closely at case law to determine the extent of a local government's authority to offer economic development incentives.

For most of the past century, North Carolina local governments were not permitted to make incentive payments to private entities. It wasn't until 1996, following the loss of economic development projects to other states, that the North Carolina Supreme Court finally decided in the seminal case *Maready v. City of Winston-Salem*[41] that economic development incentives serve a constitutionally permitted public purpose—*under certain conditions*. Those conditions were reinforced in subsequent cases decided by the North Carolina Court of Appeals and therefore merit closer examination.[42]

The aforementioned cases involved dozens of economic development incentives provided by local governments to private companies pursuant to Section 158-7.1 of the North Carolina General Statutes (hereinafter G.S.). In *Maready*, the court opined that economic development incentives authorized by G.S. 158-7.1 are constitutional "so long as they primarily benefit the public and not a private party." The requisite "net public benefit," according to the court, is accomplished by providing jobs, increasing the tax base, and diversifying the economy. A driving force behind the *Maready* decision was the sense that, without incentives, job-creating facilities

38. G.S. 158-7.2. *See also* Kara Millonzi, *Local Government Appropriations/Grants to Private Entities*, Coates' Canons: NC Loc. Gov't L. blog (June 17, 2010; updated August 2013), https://www.sog.unc.edu/blogs/coates-canons/local-government-appropriationsgrants-private-entities.

39. G.S. 158-7.1(h).

40. G.S. 158-7.1(b). *See also* C. Tyler Mulligan, *Economic Development Incentives and North Carolina Local Governments: A Framework for Analysis*, 91 N.C. L. Rev. 2021, 2036 (2013); C. Tyler Mulligan, *When May NC Local Governments Pay an Economic Development Incentive?* Coates' Canons: NC Loc. Gov't L. blog (Dec. 17, 2013), https://www.sog.unc.edu/blogs/coates-canons/when-may-nc-local-governments-pay-economic-development-incentive.

41. 342 N.C. 708 (1996).

42. Haugh v. Cnty. of Durham, 208 N.C. App. 304 (2010); Blinson v. State, 186 N.C. App. 328 (2007).

would be "lost to other states." The court openly fretted about "the actions of other states" and "inducements . . . offered in other jurisdictions." There was, therefore, an underlying assumption that all of the incentives in *Maready* involved interstate competition.[43] Furthermore, the court approvingly noted the strict procedural requirements imposed by statute and essentially assumed that cash payments to companies for the purchase or improvement of property were subject to the same procedural requirements as if the local government engaged in those activities directly.

In subsequent cases before the North Carolina Court of Appeals, the court has refused to strike down incentives that are "parallel" to those approved in *Maready*.[44] The determination of whether an incentive is "parallel" to *Maready* cannot be reduced to a simple formula, but in general, there are two basic components that should be examined.

First, the consideration (or value) that the local government receives in exchange for an incentive must result in a net public benefit, primarily from job creation and capital investment, that otherwise would be "lost to other states."[45] Specifically, every incentive approved by *Maready* involved both substantial job creation and new tax revenue that paid back the incentives within three to seven years.

Second, the *Maready* court described the typical procedures employed by the local government in approving the incentives in that case. Local governments aiming to make their incentive approval process "parallel" to *Maready* should adhere to the following procedures:

- An initial "but for" or necessity determination is made, typically in a competitive situation, that the incentive is required in order for a project to go forward in the community.
- A written guideline or policy is applied to determine the maximum amount of incentive that can be given to the receiving company.
- Expenditures take the form of reimbursements, not unrestricted cash payments.
- Final approval is made at a public meeting, properly noticed.
- A written agreement governs implementation.

These criteria are not difficult to achieve in the typical economic development incentive scenario, that is, one in which a local government is engaged in competition with other jurisdictions to win a sizable facility with a significant number of permanent jobs. However, not all CED projects provide the requisite job creation and meet the other criteria listed above. That should not be surprising; "CED is *broader than economic development* because it includes community building and the improvement of community life beyond the purely economic."[46] When a project does not involve competing for job creation and capital investment, it may nonetheless be possible

43. *Haugh*, 208 N.C. App. at 317.

44. *Id.* at 319.

45. For more discussion of these forms of consideration and others, see Mulligan, *Economic Development Incentives and North Carolina Local Governments, supra* note 40.

46. Clay and Jones, *supra* note 1, at 3.

to assist the project, provided it accomplishes community development and revitalization objectives. Accordingly, the next section examines statutory authority for providing public aid for private community development and revitalization activities apart from economic development.

Community Development and Revitalization

Local governments have considerable statutory authority to engage in community development activities for the benefit of low-income persons and in revitalization activities to reduce or eliminate blight. Because the pertinent statutes were enacted at different times and in response to different programmatic needs, a local government's authority to undertake community development and revitalization activities is not neatly laid out in one place. The General Assembly passed the Housing Authorities Law in 1935 to enable communities to take advantage of federal grants for public housing. This law, as amended, appears as Article 1 of G.S. Chapter 157. In 1951, responding to the broader purposes of blight eradication in the federal Housing Act of 1949, the General Assembly passed the Urban Redevelopment Law, which, as amended, appears as G.S. Chapter 160A, Article 22. Finally, in response to the Housing and Community Development Act of 1974, the General Assembly passed and later amended G.S. 153A-376 and -377 (counties) and G.S. 160A-456 and -457 (municipalities) to permit local governments to engage in Community Development Block Grant (CDBG) activities authorized by the federal act. These statutes, among others, authorize all counties and municipalities to assist persons of low and moderate incomes using either federal and state grants or local funds. Additional detail on the relevant statutes is provided below.

Urban Redevelopment

Lower income communities, in particular, are often characterized by distressed or blighted built environments, so revitalization and redevelopment of those areas is a natural focus of CED efforts. North Carolina's Urban Redevelopment Law[47] grants authority to both municipalities and counties[48] to engage in programs of blight eradication and redevelopment through the acquisition, clearance, rehabilitation, or rebuilding of areas for residential, commercial, or other purposes. Local governments are authorized to levy taxes and issue and sell bonds for this purpose.[49]

A redevelopment commission must be formed to exercise the powers granted by the Urban Redevelopment Law.[50] The governing board of a local government may serve in this role.[51] Once a commission is formed, its first order of business is to

47. G.S. §§ 160A-500 through -526 (Urban Redevelopment Law). *See also* Tyler Mulligan, *Using a Redevelopment Area to Attract Private Investment*, *Community and Economic Development in North Carolina and Beyond,* CED in NC blog (Nov. 20, 2012), http://ced.sog.unc.edu/using-a-redevelopment-area-to-attract-private-investment.

48. G.S. 160A-503(9) (defining "municipality" to include counties for purposes of Urban Redevelopment Law).

49. G.S. 160A-520.

50. G.S. 160A-504 through -507.1.

51. G.S. 153A-376(b) for counties; G.S. 160A-456(b) for municipalities.

create a redevelopment plan.[52] The redevelopment plan must be approved by the local governing board. Until the redevelopment plan is approved, the commission cannot exercise most of its important development powers.[53]

Once a redevelopment plan has been approved, the redevelopment commission may exercise extensive powers within its area of operation to undertake redevelopment projects directly and to enter into public-private partnerships, "including the making of loans," for the rehabilitation or construction of residential and commercial buildings in the designated area.[54] A unique and useful procedure for property conveyance is also authorized, as discussed in the section titled "*Contributing Real Property in a Public-Private Partnership*," below. The exercise of statutory powers within a formally designated redevelopment area by a redevelopment commission has been upheld by the North Carolina Supreme Court as serving a public purpose.[55]

Community Development and Affordable Housing

CED efforts typically focus on low-income communities in which markets are perceived to work poorly or inefficiently. In the American Community Survey, hundreds of thousands of households in North Carolina were reported to suffer from some kind of housing problem, whether physical inadequacy, overcrowding, or cost burden.[56] This suggests that private market forces are unable to respond to consumer demand for safe, decent, and affordable housing. Local governments have therefore attempted to address these problems through a variety of housing programs.

Local governments possess broad powers to rehabilitate or construct affordable housing directly, to include the use of eminent domain to take property in furtherance of that purpose.[57] These powers are derived primarily from North Carolina's sweeping Housing Authorities Law.[58] Regardless of whether or not a formal housing authority has been established by a local government, the governing board may exercise the powers of a housing authority directly.[59] Those powers include the authority to enter into public-private partnerships by offering grants, loans, and other programs of financial assistance to public or private developers of housing for persons of low and moderate incomes.[60] When financial assistance is provided to a multi-family rental housing project, at least 20 percent of the units must be set aside for low-income

52. G.S. 160A-513.

53. G.S. 160A-513(j).

54. G.S. 160A-512; G.S. 160A-503(19).

55. Redevelopment Comm'n of Greensboro v. Sec. Nat'l Bank, 252 N.C. 595 (1960).

56. Data on the extent of affordable housing problems in North Carolina as reported in the American Community Survey can be reviewed through the CHAS (Comprehensive Housing Affordability Strategy) data query tool, https://www.huduser.gov/portal/datasets/cp.html.

57. *In re* Hous. Auth. of City of Charlotte, 233 N.C. 649 (1951).

58. G.S. Chapter 157, Article 1.

59. G.S. 160A-456(b) (municipalities); G.S. 153A-376(b) (counties).

60. G.S. 157-3(12). The North Carolina Supreme Court has found activities undertaken for the benefit of low- and moderate-income persons to serve a public purpose. *See In re* Housing Bonds, 307 N.C. 52 (1980) (approving bonds for loan products intended for moderate income households). *See also* Mulligan, *supra* note 32.

persons for at least fifteen years.[61] Several local governments in North Carolina have offered financial incentives to private developers in exchange for promises to produce affordable housing as part of larger market-rate residential developments, sometimes in conjunction with land use regulations known as inclusionary zoning or inclusionary housing programs.[62]

Community development efforts are not limited to housing. Local governments are authorized to offer grants or loans for rehabilitation of private buildings as part of "community development programs and activities,"[63] which refer to programs for the benefit of low- and moderate-income persons pursuant to the federal CDBG program (described above in the "Federal Programs" section).[64] Although the statutory authority was enacted to enable local governments to participate in the CDBG program, the statute is written broadly enough that a local government can use the authority provided in the statute to undertake community development activities outside of the CDBG program that would otherwise meet CDBG requirements. Municipalities are permitted to use property tax revenues for such purposes;[65] counties, however, are limited in that local and state funds may be used only for housing and housing rehabilitation (not other activities), unless pursuant to referendum.[66]

Downtown Revitalization and Business Improvement Districts (BIDs)

When the focus of CED efforts is a central business district (or other qualifying urban area in a municipality), municipalities (but not counties) may support development through a municipal service district—also known as a business improvement district or BID—in which additional property taxes are levied on property in the district for the purpose of engaging in "downtown revitalization projects" or "urban area revitalization" in certain areas outside of downtowns.[67] In addition to the service district levy, a municipality may allocate other revenues to the service district.[68] Once the area is properly designated as a municipal service district for downtown or urban area revitalization, permissible revitalization activities in the area include making infrastructure improvements, marketing the area, sponsoring festivals, and providing supplemental cleaning and security services, among others. In particular, the proceeds from the additional tax levy may be expended for "promotion and developmental

61. G.S. 157-9.4.

62. A detailed examination of inclusionary housing programs and associated incentive policies applicable to any local government affordable housing program is provided in C. Tyler Mulligan and James L. Joyce, *Inclusionary Zoning: A Guide to Ordinances and the Law* (Chapel Hill: UNC School of Government, 2010).

63. G.S. 160A-456 (municipalities) and G.S. 153A-376 (counties).

64. *North Carolina Legislation 1975*, edited by Joan G. Brannon (Chapel Hill: UNC Institute of Government, 1975), 51–52 (explaining that the predecessor to G.S. 160A-456 was enacted in 1975 to eliminate questions about whether North Carolina communities were authorized "to participate fully" in the CDBG program authorized by the Housing and Community Development Act of 1974).

65. G.S. 160A-456; G.S. 160A-209(c)(9a), (15a), (31a).

66. G.S. 153A-376(e); G.S. 153A-149(c)(15a), (15b).

67. G.S. 160A-536.

68. G.S. 160A-542.

activities," such as "promoting business investment" in the district.[69] Several local governments have used this authority as the basis for providing matching grants for building façade improvements in order to induce private owners to enhance the safety and appearance of public spaces within the district.

The statutory language quoted above arguably can be stretched to include the payment of cash incentives to induce construction or rehabilitation of privately owned real property in the district. There likely are constitutional problems with interpreting the statute this way.[70] The statute's current language was enacted prior to the *Maready* case described above—at a time when incentives were not permissible in any form—and therefore the original language did not contemplate incentives to private entities.[71] Even if the language is interpreted broadly today, arguably it is subject to the constitutional limitations imposed by *Maready*—namely, any incentive must secure substantial job creation and capital investment that otherwise would be "lost to other states." In addition, a review of case law across the nation offers no support for such incentives—no cases suggest there is a constitutional basis for granting public subsidies to private developers outside of the instances already mentioned above: economic development with competition for jobs, urban renewal of blighted areas, and projects primarily for the benefit of low- and moderate-income persons.[72] To the contrary, the Arizona Supreme Court, en banc in 2010, held that cash payments to the developer of a mixed-use development were an unconstitutional gift because tax revenues alone were not valid consideration under that state's gift clause.[73] The holding in Arizona, while possibly influential, is not controlling in North Carolina, so the question remains unresolved here.

Accordingly, there is legal risk associated with relying on North Carolina's downtown revitalization statute to make incentive payments to private developers. For those local governments that wish to take advantage of the ambiguity in this statute to offer such incentives anyway, it is recommended that they mitigate their risk somewhat in two ways: (1) adhere to the *Maready* procedural requirements described in the section titled "Economic Development," above, and (2) attempt to determine the "necessity" of the grant.[74]

Determining "necessity" may be particularly challenging for a *noncompetitive* downtown revitalization project as compared to a *competitive* economic development

69. A local government is permitted to allocate other funds to the district in addition to the funds collected through the municipal service district levy. G.S. 160A-542.

70. C. Tyler Mulligan, *Cash Grants for Real Estate Developers without Competition for Jobs—A Constitutional Quandary*, Coates' Canons: NC Loc. Gov't L. blog (Sept. 15, 2015), https://www.sog.unc.edu/blogs/coates-canons/cash-grants-real-estate-developers-without-competition-jobs%E2%80%94-constitutional-quandary.

71. 1973 N.C. Sess. Laws ch. 655; 1977 N.C. Sess. Laws ch. 775.

72. Reynolds, *supra* note 33, at 522 (stating that slum clearance and affordable housing serve a public purpose for "spending of government money"); Mulligan, *Economic Development Incentives Must Be "Necessary," supra* note 16, at S16–S18.

73. Turken v. Gordon, 224 P.3d 158 (Ariz. 2010).

74. *See supra* note 16.

project that could be "lost to other states" if an incentive is not offered.[75] Most retail and residential projects are not competitive for location because they are financed and constructed to meet local market demand, which is the reason why such projects are routinely excluded from state incentive programs.[76] Incentive-seeking developers of noncompetitive projects may claim that incentives are "necessary" to make their projects feasible, but careful analysis is required to determine whether such claims are legitimate.[77] Alternatives that do not involve direct subsidies, such as fair market value lease arrangements, market-rate mezzanine loans, and construction of supporting public infrastructure, should be considered first—and if those alternatives make the project feasible, then an incentive grant cannot be "necessary."[78]

Even if a grant is determined to be "necessary," it should be considered equivalent to an equity contribution to the project.[79] Accordingly, in return for a grant, the local government should receive a share of future project revenues (separate from tax revenue) or other form of consideration, secured by a deed of trust on the property that can be removed after the grant is repaid. Other rights might also be secured in the arrangement, such as the right to enter the property to make repairs and to apply the cost of such repairs to the outstanding balance on the deed of trust. By securing such rights for the public, the local government may possibly avoid the claim that it has made an unconstitutional gift to a private entity.

Contributing Real Property in a Public-Private Partnership

Local governments occasionally encourage development by contributing real property to a public-private partnership. Authority for local governments to contribute property to private development projects—particularly at a subsidized price—is quite limited under North Carolina law.

As a general rule, local governments are always permitted to convey real property to private entities by following competitive bidding procedures: sealed bid, upset bid, or public auction.[80] The price reached through competitive bidding is presumed by the courts to be the fair market value of the property.[81] However, those procedures do not permit the local government to impose restrictions on the use of the property or to select the buyer for reasons other than bid amount. As a result, competitive bidding

75. Mulligan, *Legal and Business Reasons Why Downtown Development Programs Should Involve Secured Loans—Not Grants, supra* note 16.

76. *See, e.g,* G.S. 143B-437.01 (imposing a wage standard and excluding retail and entertainment from consideration for a Utility Fund grant); G.S. 143B-437.53 (excluding retail from consideration for Job Development Investment Grants (JDIG)).

77. Mulligan, *Economic Development Incentives Must Be "Necessary," supra* note 16, at S25–S27.

78. For additional explanation of the available alternatives, see *Mulligan*, *supra* note 70.

79. For a discussion of equity investments by local governments, see David M. Lawrence, *Economic Development Law for North Carolina Local Governments*, 50–51 (Chapel Hill: UNC School of Government, 2000).

80. G.S. 160A-268, -270, -279. *See also* Chapter 10, "Procurement, Contracting, and Disposal of Property."

81. Redevelopment Comm'n of Greensboro v. Secu. Nat. Bank of Greensboro, 252 N.C. 595, 612 (1960).

procedures may not work well for CED purposes where the normal market is presumed to function poorly or inefficiently. It is often necessary for a local government to impose conditions and requirements on a buyer of real property for a CED project and to select the buyer that is capable of meeting the requirements, in order to ensure that the property is developed in accordance with local priorities.

The statutes contemplate this necessity. Local governments are, in certain situations for CED purposes, authorized to place conditions on the sale of government property, either by selecting a specific buyer through "private sale" or by imposing restrictions on how the property is to be used. It should be noted that the authority to convey property by private sale does not mean that the property can be given away. Rather, the property is to be sold at or near fair market value. Even if statutes fail to impose an explicit requirement regarding a minimum sale price, the state constitution, as already discussed, prohibits gifts of public money or property to private persons.

How or why a property was first acquired may constrain how it can later be conveyed to a private entity. Specified acquisition procedures must be followed for a local government to be able to take advantage of some of the more flexible conveyance statutes when the property is eventually sold.[82] A comprehensive examination of property acquisition and conveyance laws is beyond the scope of this chapter,[83] but the following discussion focuses on the key statutes permitting a local government to deviate from competitive bidding procedures for CED purposes.

Conveyance of Real Property for Economic Development

Pursuant to the Local Development Act of 1925,[84] property acquired for economic development may later be conveyed "by private negotiation [subject to] such covenants, conditions, and restrictions as the county or city deems to be in the public interest."[85] The consideration "may not be less than" the "fair market value of the interest," and the sale must be preceded by a properly noticed public hearing (G.S. 158-7.2(d)). The conveyance may be subsidized only if certain statutory requirements are met: the buyer must be contractually bound to construct improvements that will generate new tax revenue over ten years that will repay the subsidy, and the buyer must promise to create a substantial number of jobs paying at or above the average wage in the county.[86] A subsidized transaction (or incentive) is also subject to the *Maready* requirements discussed earlier in this chapter, such as substantial job creation and capital investment that would otherwise be lost to other states. These requirements apply equally to conveyances of property to nonprofit economic development organi-

82. C. Tyler Mulligan, *Follow Procedures Prior to Acquiring Property for Redevelopment*, Coates' Canons: NC Loc. Gov't L. blog (Mar. 15, 2016), https://www.sog.unc.edu/blogs/coates-canons/follow-procedures-prior-acquiring-property-redevelopment.

83. Procedures for conveyance of real property by local governments are discussed in detail in David Lawrence, *Local Government Property Transactions in North Carolina*, 2nd ed. (Chapel Hill: UNC School of Government, 2000).

84. G.S. Chapter 158, Article 1.

85. G.S. 158-7.1(d).

86. G.S. 158-7.1(d2).

zations that work with local governments; that is, a nonprofit economic development organization must pay fair market value for any property it acquires from the local government if later it intends to sell that property to private businesses.[87]

A unit that wants to take advantage of the flexible conveyance procedures for economic development available under the Local Development Act typically *must first acquire the property pursuant to the act*. This requires strict adherence to the notice and hearing requirements of G.S. 158-7.1(c).[88] A unit that fails to adhere to these procedures has, by default, probably acquired the property for redevelopment, which is governed by a statute that imposes no acquisition procedures. However, although there are no set procedures to follow when property is acquired for redevelopment, the trade-off is that redevelopment offers less flexibility upon conveyance, as described in the next section.

Conveyance of Real Property for Redevelopment

When local governments acquire property for redevelopment, the applicable statutory authority for the acquisition is G.S. 153A-377 (counties) and G.S. 160A-457 (municipalities). No special acquisition procedures must be followed.[89] Property so acquired "shall be [disposed] in accordance with the procedures of Article 12" of G.S. Chapter 160A.[90] In other words, competitive bidding must be employed and no conditions may be placed on the buyer, except in the case of a sale to a nonprofit organization pursuant to G.S. 160A-279 (discussed at the end of this chapter).

An exception to this general rule is provided for municipalities—but not counties—for property "in a community development project area."[91] Such property may be conveyed "to any redeveloper at private sale" for the appraised value "in accordance with the community development plan."[92] The reference to a community development plan, as previously noted in the discussion of community development, signifies that the activity should benefit low- and moderate-income persons and otherwise meet CDBG requirements.[93] Examples of a "community development project area" include a Neighborhood Revitalization Strategy Area, which is an area designated by

87. C. Tyler Mulligan, *Conveyance of Local Government Property to Nonprofit EDC for Industrial Park*, Coates' Canons: NC Loc. Gov't L. blog (Mar. 17, 2015), https://www.sog.unc.edu/blogs/coates-canons/conveyance-local-government-property-nonprofit-edc-industrial-park.

88. For an explanation of the acquisition procedures to follow in order to obtain greater flexibility later upon conveyance, see Mulligan, *supra* note 82.

89. *Id.*

90. G.S. 160A-457(3).

91. G.S. 160A-457(4).

92. *Id.*

93. For a brief discussion of the history and evolution of G.S. 160A-457, see C. Tyler Mulligan, *Conveyance of Property in a Public-Private Partnership for a "Downtown Development Project,"* Coates' Canons: NC Loc. Gov't L. blog (June 22, 2017), https://www.sog.unc.edu/blogs/coates-canons/conveyance-property-public-private-partnership-%E2%80%9Cdowntown-development-project%E2%80%9D.

an entitlement community for targeted CDBG programs,[94] and Community Revitalization Strategies created through the CDBG Small Cities Program.[95] In such cases, the sale may be "subject to such covenants, conditions and restrictions as may be deemed to be in the public interest." These community development sales must be preceded by a properly noticed public hearing.

Conveyance of Real Property Pursuant to the Urban Redevelopment Law

A redevelopment commission, or a governing board exercising the powers of a redevelopment commission, may convey property owned by the commission in a designated redevelopment area.[96] Conveyance is permitted only for purposes that accord with the redevelopment plan, and the governing board must approve any sale. Competitive bidding procedures must be employed, but unlike other conveyance statutes, this one authorizes the sale to be subject to covenants and conditions to ensure that any redevelopment complies with the redevelopment plan. Typically, a competitive bidding process may not be encumbered by such restrictions on the buyer.[97] Urban redevelopment law, however, uniquely combines competitive bidding procedures with the ability to place restrictions on the buyer. Only a housing authority, which is entirely exempt from typical conveyance procedures as described below, can dispose of property in a similar manner.

Conveyance of Real Property Pursuant to the Housing Authorities Law

A housing authority, or a governing board exercising the powers of a housing authority, may convey property it owns for purposes of constructing or preserving affordable housing for persons of low and moderate income.[98] It is important to point out that statutory disposition requirements that apply to other public bodies are not applicable to conveyances under the Housing Authorities Law.[99] This means that the local government may impose restrictions and covenants as well as subsidize the sale in order to ensure that the buyer will use the property for affordable housing. Although such transactions are exempt from typical conveyance procedures, as a matter of

94. For an explanation of Neighborhood Revitalization Strategy Areas, see U.S. Department of Housing and Urban Development, Notice CPD-96-01 (Jan. 16, 1996), www.hudexchange.info/resources/documents/Notice-CPD-96-01-CDBG-Neighborhood-Revitalization-Strategies.pdf.

95. Community Revitalization Strategy areas through the Small Cities Program are described in U.S. Department of Housing and Urban Development, Notice CPD-97-1 (Feb. 4, 1997), https://www.hudexchange.info/resource/2137/notice-cpd-97-01-cdbg-community-revitalization-in-state-cdbg-program.

96. G.S. 160A-514

97. Puett v. Gaston Cnty., 19 N.C. App. 231, 235 (1973).

98. G.S. 157-9.

99. "No provisions with respect to the acquisition, operation or disposition of property by other public bodies shall be applicable to an authority unless the legislature shall specifically so state." G.S. 157-9(a). Note also that supplemental authority to sell real property for affordable housing has been enacted for counties (G.S. 153A-378) and municipalities (G.S. 160A-457.2).

practice, many local governments voluntarily follow the statutory procedures for conveyance by private sale.[100]

Conveyance of Real Property in Public-Private Partnership Construction Contracts

Local governments are authorized to contribute property when entering into public-private partnerships for construction of downtown development projects[101] and as part of public-private partnership construction contracts.[102] The projects authorized under these statutes include joint developments with private developers in which public capital facilities are constructed as part of a larger *private* development project. Real property may be contributed by the local government to the larger development project. The statutes do not authorize the local government to subsidize the conveyance of property (and, as previously noted, the state constitution prohibits making gifts to private developers), so it is presumed that any property contributed by the local government will be valued at fair market value and that development costs paid by the local government for public facilities will be reasonable. The local government and the developer may enter into agreements governing the development project, thereby offering the local government some control over the development process and its outcomes.

Other Purposes for Conveyance of Real Property

Local governments also may convey property for other purposes, such as conveyances to historic preservation organizations or to entities carrying out a public purpose. In the case of conveyances to historic preservation organizations, the statute does not authorize any subsidy as part of such conveyance—the benefit conferred by statute is the authority to deviate from competitive bidding procedures in order to select the buyer and convey by private sale.[103] In the case of conveyances to entities carrying out a public purpose, the local government may accept non-monetary consideration (meaning the conveyance may be subsidized by accepting less than fair market value), but the "city or county shall attach to any such conveyance covenants or conditions which assure that the property will be put to a public use *by the recipient entity.*"[104] Thus, the recipient entity is not permitted to re-convey the property to another entity.

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100. Private sale procedures are found in G.S. 160A-267.

101. G.S. 160A-458.3. *See also,* Mulligan, *supra* note 93.

102. G.S. 143-128.1C. *See also* Norma Houston, *New Construction Delivery Methods—Public-Private Partnerships (P3)*, Coates' Canons: NC Loc. Gov't L. blog (Mar. 5, 2014), http://canons.sog.unc.edu/new-construction-delivery-methods-public-private-partnerships-p3.

103. G.S. 160A-266(b). *See also Tyler Mulligan*, *Sale of Historic Structures by NC Local Governments for Redevelopment*, Coates' Canons: NC Loc. Gov't L. blog (Dec. 16, 2014), http://canons.sog.unc.edu/sale-of-historic-structures-by-nc-local-governments-for-redevelopment.

104. G.S. 160A-279 (emphasis added).

Conclusion

Although they are accorded broad statutory authority for subsidies and other activities in partnership with private entities in pursuit of CED goals, local governments should carefully structure such partnerships to comply with constitutional and statutory requirements. Furthermore, local governments should evaluate whether subsidies are necessary and whether public-private partnerships secure substantial public benefit at a reasonable cost. How to structure these transactions in order to maximize public benefit goes well beyond the scope of this chapter, but local governments should consider developing internal capacity or seek expert assistance to understand the financial and legal aspects of public-private partnerships.[105]

105. The UNC School of Government provides specialized finance and development expertise to local government officials regarding CED projects. More information is available at ced.sog.unc.edu.

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NC Economic Development Toolbox:
Local Government Legal Authority and Options

Essentials of Economic Development
Kernersville, NC
February 13, 2019

Tyler Mulligan
Professor of Public Law and Government

UNC SCHOOL OF GOVERNMENT www.sog.unc.edu

Overview

- Legal context for economic development
- Explore tools depending on project characteristics
  - Industrial recruitment vs. everything else
  - Placemaking and real estate development
- Time permitting: Opportunity Zones

Incentives prior to 20th Century

- Issued bonds to subscribe to the stock of "quasi-public" railroad companies
- Bought bank stock to encourage banking
- Made loans to textile mills
- Constructed roads to mills

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Limits imposed in state constitutions nationwide

- Panic of 1837 led to constitutional limitations on incurring state debt
- No restrictions on municipalities and counties, who eagerly invested in RR
- Many railroad lines abandoned as unprofitable, dangerously impairing credit of municipalities.
- Second constitutional reaction placed limits on municipalities and counties

Pinsky, 111 U. Pa. L. Rev. 265 (1963)

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NC Constitutional Limitations

- No loan of credit
- Tax exemptions statewide only
- No gifts to private entities (no "exclusive emoluments")
- Payments to private entities *only in return for public services*
- Expenditures must serve public purpose
  - Late 1800s: "Beneficent provision for the poor, the unfortunate, and the orphan"
  - Early 1900s: light, water, sewer

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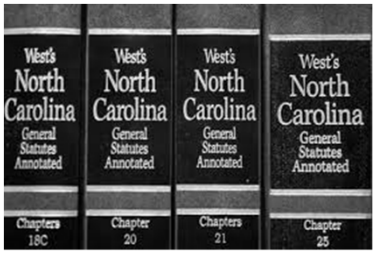
Statutes Are Everything



"The General Assembly … may give such powers and duties to counties, cities, and towns … as it may deem advisable."

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Local Development Act of 1925

G.S. 158-7.1

"Each county and city … is authorized to make appropriations for *economic development* purposes.

Those appropriations must be determined by the governing body … to increase the population, taxable property, agricultural industries, employment, industrial output, or business prospects of the city or county."

Notice and hearing for <u>all</u> expenditures.

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The Town of Yall proposes to make a cash grant to assist the locally owned pie shop with building an addition to its downtown store. Permissible?

No

Only if approved after notice and public hearing

Start the presentation to see live content. Still no live content? Install the app or get help at PollEv.com/app

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Statutes Are Nothing

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Public Purpose Required by NC Constitution

- "No person … is entitled to … privileges from the community **but in consideration of public services**" (no gifts)
- The power of taxation shall be exercised … **for public purposes only**…."
- "[A] public corporation may contract with and appropriate money to any person, association, or corporation for … **public purposes only**."

NO GIFTS

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When do cash grants to private businesses serve public purpose?

Never … in case after case…

until 1996

- Maready v. City of Winston-Salem (1996)
- NC Supreme Court gets last word on meaning of public purpose

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New public purpose in *Maready*: interstate business recruitment

- Increase in "jobs and tax base" that "might otherwise be *lost to other states*."
- "Strict procedural requirements"
  - Finding of "necessity" (aka "but for"/competition)
  - Promise substantial job creation
  - Tax revenue pays back incentive within 7 years

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"Parallel" to *Maready* incentives

- All subsequent cases evaluating incentive grants have involved:
  - Job creation/ retention
  - Increased tax base
  - "Necessary" in interstate competition

- It is hard to say how a court would handle a different set of facts.

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Pie Shop Seating Expansion: "Parallel to *Maready*?"

How Support Pie Shop LEGALLY?
(No Unconstitutional Gifts)

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Subsidies for private business when no interstate competit.?

- Small businesses
- Real estate development

Not permitted unless fits under constitutional category:

- *Maready-"parallel" recruitment incentives*
- *For welfare of "poor" or "low-income" persons*

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Interstate competition has different rules

Interstate Competition

Real Estate Development

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Company perspective on recruitment incentives

- Fiduciary responsibility to shareholders
- Company's goal is interstate competition
- Role of consultants
- Last step: approach governments

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Recruitment Incentives & Prisoner's Dilemma

- More than one prisoner
- Prisoners separated
- No communication
- Both seek to confess to avoid harshest sentence
- How can prisoners break this dilemma?

	Prisoner 1 confesses	Prisoner 1 stays silent
Prisoner 2 confesses	Moderate sentence for both	Light for 2, harsh for 1
Prisoner 2 stays silent	Light for 1, harsh for 2	Both go free

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What can prisoners do?

- Decide in advance
  - Law sets floor
    - Clawbacks required
    - "Substantial job creation"
    - Revenue must exceed incentives
  - Policy sets aspirations
    - Know what you want
    - Anchoring
- Communicate with the other prisoner(s)?

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Common Incentive Questions

- Wage and benefits requirements
- Local hire requirements
- Steal a company from neighboring city?
- Prevent existing business from moving out of state?

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Procedural Incentive Questions

- Company name appear in notice of public hearing?
- New hearing if # of jobs or incentive amount changes after original hearing?
- Giving property to EDC? Or giving money to EDC to buy property?
- Other questions?

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Real estate development tools (no grants)

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Interstate competition is different

Interstate Competition

Real Estate Development

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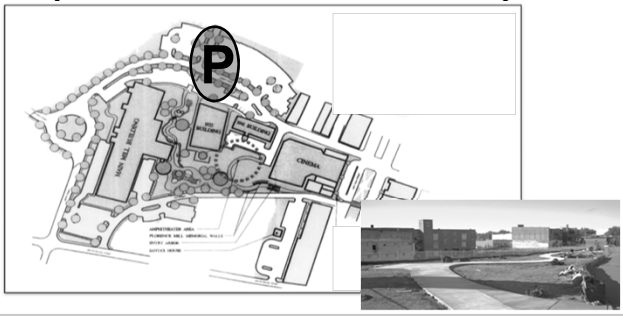
Simplified Case Study (and True Story)

"I have a financing gap"
(despite lots of tax credits)



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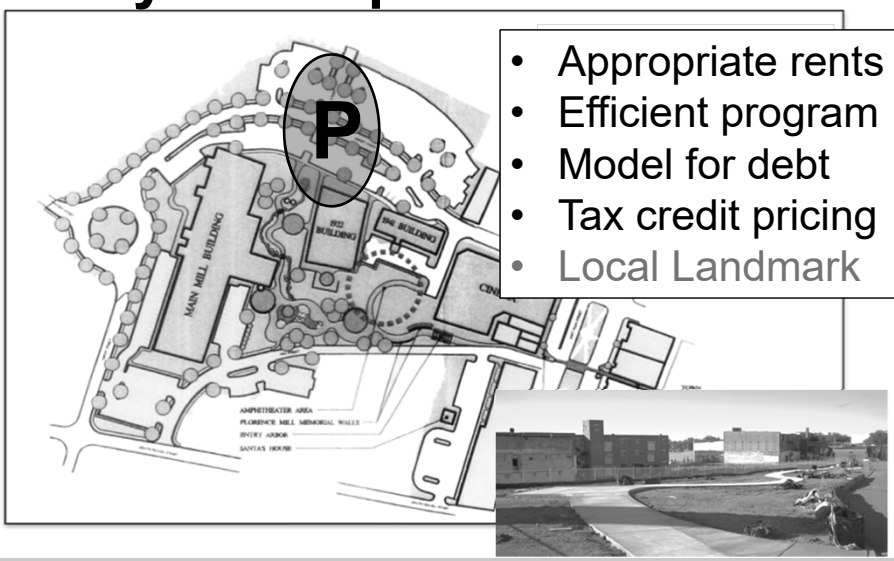
Verify assumptions



- Appropriate rents
- Efficient program
- Model for debt
- Tax credit pricing
- Local Landmark

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Private Financing

$10 MM Cost	($8M rehab, $2M parking)
$7.5 MM bank loan (75%)	(5% interest rate)
Equity needed?	(demands 15%++ IRR)

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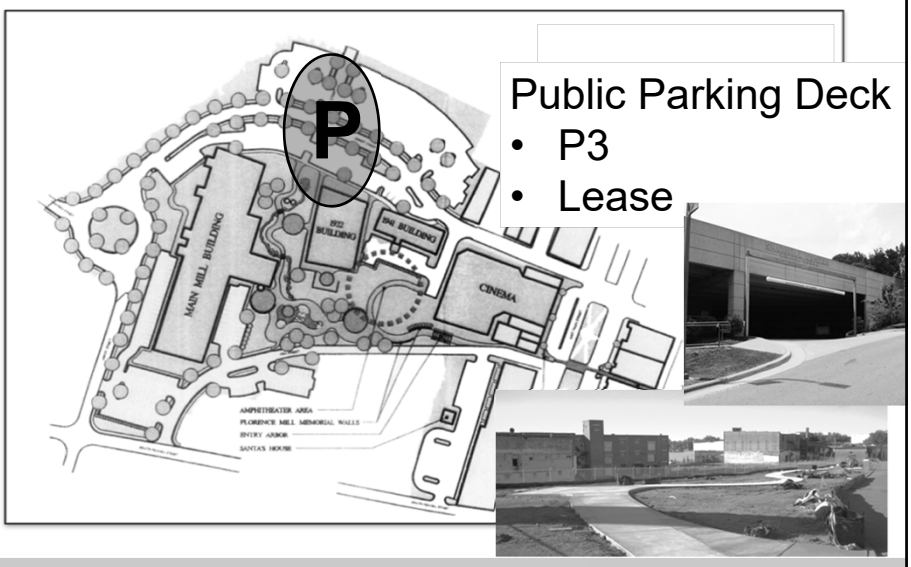
Public Infrastructure & Facilities



Public Parking Deck
- P3
- Lease

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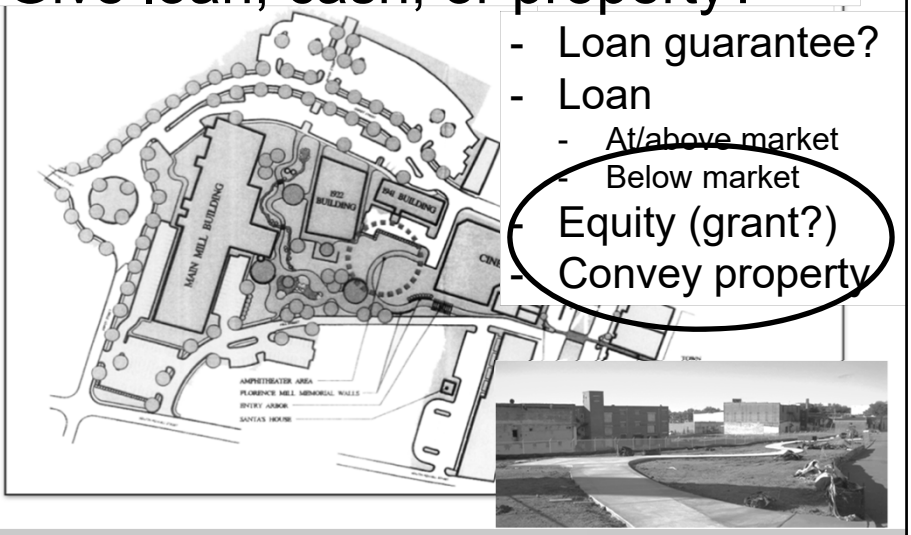
Finance the *private* side: Give loan, cash, or property?



- Loan guarantee?
- Loan
  - At/above market
  - Below market
- Equity (grant?)
- Convey property

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Loan Structure Depends on Return Hurdle

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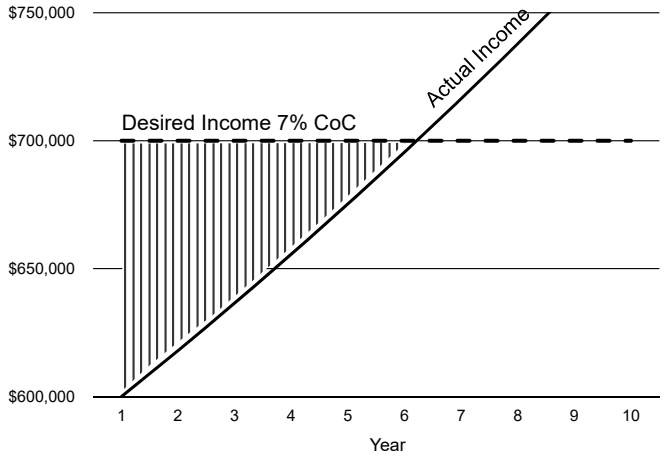
Strategy for CoC or YoC Return Hurdle

Total Development Cost: $10M



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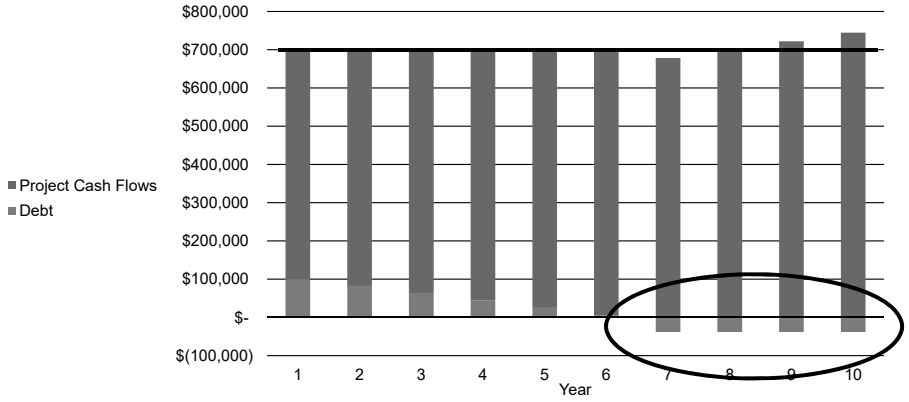
Cash Flows with Line of Credit (Developer Must Pay Back)



A loan almost always works in market-rate development; therefore an incentive grant cannot be *necessary*.

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Plenty of helpful tools don't involve gift to private entity

- Construct supportive *public-owned* infrastructure
  - Parking
  - Street improvements
- Market rate/ fair value transactions
  - Hold property for development until needed
    - Demolish outdated structures
    - Pursue brownfields agreemenr
  - Loan, not grant
    - Security for loan (collateral)
    - Risk-appropriate interest rate
  - Prelease space
- Conduct feasibility analysis to reduce developer risk

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Opportunity Zones
(Time Permitting)

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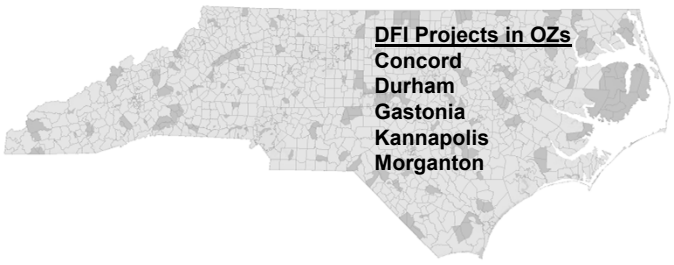
NC Opportunity Zones

Counties with the most OZs	
Mecklenburg	17
Wake	13
Guilford	12
Forsyth	11
Cumberland	9
Gaston	9
Robeson	7
Durham	7
Rowan	5
Pitt	5
Edgecombe	5
Buncombe	5



- NC Opportunity Zones: 252
- US Opportunity Zones: 8,700 (12% of US census tracts)

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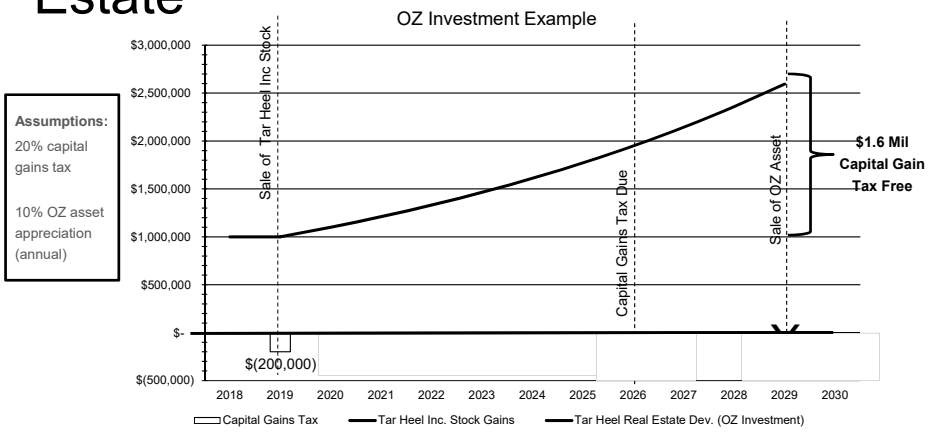
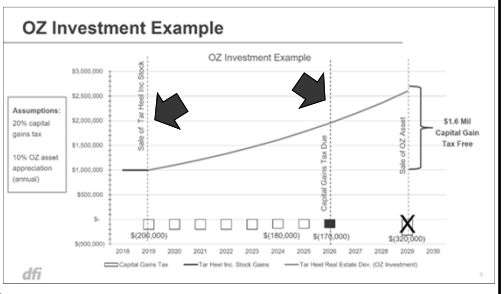
10 Year Hold: Advantage for Real Estate

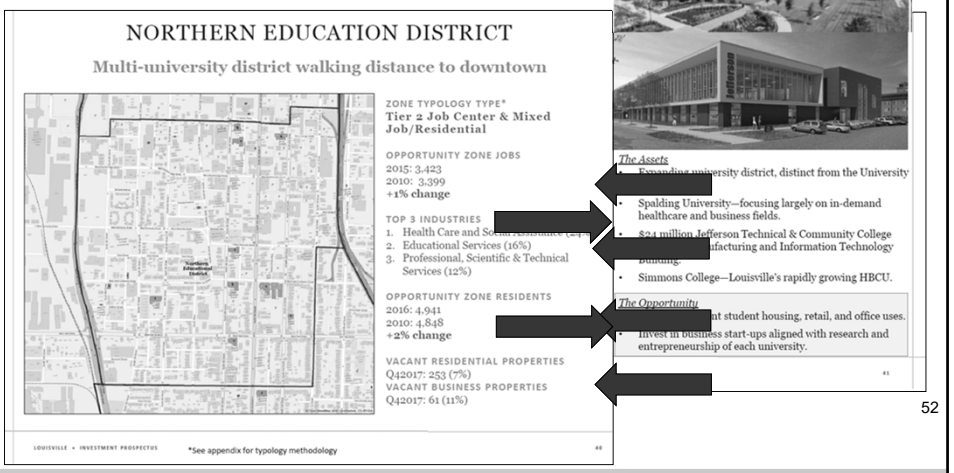


Why "Investment Ready" Is Important

- **OZ designation is not a strategy**
  - Capital flows to "ready" projects
  - Best practice for P3 (OZ or not)
- **OZ timing**
  - Max benefits if invest by 2019
  - Short period to invest cap gains in OZ
    - Investor has 180 days to invest in "Opportunity Fund"
    - ***No outside "fund" is required***; developer or investor can simply "self-certify" as "Opportunity Fund"
    - "Opportunity Fund" must hold OZ property for semi-annual 90% test



General Marketing



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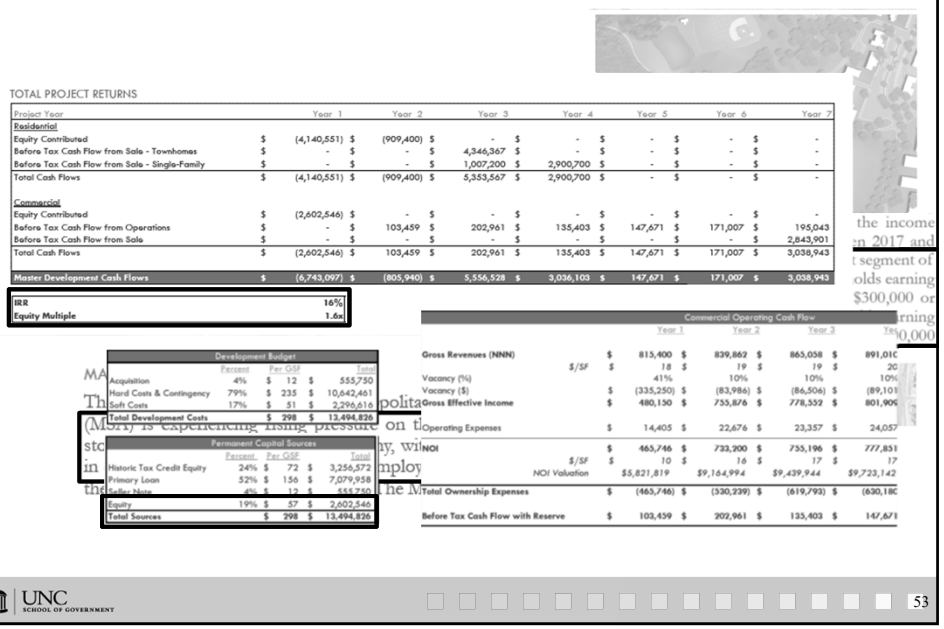
"Investment Ready" Marketing



TOTAL PROJECT RETURNS

Project Year	Year 1	Year 2	Year 3	Year 4	Year 5	Year 6	Year 7
Residential							
Equity Contributed	$ (4,140,551)	$ (909,400)	$ -	$ -	$ -	$ -	$ -
Before Tax Cash Flow from Sale - Townhomes	$ -	$ -	$ 4,346,367	$ -	$ -	$ -	$ -
Before Tax Cash Flow from Sale - Single-Family	$ -	$ -	$ 1,007,200	$ 2,900,700	$ -	$ -	$ -
Total Cash Flows	$ (4,140,551)	$ (909,400)	$ 5,353,567	$ 2,900,700	$ -	$ -	$ -
Commercial							
Equity Contributed	$ (2,602,546)	$ -	$ -	$ -	$ -	$ -	$ -
Before Tax Cash Flow from Operations	$ -	$ 103,459	$ 202,961	$ 135,403	$ 147,671	$ 171,007	$ 195,043
Before Tax Cash Flow from Sale	$ -	$ -	$ -	$ -	$ -	$ -	$ 2,843,901
Total Cash Flows	$ (2,602,546)	$ 103,459	$ 202,961	$ 135,403	$ 147,671	$ 171,007	$ 3,038,943
Master Development Cash Flows	$ (6,743,097)	$ (805,940)	$ 5,556,528	$ 3,036,103	$ 147,671	$ 171,007	$ 3,038,943

IRR	16%
Equity Multiple	1.6x

Development Budget	Percent	Per GSF	Total
Acquisition	4%	$ 12	$ 555,750
Hard Costs & Contingency	79%	$ 235	$ 10,642,461
Soft Costs	17%	$ 51	$ 2,296,616
Total Development Costs		$ 298	$ 13,494,826

Permanent Capital Sources	Percent	Per GSF	Total
Historic Tax Credit Equity	24%	$ 72	$ 3,256,572
Primary Loan	52%	$ 156	$ 7,079,958
Seller Note	4%	$ 12	$ 555,750
Equity	19%	$ 57	$ 2,602,546
Total Sources		$ 298	$ 13,494,826

Commercial Operating Cash Flow

		Year 1	Year 2	Year 3	Year
Gross Revenues (NNN)		$ 815,400	$ 839,862	$ 865,058	$ 891,010
	$/SF	$ 18	$ 19	$ 19	$ 20
Vacancy (%)		41%	10%	10%	10%
Vacancy ($)		$ (335,250)	$ (83,986)	$ (86,506)	$ (89,101)
Gross Effective Income		$ 480,150	$ 755,876	$ 778,552	$ 801,909
Operating Expenses		$ 14,405	$ 22,676	$ 23,357	$ 24,057
NOI		$ 465,746	$ 733,200	$ 755,196	$ 777,851
	$/SF	$ 10	$ 16	$ 17	$ 17
	NOI Valuation	$5,821,819	$9,164,994	$9,439,944	$9,723,142
Total Ownership Expenses		$ (465,746)	$ (330,239)	$ (619,793)	$ (630,180
Before Tax Cash Flow with Reserve		$ 103,459	$ 202,961	$ 135,403	$ 147,671

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Need help? Pros or Grad Students

dfi development finance initiative

Graduate Student Teams

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Questions and Comments

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Common Incentive Questions

- ✓ Wage and benefits requirements
  - Statute explicitly refers to wages
  - Chatham County policy offers points
- ✗ Local hire requirements
  - U.S. Constitution – Privileges and Immunities
  - N.C. Constitution – "right to earn a living"
- ✗ Steal a company from neighboring city?
  - Haugh v. County of Durham
- ✓ Prevent existing business from moving out of state?
  - "Might otherwise be lost to other states"

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Procedural Incentive Questions

- Company name appear in notice of public hearing?
  - The required information does not include name
- New hearing if # of jobs or incentive amount changes after original hearing?
  - If worse for taxpayer, new notice & hearing
- Giving property to EDC? Or giving money to EDC to buy property?
  - Local government retains ownership, not EDC
- Other questions?

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