Community and Economic Development in North Carolina and Beyond Blog: Getting It Under Control: Acquiring Property for Redevelopment (Part 2)

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In the previous post of this two-part series, we discussed how a purchase agreement with an extended due diligence period could be used to obtain site control of properties with redevelopment potential. We also discussed the specific negotiable terms of assignability, due diligence, earnest money, and exclusivity. Local governments should be mindful of these terms during any real estate negations, and the local government attorney should be involved throughout the process. For further discussion, see Tyler Mulligan's blog post, **Follow Procedures Prior to Acquiring Property for Redevelopment**.

Two alternative scenarios from the fictional Town of Ponder Mountain provide insight into a local government's use of purchase agreements as a site control strategy. Eager to catalyze their town's downtown development, Ponder Mountain officials wished to see a boutique hotel that would cater to tourists that visited the area to ski in the winter, hike in the spring and summer, and drive along the Blue Ridge Parkway in the fall. The Town of Ponder Mountain did not own any property downtown and therefore officials looked to gain site control of privately owned property.

Scenario One: Environmental Due Diligence and Mitigated Risk

Ponder Mountain engaged the **Development Finance Initiative (DFI)**, a team of development experts at the School of Government dedicated to advising local governments, to lead the Town through a pre-development process and attract a private developer. Following an opportunity analysis period, DFI's process led to the identification of a site that would work well for the potential hotel development. The Ponder Mountain Council was thrilled by the prospect and directed DFI to proceed with pre-development. The catch, however, was the preferred development site itself, which consisted of two privately owned historic buildings on the edge of the town's commercial district, and each building was owned by a different owner.

The Town approached both the property owners and asked about their plans for their respective properties. Both replied that they had not given it much thought but nevertheless recognized their properties' potential value. At the Town's next work session, the Ponder Mountain Council entered into a **closed session to discuss and negotiate a potential acquisition agreement** with the two property owners (as described in Scenario 2 of **this blog post**).

During negotiations, the City Manager presented each owner with a purchase contract that included 15-month due diligence periods. The two owners were at first hesitant due to the long due diligence periods and requested exclusivity. The Town assured them that it was serious about following through, and needed that amount of time to perform its typical due diligence activities. In recognition of the property owners' carrying costs and exclusivity required, the Town offered to begin making payments 120 days after the start of the agreement, and in the end, both property owners agreed and executed their individual purchase agreements.

As promised, the Town immediately began its due diligence, during which it engaged a firm to perform an environmental site assessment. When the firm reported their findings, they identified significant asbestos in one of the existing buildings and estimated the Town would need to spend at least $600,000 for the abatement. Unfortunately, after a rigorous financial analysis by DFI, the Town ultimately concluded that the expense simply made the redevelopment program financially infeasible.

Faced with no other alternative, the Town exercised its right to terminate the purchase agreements. The sellers regained full control of their properties and the Town avoided acquisition of parcels that would have been difficult to redevelop.

Scenario Two: A Successful Redevelopment Strategy

After withdrawing from the earlier purchase agreements, the Town pursued another location for a potential boutique hotel. The alternative site also included two privately owned parcels, one listed for sale and the other not. After acquiring site control of the property listed for sale, the Town reached out to the owner of the neighboring property.

Recognizing the potential not only to sell her property but also to help the community develop a more prosperous downtown, the property owner was more than willing to engage the Town. With the help of DFI, Ponder Mountain's Town Manager executed a purchase agreement with a 15-month due diligence period and the Town immediately began its due diligence, including environmental site assessments. This time, the consultants did not identify any significant environmental liabilities and after thorough site and financial feasibility analyses, DFI solicited private development partners interested in redeveloping the site.

Entering the purchase agreement did present some risk for the Town. The property owners required that if the Town did not find a developer to assign the purchase agreements to by the end of the 15-month due diligence period, the Town's earnest money deposit would be non-refundable. However, the Town also understood that securing these properties would be critical to attract a hotel developer. Even if the Town could not find a development partner in time and ended up purchasing the properties, the Town would retain control of two contiguous parcels that could be attractive for future development.

With two months to spare on the term of their purchase agreement, the Town entered into a contract with a private developer who was eager to develop a boutique hotel on the site. The Town assigned its purchase agreement to the private developer who then closed on the properties.

Conclusion

As discussed in the previous post, local governments in North Carolina are vested with statutory authority allowing them to acquire, develop, and convey real estate property. Furthermore, mechanisms that achieve site control through means other than traditional acquisition, such as extended due diligence periods, have the potential to mitigate the risks of property acquisition.

In both scenarios above, the Town of Ponder Mountain gained site control with minimal risk. Rather than acquire property for potential development, the Town engaged property owners through purchase agreements with extended due diligence periods. While in the first scenario, development was ultimately infeasible, Ponder Mountain was not burdened with a costly and failed investment. For minimal expense, they were able to gain site control to conduct proper analysis. In the second scenario, a similar strategy resulted in the attraction of private investment. The inclusion of an assignability clause further facilitated the Town's ability to encourage development.

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