Community and Economic Development in North Carolina and Beyond Blog: Conveyance of Local Government Property to Nonprofit EDC for Industrial Park

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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

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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.

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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

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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 loans instead of grants.

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

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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?

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