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## Community and Economic Development in North Carolina and Beyond Blog: Local government assistance for a real estate development project—without making a grant

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Al Czervik is a real estate developer who has invested in several shopping malls and mixed-

use developments across the Tar Heel state. He is planning a mixed use development called “Gopher Commons” in your community, but “in order to make the numbers work,” he claims that he needs local government assistance to address a “financing gap.” He wants the local government to provide him a cash grant to be paid out over five years, with the annual grant amount equivalent to 50% of the additional tax assessed as a result of the higher taxable value of the property upon completion. He hasn’t locked down any commercial tenants yet, so he can’t promise any jobs. He’s also not exactly sure what kinds of tenants might occupy the space, but he’s certain that the retail businesses will need to hire new employees.

The city council wants to support the project because it generally comports with the council’s vision for development in this area. But the council is not interested in offering grants to real estate developers. The claims about new jobs ring hollow, since the developer can’t promise any, and retail establishments generally don’t pay high wages. Besides, the council reasons, any new jobs at this development will likely come at the expense of retail establishments elsewhere in the community. There certainly is no interstate competition for this project—the developer can’t threaten to take his development elsewhere. The city attorney has raised concerns about the developer’s request right from the start. Is there a way for the council to offer support for this real estate development without offering a grant or other direct subsidy?

This post will describe three methods under North Carolina law by which a local government can support a real estate development without offering a direct subsidy or grant. Before getting to those methods, however, there are several financial considerations the city should address with the developer.

### **Financial Considerations**

As a threshold issue, the city should carefully examine the “financing gap” about which the developer complains. A properly planned and financed development shouldn’t have a financing gap; there should be sufficient equity from investors and enough debt from lenders to cover the costs of development. In other words, a development project should be planned to generate enough revenue to pay debt service and still provide the equity investors with a reasonable rate of return. When there isn’t enough debt or equity (or both) to cover the costs of development—for any number of reasons—the project is usually abandoned. But sometimes developers come to the local government seeking financial assistance. When this happens, hard questions should be asked and the developer’s financials should be carefully examined. The School of Government’s Development Finance Initiative helps local governments analyze developer financials to determine whether the developer’s claims are legitimate and reasonable.

Beyond the threshold question of whether the developer truly needs financial assistance, there is also a question of the form that financial assistance should take. Most developers simply default to asking for a grant, even if a loan would work



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just as well. A loan can be offered at a market rate of interest (or higher) and still address a developer's "financing gap." Here again, the School of Government's Development Finance Initiative can examine developer financials and demonstrate how a loan can be just as effective at addressing a financing gap as a cash grant. Indeed, if it can be demonstrated that a loan works just as well as a grant, then a cash grant would fail the "necessity determination" required for economic development incentives under G.S. 158-7.1 as described in this blog post, and therefore a cash grant pursuant to that statute would be impermissible.

If the local government is still willing to support the development—but without offering a grant or subsidy—then the next step is evaluating the legal mechanisms under North Carolina law for doing so.

### **Pay for Public Components of the Development**

Local governments have long supported development through the construction of public infrastructure, such as water and sewer. However, there may also be aspects of a developer's project that were originally planned by the developer to be private but could be converted to public use. These potentially public components of a development—such as sidewalks, vehicle parking, or public parks and spaces—can be financed and owned directly by a local government under authority granted to local governments for that purpose (for example, G.S. 160A-353 authorizes counties and cities to construct parks and recreation facilities). To the extent that a local government can construct and own these public aspects of a private development, the land and construction costs related to those facilities are removed from the developer's balance sheet, perhaps reducing or eliminating the developer's financing gap. In this way, the local government participates in the project but does not make a grant to the private developer.

Cities possess statutory authority to contract with a developer for the construction of public facilities associated with downtown development projects under G.S. 160A-458.3, provided the public facilities cost no more than half the total cost of the development and are constructed for a "reasonable price." For projects and jurisdictions that don't qualify under G.S. 160A-458.3, some local governments have sought and obtained local acts from the General Assembly that provide similar authority. (2013 UPDATE: Session Law 2013-401 enacted new G.S. 143-128.1C, which authorizes local governments to enter into public-private partnership construction contracts for public facilities as described in this blog post .)

### **Convey real property at fair market value (no subsidy)**

Another form of assistance is the conveyance—by sale or lease—of some interest in real property to the developer. Sometimes a local government owns or acquires property that the developer wants (or that the local government has been holding for development). G.S. 158-7.1(d) permits a local government to convey property at private sale for economic development purposes, thereby avoiding a competitive bidding process. Indeed, the local government even possesses statutory authority to construct a building for the developer (subsection (b)(4) of G.S. 158-7.1)—including on developer-owned land—and to convey the building to the developer. The key question is whether, in exchange for the conveyance, the government receives cash payment for fair market value or for some amount less than fair market value.

*Conveyance for fair market value (no subsidy).* If the local government obtains cash payment in an amount *equal to or greater than the fair market value* of the interest being conveyed (subject to any restrictions or covenants placed on the property by the local government), then there is no subsidy to the purchaser or lessee. As a result, the approval process for the conveyance is minimal under G.S. 158-7.1(d). The conveyance may be approved following a public hearing and after the governing body has determined the "probable" wage to be paid to workers at the property. The purchaser or lessee is not contractually bound to create jobs or construct improvements.

*Subsidized Conveyance.* If, however, the local government receives *less than the fair market value* for the conveyance, heightened procedural requirements are imposed pursuant to G.S. 158-7.1(d2). In addition to the public hearing requirement mentioned above for unsubsidized conveyances, a substantial number of jobs must be created at or above the "median average [sic] wage" and the local government shall "contractually bind" the purchaser or lessee to construct the promised improvements within five years or reconvey the property back to the local government. Because an "economic development agreement" is necessarily a part of this transaction, the conveyance will also be subject to G.S. 158-7.1(h) recapture requirements.

The following table compares the statutory requirements for subsidized and unsubsidized conveyances of real property



under G.S. 158-7.1(d) and (d2):

	Sell or lease property for fair market value  (NO subsidy or grant)	Sell or lease property for less than fair market value (NO subsidy or grant)
Public Hearing	?	?
Determine "probable average hourly wage to be paid to workers" at the property	?	?
Purchaser or lessee must create "substantial number of jobs"		?
"[C]ontractually bind the purchaser" or lessee to construct promised improvements		?
Economic development agreement under G.S. 158-7.1(h) (recapture subsidy if fail to create jobs, make capital investment, or maintain operations as promised)		?

It should be noted that a sale or lease for less than fair market value (or acceptance of non-monetary consideration), by definition, contains an implied subsidy or grant. To quote the North Carolina Supreme Court, any "economic development incentive grant" must also serve a public purpose (**necessary to secure substantial jobs and tax base that "might otherwise be lost to other states"**) and comply with the "strict procedural requirements" of G.S. 158-7.1. *Maready v. City of Winston-Salem*, 342 N.C. 708, 467 S.E.2d 615 (1996). This post focuses on transactions in which no subsidy is provided to the private entity, so the additional requirements for subsidies and grants will not be discussed here (to learn more about the requirements when a subsidy or grant is provided to a business, see this post).

**Make a loan to developer at the market rate of interest or higher (no subsidy)**

As mentioned at the beginning of this post, oftentimes a loan can work just as well as a grant in addressing a developer's perceived "financing gap." Authority to make loans comes from a general grant of authority in G.S. 158-7.1(a), which permits local governments to make appropriations for economic development purposes. Under this general grant of authority, the only procedural requirement is holding the public hearing required for all economic development appropriations or expenditures, as explained in this blog post. A conservative approach would follow the additional procedures for conveying property. A loan of cash holds many similarities to a lease of real property, so it would be reasonable to treat a loan in the same way as a lease. If we take the procedures for a lease of real property as described in the table above, and we apply those same procedures to loans, then we get a new table for loans as follows:

	Make a loan for the market rate of interest or higher (based on terms of the loan)  (NO subsidy or grant)	Make a loan for LESS than the market rate of interest (implied subsidy) effectively buys favor
Public Hearing	?	?
Determine "probable average hourly wage to be paid to workers" by the borrower	?	?
Borrower must create "substantial number of jobs"		?



"[C]ontractually bind" the borrower to construct promised improvements		?
Economic development agreement under G.S. 158-7.1(h) (recapture subsidy if fail to create jobs, make capital investment, or maintain operations as promised)		?

Accordingly, a loan provided at fair market value would involve the same minimal procedures as a conveyance of real property at fair market value. That is, the loan may be approved following a public hearing and after the governing body has determined the "probable" wage to be paid to workers by the borrower. The borrower need not be contractually bound to create jobs or construct improvements. Public officials should, however, pay attention to the loan terms—interest rate, repayment period, and type of security for the loan (e.g., lien in first position or second position)—to ensure the local government is charging the market rate of interest or higher.

A loan offered for *less* than the market rate of interest is actually a market-rate loan sitting alongside a subsidy that "buys down" the interest rate in the same way a home buyer might pay points to a bank in order to get a lower interest rate on a mortgage loan. Any such subsidy is essentially the equivalent of a cash grant, so in the case of low-interest loans, the local government should follow the same procedures for cash grants and ensure the project meets the constitutional requirements (**necessary to secure substantial jobs and tax base that "might otherwise be lost to other states"**). See this post for more on the constitutional and statutory requirements.

Armed with these alternatives, the local government can make a decision regarding Czervik's "Gopher Commons." The tougher call will be deciding what to do with Czervik's next project, the redevelopment of Bushwood Country Club into condominiums.

2017 UPDATE: This post has been updated to reflect statutory changes enacted in 2015. For more on the constitutional analysis supporting this blog post, see the following law review articles:

*Economic Development Incentives and North Carolina Local Governments: A Framework for Analysis*, 91 North Carolina Law Review 2021 (2013)

*Economic Development Incentives Must Be "Necessary" – A Framework for Evaluating the Constitutionality of Public Aid for Private Development Projects*, 11 Harvard Law & Policy Review s1 (2017)