

INCENTIVE SUPPORT FOR RETAIL PROJECTS: YES OR NO?

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INCENTIVE SUPPORT FOR RETAIL DEVELOPMENT:

YES OR NO?

Since the early 1990s, when the use of incentives to stimulate economic growth began to be used more frequently in North Carolina, there has been a question as to whether state or local government incentive programs can and should be used to attract retail projects.

With one exception, at the state level, incentive programs by statute or administrative rules exclude retail projects from incentive support. In the mid 1980s, the General Assembly adopted the first job creation tax credit program. That statute did not exclude retail as a type of project that could obtain the tax credits. After a company that built a fast food restaurant claimed the tax credits, the statute was amended to exclude retail projects. Since then, all state incentive grant and tax credit programs have excluded retail projects from consideration.

Consequently, the focus of this article is on local incentive support for retail projects. It addresses two questions. First, is there legal authority for local governments (counties or municipalities) to provide incentive support for retail projects? And second, aside from the legal authority for this, is it advisable or good policy to provide financial support to induce the development of retail projects?

Legal Authority

The general authority for a local government to make grants or to utilize real estate assets to induce or assist in the siting within a county or in or near a municipality of facilities that will create jobs and/or increase the local property tax base is contained in G.S. § 158-7.1, which was originally entitled The Local Development Act. The authority under

this section has been used for years in projects that involved manufacturing, distribution, headquarters, and other business facilities, most of which were considering multiple locations within North Carolina only or in multiple states as a potential site.

The constitutionality of incentive grants under this section was upheld by the North Carolina Supreme Court in *Maready v. The City of Winston-Salem, et al.*, 342 N.C. 708. The court found that, “section 158-7.1 clearly serves a public purpose. It’s self proclaimed end is to ‘increase the population, taxable property, agricultural industries and business prospects of any city or county.’” The court went on to state:

“The public advantages are not indirect, remote or incidental; rather they are directly aimed at furthering the general economic welfare of the people of the communities affect. While private actors will necessarily benefit from the expenditures authorized, such benefit is merely incidental. It results from the local government’s efforts to better serve the interests of its people.”

Since that ruling, the authority under this section has been used often, and by most local governments in North Carolina, to provide incentive grants and real estate based incentives to induce industrial and other business facilities to locate in their geographical jurisdiction. It was the determination of each local government that the utilization of the incentives in each project was a justifiable and reasonable measure to promote “the general economic welfare of the people of the communities affected.”

However, incentives under the authority of G.S. § 158-7.1 have been used less often, by fewer communities, to support the location of commercial/retail facilities in the city or county in question. Some question whether the authority of this section extends to utilizing incentive grants and real estate based incentives to induce or assist commercial/retail facilities to locate in a local government’s jurisdictional territory.

In this writer's opinion, the authority under G.S. § 158-7.1 clearly applies to incentive grants and real estate-based incentives used for this purpose, and utilizing this authority for commercial/retail facilities is constitutional and within the scope of G.S. § 158-7.1.

It seems that for many attorneys who question the statutory authority or constitutionality of utilizing incentive grants or real estate based incentives for commercial/retail projects base this opinion in large part as to whether utilizing incentives for this purpose is competitively necessary. That standard is often stated as a "but for" requirement, which is to say, "but for" certain incentive support, the company in question would not locate the facility in question within the city's or county's jurisdiction.

Certain state-level incentive programs have an explicit competitive necessity or "but for" requirement. For most industrial or business facilities, such as manufacturing, distribution, research and development, or headquarters, the companies in question can choose one of several locations in multiple states as sites. Consequently, the competitive necessity or "but for" requirement of state incentives is satisfied by those incentives being utilized to induce a company to choose a location for a facility in this state or one locality, rather than another state or another locality.

However, it is this writer's opinion that:

- Utilizing this authority for commercial/retail projects is explicitly allowed;
 - There is no competitive necessity or "but for" requirement under G.S. § 158-7.1;
- and

- Even if there was a competitive necessity requirement under G.S. § 158-7.1, that requirement is satisfied by a different type of competitiveness as opposed to the nature of competition for an industrial facility.

As to the first point above, Subsection (a) of G.S. § 158-7.1 is the broadest statement of authority and discretion for local governments in the act. This statute leaves to the good discretion of “the governing body of the city and county” to determine when the use of incentive support is advisable “to increase the *population, taxable property, agricultural industries, employment, industrial output, or business prospects* of the city or county” (emphasis added). All of the above italicized desirable outcomes of utilizing incentives are realized from certain commercial or retail projects in certain local areas.

Also, in other subsections this statute specifically refers to the authority under the act as applying to “commercial” activities and end uses that are “commercial.” This is the case in Subsections (b)(1), (b)(2), (b)(3), (b)(4), and (b)(8). Finally, in Subsection (d)(2), the act states that in determining the amount of consideration a local jurisdiction receives in return for the conveyance of real estate to induce a project to locate within that jurisdiction, the governing board “may take into account” various tax revenues and other income to be realized by the county or city, to include “prospective sales tax revenues to be generated in the area” This language would obviously seem to be a direct reference to retail projects.

As a result, it seems abundantly clear that there is explicit authority under G.S. § 158-7.1 to allow for the use of incentives to induce or support the development of commercial/retail projects in a local government’s jurisdictional area.

As to the second point mentioned above, this writer believes there is no competitive necessity or “but for” requirement for utilization of incentive authority under G.S. § 158-7.1. There is no explicit language in this statute that requires a project to be competitively considering sites in two or more states or localities for incentive authority to be utilized.

Some would contend the case law that interprets The Local Development Act requires or implies the need for a competitive situation or a “but for” requirement. This writer does not read the case law that way. In the *Maready* ruling cited above, the projects involved were competitive as to choosing from among two or more competing sites. But, as Tyler Mulligan with the University of North Carolina School of Government noted in an article entitled “Is Interstate Competition Required for Economic Development Incentives,” in the North Carolina Supreme Court’s ruling in *Maready*, “(t)he court never clarified, however, whether interstate competition was required in order for incentives to serve a public purpose.”

Further, in interpreting statutory language, the courts should never impose a requirement that is illogical. It would be illogical and perverse public policy to tell a company considering whether to put an industrial, business, or commercial facility or project in a local government’s area, that “the only way we can consider supporting your project with incentives is if you choose to look elsewhere for another location.” Why would any local government ever cause a project to consider other locations?

So, this writer is of the opinion that there is no competitive necessity or “but for” requirement under G.S. § 158-7.1.

As a third point, even if a local government chose to interpret that a project must be competitive in order to be considered for incentives, most large retail projects are competitive, but just in a different way than industrial projects are.

An industrial, distribution, or headquarters project will almost routinely consider sites in several locations and within several states. That type of project can most often function just as well at any of several different sites. That is one kind of competition.

However, any large commercial/retail developer, at any given time, likely has 10 or 20 possible projects it is considering for development. As would be the case with any responsible business, a commercial/retail developer will give priority to projects in which upfront risks and costs are reduced, and to those that offer the greatest possible return on investment. For this reason, any single commercial/retail development project is in competition with numerous other projects.

Consequently, if one ever concludes that a competitive necessity or “but for” requirement is embodied in G.S. § 158-7.1, a conclusion this writer does not accept, that competitive necessity requirement is met, as the developer could choose to undertake other projects and forego the project under consideration.

For all of the reasons stated above, there is clear statutory and constitutional authority under G.S. § 158-7.1 to utilize incentives to support or induce the location of commercial/retail projects in a local government’s jurisdictional area.

This analysis has focused on the general, broad authority of local governments to provide incentives under G.S. § 158-7.1. However, there are other statutory provisions that might be utilized as a source of authority for a local government to support and induce the

development of commercial/retail facilities. Two examples of these additional statutory authorities are cited below.

G.S. § 160A-499(a) provides that, a “city may enter into reimbursement agreements with private developers and property owners for the design and construction of municipal infrastructure that . . . serves the developer or property owner.” Municipal infrastructure includes “water mains, sanitary sewer lines, lift stations, storm water lines, streets, curb and gutter, sidewalks, traffic control devices, and other associated facilities.”

G.S. § 153A-451(a) provides that a “county may enter into reimbursement agreements with private developers and property owners for the design and construction of municipal infrastructure that . . . serves the developer or property owner.” This statute contains a similar list of infrastructure, the cost of which can be reimbursed.

These two statutes are examples of other statutory authority for funds to be appropriated from a local government to reduce the cost of a commercial/retail project.

Policy Considerations

The beauty of The Local Development Act is that it gives broad discretion to local government boards as to when to use incentive support pursuant to the statute. This is highly desirable. Each local municipality or county has its own set of needs and considerations. What might be considered to be a significant project that calls for the use of incentive support in one county, may not be of significance in another county. Likewise, the same is true for municipalities.

Consequently, there are no specific guidelines as to when incentives should be used to support or induce the location of commercial/retail facilities. However, there are some general considerations that are advisable to be taken into account.

To begin with, they should be used for a project that will have a significant impact. Generally, this will not be to support the location of a single retail store. The fact is, a fast food restaurant will not locate where it cannot sell its food. On the contrary, if there is a market for its product in a locality, it will put a facility there regardless of whether incentive support is provided. Thus, as a general rule, incentives should be limited to projects that are impactful and large in relation to the locality in question.

Authority to do incentives under the Local Development Act should be utilized when it appears to be a consequential part of the company's decision process. For example, if a company is building a facility because of external needs that make it essential the prospect be in that locality, the need for incentive support is reduced or eliminated. But if one is dealing with a large commercial/retail developer that has multiple projects that can be pursued, the desirability and policy wisdom of supporting that facility increases.

In addition to deciding when to utilize incentive support for a commercial/retail facility, consideration should be given to how that incentive support should be provided. A locality could do so, and in calculating the amount, could reflect upon the projected property tax collections, sales tax collections, or both. However, the amount of incentive support should be at a level that assures a positive return on investment to the local government and its citizens from the outset. That is to say, the commercial development should be producing significantly more taxes, revenues, and other sources of income for the local government than the local government is paying out in incentives.

Another consideration is the structure of the support. Generally, incentive support for any company, whether a commercial/retail facility or an industrial project, is paid out over a period of time as revenues are being realized by the local government. This is a

desirable way to do it, although admittedly, a local government can provide cash upfront and count on future revenues and taxes to offset that initial payment. Yet, by paying incentive payments in the future while the local government is realizing revenues, the local government is in a much safer position. This approach is also more defensible as a public policy measure in that the local government is receiving a return on investment immediately that is well above the investment it is making in the project.

Lastly, it is always important to have provisions in a written agreement that protect the position of the local government. The local government should have specific provisions that allow for a reduction in the amount of incentive payments, or claw back provisions, if the developer falls short in its commitments or fails to complete the project as planned. These are all normal considerations in any incentive agreement, regardless of whether it is a commercial/retail development or an industrial project.

As stated above, it is in the sound discretion of the local government board as to when to use incentive support to induce a company to locate a new facility. In doing so, the board might take into account not only the return on investment, but also whether the development will open up a new area in the city for development, provide needed services and retail facilities for its citizens, or serve other purposes.

Conclusion

For all the reasons stated above, this writer is firmly of the opinion that it is within the discretion of local government boards to provide incentive support for commercial/retail projects. This can be done in a way that provides a high return on investment for the local government and fully protects its interests.

Although incentive support for commercial and retail developments has not been done as frequently in the past as is the case with incentive support for industrial development, there is substantial precedent around North Carolina in which the utilization of incentives to support commercial/retail projects has been done. Also, it appears to be the case that going forward, there is an increasing level of projects in which incentive support for commercial/retail facilities is being utilized.

Any local government should be willing to give consideration to supporting such projects when in the discretion of the governing board it would be desirable to do so.

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