Coates' Canons Blog: Downtown Facade Improvement Programs

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The national Main Street Program touts “coordinated, small-scale facade improvements” in rural downtown commercial districts as having the “power to not only preserve valuable historic resources in rural communities, but also to spur economic growth in the surrounding area.” What local government tools are available and appropriate for encouraging private owners to make facade improvements?

This post provides an overview of four tools available to North Carolina local governments:

1. Code enforcement
2. Property tax exemptions
3. Acquisition of buildings or facades, and improvement of such government-owned property
4. Loan programs

The post concludes with a discussion of questionable practices that have been observed in the field and other considerations such as limitations for nonprofit development corporations.

Code enforcement

An often-overlooked tool for encouraging owners to improve their facades is basic code enforcement. Municipalities possess statutory authority to require downtown commercial property owners to comply with aesthetic maintenance regulations pursuant to three statutory regimes:

1. General ordinance making power (G.S. 160A-174 (municipalities) and G.S. 153A-121 (counties)). North Carolina local governments may design and enforce their own regulations of anything that is “detrimental to the health, safety, or welfare” of residents and the “peace and dignity” of the jurisdiction. The Supreme Court of North Carolina, in *State v. Jones*, even upheld police power regulations for *aesthetic considerations alone*, provided the “gain to the public” outweighs the burden on the property owner.[1] Some North Carolina towns have adopted ordinances requiring owners to eliminate any “evidence of vacancy” in commercial buildings, such as empty or papered window fronts, visibly vacant spaces, inattention to exterior building appearance, and other deficiencies that impair the downtown “character and integrity.” An example of one such ordinance is provided in a prior blog post here.
2. Compulsory repair in Urban Redevelopment Areas (G.S. 160A-503(19)). Local governments may enact programs of compulsory repair *within blighted areas designated as urban redevelopment areas (URAs)*. The process for designating a redevelopment area is described in an earlier blog post, Using a Redevelopment Area to Attract Private Investment. An example of one municipality’s URA program is available here.
3. Prevent neglect of historic landmarks (G.S. 160A-400.14). Maintenance requirements can be imposed on owners of historic landmarks, through a “demolition by neglect” ordinance, as discussed in a blog post on demolition by neglect written by School of Government faculty member Adam Lovelady.

For additional information on these and other code enforcement options, see this blog post: Maintenance of vacant or neglected commercial buildings: options for NC local governments.

Property Tax Exemptions

In a number of other states, municipalities may possess authority to enact special property tax exemptions for commercial buildings in the downtown, as an incentive for facade improvement. North Carolina municipalities do not have that power.

Rather, property tax exemptions in North Carolina must be enacted by the General Assembly and made applicable on a statewide basis. A number of statewide exemptions have been enacted over time, and those related to development are described in this blog post by School of Government faculty member Chris McLaughlin: Property Tax Exemptions and Community Economic Development.

One exclusion available in North Carolina is particularly relevant to facade improvement. A city or county may designate a property as a historic landmark (G.S. 105-278), after following procedures described in this blog post on designation, and thereafter the property will enjoy an exclusion that reduces the taxable value of the property by 50%. Regardless of whether a city or a county makes the designation, the exclusion is applied to both city and county taxes, and the property retains the exclusion in perpetuity, so long as the property's exterior historical significance is not impaired. This represents a significant subsidy and involves a substantial loss of revenue for local government activities, so officials are advised to be very selective in its application.

Acquisition of buildings or facades and improvement of such government-owned property

Local governments may acquire real property through voluntary means in several ways, including by purchase and by received gift. After acquiring a downtown property, a local government can invest public dollars to improve the property. North Carolina local governments possess ample authority to improve properties that they own.

However, there's no need for a local government to own an entire building or facade to achieve its facade improvement goals—it could simply purchase an easement over the facade. An easement is defined as the "right of one person to use the property or property rights (e.g., the right of access, the right to limit exterior alterations) of another for a stated term."

When a local government purchases a facade easement from a private property owner, the easement purchase serves several purposes:

1. The easement itself can involve a legally binding arrangement in which the private building owner is required to improve and maintain the facade.
2. Proceeds from the easement sale provide an infusion of cash to the owner that can (and should) be used by the owner to improve the facade—or even better, the facade should be improved in advance as a condition for the easement purchase.
3. The government obtains some rights of ownership over the facade, giving the government a right to inspect and control the condition of the facade, without requiring the government to own the entire building.

Easements are a common tool for preservation of facades of historic buildings. The National Park Service has issued a report on historic preservation easements here. An example of a historic preservation easement is provided in Exhibit 6-A of the Historic Preservation Fund Grants Manual. Examples of facade easements from states around the nation can be found by searching online. Representative examples are here (historic) and here (non-historic).

In North Carolina, the lesser power to purchase an easement is arguably included in the greater power to acquire a property in fee simple.:

- G.S. 160A-457 authorizes a municipality to acquire property that is "[a]ppropriate for rehabilitation or conservation activities."
- G.S. 160A-400.8 empowers a historic preservation commission to acquire "by any lawful means the fee or any lesser included interest, including options to purchase, to properties within established [historic] districts…."), and G.S. 158-7.1(b)(8) authorizes a city or county to "make grants or loans for the rehabilitation of commercial or noncommercial historic structures, whether the structure is publicly or privately owned." As discussed later in this post, the transaction cannot amount to a gift, so any grant payment would be in exchange for a similarly valued ownership interest such as an easement. Loans are discussed in the next section.
- Within a municipal service district for "downtown revitalization" (G.S. 160A-536), funds may be expended for improvements, services, functions, promotions, and developmental activities intended to further the well-being of the central city or downtown area. Property acquisition is not specifically mentioned, but it is arguably implied in the broad scope of the statute.
- The definition of a redevelopment project (G.S. 160A-503(19)) includes acquisition of property within a designated

> urban redevelopment area when the acquisition "is necessary or incidental to the proper clearance, development, or redevelopment of such areas or to the prevention of the spread or recurrence of conditions of blight."

A local government should endeavor to pay a reasonable price and avoid overpaying for the easement. In North Carolina, the state constitution prohibits making gifts to private entities, and paying more than the fair value could be challenged as an unconstitutional gift to the property owner.

The National Park Service (NPS) has, in the past, run a program that provides grants to communities for the purchase of historic facade easements. NPS is careful to note that the grant program is "funded through the Historic Preservation Fund using revenue from … oil lease revenue, not tax dollars."

This section has described a method for acquiring property and then improving the public-owned property. Along the same lines, downtown development directors should prioritize investments in traditional public-owned facilities that contribute to revitalization, such as making improvements to streets and sidewalks, burying power lines, and installing wayfinding markers. Such investments in public-owned facilities (not payments to private individuals) were the intended purpose of the statutes for redevelopment and downtown revitalization—this becomes obvious from a quick read of the statutes and the examples they provide (street lighting, parking facilities, bike paths, and visitor centers are among the listed items). In addition, activities such as street fairs, farmer's markets, festivals, and other events also contribute to revitalization and are clearly within the authority of a local government to plan and execute.

Loan Programs

A common obstacle that prevents a private owner from making facade improvements (and redevelopment in general) is finding enough upfront capital. A local government can address this issue by offering a "facade improvement loan" to a private owner. The loan will not be an unconstitutional gift to the owner so long as the loan is reasonably secured with collateral and carries an appropriate risk-adjusted interest rate based on the terms and collateral provided. In other words, low-interest loans and forgivable loans are not appropriate for both business and legal reasons as discussed in this prior blog post: Legal and Business Reasons Why Downtown Development Programs Should Involve Secured Loans—Not Grants.

Specific statutory authority for offering facade improvement loans is found in a variety of sources. For example:

- G.S. 158-7.1(a) provides broad authority to make appropriations for economic development purposes, to include making "loans for the rehabilitation of commercial or noncommercial historic structures."
- Within a municipal service district for "downtown revitalization projects" (G.S. 160A-536), the broad scope of the statute appears to authorize making loans "intended to further the well-being of the central city or downtown area."
- The definition of a redevelopment project (G.S. 160A-503(19)) includes "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."

The National Main Street program (using private foundation funds) provides grants to communities in order to support and capitalize revolving loan programs for facade improvement.

Questionable activities and other considerations

In order to improve facades of privately owned buildings, can a local government donate its property to a private property owner (such as purchasing a facade easement and then conveying the easement back to the private owner at no charge), or simply make a cash payment to a private owner? In short, the answer is no, due to constitutional and statutory restrictions. It does not matter whether the recipient is a nonprofit charity.[2]

The North Carolina Constitution allows governments to grant cash or property to individuals or businesses for private development only in very limited circumstances, such as affordable housing for low income persons (assisting the "the poor, the unfortunate, and the orphan" as stated in Section 4 of Article XI of the North Carolina Constitution) or to provide business location incentives **when necessary** to attract substantial job creation and tax base that "might otherwise be lost to other states" (*Maready v. City of Winston-Salem*, 342 N.C. 708 (1996)). That is a high bar. Private facade improvement is important, but it doesn't meet those standards set in case law. Currently there is no holding in North Carolina

constitutional law, nor have researchers identified precedent from other states with similar constitutional provisions, that upholds making cash payments to induce private owners to invest in their own private property for the purpose of private "facade improvement" or private "revitalization." This does not prevent a government from accomplishing its facade improvement and downtown revitalization goals—it simply means the government should use the other tools described earlier in this post rather than making cash payments to private owners.

The statutes for property conveyance in North Carolina echo this constitutional rule. For example, the economic development statute mandates that the price received for sale of government 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 when selling property, 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). Conveyance of historic property for fair market value is described in the blog post, Sale of Historic Structures by NC Local Governments for Redevelopment. This emphasizes why it is legally problematic to make cash payments to private owners for private improvements to facades or buildings: not only would such cash payments amount to an unconstitutional gift, but such payments would also create an end-run around the property conveyance statutes and the statutes described earlier regarding tax exemptions. A cardinal rule of statutory interpretation is that statutes should not be interpreted in a way that renders statutory language superfluous or irrelevant, and further, courts will interpret statutes in a way to avoid raising serious questions about their constitutionality.

The prohibition on making gifts of public property to private persons is a national rule, not merely a North Carolina rule. As one national local government law treatise explained in 2017, "Local government property cannot be conveyed to a private party without adequate consideration, for to do so would constitute an improper gift of public property or the granting of a subsidy contrary to state constitutional constraints."[3] And another local government law treatise from 2015 states, "*Gifts* of property by local governments—at least to private individuals—are generally banned by statute or as a matter of common law; any transfer of municipal property must be supported by some reasonable compensation or benefit in return." [4]

Some local government boards may insist on making cash payments for facade improvement despite this legal analysis. In such an event, my colleague Kara Millonzi advises staff to protect the local government by, at a minimum, (i) entering into a written contract with the recipient, (ii) requiring the recipient to follow public bidding rules for any work that will be paid or reimbursed by government funds (see, for example, this post on reimbursement agreements), and (iii) complying with statutory requirements such as special contracting rules in municipal service districts set forth in G.S. 160A-536(d)-(d1), as further described here. The most legally sound approach, however, is to convert the grant program into a facade easement purchase program, or shift to other tools discussed above.

Can a nonprofit downtown development corporation do what governments cannot?

What if a local government works with a nonprofit downtown development organization, and the *nonprofit* makes cash payments to private owners for facade improvement? First, local governments can only appropriate funds to a nonprofit for activities that the local government itself is authorized to do. A government cannot pay a nonprofit to do something the government cannot do. Second, even if the nonprofit found private funds for a grant program, the nonprofit should beware: providing financial assistance to private businesses is not a charitable activity, so the nonprofit runs the risk of losing its tax exempt status. IRS Revenue Ruling 77-111, for example, denied tax exempt status for two organizations that promoted business activity in a deteriorated area because they failed to limit their activities to disadvantaged businesses (rather, the organizations helped all businesses in the deteriorated areas). The presence of a single substantial nonexempt purpose can destroy the tax exemption regardless of the number or importance of exempt purposes. *Better Bus. Bureau v. United States*, 326 U.S. 279, 238 (1945); *Am. Campaign Acad. V. Commissioner*, 92 T.C. 1053, 1065 (1989). Any nonprofit that carries out a program involving cash payments to private property owners should seek advice from a tax attorney about those activities. See also Chris McLaughlin's post here.

[1] *State v. Jones,* 305 N.C. 520 (1982). The assessment of the "gain to the public" may include "corollary benefits to the general community" such as "protection of property values," "preservation of the character and integrity of the community," and "promotion of the comfort, happiness, and emotional stability of area residents." The reasonableness of aesthetic regulations is determined on a case-by-case basis by examining "whether the aesthetic purpose to which the regulation is reasonably related outweighs the burdens imposed on the private property owner by the regulation." *Id.* at 530--31.

[2] See the blog post by School of Government faculty member Frayda Bluestein, Donating Property: Beware of Constitutional Constraints, in which Professor Bluestein describes the case, Brumley v. Baxter, 225 N.C. 691 (1945), which found a violation of the constitution's gift clause where property was granted to a charitable entity without ensuring the property would be returned to the municipality once the property ceased to be used for the original public purpose.

[3] John Martinez, 3 Local Government Law § 16:19, at 16-53 (2d ed. 2017)

[4] Osborne M. Reynolds, Jr., Local Government Law 515 (4th ed. 2015) (italics in original).

Links

- www.mainstreet.org/home
- www.mainstreet.org/mainstreetamerica/ourwork/projectspotlight/facadeimprovements
- www.ncleg.net/EnactedLegislation/Statutes/HTML/ByArticle/Chapter_160A/Article_8.html
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