
Coates' Canons Blog: Tapping Private Resources for Construction of Public Facilities – Some Legal Limitations Local Government Officials Should Know About

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Times are tough and money is tight. Public officials and private developers, trying to imagine new and creative ways to finance and construct needed infrastructure, might suggest a new approach: A private developer will front the money to build a new public facility or renovate an existing building for public use. The project might use property owned by the private developer, perhaps in an area that the local government would like to see improved or developed. Or the local government may own property for the project that it will transfer to a private developer, so that the developer can use it as security to obtain private financing. The private developer will finance and construct the project, which will then be leased back to the local government over a period of time, with title eventually transferring back to the local government. The cost of construction is repaid through the lease payments. The local government gets its facility without having to raise taxes or borrow money and the developer uses its resources to finance and construct the project in a cost effective and efficient manner. Sounds like a win-win. Can North Carolina local governments do it?

Not under current law. For North Carolina local governments, there are two significant legal barriers to this type of arrangement: The competitive bidding requirements, and the lack of authority for this type of financing.

Competitive Bidding Requirements

A developer-financed and constructed project involves a contract between a public agency and a private party for “construction and repair work.” That triggers the bidding requirements in **G.S. 143-129**, even though the developer will most likely subcontract out the actual construction work. It may not seem obvious that this type of transaction requires bidding, but several statutes and at least one case strongly suggest that it does.

In *Styers v. City of Gastonia*, 252 N.C. 572 (1960), an individual constructed some utility improvements located outside of the city limits, and later sued the city, arguing that the city had promised to purchase the improvements upon annexation of the area in which they were built. In denying the claim the court noted that even if there had been a contract for purchase of the improvements, the contract would be void under **G.S. 143-129** (the main competitive bidding statute). While the facts of this case are not exactly on point with our creative idea, I believe its holding means that a contract with a third party to construct facilities that will be paid for with public funds, even if the payments are sometime in the future, is subject to the public bidding requirements.

Several existing statutes further support the conclusion that the bidding laws apply when a private developer constructs projects that are funded in whole or part with public funds. In some cases, the legislature has created an exemption from bidding, while in others the statutes require the developer to conduct the bidding. Either way, there is a recognition that public funding of private projects triggers the bidding requirements.

For example, **G.S. 160A- 458.3**, which authorizes public/private projects in a “downtown development area,” specifically provides that bidding is not required for these projects as long as the public funds involved do not exceed 50% of the total project cost. This statute also authorizes the conveyance of property to a private developer without complying with the **competitive sale requirements** that would otherwise apply to the sale of local government property.

Other statutes address bidding requirements that arise when cities or counties reimburse private developers who construct improvements requested by the local government. This can occur, for example, when a developer is asked to increase the

size or scope of improvements for a private development in order to accommodate system-wide needs. The statutes that authorize reimbursement by **cities** and **counties**, require the private developer who receives the public funds to bid the work. There is also authority for **cities** and **counties**, to reimburse private developers for public enterprise improvements, including **city roadway improvements** (such as an extra lane in a street), that are ancillary to their developments. Bidding requirements also apply to these improvements unless they are below \$250,000 and other criteria in the statutes are met.

Local school units have authority for public/private school construction projects under a complicated statutory framework set out in **G.S. 115C-521**. Local school units may contract with private developers to finance and construct schools, provided the developer competitively bid the actual construction work. G.S. 143-129.

Could the statutory bidding requirements be satisfied in our scenario if the local government requires the developer to bid the work? I don't think so. The bidding laws require the unit of government to competitively bid and award the contracts for construction or repair work. In our scenario, the only contract the government has is with the developer, so under the bidding statute, that's the contract that would have to be bid. While some of the statutes that specifically address public/private arrangements do require the developer to bid, the presence of these statutes make even more obvious the lack of authority for a complete "turn-key" project outside the scope of those statutes. Requiring the developer to bid the project does not fill this legal gap, nor does it meet the local government's obligation under the bidding statute.

It's theoretically possible to competitively bid the contract with the developer, but it won't usually be practical to do so. The competitive bidding statutes apply to the actual construction work, which isn't really the nature of the contract with the developer. This may seem like a good basis for arguing that the statutes don't apply to this type of project, but it's hard to get around the *Styers* case, which suggests that bidding would be required, and the lack of statutory authority for this type of arrangement. After all, it would be easy to evade the bidding requirements if they simply don't apply when a local government contracts with a developer – rather than a contractor – to construct and deliver a completed project pursuant to the specifications provided by the public entity.

Although a court might conclude that the bidding requirements don't apply in this situation, it would be risky to undertake such a project without more support in the case law or statutes. It seems more likely that a court would defer to the legislature to authorize this type of project (either with or without a bidding component). Local acts **authorizing alternative construction methods** or **exempting local government from bidding for specific projects** are not uncommon. This is always an option, but it only deals with the bidding issue.

Financing

A key advantage to the local government in a privately developed project is the ability to spread out the payments for the construction costs over time, often through a contract that is structured as a lease. In essence, this is a method of financing public projects by relying on private capital to front the cost of construction. Cities and counties have broad authority to lease property under **G.S. 160A-19** and **153A-165**, but it may be too simplistic to view that as authority to borrow money from a developer in order to finance the cost of constructing a public facility.

Cities and counties do have authority to finance construction under **G.S. 160A-20** using an installment- or lease-purchase agreement. Under this type of financing, the local government maintains ownership of the land and the new facility being constructed. The developer finances the construction through a loan to the local government and obtains a security interest in the land or facility as collateral for the loan. The local government repays the loan to the developer over time. Projects under this statute must be approved by the Local Government Commission. There is a potential disadvantage, however, to using this type of arrangement for a developer-financed project. The fact that the local government retains ownership of the property may hinder the developer's ability to obtain financing, since the developer would normally need to use the property or facility as security for its loan.

It is sometimes suggested that a developer-financed project could be approved under **G.S. 159-148**. That statute, however, does not create authority for a particular financing method, but instead simply lays out the requirements for approval of financing agreements by the Local Government Commission. Unless the authority to lease property is sufficient to authorize the borrowing and repayment of funds in a developer-financed project, there is no authority currently in the law for this type of financing arrangement. If the legislature were to specifically authorize this type of borrowing, the state constitution may require such legislation to be in a general law, rather than a local act. See **NC Constitution, Article V, Section 4(1)**.

Other Types of Lease Arrangements

Does this mean that it's illegal for a local government to lease property from a private property owner and include in the lease payment some agreed upon payment for "upfit" of the leased space? Probably not. Reasonable costs (not involving significant construction or repair work) necessary to make leased space suitable for the local government to use as lessee are probably acceptable as part of the lease payment. Modifications to the space that involve construction or repair work expenditures within the statutory bidding thresholds, however, should be competitively bid and paid for separately, rather than incorporated into lease payments.

Links

- www.ncleg.net/EnactedLegislation/Statutes/HTML/BySection/Chapter_143/GS_143-129.html
- www.ncleg.net/EnactedLegislation/Statutes/HTML/BySection/Chapter_160A/GS_160A-458.3.html
- www.ncleg.net/EnactedLegislation/Statutes/HTML/BySection/Chapter_160A/GS_160A-266.html
- www.ncleg.net/EnactedLegislation/Statutes/HTML/BySection/Chapter_160A/GS_160A-499.html
- www.ncleg.net/EnactedLegislation/Statutes/HTML/BySection/Chapter_153A/GS_153A-451.html
- www.ncleg.net/EnactedLegislation/Statutes/HTML/BySection/Chapter_160A/GS_160A-320.html
- www.ncleg.net/EnactedLegislation/Statutes/HTML/BySection/Chapter_153A/GS_153A-280.html
- www.ncleg.net/EnactedLegislation/Statutes/HTML/BySection/Chapter_160A/GS_160A-309.html
- www.ncleg.net/EnactedLegislation/Statutes/HTML/BySection/Chapter_115C/GS_115C-532.html
- www.ncleg.net/EnactedLegislation/Statutes/HTML/BySection/Chapter_143/GS_143-129.html
- www.ncleg.net/enactedlegislation/sessionlaws/html/2007-2008/sl2007-48.html
- www.ncleg.net/enactedlegislation/sessionlaws/html/2007-2008/sl2008-7.html
- www.ncleg.net/EnactedLegislation/Statutes/HTML/BySection/Chapter_160A/GS_160A-19.html
- www.ncleg.net/EnactedLegislation/Statutes/HTML/BySection/Chapter_153A/GS_153A-165.html
- www.ncleg.net/EnactedLegislation/Statutes/HTML/BySection/Chapter_160A/GS_160A-20.html
- www.ncleg.net/EnactedLegislation/Statutes/HTML/BySection/Chapter_159/GS_159-148.html
- www.ncleg.gov/Laws/Constitution/Article5