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ECONOMIC DEVELOPMENT AGREEMENTS: THE BASICS

For political subdivisions in Indiana (regardless of the nature thereof, a "Public Entity") providing economic incentives to developers, a "development" or "project" agreement (either, a "Development Agreement") can help manage the expectations of the parties by serving as a "roadmap" for the transaction.

Development Agreements often include many of the provisions found in purchase agreements, such as conditions to closing, the obligations of the parties in connection with the closing, remedies of the parties if the closing does not occur, and authority and other representations. Accordingly, a strong purchase agreement template serves as an excellent launching point when drafting a Development Agreement. However, consideration should be given as to whether and how those provisions may need to be augmented to apply to the project that the developer is required to construct pursuant to the Development Agreement (the "Project").

The Development Agreement should outline the incentives to be provided, and the obligations undertaken by the developer in exchange for receiving those incentives. It should identify any special rights afforded to the Public Entity (such as plan approval rights, inspection rights and remedies if construction is not commenced or falls significantly behind schedule). If certain "specialty" agreements will be required to be executed at closing (such as taxpayer agreements, guaranties, covenants or profit-sharing agreements), then the Development Agreement should include reasonably a detailed description as to what will be contained in such agreements to minimize misunderstandings and help facilitate the negotiation of those agreements once the Development Agreement has been executed. Finally, unlike a basic purchase agreement, the Development Agreement should include the obligations of the parties post-closing and the available rights and remedies if either party defaults.

PLAN APPROVAL

Public Entities may agree to provide incentives to retain some level of control over the development of certain property. As a result, in addition to (and not in lieu of) what may be required by local laws, the Development Agreement may grant plan approval rights to the Public Entity.

The plan approval process can be as simple as requiring the developer to provide its otherwise final plans to the Public Entity for approval, or it can be more detailed and involve multiple stages. If the rights granted to the Public Entity are general and are limited to reasonable overall approval, then a simple process works fine. If the Public Entity has more significant rights, including over exterior materials, then a staged process works better. It allows the developer to rely on the approvals given by the Public Entity at each stage as it progresses to final plans, and exposes any potential disagreements earlier rather than later, allowing the developer to correct course before it spends too much money on a design that the Public Entity rejects.

CONSTRUCTION

The Development Agreement obligates the developer to construct the Project in a good and workmanlike manner, in substantial accordance with the final approved plans (including the approved schedule), and otherwise in compliance with the terms of the Development Agreement and all laws. Consideration should be given to other provisions commonly included in contracts executed by the Public Entity, such as, by way of example, prohibitions against discrimination, requirements with respect to new jobs to be generated as a result of the construction of the Project, E-Verify requirements and XBE participation goals.

INSPECTION

The Public Entity may require the right to undertake construction inspections that are in addition to those required by law. Inspections may be general rights to inspect as and when the Public Entity deems it to be appropriate, or there can be a structured approach that includes monthly inspections, sample work or other interim inspections, and/or a final inspection. As part of its right to inspect, the Public Entity should have the right to object to any defects that it identifies, and to require correction thereof by the developer. Regardless of the nature of the inspection rights (if any), it is important to consider requiring the developer to provide regular construction reports and/or to attend construction meetings to keep the Public Entity up to date on the status of construction.

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RESPONSIBILITY

It is a good plan to provide that, notwithstanding any participation by the Public Entity in the plan process, or any inspections by the Public Entity, as between the Public Entity and the developer, it is the developer that retains responsibility for the design, engineering and construction of the Project (though this would not prevent the developer from proceeding against its contractors where applicable).

PROTECTIONS

When Public Entities elect to provide incentives, they do so based on a determination that the resulting Project will be a benefit to the general public. Because the benefit of the Project is realized only if the Project is completed, it is fairly standard to require a completion guaranty.

Depending on the nature of the incentives, the Public Entity may want to include additional protections, such as: (a) conditions to disbursement of funds (ideally similar to those imposed by construction lenders on disbursements of construction loan proceeds); (b) taxpayer agreements that, pursuant to Ind. Code §36-7-25-6, have the priority of, and are on parity with, real estate tax liens (under which, for example, if the tax increment generated is less than that projected, then the owner of the real estate will cover the shortfall); (c) guaranties of obligations under taxpayer agreements; and (d) multi-party agreements with construction lenders under which the Public Entity may purchase the construction loan at par if the developer is in default.

SPECIAL REMEDIES

Despite the best of intentions and rings of protection, sometimes things can go wrong. While providing for the standard "all remedies under law and at equity" is a good idea, it may not be adequate for construction-related issues like failing to commence construction, falling significantly behind schedule or stopping work altogether. Special remedies may include: (a) the right of the Public Entity to acquire (or reacquire) the subject real estate and, if applicable, the improvements and materials in place thereon; (b) if construction falls significantly behind schedule, the right to require the developer to work with the Public Entity on a plan pursuant to which it will avoid falling further behind schedule, and implement such plan once the Public Entity approves it; and/or (c) the right of the Public Entity to "claw back" all or a portion of the incentive.

For questions or additional information on this topic, please contact:

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