
Coates' Canons Blog: Local Government Appropriations/Grants to Private Entities

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UPDATE August 2013: In 2012 the General Assembly imposed additional accountability requirements on nonprofit corporations that receive over \$5000 of public funds within a fiscal year from grants, loans, or in-kind contributions. [Click here](#) to learn more about the requirements.

At the local government's budget hearing, representatives from several private entities make requests for grants from the unit. A religious organization wants funds to organize a community festival. A local non-profit agency, trying to survive in the tough economic climate, seeks funds to finance its general operations. The local Rotary Club asks that the local government become a dues paying member. A homeowners' association requests money to improve its privately owned and maintained water system. A small company asks the unit to subsidize the company's capital expansion.

These requests may sound familiar. Local government officials typically field a myriad of similar requests around budget time. The requests often come from local non-profit agencies, some with religious affiliations. Requests also come from a variety of other sources, though, including corporations, loosely affiliated community groups, and even individuals. And, the purposes for the requests vary greatly—from seeking limited funding for a specific activity, to requesting funding to support the general operations of an organization, to asking for funding for major capital projects. May a county or city appropriate moneys to these private entities?

Grants to Private Entities

The short answer to this question is "it depends." But on what exactly does it depend? Local government officials often believe that it depends on who is asking for the funds. For example, many officials think that it likely is appropriate for a unit to give funds to a local non-profit agency or local Rotary Club, but that it is not appropriate for the unit to provide funds to a religious organization or corporation. In fact, this is not the case. Whether or not a local government may give a grant to a private entity does not depend on the type of private entity asking for the funds; instead the answer to the question depends on the purpose for which the funds ultimately will be spent.

Constitutional Authority and Requirements. Article V, Section 2(7) of the North Carolina Constitution permits the General Assembly to authorize local governments to "contract with and appropriate money to any person, association, or corporation for accomplishment of public purposes only." And, in fact, all expenditures of public funds must satisfy the North Carolina Constitution's public purpose requirement. See N.C. Const. Art. V, Sect. 2(1). I discussed the contours of this requirement in a previous [post](#), but generally the provision requires that all public funds, no matter what their source, be expended for the benefit of the citizens of a unit generally, and not solely for the benefit of particular persons or interests.

Statutory Authority and Requirements. Furthermore, satisfying the public purpose requirement is necessary but not sufficient. A local government also must have statutory authority to expend public funds for a particular purpose. See *Hughey v. Cloninger*, 297 N.C. 86 (1979). The General Assembly has authorized both counties and municipalities to "appropriate money to any person, association, or corporation . . ." G.S. 160A-20.1 (municipalities); G.S. 153A-449 (counties). There is an important limitation on this authority, though. The appropriations ultimately must be used to "carry out any public purpose that the [local governments are] authorized by law to engage in." *Id.*

Thus, the statutory authorization incorporates the constitutional public purpose requirement. It also places a further limitation on the appropriation of public funds to private entities—the private entity that receives the public funds is limited to expending those funds only on projects, services, or activities that the local government could have supported directly.

In other words, if a municipality or county has statutory authority to finance a particular program, service or activity, then it may give public monies to a private entity to fund that program, service, or activity. But, a municipality or county may not grant public monies to any private entity, including non-profit agencies or other community or civic organizations, if the monies ultimately will be spent on a program, service, or activity that the government could not fund directly. This authority allows local governments to contract with private entities to operate government programs or provide government services. It also allows local governments to support private entities, at least to the extent that those private entities seek to provide programs, services, or activities that a local unit could provide directly.

For example, a local unit may appropriate funds to a religious organization to fund a community festival that is open to all citizens of the unit because the local unit may support such an activity directly. A unit may not appropriate funds to that same religious organization, however, to finance the installation of a new roof on a church, synagogue, mosque, or other religious structure because the unit does not have authority to spend monies directly on this type of project. Perhaps a more common example arises when a local unit is asked to become a dues paying member of a civic or community organization, such as a chamber of commerce or rotary club. The local government must be very careful to ensure that its dues are expended only for purposes that the government could have funded directly. A safer approach is to ask the organization to make a request for funds for a specific project, service, or activity.

Loans to Private Entities

What about loans to private entities? The statutes cited above specifically authorize "appropriations" to private entities under certain circumstances but are silent with respect to the authority to loan public funds. The authority to appropriate monies to a private entity likely also includes the authority to loan monies to that entity. Thus, to the extent that a local government has authority to appropriate monies to a private entity for a particular purpose, it also has authority to loan monies to the private entity for that same purpose.

Non-legal Considerations

As a threshold matter, a local government must ensure that any appropriations or loans to private entities fall within the contours of the unit's constitutional and statutory authority. Before making grants or loans to private entities, local government officials also should consider a number of practical and strategic considerations, including how the governing board will choose among a number of competing requests for limited public funds, and whether only certain types of entities are eligible to receive government grants or loans. Local governments often benefit from developing detailed policy guidelines governing both the process for requesting and the process for granting requests for public funds by private entities.

Ensuring Appropriate Expenditures by Private Entities

Finally, once a local government gives or loans public monies to a private entity for a particular purpose, does the local government have any obligation to make sure that the monies are appropriately spent? The answer to this question is "yes." A unit's governing board is responsible for ensuring that public funds ultimately are spent for a statutorily authorized public purpose, even after those funds are appropriated to a private entity. There are a number of ways that a local government may go about monitoring the expenditures of public funds by a private entity—and the methods likely will vary depending on the size of the unit and the types of expenditures at issue.

The North Carolina Supreme Court has provided some guidance to local governments on this issue—sanctioning a particular oversight method in *Dennis v. Raleigh*, 253 N.C. 400 (1960). That case involved a challenge to an appropriation of funds by the City of Raleigh to a local chamber of commerce, to be spent on advertising the city. The chamber of commerce engaged in a variety of activities, some of which were unlikely to be considered public purposes. Thus, the city sought to ensure that the public funds it appropriated to the chamber of commerce were spent appropriately. The city put in place three separate "controls." First, the appropriation to the chamber of commerce was specific—it stated that the monies were to be used "exclusively for . . . advertising the advantages of the City of Raleigh in an effort to secure the location of new industry." Second, the city council reserved the right to approve each specific piece of advertising. Third, the chamber of commerce had to account for the funds at the end of the fiscal year. On the basis of the control exercised by the city over the expenditure of the public funds, the court upheld the appropriation.

Note that the first and third "controls" placed on the chamber of commerce by the City of Raleigh in *Dennis* likely are

particularly instructive. These controls parallel the appropriation and annual audit requirements placed by the Local Government Budget and Fiscal Control Act on moneys spent directly by a municipality or county. At a minimum, a local government should provide clear guidelines and directives to the private entity as to how and for what purposes public monies may be spent, and the unit should require some sort of accounting from the private entity once the funds are spent. (Note that the accounting does not have to rise to the level of an official audit, although G.S. 159-40 authorizes local governments to require non-profit agencies that receive \$1,000 or more in any fiscal year (with certain exceptions) to have an audit performed for the fiscal year in which the funds are received and to file a copy of the report with the local government.)

Links

- www.ncga.state.nc.us/Legislation/constitution/article5.html
- sogweb.sog.unc.edu/blogs/localgovt/?p=1608
- www.ncga.state.nc.us/EnactedLegislation/Statutes/HTML/BySection/Chapter_160A/GS_160A-20.1.html
- www.ncga.state.nc.us/EnactedLegislation/Statutes/HTML/BySection/Chapter_153A/GS_153A-449.html
- www.ncga.state.nc.us/EnactedLegislation/Statutes/HTML/ByArticle/Chapter_159/Article_3.html
- www.ncga.state.nc.us/EnactedLegislation/Statutes/HTML/BySection/Chapter_159/GS_159-40.html

Coates' Canons Blog: A Look at North Carolina's Constitutional Public Purpose Requirement

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In a [post](#) describing the recently enacted legislation that (potentially) authorizes North Carolina local governments to establish revolving loan funds or impose special assessments in order to finance energy efficiency improvements and distributed generation renewable energy sources permanently affixed to private property, I indicated that one (of many) complicating factors is determining whether or not such “energy financing” programs satisfy the public purpose clause of the North Carolina Constitution. As I stated in that [post](#), I think there is a good argument that, at least under certain circumstances, such programs could satisfy this constitutional requirement. The analysis of this issue is fairly extensive and very dependent on the facts and circumstances surrounding a particular unit’s program, though. In this post, I describe the current, general framework for evaluating the application of this constitutional provision. Note that this framework applies to the expenditure of public funds for any activity, project, or purpose—thus, the analysis may provide a helpful review for public officials generally.

Defining Public Purpose

Section 2(1) of Article V of the North Carolina Constitution provides that “[t]he power of taxation[] be exercised in a just and equitable manner, for public purposes only” Known as the public purpose limitation, this provision requires that all public funds, no matter what their source, be expended for the benefit of the citizens of a unit generally, and not solely for the benefit of particular persons or interests. (“Although the constitutional language speaks to the ‘power of taxation,’ the limitation has not been confined to government use of tax revenues.” *Madison Cablevision v. City of Morganton*, 325 N.C. 634, 386 S.E.2d 200 (1989).)

The North Carolina Supreme Court has not specifically defined the term “public purpose;” instead it has left the issue to be determined on a case-by-case basis. In fact, according to the Court, the “[t]he initial responsibility for determining what is and what is not a public purpose rests with the legislature,” and the legislature’s determination is “entitled to great weight.” *In re Housing Bonds*, 307 N.C. 52, 296 S.E.2d 281 (1982). Whether a particular activity, in a particular context, constitutes a public purpose is a legal issue that ultimately must be decided by the courts, though. The North Carolina Supreme Court has set forth two guiding principles to analyze whether a government activity satisfies the constitutional requirement. First, the activity must involve a “reasonable connection with the convenience and necessity of the particular” unit of government. Second, the activity must benefit the public generally, as opposed to special interests or persons.

Reasonable Connection with Unit of Government

The North Carolina Supreme Court has provided further guidance on the first guiding principle, stating that “whether an activity is within the appropriate scope of governmental involvement and is reasonably related to communal needs may be evaluated by determining how similar the activity is to other which this Court has held to be within the permissible realm of governmental action.” *Maready v. City of Winston-Salem*, 342 N.C. 708, 467 S.E.2d 615 (1996). Thus, as to the first prong, there are two parts to the inquiry. The first is whether or not the activity is an appropriate one for a local government to engage in. North Carolina courts routinely have held that traditional government activities—such as fire protection, street construction, or public health programs—serve a public purpose. There is a notion, however, that there are some activities that should be reserved for the private sector of the economy, and, therefore, are not appropriate for government action. Determining where the line should be drawn is difficult, though. As the Court repeatedly has explained,

[a] slide-rule definition to determine public purpose for all time cannot be formulated; the concept expands with the population, economy, scientific knowledge, and changing conditions. As people are brought closer together in congested areas, the public welfare requires governmental operation of facilities which were once

considered exclusively private enterprises, and necessitates the expenditures of tax funds for purposes which, in an earlier day, were not classified as public. *Martin v. Housing Corp.*, 277 N.C. 29, 175 S.E.2d 665 (1970).

North Carolina courts, thus, have held that “new” activities that are perceived as outgrowths of more traditional government functions serve a public purpose. For example, in *Martin v. North Carolina Housing Corporation*, 277 N.C. 29, 175 S.E. 2d 665 (1970), the North Carolina Supreme Court held that government funding of low income residential housing served a public purpose. In so holding, the Court tied the government’s concern for safe and sanitary housing for its citizens to its traditional role of combating slum conditions. Similarly, in *Madison Cablevision, Inc. v. City of Morganton*, 325 N.C. 634, 386 S.E.2d 200 (1989), the Court held that the municipal provision of cable television services served a public purpose because such services were a natural outgrowth of the types of communications facilities that local governments had been operating for many years, including auditoriums, libraries, fairs, public radio stations, and public television stations.

But, in a few cases, the courts have found that an activity is neither a traditional government activity, nor an outgrowth of a traditional government activity, and, consequently, the activity does not serve a public purpose. For example, in *Nash v. Tarboro*, 227 N.C. 283, 42 S.E.2d 209 (1947), the North Carolina Supreme Court held that it was not a public purpose for a town to issue general obligation bonds in order to construct and operate a hotel, finding that, at least at the time, owning and operating a hotel was purely a private business with no connection to traditional government activities.

And, occasionally, courts have determined that activities that appear to be natural extensions of traditional government activities, nonetheless, do not satisfy the public purpose clause. In *Foster v. North Carolina Medical Care Commission*, 283 N.C. 110, 195 S.E.2d 517 (1973), the North Carolina Supreme Court held that the expenditure of public funds to finance the construction of a hospital facility that was to be privately operated, managed and controlled, did not serve a public purpose, even though the “primary purpose” of a “privately owned hospital is the same as that of a publicly owned hospital.” According to the Court, “[m]any objects may be public in the general sense that their attainment will confer a public benefit or promote the public convenience but not be public in the sense that the taxing power of the State may be used to accomplish them.” Thus, a court must look not only at the ends sought, but also the means used to accomplish a public purpose.

The first guiding principle also requires that the activity benefit the citizens of the unit that is engaging in the activity, as opposed to citizens in other units. That is, the primary public that is to benefit from an expenditure of public funds must be the citizens of the jurisdiction that is making the expenditure. However, it is the benefit to the unit’s citizens that is important rather than the location of the activity. Courts have upheld expenditures of public funds on activities or projects located outside the jurisdiction of a unit as long as the benefit of the expenditures is for the citizens of the unit. Courts also have rejected challenges to government activities because the purported public benefit is too broad; that is, that the benefit extends beyond a unit’s citizens. As long as the local benefit accompanies the broader benefit, the activity may serve a public purpose.

Benefits the Public Generally, Not Special Interests or Persons

Even if an activity involves a “reasonable connection” with the unit of government, it does not necessarily mean that it serves a public purpose. The activity also must “primarily benefit the public and not a private party.” According to the North Carolina Supreme Court, “[i]t is not necessary, [however], in order that a use may be regarded as public, that it should be for the use and benefit of every citizen in the community. It may be for the inhabitants of a restricted locality, but the use and benefit must be in common, and not for particular persons, interests, or estates.” *Briggs v. City of Raleigh*, 195 N.C. 223, 141 S.E. 597 (1928). In other words, “the ultimate net gain or advantage must be the public’s as contradistinguished from that of an individual or private entity.” *Martin v. Housing Corp.*, 277 N.C. 29, 175 S.E.2d 665 (1970). But, “an activity does not lose its public purpose merely because it involves a private actor. Generally, if an act will promote the welfare of a state or a local government and its citizens, it is for a public purpose.” *Parker v. New Hanover County*, 173 N.C.App. 644, 619 S.E.2d 868 (2005). Courts often resort to engaging in a balancing test of the public and private benefits; invalidating the expenditure if the private benefit is predominant. Unfortunately, as several courts have noted, “[o]ften public and private interests are so co-mingled that it is difficult to determine which predominates.” *Martin v. Housing Corp.*, 277 N.C. 29, 175 S.E.2d 665 (1970).

And, the outcome of the analysis depends largely on how the benefits are characterized. In *Mitchell v. Financing Authority*, 273 N.C. 137, 159 S.E.2d 745 (1973), for example, the North Carolina Supreme Court determined it was not a public



purpose to use state funds to acquire sites and construct and equip facilities for private industrial development. Significantly the Court considered the “benefits” to simply constitute a win-fall to only a few private companies, at the expense of other companies and of the public generally. It, thus, found that the expenditure of public funds for this purpose did not serve a public purpose. Contrast that with a more recent decision in *Maready v. City of Winston-Salem*, 342 N.C. 708, 467 S.E.2d 615 (1996), in which the North Carolina Supreme Court held that economic development incentive grants to private businesses did not violate the public purpose clause. In this case, the Court took a much broader view of the “benefits,” stating that the ultimate goal of providing such incentives to one or more private entities was to improve the community at large—through, among other things, increased tax revenues and job opportunities. The *Maready* case appears to reflect the Court’s recognition of the “trend toward broadening the scope of what constitutes a valid public purpose that permits the expenditure of public revenues” in modern society.

Applying Framework to Proposed Government Activity

There is substantial case law analyzing the public purpose clause. The cases cited above, however, are representative of the current framework North Carolina courts are employing to analyze this issue. In the absence of direct court guidance with respect to a particular proposed expenditure of public funds, a unit must determine whether both the means used and the ends sought comprise a traditional government activity, or a natural extension or outgrowth of a traditional government activity. Furthermore, the activity must benefit the citizens of the unit making the expenditure generally. That does not mean it has to benefit all citizens equally. It also does not mean that the proposed expenditure of public funds cannot significantly and directly benefit specific individuals or entities. But the overall purpose of the activity must be to benefit the unit and its citizens; and this broader public benefit ultimately should predominate over the benefit to any single individual or entity. (Of course, there is a great deal of subjectivity in this analysis, which is why the courts appear to be fairly deferential to the Legislature’s or a governing body’s determination that a particular activity benefits the public.)

Satisfying Public Purpose Clause Does Not Automatically Authorize Expenditure

Finally, note that even if a proposed expenditure of public funds constitutes a public purpose, it does not automatically mean that a unit may engage in the proposed activity. A local government also must have statutory authority to both engage in an activity and expend public funds for that activity.

Links

- sogweb.sog.unc.edu/blogs/localgovt/?p=1319
- www.ncga.state.nc.us/Legislation/constitution/article5.html

Part 5. Nonprofit Corporations Receiving Public Funds.

§ 159-40. Special regulations pertaining to nonprofit corporations receiving public funds.

(a) If a city or county grants or appropriates one thousand dollars (\$1,000) or more in any fiscal year to a nonprofit corporation or organization, the city or county may require that the nonprofit corporation or organization have an audit performed for the fiscal year in which the funds are received and may require that the nonprofit corporation or organization file a copy of the audit report with the city or county.

(b) Any nonprofit corporation or organization which receives one thousand dollars (\$1,000) or more in State funds shall, at the request of the State Auditor, submit to an audit by the office of the State Auditor for the fiscal year in which such funds were received.

(c) Every nonprofit corporation or organization which has an audit performed pursuant to this section shall file a copy of the audit report with the office of the State Auditor.

(d) The provisions of this section shall not apply to sheltered workshops or to Adult Development Activity Programs or to private residential facilities for the mentally retarded and developmentally disabled or to Developmental Day Care Centers or to any nonprofit corporation or organization whose sole use of public funds is to provide hospital services or operate as a volunteer fire department, rescue squad, ambulance squad, or which operates as a junior college, college or university duly accredited by the southern regional accrediting association.

(e) Repealed by Session Laws 1979, c. 905. (1977, c. 687, s. 1; 1977, 2nd Sess., c. 1195, s. 1; 1979, c. 905.)