REAL ESTATE DEVELOPMENT IN THE FACE OF RURAL MIGRATION

BY KATIE DOWELL
Raleigh Real Estate Law

The recession of 2007 saw unprecedented numbers of people move to urban centers and metropolitan areas in search of employment and housing. The post-pandemic market tells a different story presenting a unique opportunity for commercial and residential real estate development.

COVID-19 transformed American society. It sent us to work from our couches, made us cancel our travel plans, and led us to avoid social interaction with all but a select few. But it also changed the employment landscape and caused a sharp shift in personal values. It taught us to embrace the availability of remote work. To value smaller communities, proximity to family, more affordable housing, and a less-congested quality of life.

In North Carolina, and other states, that value shift translated to a great domestic migration out of urban areas to rural communities at a previously unheard of pace. Rural counties in North Carolina that had sustained population decline for a decade before the pandemic (such as Warren and Nash Counties) saw a reversal of that trend in 2021. Despite decreasing birth rates and increasing mortality rates in these areas during the same period, they continue to grow as more and more people embrace small towns and the value of life they provide. With rising interest rates pricing many homebuyers out of metropolitan and suburban areas, and seemingly no end in sight for the popularity of remote work, migration to smaller towns is expected to continue. It's also created a recent but strong demand for housing and commercial development to meet the needs of these growing communities. While mainstream development has largely focused on urban areas, those commercial and residential real estate developers following this demand face a variety of unique benefits and incentives. Here are some of the benefits early adopters of the rural development movement can expect based on my experience representing commercial and residential developers following this trend.

LOWER COST AND BETTER INVENTORY

The inflationary market of materials and rising cost of labor have led to soaring costs of construction for new developments and increased rent pressures in urban areas. These same costs aren't necessarily reflected in rural markets where the cost of living, labor, and ultimately construction are lower. In addition to the lower cost of construction, developers in these communities face a far lower cost of acquisition of existing inventory and far greater availability of raw land compared to the extremely competitive metropolitan or suburban markets. While the lower acquisition costs and available inventory in rural communities might not be new, the population growth in these areas and resulting consumer demand is a recent development that many developers have yet to capitalize on. As a result, compared to similar projects in popular suburban and metropolitan areas, developers can now acquire inventory (raw land included) at a fraction of the cost, build residential homes and commercial developments for cheaper, and sell or hold with comparable demand and cash flow as similar more expensive projects in urban areas.

This dynamic is particularly true for commercial development of existing structures. Developers can invest in commercial buildings at well below market value, for far less than the cost to build the same structures new construction, and well below the cost to acquire a comparable property in metropolitan areas. And with minimal effort and expense (but far greater incentives than similar projects in metropolitan areas as discussed below), are renovating, revitalizing, and repurposing these structures into modern commercial retail and office spaces, the ever-popular multi-family, and mixed-used developments, often with full occupancy to show for it.

COOPERATIVE MUNICIPAL GOVERNMENTS

Cooperative small towns and municipal governments condense the timeline and bureaucracy of the development process when they are motivated to encourage projects that will economically benefit the communities they serve. From contract negotiations in private-public development projects to various municipal approvals, project timelines are significantly shortened thanks to this dynamic. For example, whereas zoning matters such as rezoning requests may take up to a year to resolve in larger counties like Wake County, they are often resolved in as little as ninety days in smaller communities. The same can be said for easement approvals, annexation, lot line adjustments, and approvals for planned unit developments – all of which take far less time to obtain with much less bureaucratic hoops to jump through.

Because the development process in rural communities is extremely condensed, the carrying costs are much lower and returns are actualized faster. As an added bonus, some smaller towns are so motivated to encourage development that developers are increasingly successful in negotiating contracts with local government entities to provide public funding toward development costs such as the construction of parking lots and engineering utilities to planned unit developments. Put simply, there is less red tape and more enthusiasm to see developments in many small towns resulting in shortened project timelines, public funding to subsidize costs, and higher rates of returns.

FINANCIAL INCENTIVES AND CREATIVE FINANCING

Eligible development projects in rural areas may qualify for numerous grants and tax credits. For example, The Historic Rehabilitation Tax Credit Investment Program is particularly appealing. Founded on the idea that restoration of existing structures and redevelopment into housing, retail and office spaces creates jobs and promotes economic growth, developers receive a tax credit for rehabilitation of existing historic buildings equal to a percentage of the renovation and construction costs. Although available statewide for qualifying projects, the State tax credit is highest for rehabilitation developments in Tier 1 and Tier 2 counties (Warren County, for example) for a total possible tax credit of 20% in addition to the Federal 20%. Thanks to 40% tax credits combined, the return on rural developments can be far higher than comparable projects in urban markets.

Developers may also qualify for grant money similarly geared towards incentivizing economic development in these communities at the State and Federal level - because of the type of industry they are encouraging, location of the development itself, or the number of jobs created upon completion of projects. The variety and availability of grant funds are too numerous to provide examples here but, depending on the project, could cut the cost of construction significantly.

Aside from tax incentives and grants, especially in the commercial arena, we are also seeing seller-financing arrangements explode in popularity in rural markets to the benefit of both parties. The terms of these arrangements vary wildly, are heavily negotiated, and are incredibly transaction specific. However, commercial buyers generally enjoy lower interest rates (if any), funding that does not contribute to their debt-to-income ratio, and flexible terms without the hassle of traditional underwriting and funding. Sellers enjoy various tax incentives from not actualizing a large lump sum return in a single tax year. From tax incentives and grants to non-traditional funding options, rural development is particularly attractive.

CONCLUSION

The great domestic migration to rural communities has led to increased demand for real estate development in those markets at both the residential and commercial level. As a result, rural opportunities abound post-COVID in unprecedented ways that developers focused on urban development have not experienced. Cooperative municipal governance, acquisition opportunities, and financial incentives unique to rural development should not be ignored. While market research into particular communities should be done in deciding where to focus development efforts, in many rural areas inventory is easier to acquire, cheaper and faster to develop, with the demand to support healthy returns. ■

RALEIGH REAL ESTATE LAW

KATIE DOWELL

Katie Dowell is owner and attorney at Raleigh Real Estate Law with offices in Raleigh, Lake Gaston, and Halifax. A graduate of Campbell Law, Katie's practice focuses on transactional real estate matters, representing clients in residential and commercial purchases and refinances, as well as builders and commercial developers in various development projects across North Carolina. She's also been recognized by her peers and fellow attorneys as Business NC's Legal Elite List for Real Estate Law in 2021 and 2022 as well as Super Lawyers Rising Stars List for 2022 and 2023.