

SHOULD SELECT TENNESSEE EXPAND TO INCLUDE INVESTMENT IN BUILDINGS?

TENNESSEE CERTIFIED ECONOMIC DEVELOPER
FINAL CAPSTONE PROJECT

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INTRODUCTION

A significant challenge facing communities across Tennessee in developing their economies is to maximize opportunities for corporate investments that lead to growth and development. The consensus of site selection professionals is that a portfolio of vacant market-appropriate industrial buildings improves a community's chances of attracting such ventures.

Area Development magazine lists "Available Buildings" as Critical-Factor-#5-in-Site-Selection for companies looking to locate new facilities.¹ Needs change rapidly and companies cannot afford the luxury of a long lead time in being able to be up and running. Suitable existing buildings often become an essential marketing tool for communities within the current competitive recruitment environment. Richard H. Thompson, International Director of Supply Chain and Logistics Solutions at Jones Lang LaSalle said: "Availability of buildings can be a driver, especially if a company is in a hurry,"²

Other industry professionals confirm Thompson's position. "Existing buildings can give a company competitive advantage, compared to new construction, by shortening the time required to implement the project and often reducing startup costs," states Don Schjeldahl, Principle at site selection firm DSG Advisors.³ Schjeldahl continues, "In a fast-paced global economy, success or failure can hinge on speed to market." Schjeldahl indicates there is an informal consensus among Site Selectors Guild members that fifty percent at a minimum of all projects start by looking for an existing building; some Guild members make it as high as seventy percent.

Economic development organizations similarly recognized the advantage of having available buildings, though not every organization incorporates programs to create a portfolio. Formerly occupied industrial buildings along with speculative ("spec") buildings make up most properties on the market. Speculative buildings are those that are constructed without a buyer or tenant and are built based on the speculation of what an end user would want.

¹ (Steve Stackhouse-Kaelble, Area Development, Q4 2016(<http://www.areadevelopment.com/corporate-site-selection-factors/q4-2016/available-buildings-critical-site-selection-factor.shtml>))

² (Steve Stackhouse-Kaelble, Area Development, Q4 2016(<http://www.areadevelopment.com/corporate-site-selection-factors/q4-2016/available-buildings-critical-site-selection-factor.shtml>))

³ January, 2017 --- interview with Don Schjeldahl, DSG Advisors, Kent, Ohio

According to Tori Ung of Austin Consulting, programs tailored to increase available buildings are not new, and they fall in and out of favor. She advises that communities must consider if the benefits outweigh the risk when determining if the construction of a spec building is a good option.⁴ However, it is often heard from economic developers, especially those with no recent “wins”, how much better their ability to locate a new industry to a community would be if they had a vacant building to market.

In a recent search of TVA Sites, the online inventory of sites and buildings in the Tennessee Valley Authority's region, 1,563 available buildings were listed from across the State of Tennessee, 853 of these were existing industrial buildings. The number may sound encouraging, but there are caveats and limitations with many. Frequently existing buildings were built for an industry in years past and although they functioned well for their original intent, they may have deficiencies that do not meet the requirements of industry today. Consequently, they are passed by when companies consider them for a modern industrial operation and thus these properties have been sitting on the market for several years.

Jonathan Gemmen, Director, Austin Consulting, has pointed out that the rehabilitation of buildings can make very good sense in some instances.⁵ However, many of the buildings in a community's inventory may have been unoccupied for a long time and for good reason. There is nothing a grant program can do in many cases to make these buildings more viable. For example, you cannot increase ceiling height. But in some instances, helping improve a few publicly-owned buildings could significantly benefit a rural community. Gemmen speculates that a company is unlikely to take on a capital investment required to improve an existing building, but a ready to go building may convince them, especially if time is a factor, to consider a less than desirable location. If they are building to suit, they would consider other locations.

Urban counties, such as Wilson, do not need to invest in speculative buildings. Due to the market demand, private developers provide this product. However, if rural communities, such as Lawrence County, want to include buildings in their inventory, they must construct them.

As with any investment in industrial development the feasibility of developing a spec building must be examined. The existing infrastructure and workforce should be evaluated to determine if it is adequate for a potential target tenant. A market analysis should be conducted to verify that the location would attract industry. In addition, because a company may not locate immediately, who will maintain and market the building should be identified.

⁴ (<http://www.theaustin.com/weighing-pros-and-cons-spec-buildings>, Austin Consulting's Blog, 10/23/14)

⁵ January, 2017 --- interview with Jonathan Gemmen, Director, Austin Consulting, Cleveland Ohio

Considering the importance of existing industrial buildings when recruiting an industrial project, this paper will explore if current programs now serving Tennessee communities assist in bringing buildings to the market. If there is a gap, should Select Tennessee be expanded to include investment in buildings, and how would these changes affect the existing program?

OVERVIEW OF PRODUCT DEVELOPMENT PROGRAMS IN THE STATE OF TENNESSEE

Tennessee Department of Economic and Community Development (TNECD)

While TNECD has no programs specifically aimed at spec buildings within Tennessee, there are some that touch the concept. Select Tennessee is a suite of programs housed in the Rural Development section of TNECD that are crafted to assist communities to create a pipeline of industrial sites ready for development. Currently none of these programs provide funding for the rehabilitation or construction of industrial buildings, but they do aid in preparing property for development. Select Tennessee programs include:

- Certified Sites Program
- Property Evaluation Program
- Site Development Grants

Certified Sites Program: When a business makes the decision to build or expand, there are many factors that come into play. The Certified Sites Program was the first program developed under the Select Tennessee umbrella.⁶ It is a rigorous process aimed at guiding communities in the due diligence necessary for corporate investment and minimizes risk factors for development. Sites are not certified by the State, but by Austin Consulting, a professional site selection third party.

With the select Tennessee Certified Sites Program, risks and guesswork are minimized when a company is locating to a new site. This program sets a constant and rigorous standard that can be relied on when making critical location decisions.

Property Evaluation Program (PEP): Prepared and available industrial properties are essential for a community to be competitive for industrial recruitment.⁷ However, developing and maintaining this inventory is difficult and many communities have few quality properties available for the market. To address this need, TNECD, with the assistance of Austin Consulting, developed a service to assist communities by providing professional advice that prioritizes where investment may be most beneficial and what steps may be needed to address issues and shortcomings.

⁶ (<http://www.tnecd.com/sites/certified-sites/apply-now>)

⁷ (<http://www.tnecd.com/sites/certified-sites/select-tennessee-property-evaluation-program>)

This program benefits communities through emphasizing the importance of and assisting with planning for the future. This includes both readying industrial properties for near-term development, as well as creating a pipeline of properties for future development.

Site Development Grant: The newest offering by TNECD under Select Tennessee is the Site Development Grants (SDG) program.⁸ With funding from the Rural Economic Opportunity Fund grants are provided to aid eligible communities in preparing industrial sites for development. Eligible activities include infrastructure activities, such as water, wastewater, access roads, etc. or property-related activities, such as the purchase of property, easements, vegetation clearing, grading, and drainage improvements.

Participation in this program requires that the site must either be certified, in the process of being certified, or if funded, will enter the certification process. Only sites with over twenty developable acres can be certified. Therefore, the construction of buildings is not an eligible activity.

FastTrack Economic Development Fund: TNECD provides grants thru their FastTrack Economic Development Fund for companies expanding or locating in Tennessee with reimbursable grants made to local industrial development boards.⁹ They aid companies in a variety of ways. The rehabilitation or retrofitting of an existing building is an eligible activity. However, these grants are only made when there is a company that is locating or expanding, creating new jobs and investing private funds. In addition, these are only used in exceptional cases where the impact of the company on a given community is significant.

Federal Programs

Tennessee Valley Authority

The Tennessee Valley Authority (TVA), a long and loyal partner in supporting economic development initiatives, has a broad portfolio of programs aimed at assisting readying communities for economic development. TVA has two programs that include funding for buildings:

- InvestPrep™
- TVA Loan Program

InvestPrep™: The Tennessee Valley Authority's (TVA) InvestPrep™ is a product-development grant program aimed at helping communities within the TVA service area ready industrial sites and buildings. TVA partners with the consulting firm KPMG LLP to

⁸ (<http://tn.gov/ecd/topic/select-tennessee-site-development-grant>)

⁹ (<http://www.tnecd.com/advantages/incentives-grants/>)

provide an objective analysis based on program goals. Projects are prioritized by the methodology developed by KPMG.

The construction of speculative buildings is an eligible activity thru these grants, but is limited to a maximum grant of \$250,000. TVA's service area covers most of Tennessee, portions of Alabama, Mississippi, and Kentucky, and small slices of Georgia, North Carolina, and Virginia. Projects in Tennessee must compete with the other areas in the region.

The Select Tennessee Site Development Grants program is similar to InvestPrep™. However, spec buildings are currently not an eligible activity for an SDG.

TVA Loan Program: TVA also offers loans to develop industrial infrastructure, including the construction of speculative industrial buildings. TVA only offers permanent financing for speculative buildings, where the applicant needs to obtain construction financing from another source and may utilize TVA financing after completion of construction.

Both TVA's InvestPrep™ and Loan program can assist communities with the rehabilitation of an existing building. The latter normally coming into play when a company has already announced they are planning to locate or expand.

United States Department of Agriculture (USDA) Rural Development

Rural Economic Development Loan (REDL) and Grant (REDG): The USDA offers two loan programs that can be used to finance industrial buildings. The Rural Economic Development Loan (REDL) and Grant (REDG) programs provide funding to rural projects through local utility organizations. USDA provides zero interest loans to local utilities, which they, in turn, pass through to local businesses for projects that will create and retain employment in rural areas. The ultimate recipients repay the lending utility directly. The utility is responsible for repayment to the Agency. These funds must be used for projects in rural areas or towns with a population of 50,000 or less.

United States Department of Housing and Urban Development

Community Development Block Grant Funds: Community Block Grants can be used for the construction of a building; however, it is a loan and not a grant program, and cannot be done on a speculative basis. It must be for a company that is locating or expanding, creating jobs and private investment.

EXPERIENCES FROM OTHER STATES

Speculative Buildings

A search of the internet did not produce any results for State sponsored grant programs for the construction of speculative industrial buildings. There are states that have similar programs to the State of Tennessee that will assist in funding a project if a company is going to locate or expand, creating new jobs and private investment.

In an interview with Don Schjeldahl, SDG Advisors, he indicated that he was not aware of programs at the State level that took the lead on spec buildings.¹⁰ He was aware of programs, like those in Tennessee that supported the development of industrial parks where a spec building could be constructed. Jonathan Gemmen concurs with this.¹¹ Gemmen notes that there are many locally run spec building programs, but for a state to get involved in the funding of such an asset may give the appearance of entering a gray area, as some feel that such activities should be left to the private sector.

There are other entities, however, that have programs for the construction of industrial spec buildings. For example, the Alabama Power Company Speculative Building Program was established in 1991 to increase the availability of quality buildings.¹² They established a limited fund from which its Economic and Community Development Department is authorized to purchase industrial development bonds issued by a local economic development agencies. However, like many programs it is only a loan, and not a grant. In addition, it has many restrictions that would not allow its principles to be transferred to a program in Tennessee, especially not one that has a special emphasis on rural communities. One of the most important of these is that it must be in an industrial park encompassing 75 acres. In many instances, it is difficult just to find a twenty-acre site in one of Tennessee's rural counties, much less a park of this size, with all the other requirements that accompany this program.

Virtual Speculative Buildings

Although not geared to the construction of speculative industrial buildings there are other programs that deal with buildings in unique ways.

It is becoming more common for communities to invest in virtual spec buildings. The Select Tennessee certified Northwest Tennessee Regional Industrial Center has a virtual speculative building that "sits" on a 40-acre parcel of the 340-acres.¹³

¹⁰ January, 2017--- interview with Don Schjeldahl, DSG Advisors, Kent, Ohio

¹¹ January, 2017 --- interview with Jonathan Gemmen, Director, Austin Consulting, Cleveland Ohio

¹² (<http://www.amazingalabama.com/services/speculative-building-program/>)

¹³ (<http://www.obioncounty.org/index.php/business/virtual-spec-building.html>)

Virtual buildings enable a prospect to visualize a building on a specific site and require far less resources than constructing an actual building. With a virtual spec building, the entire process of building a facility has been completed, except for actual construction. The utilities should be in place, the pad graded and permitting has occurred. One of the primary advantages of a virtual Spec building over an existing building is adaptability. A company can determine if modifications better suit their needs. Budgets and a construction schedule accompany the computer renderings

As stated previously, Tori Ung in the Austin Consulting blog discusses the risks of spec buildings.¹⁴ There is no one-size-fits-all building. Different types of companies require different layouts. A community could be limiting their range of prospects. They could over-build and not recoup their investment. In addition, when a spec building sits on the market, the land on which it is constructed must come off the market for a site search. A virtual spec building can minimize these risks.

However, virtual spec buildings are not perfect solutions. Jonathan Gemmen, Austin Consulting, points out that virtual spec buildings are a good thing if the pad is graded and the utilities are stubbed.¹⁵ However, when communities respond to an RFP requiring an existing building, site selectors typically discard virtual spec buildings. They do not fit into one of the typical boxes. Virtual buildings do not usually save time over finishing a genuine spec building to fit a company's needs. Weather can cause delays in construction, which is not an issue if there is an actual building. However, there are trade-offs with the flexibility of a virtual building.

Although, no projects regarding virtual spec buildings have been funded to date, both are eligible activities under the Select Tennessee Site Development Grants and the TVA InvestPrep™ programs. Those sites awarded a Site Development Grant that are not already certified must enter the certification process as a requirement of the current program. Buildings cannot be certified under this program. A virtual spec building would preserve the certification, while providing a next best step. The grants are competitive, and as with any other applications, they would need to show how they would increase the attractiveness of the site to prospective tenants.

Demolition of Existing Buildings

North Carolina has a program that does not provide funding to construct a building, but to tear one down to create site availability. The Rural Building Demolition Program, administered by the North Carolina Department of Commerce, provides grants to local

¹⁴ <http://www.theaustin.com/weighing-pros-and-cons-spec-buildings>, Austin Consulting's Blog, 10/23/14)

¹⁵ January, 2017 --- interview with Jonathan Gemmen, Director, Austin Consulting, Cleveland Ohio

governments to support the demolition of vacant buildings to encourage site rehabilitation for economic development purposes.¹⁶ The only eligible expense is building demolition and removal, and upon completion of the project, the property must be site ready for development.

Both the TVA InvestPrep™ program and the TNECD Select Tennessee Site Development Grants allow as an eligible activity the demolition of buildings to create an industrial site. Unicoi County was provided funding by TVA to raze a building to provide an industrial site. Unicoi County has just experienced a major economic setback due to the closing of the CSX switchyard operations. Tearing down this building was one of the recommendations in their Property Evaluation Program (PEP) report. However, it was not eligible for Site Development Grant assistance, as the site was less than twenty acres.

CONCLUSIONS

A portfolio of available market-ready buildings, without question, adds to a community's ability to attract economically beneficial investments. A review of programs in Tennessee and elsewhere indicates there are three broad approaches for either creating competitive buildings for the market, or readying properties that lower barriers for constructing buildings:

- Retrofit a pre-occupied building to modern standards
- Develop a speculative ("spec") building
- Create a "virtual spec building"

The gap in TNECD's Select Tennessee suite of programs is in providing funds for the construction of speculative buildings and the rehabilitation of existing buildings. The Site Development Grant program has focused only on sites, as it has been coupled with its sister program, Certified Sites. Adding to the requirements already in place for Certified Sites by confirming building quality and developing standards for the diverse variety of buildings is not an activity TNECD would want to pursue. However, an attractive available building is a welcome asset in a community's portfolio of economic property. The Select Tennessee Property Evaluation Program already includes buildings in its evaluation.

Another requirement of TNECD's Site Certification program is that only sites that have, at a minimum, twenty developable acres can be certified. This criterion coupled with the stringent requirements concerning utilities, transportation and due diligence create a site where companies generating new jobs with large private investment would likely locate. But this can be an obstacle in providing Site Development Grant funding for the razing of industrial buildings. Although in the case of Unicoi County, it was an eligible SDG activity, this requirement prevented them from applying for the building they were tearing down. It provided a site much less than twenty acres. However, this was a

¹⁶ (<https://edpnc.com/incentives/rural-division-rural-building-demolition-program/>)

recommendation from one of the other Select Tennessee programs and may be their best economic strategy. Existing buildings in need of rehabilitation also often do not sit on twenty acres.

For some of our rural communities, landing a large company with many jobs and high private investment may not be realistic. Their growth will more than likely come from home grown companies, expanding incrementally or smaller companies locating. For these communities developing smaller sites to accommodate industry would be a smarter strategy. Properties are being identified thru the Property Evaluation Program.

Becoming a Select Tennessee Certified Site is a rigorous endeavor, and the process should not be diluted. The requirement of having a minimum of twenty developable acres to be a Select Tennessee Certified Site is a good one and should be preserved. The standards of the program make it nationally recognized and garner the attention of site selectors. It is also not in the best interest of the Select Tennessee Certified Site program to include buildings. However, it may make sense to change the Site Development Grant requirement of pursuing certification to increase industrial real estate, especially in rural communities.

If these changes were made in the Site Development Grant program, other modifications would be needed. The primary one would be in the scoring system for the Site Development Grants. It is currently not geared for the inclusion of these activities. It would need to be revised to be able to score both sites and buildings and maintain the integrity of the system. The current scoring for selecting which projects to fund addresses how the proposed project would make the site more attractive and increase the chances of landing a company. Those projects that do not do this do not score highly. If buildings are to be included, the current scoring system would need to be reevaluated. Speculative buildings on sites not warranting their construction, or buildings where rehabilitation would not preserve them for a likely tenant also should not score well.

With any grant program, expectations will need to be managed. It is seen all too often a Site Development Grant application for a graded pad for a 100,000+ SF building. When asked why they chose that size pad, the answer is invariably because that is the RFP they see most circulated by project managers. This may not be realistic for a more rural county. Likewise, building a speculative building for some communities may not be a wise choice. Because an activity is eligible does not make it the best course of action for that community. Careful planning utilizing the Property Evaluation Program and including other stakeholders should be emphasized when marketing the Site Development Grants.

The goal of the suite of Select Tennessee programs is to assist communities with the creation and development of attractive and market ready industrial properties. To this end, it is possible to address an existing gap by expanding and adjusting these programs to foster the development of industrial buildings, a critically important element of marketing inventory. TNECD would be wise to align programs with the goal of more communities developing market-ready buildings. Buildings increase exposure to corporate projects. It is recommended that there be a discussion with the Site

Development Grant Advisory Committee and TNECD leadership regarding the inclusion of the rehabilitation of existing industrial buildings and the construction of speculative buildings as eligible activities for Select Tennessee Site Development Grants. This discussion would need to address how the Select Tennessee programs could best work together in providing more broadly based industrial real estate product.