

The Industrial Development Agency's "Straight Lease" Transaction

PART ONE OF A TWO PART ARTICLE:

Introduction to the Basic Concepts and Steps Involved in a Straight Lease Transaction



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INTRODUCTION

Industrial Development Agencies ("IDAs") may be synonymous with bond financing for those familiar with the term. While it is true that IDAs are well known for issuing bonds to finance real estate projects, IDAs have an alternative means of financing real estate projects, the so-called IDA "straight-lease" transaction which offers mortgage recording tax exemption, sales and use tax exemption, real property tax abatements and discounts on utility rates to qualifying projects.

This two part article will discuss the fundamental concepts, processes and procedures involved in an IDA Straight-Lease Transaction as well as why an IDA Straight-Lease Transaction is worthwhile to developers, real estate professionals and owners/operators of real property.

Although the concept of an IDA Straight-Lease Transaction may sound strange or arcane to real estate owners, operators or developers, the transaction is used quite frequently by many small and large companies as a viable means of financing or supplementing the financing of real estate projects.

This article will discuss the IDA Straight-Lease Transaction in two parts. Part I will provide an introduction to IDAs and will describe the basic concepts and steps involved in a Straight-Lease Transaction. Part Two will discuss the benefits one can obtain from undertaking and closing on a Straight-Lease Transaction.

THE LAW

IDAs are public benefit corporations and most IDAs were created pursuant to Article 18-A of the General Municipal Law of the State of New York. IDAs exist on the county level in most parts of New York State. For example, Westchester and Putnam counties each have an IDA. However, there are some cities, towns and villages that have their own IDAs. For example, the City of Yonkers and the Village of Port Chester.

Article 18-A of the General Municipal Law enables IDAs, for the benefit of New York State and its counties, cities, villages and towns, to acquire, construct, lease, improve, equip and furnish real and personal property, suitable for, among other things, manufacturing, warehousing,

research, commercial or industrial purposes, in order to advance the job opportunities, health, general prosperity and economic welfare of the people of the State of New York.

In essence, the primary goal and function of an IDA is to foster economic development in New York State through financing real estate projects.

WESTCHESTER COUNTY'S VIEW OF IDAs

Although today's difficult economic environment limits governmental financial resources and incentives available for assisting businesses, Westchester County views its IDA as a vital tool in its economic development toolbox for retaining, expanding and attracting companies to the County.

TYPE OF PROJECTS

If a project is eligible, IDAs may offer financial assistance for the acquisition, development, construction and/or renovation of real property and the buildings located thereon as well as the acquisition of personal property in order to equip and furnish such buildings.

Westchester County IDAs' projects

run the gamut from assisting local developers build medical treatment centers, assisting software firms to move from Connecticut, to retaining major businesses in the County (such as Pepsi Beverages and Atlas Air) and may include assistance with straight-forward small equipment purchases to complicated real estate refinancing projects.

IDA BASICS

Typically, IDAs may only offer financial assistance to projects within its jurisdiction, so, for example, New York City's IDA will not have the ability to offer financial assistance to a project in Dutchess County.

IDAs foster economic development and offer financial assistance to projects by two primary means: the issuance of bonds and the Straight-Lease Transaction. IDA bond financing has been used to obtain funds to finance a project; in a nutshell, the IDA issues

bonds, the bonds are sold by an underwriter and the proceeds from the sale of the bonds finance the project.¹

In an IDA Straight-Lease Transaction, however, a borrower will not receive any funds or bond proceeds. Rather, the IDA offers financial assistance in the form of benefits. The benefits, which will be described in Part II of this Article, include mortgage recording tax exemption, sales and use tax exemption, real property tax abatements and discounts on utility rates.

THE STRAIGHT-LEASE TRANSACTION

Straight-Lease Transactions have been used in conjunction with traditional real estate loans, new markets tax credits transactions, residential developments and all types and varieties of commercial real estate transactions. It is very common that a borrower will undertake a Straight-

Lease Transaction in conjunction with a traditional mortgage loan. However, some applicants/borrowers undertake a Straight-Lease Transaction with their own funds instead of obtaining a traditional mortgage loan.

THE APPLICATION PROCESS IN WESTCHESTER COUNTY

One of the first steps in a Straight-Lease Transaction consist of an applicant/borrower submitting an application to the appropriate IDA requesting financial assistance. The application will describe the project and the benefits being sought by the borrower. The IDA will review the application and advise the applicant whether the IDA will offer financial assistance. For example, the Westchester County IDA's Director and Office of Economic Development would work in partnership to determine the strength of a project based upon several factors, such as

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whether the Westchester County IDA's actions will result in significant job retention and/or employment growth, additional financial investments, and create opportunities for new business partnerships. In addition, the Westchester County IDA would examine the financial stability of the people involved in the project as well as whether they have the resources to undertake and complete the project. Ultimately, the IDA needs to determine if a project will be worthwhile. In the Westchester County IDA's case, the Board of Directors, the Executive Director and the Office of Economic Development Director must jointly feel a project is a worthy investment for the people of Westchester County and, further, that the project will withstand public scrutiny.

DOCUMENTATION

If the IDA decides to provide financial assistance, then the IDA's lawyer will start preparing the straight-lease documentation. The

straight-lease documentation will reflect that the IDA will have an interest (usually a leasehold) in the project. In essence, the borrower will lease the project (*i.e.*, the real property and/or personal property) to the IDA and the IDA will lease the property back to the borrower. New York State law requires that the IDA have an interest in the project in order for the borrower to obtain the financial benefits. Further, the documentation will reflect that the borrower is an "agent" of the IDA and, as such, the borrower is carrying out the project on behalf of the IDA. Again, this legal fiction is necessary, pursuant to New York State law, to ensure that the project receives the benefits. Once the documentation has been completed and negotiated by the IDA's counsel and the borrower's counsel, and provided that the borrower is otherwise ready to close, the parties will proceed to a closing. Once the transaction closes, the borrower will be entitled to the financial benefits.

Part Two of this article which will be published in the upcoming edition of the *Newsletter* will discuss

the benefits one can obtain from undertaking and closing on a Straight-Lease Transaction.

ENDNOTE

1. See the November 2008 issue of the *Westchester County Bar Association Newsletter*: "Mahopac Volunteer Fire Department Uses Low-Cost Bond Financing To Build a New State-of-the-Art Firehouse" by Eon S. Nichols, Esq. which describes the mechanics of an IDA bond financing.

Eon S. Nichols, Esq., is a Partner at the law firm of Cuddy & Feder LLP. His practice includes real estate transactions, both commercial and residential, real estate financing, commercial lending transactions and leasing. He is also involved in Industrial Development Agency bond financing and represents many borrowers, among them not-for-profit organizations and for-profit companies in tax-exempt and taxable bond financing.

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