



WESTCHESTER COUNTY BAR ASSOCIATION NEWSLETTER

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President's Message

BY JEROLD R. RUDERMAN, ESQ.



**NO COURTS,
NO JUSTICE,
NO FREEDOM**

These words were spoken by the president of the American Bar Association, William Robinson, at the annual May Day celebration of the Courts and Law. During his speech Mr. Robinson called for an expanded effort nationwide to fund and support the courts in order to help them better meet the needs of our citizens.

For the last two years Chief Judge Jonathan Lippman and Administrative Justice Alan D. Scheinkman have labored to keep the courts in the Ninth Judicial District meeting the needs of the two million people living in the district. In my estimation, they have been successful in keeping the courts running but not at a level necessary to meet the needs of the district. This statement is not a criticism of the judges but of a situation in which the state legislature, in its wisdom, has cut millions of dollars from the court budgets. The courts, therefore, are dealing with large caseloads, political indifference, reduced funding and public ignorance—all at the same time.

WHAT ARE SOME OF THE RESULTS?

1. The courts are open fewer hours, including a mandated one and a half hours at lunch and an earlier closing time of 4:30 pm

(CONTINUED ON PAGE 2)

PART TWO OF
A TWO PART
ARTICLE

Benefits Obtain From Undertaking and Closing on a Straight-Lease Transaction

The Industrial Development Agency's "Straight Lease" Transaction



BY EON S. NICHOLS, ESQ. &
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This is the second part of a two part article that discusses the fundamental concepts, processes and procedures involved in an IDA Straight-Lease Transaction and why an IDA Straight-Lease Transaction is worthwhile to developers, real estate professionals and owners/operators of real property.

Part I, published in the May 2012 issue of the *Newsletter*, introduced IDAs and the basic concepts and steps involved in a Straight-Lease Transaction. This part will discuss the benefits one can obtain from undertaking and closing on a Straight-Lease Transaction.



THE FINANCIAL BENEFITS

The financial benefits offered by the IDA consist of mortgage recording tax exemption, sales and use tax exemption, real property tax abatements and discounts on utility rates. We will use a hypothetical project to discuss and explain the benefits. The hypothetical project involves the acquisition, construction, furnishing and equipping of real property for a total project cost of \$3.5 million. Our hypothetical borrower will borrow \$3 million from an institutional lender to fund the cost of the project and will insert \$500,000 of its own money as

(CONTINUED ON PAGE 23)

INSIDE...

Golf Outing Invitation.....	3	Members on the Move.....	14
Medicaid: Married/Remarried?.....	5	Spotlight.....	15
Court Funding.....	6	Golf Fridays.....	15
Judge Lippmans Remarks.....	7	Save the Dates.....	17
Sections & Committees.....	8-9	From the Back Bench.....	20
Annual Banquet Photos.....	10-11	Classifieds.....	24
CLE Center.....	12-13		

IDA STRAIGHT LEASES

(CONTINUED FROM PAGE 1)

equity. The cost breakdown is as follows: \$750,000 for the acquisition of the land, \$2 million to build the building (or renovate an existing building) and \$750,000 to furnish and equip the building.

Unless exempt, all mortgages recorded in New York State are subject to mortgage recording tax. The amount of mortgage recording tax owed depends on the location of the real property; a mortgage on commercial property in Rockland, Dutchess and Westchester Counties (except Yonkers where the tax is 1.8%) is subject to a tax of 1.3% on the face amount of the mortgage while a mortgage on commercial property in Putnam and Orange Counties is subject to a 1.05% tax on the face amount of the mortgage. In an IDA Straight-Lease Transaction, the IDA, in addition to the borrower, will be a party to the mortgage (with non-recourse language in favor of the IDA and the IDA having no obligations under the Mortgage).

By having the IDA as a party to the mortgage, the mortgage will be exempt from mortgage recording tax. This benefit can amount to huge savings for borrowers. In our hypothetical project, assuming the lender will want to record a \$3 million mortgage on the real property as collateral for the \$3 million loan, the borrower would save \$39,000 if the project is in Rockland, Dutchess or Westchester County (\$54,000 if the project is in Yonkers); \$31,500 if the project is in Putnam or Orange Counties.

Purchases of construction materials to construct a facility are subject to sales tax and, further, purchases of machinery, equipment, and furnishings (including personal property such as computers) are also subject to sales tax. In New York State, the sales tax rate ranges from 7.000% to 8.875%. In an IDA Straight-Lease Transaction, the IDA will issue a sales tax exemption letter which will exempt sales tax on materials, machinery, equipment and furnishings for the project. The borrower (and or its contractors, agents, etc.) will present the sales tax letter when purchasing such materials, machinery, equipment and furnishings for the project.

Depending on the amount of materials being bought, the sales and use tax exemption can amount to considerable savings. Under the hypothetical project, the borrower is spending \$750,000 to furnish and equip the building which, in an IDA Straight-Lease Transaction, would save the borrower about \$55,000 in sales tax, assuming a sales tax rate of 7.375% for most parts of Westchester (in certain areas where the sales tax is greater, the savings would be greater). Note that in our hypothetical project, we assumed that only \$750,000 was allocated to furnishing and equipping the building. We did not factor in the sales tax which would be paid on construction materials. In the hypothetical project, \$2 million has been allocated to construction of the building.

It is safe to assume that a good portion of that sum will be allocated to the purchase of materials for construction, which purchases would not be subject to sales tax under an IDA Straight-Lease Transaction and, therefore, would lead to further savings for our hypothetical borrower.

New York State law provides that once an IDA has an interest in real property (whether fee simple or leasehold), the real property is exempt from real property taxes. IDAs do not typically provide 100% real property tax exemptions, therefore, IDAs and borrowers enter into an agreement with respect to the real property taxes (better known as the payment-in-lieu-of-taxes agreement or PILOT Agreement).

In some instances, the IDA may require that the borrower pay real property taxes as though the IDA had no involvement with the property. In other instances, upon the borrower's request and the IDA's agreement, real property taxes on the project may be abated for a certain period of time. For example, the IDA may provide the borrower with a 50% abatement for the first three years of the project, 25% abatement for the second three years and, thereafter, the property would be fully taxable.

What the IDA offers and what the borrower is able to obtain in terms of real property tax abatements depend on the project and the needs of the borrower as well as the IDA's tax policy. In addition, real property tax abatements would have to be negotiated with the municipalities who have taxing authority over the project (for example, a school district).

The Westchester County IDA, for example, will not negotiate the terms of a PILOT Agreement but will only enter into (and approve) a PILOT Agreement provided that the borrower and the local taxing jurisdictions have agreed upon the terms of a PILOT Agreement. In any event, an IDA Straight-Lease Transaction may provide a borrower and a project with real property tax abatements resulting in substantial savings for a borrower which, ultimately, will help a borrower get the project "off the ground."

The last benefit provided to some borrowers under an IDA Straight-Lease Transaction consists of utility discounts. Depending on need and eligibility, borrowers, by virtue of entering into an IDA Straight-Lease Transaction, have the ability to seek discounts from utility agencies. For example, borrowers may make an application to obtain less costly power through the County of Westchester Public Utility Service Agency's Business Incentive Rate Program, which would enable the borrower to realize a substantial reduction in energy costs through the County of Westchester Public Utility Service Agency.

Borrowers who do not want to raise capital via an IDA bond financing but need financial assistance with a project have chosen the route of an IDA Straight-Lease Transaction to capture the core benefits the IDA offers. The Straight-Lease Transaction, whether or not it is coupled with a traditional mortgage loan transaction, offers substantial benefits to

IDA STRAIGHT LEASES

(CONTINUED FROM PAGE 23)

borrowers and ultimately makes the difference in whether a project will be financially viable and successful.

Avon, a leading global cosmetics company, and Pentegra Retirement Services, a small business which administers retirement benefit plans, are two recent examples of Straight-Lease projects undertaken with the Westchester County IDA where the savings from the financial benefits received substantially defrayed the relocation cost of employees during the renovation of existing facilities.

In each case, the company decided to stay in Westchester rather than relocate out-of-state, resulting in the retention of nearly 700 jobs and tens-of-millions of dollars of capital investment staying in Westchester County.

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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