DEVELOPMENT AUTHORITIES

THEIR PECKING ORDER, THEIR "COUSINS", AND THEIR PROJECTS

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July 2015

PART 2
THE "JUST SIGN A LEASE" PROJECT

DEVELOPMENT AUTHORITY PROJECTS

LEARN DEVELOPMENT AUTHORITY RULES FROM THIS CASE STUDY

"JUST SIGN A LEASE"

- A "JUST SIGN A LEASE" PROJECT IS WHEN YOUR COMMUNITY COULD LOCATE AN ECONOMIC DEVELOPMENT PROJECT…
  - IF YOU JUST HAD A SUITABLE EXISTING BUILDING OR SPEC BUILDING
- EVEN IF YOU DON'T, SOMETIMES YOU ARE STILL COMPETITIVE ENOUGH THAT YOU CAN OFFER TO-
  - DO A "BUILD TO SUIT", OR
  - ACQUIRE AND RETROFIT AN EXISTING BUILDING SO THAT IT WORKS

RESPONSIBILITIES

THE DEVELOPMENT AUTHORITY

- ACQUIRE
- DEVELOP
- FINANCE
- DESIGN (UNLESS DESIGN PROVIDED)
- CONSTRUCT
- LEASE
- MANAGE

RESPONSIBILITIES

- THE PROSPECT
  - APPROVE THE DESIGN
  - APPROVE THE RENTAL RATE
- IN OTHER WORDS, THE PROSPECT WANTS TO "JUST SIGN A LEASE"
- AND, OF COURSE,
  - THE PROSPECT WILL WANT "NORMAL INCENTIVES", AS WELL!

HERE IS A HYPOTHETICAL "JUST SIGN A LEASE" PROJECT

- A Midwestern manufacturer is looking at a Georgia community
- The Company needs a 46,250 square foot building
- Also needs a rail spur
- The development authority owns the 13 acres of land needed for the project (value: $325,000)
- The Company is willing to pay an annual rent of $250,000
- The Company is also willing to sign a 10 year lease of a building
- The Company wants the lease to be off-balance sheet; i.e., an operating lease

HYPOTHETICAL

- The Company will provide its own equipment
- The Company wants property tax abatement for both the land and building (the real estate) and its equipment (the personal property)
- You have out of state competition for the project
- The project will create 42 jobs and the Company's investment in its equipment will amount to $3 million.
- THE COUNTY DEVELOPMENT AUTHORITY IS THE COMMUNITY LEAD ON THE PROJECT. IT IS A STATUTORY DEVELOPMENT AUTHORITY.
- YOU ARE THE CHAIR. WHAT DO YOU DO NEXT?

PASS THE BUCK

- Threshold question- The project is in the city, but you are a county development authority? Do you have jurisdiction?
- Yes, but you quickly decide that you don't want to be a developer.
  - "If a developer is needed, let's get a real developer."
- Do you have to do an RFP?
- Can you provide incentives to the prospect if there is a developer in the middle?
- You work through all of those issues, talk to some developers, and then find out- None of the developers want to do the project!

WHY?

THE PROSPECT'S MOTIVES

- There are 4 main reasons why a prospect wants to "just sign a lease."
- This prospect has all 4 motives.
- At least three out of the four make the prospect unattractive to a developer.
- What are they?

THE "BIG 4"

Here's why the prospect may want to "just sign a lease"-

- Time pressures
  - Started too late with the project
- Credit issues with doing its own financing
- Want to keep the project (and the financing) off its balance sheet
- Want to avoid paying a profit (in the rent) to a private sector developer

THE ONE BIG THING

- Now the ball is back in your court.
- Here are your first steps-
  - Determine that this is a proper project for the development authority
  - Assemble a project team with the necessary expertise
    - Who should be on the team?
    - Clue: Where do the figures you need come from?
    - Clue: Do you have in-house project management expertise?
  - Develop a preliminary budget
- What is the one big thing you want to avoid?

PRELIMINARY BUDGET

- Hard Costs (including reserve): $2,888,057
  - What did you include in hard costs?
- Soft Costs (including capitalized interest): $527,943
  - What is capitalized interest and why do you include it?
  - What else is included in soft costs?
- Total building costs: $3,416,000
- Rail spur: $500,000
  - Why did you break that out separately?
- Total Project Costs: $4,241,000

THE RENT- FIRST PASS

- Your friendly local banker says that you can finance your Total Project Costs at 3.75% for 10 years for annual debt service (rent) of $516,390
- But that's more than twice what the Company wants to pay.
- What do you do next?
- In order to reduce your rent, you look at <u>reducing</u> two things-
  - Total Project Costs
  - Interest Rate
- And <u>increasing</u> one thing- the term of the lease!

SOURCES

- Potential sources to pay down Total Project Costs and reduce the amount that has to be financed:
  - SPLOST
    - City $500,000
    - County $150,000
- USDA Grant $85,000
- EDGE Grant $81,000
- Subtotal $816,000
- Development Authority equity $325,000 (land)
- EIP (rail spur) $500,000
- Total sources $1,641,000
- Remaining balance of Total Project Costs $2,600,000

CONCESSION

- If the development authority didn't have the cash for its equity, what is one concession you could ask the Company for?

THE LEASE

- You re-run the amortization based on $2,600,000 in principal, an interest rate of 3.75%, and a term of 10 years
- The annual rent/debt service is $316,580, so that doesn't work
- You need to improve the economics of the financing.

FINANCING

- One potential improvement is in the interest rate
- Your friendly local banker now tells you that he was quoting you a taxable interest rate, but he would, of course, be willing to finance the project on a tax-exempt bond basis
- Your team includes your friendly bond counsel. You consult with him and he tells you a few things-
  - Subject to tax due diligence, it looks like most of the project costs qualify for tax-exempt "small issue" manufacturing bonds, but, IRS rules have to be satisfied for the term of the financing.
  - What are your options if the Company walks?
  - You decide to stick with taxable bonds.

THE LEASE

- It's time to actually ask the Company for a concession.
- You ask for a 15 year lease
  - Using a 15 year term, the annual rent/debt service drops to $261,282
  - The Company reminds you, though, that the lease has to be off-balance sheet
  - You think- What did they mean by that?
    - Clue: FAS 13 and a $650,000 residual after 10 years
    - Head's up: Pending changes to FASB rules

FAS 13

If at its inception ... a lease meets one or more of the following four criteria, the lease shall be classified as a capital lease by the lessee. Otherwise, it shall be classified as an operating lease.

a. The lease transfers ownership of the property to the lessee by the end of the lease term ....

b. The lease contains a bargain purchase option....

c. The lease term ... is equal to 75 percent or more of the estimated economic life of the leased property....

d. The present value at the beginning of the lease term of the minimum lease payments ... equals or exceeds 90 percent of the ... fair value of the leased property ...at the inception of the lease....

Source: FASB

THE MEETING

It's time to sort things out, so you have a meeting among the community's project team, the Company representatives, and the bank. Here are the issues-

- The Company refuses to commit to pay rent for the additional 5 years because the commitment would put the project on-balance sheet. They would agree to including a 5 year extension at the end of the 10 years- at the Company's option!

THE MEETING

- You may not want to get into FAS 13, but you have to satisfy the prospect's requirements if you want to locate the project.
- So, as a statutory development authority, can you agree to a lease structure where the basic rent doesn't cover the bond payments?
  - Clue: O.C.G.A. Sec. 36-62-7 lease requirements
  - And if you do, how do you get the project financed?
- What can you agree to?
  - The Company makes the appropriate concession.

THE MEETING

- The Company then says, "But we were asking for a "gross rental rate", not a "triple net rate".
- What's the difference?
- As a statutory development authority, what can you agree to?
  - Clue: O.C.G.A. Sec. 36-62-7 lease requirements
  - Fortunately, the Company is willing to make the necessary concession.
- Then the Company says that they need to start construction next week.
  - You ask them if they have heard of the Georgia Local Government Public Works Construction Law.
  - They have to concede on this point.

THE MEETING

- The schedule also is impacted by the need to validate the bonds
- Why bonds instead of a promissory note?
  - Clues: powers; validation
  - The Company recognizes both the necessity and the advantages of bond validation, and agrees to adjust the schedule.

THE MEETING

- You know you can provide property tax savings with bonds, but only the real estate is being financed
  - The Company wants property tax savings on its equipment, too
  - What are the Company's choices?
- The Company wants a purchase option on the real estate.
- How much should they have to pay?
- How does this relate back to balance sheet treatment?

THE MOU

- Despite all odds, you have navigated through the issues, the Company has made concessions when necessary, and you are ready to sign.
- What do you sign? How do you protect the community?
  - Clues: clawbacks and the MOU
- What is the "one big win" in this "just sign a lease" project?
  - Clue: What did you avoid doing that other communities often have to do in such a case?
- Despite that, there are rumblings in the community about the "large" amount of incentives.

THE BLOGOSPHERE

CRITICISM OF THE PROJECT INCLUDES THE COST PER JOB, OPPOSITION TO INCENTIVES GENERALLY- THE USUAL

ONE TAKEAWAY- BE VERY CAREFUL IN GOING INTO EXECUTIVE SESSION. OBSERVE ALL RULES.

THE VOTE

- Nevertheless, it is time for the development authority to approve the MOU.
- You have a 7 person board. How many have to vote in favor to pass a resolution?
- One of the members is unhappy about the project and resigns. The term of one sitting member has expired. Another member has moved outside of the County. And a third member turns out to be your friendly banker.
- What is the maximum number of votes that you have?
- What does the banker have to do?

DEVELOPMENT AUTHORITIES - THEIR PROJECTS

CONCLUSION

CONCLUSION

Congratulations!

The MOU is adopted unanimously by 4 votes.

The community has not only gained a great project, but a few valuable lessons are now out there -

CONCLUSION

- THE RULES GOVERNING DEVELOPMENT AUTHORITIES GET MORE COMPLICATED EVERY YEAR
- DEVELOPMENT AUTHORITIES ARE AN INDISPENSABLE TOOL FOR ECONOMIC DEVELOPMENT
- STAKEHOLDERS MUST UNDERSTAND
  - CORPORATE GOVERNANCE
  - THE ROLE OF THE BOARD, THE OFFICERS, AND THE STAFF
  - RELATIONSHIPS WITH OTHER PUBLIC BODIES
  - DO'S AND DON'TS
  - CAN'S AND CAN'TS
- I HOPE THIS PRESENTATION WILL HELP!

REFERENCES

THIS PRESENTATION AND OTHER REFERENCES CAN BE DOWNLOADED AS FOLLOWS:

- January 2013 - “Development Authorities 101”
- June 2012 - “Bonds 101”
- June 2011 - "TIFs and TADs in Tough Times“; TIFs and TADs Questions and Answers
- January 2011 - “Introduction to Tax-Exempt Bonds”
- January 2011 - “Introduction to 'Taxable Floaters' ”
- January 2011 – "Everything You Need To Know About Joint Development Authorities"
- August 2010 – "Bonds For Title“
  at http://danmcrae.info/whitepapers

QUESTIONS?

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