Calculating IDA Benefits

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Many times, the acquisition and development of commercial properties involve a local Industrial Development Agency (IDA), which provides financial assistance to the purchaser. Timing of the entrance of the IDA into the transaction may substantially affect the transaction costs to the seller and the purchaser, particularly title insurance premiums. Real estate transfer taxes are also affected.
It is important for counsel to keep this in mind in structuring the transaction so that transaction costs can be minimized.

IDAs and Eligible Projects
IDAs are public benefit corporations, created under §852 of Article 18-A of the New York State General Municipal Law (GML). The purpose of an IDA is to promote, develop, encourage and assist in the acquisition, construction and improvement of industrial, manufacturing and commercial facilities in order to advance job opportunities and the economic welfare of the people of the State of New York.

IDAs are vested with statutory powers to achieve these goals, such as entering into contracts and leases; issuing bonds; acquiring, selling, leasing or mortgaging real property; and entering into agreements requiring payments in lieu of taxes.

Not all commercial acquisitions and developments are eligible for IDA assistance, however. For example, with some exceptions, IDA assistance will not be made available if the project would result in a facility or plant being moved from one area of the state to another.

Generally, no IDA assistance will be made available for projects primarily involving making retail sales to customers, except in instances where the project is in a highly distressed area or, if assistance was not given, the jobs would be moved out of state. Other requirements apply, but are beyond the scope of this article.

Transaction Structure

In order for a purchaser to avail itself of the financial benefits afforded by an IDA, the purchaser must cause conveyance of fee title or the leasehold interest in the property to the IDA.

The GML provides that the creation of an IDA is for the benefit of the people of the State of New York and shall be regarded as performing a governmental function in the exercise of its powers and, therefore, the IDA shall be required to pay no taxes or assessments upon any of the property it acquires.

Upon acquisition of the property, the IDA will either lease it to, or enter into an installment sales agreement with, the purchaser (leases are generally entered into and will be the focus of this article). Payments made to the IDA under leases will typically be for a fixed nominal amount, plus any debt service on bonds issued by the IDA.

The IDA will remain in title for the duration of the financial assistance it provides. Upon the expiration of the lease, the IDA will cause the fee title or leasehold interest to be conveyed to the purchaser, typically for a nominal amount.

Financial Assistance

IDAs provide financial assistance to purchasers of commercial properties in several ways: mortgage recording tax exemption, real property tax abatement, sales tax exemption and tax exempt bond issuance.

Upon the recording of a mortgage, the county clerk or registrar will collect a mortgage recording tax. The mortgage recording tax rate currently ranges from .75 percent to 2.75 percent of the principal amount of the mortgage being recorded.

As the fee owner of the property, the IDA will necessarily be a mortgagor on any mortgage encumbering the property. The GML exempts the IDA from payment of mortgage recording tax, which can be a substantial savings. For example, a $10 million mortgage recorded in Nassau County otherwise would be subject to $100,000 mortgage recording tax.

Pursuant to the GML, IDAs are exempt from the payment of real estate taxes and assessments upon any real property they own or that is under their control. An IDA will, however, enter into a Payment-in-Lieu-of-Tax Agreement (PILOT Agreement) with the purchaser of the project, wherein the purchaser agrees to make payments to the local taxing jurisdictions in lieu of the real estate taxes. IDAs are required to establish a uniform tax exemption policy for PILOT Agreements, which policy must include, among other things, the period of exemption, percentage of exemption and types of projects eligible for exemption. PILOT Agreements typically have a period of between 10 and 20 years and can either require the purchaser to pay fixed amounts or can provide for percentage abatements to be paid periodically.

Entering into a PILOT Agreement does not disqualify a purchaser from eligibility under other real estate tax abatement programs. For example, a purchaser may still be eligible for New York State Economic Development Zone (Empire Zone) real property tax credits, which permits a credit to a qualified purchaser on its income tax return for real estate taxes paid on property in an Empire Zone.

An IDA is also exempt from sales and use taxes exacted on any property acquired by it. Sales and use taxes range from 7 ¼ to 8 ¾ percent in New York State. As a result, a purchaser will pay no sales and use taxes on the equipment and materials purchased for the refurbishment of a property or development of a project.

As an example of potential savings, a purchaser in Nassau County spending $3 million to refurbish a property or develop a project can save $262,500 in sales and use taxes. As with real estate taxes, the IDA exemption does not preclude the purchaser from availing itself of other benefits, such as exemption from the payment of the state portion of sales taxes in Empire Zones.

IDAs are authorized by statute to issue notes and bonds. The IDA does not lend money directly to the purchaser, but issues the bonds in the name of the IDA, secured by the underlying project. The income generated from the property and the creditworthiness of the company, therefore, are crucial and guarantees and letters of credit may need to be established as credit enhancements.

IDA bonds are exempt from state and federal income tax. Due to this tax exemption, the interest rates payable on these instruments are typically lower than interest rates on other financing vehicles.

Title Insurance Matters
Typically, when a purchaser acquires real property, it will purchase title insurance to the property. This insurance insures the purchaser that it owns fee title to the property and that there are no superior rights or encumbrances except as set forth in the title policy. In an IDA transaction, the timing of the IDA's participation in the transaction will affect the title insurance costs of the purchaser.

The IDA can enter the transaction at the outset by taking title to the real property directly from the seller and then leasing it to the purchaser. Alternatively, the purchaser may close on its purchase from the seller and subsequently transfer title to the IDA and enter into the lease at that time. This bifurcated transaction typically occurs because of timing issues (e.g., seller or purchaser is under contractual time constraints to close and is unable to wait for the IDA inducement hearing, the statutory public notice period and scheduling for an IDA closing). The title insurance costs in each of these scenarios are very different and are discussed below.

Simultaneous Transaction. In a simultaneous transaction, the purchaser will cause the seller of the real property to transfer fee title to the real property directly to the IDA at the same time the purchaser is closing its transaction with the IDA. As the owner of the real property, the IDA will require the purchaser to purchase title insurance for the IDA's benefit. The title policy will be in the same form and amount the title policy would have been had it been issued to the purchaser.

Although the amount of the IDA's exposure from a title loss would not be as great as that of the purchaser, since the IDA is not paying to purchase the property, the IDA's title insurance must generally be in the amount of the contract price. The Title Insurance Rate Service Association (TIRSA) requires that, with limited exceptions, an owner's policy of title insurance be in an amount not less than the greater of the contract price or the fair market value of the premises.

Upon termination of the IDA assistance, the IDA will convey title to the purchaser and the title insurance will expire. Does the purchaser now have to pay another title insurance premium? No.
To address this future event, the purchaser, at the time title is conveyed to the IDA, should purchase what is known as an "IDA Endorsement," which is a part of the IDA's fee policy. The endorsement grants the purchaser the benefits of the IDA's title insurance policy retroactive to the original date of the IDA's policy.

The endorsement eliminates the need for a new title insurance policy to be purchased at the time of the conveyance of fee title to purchaser by the IDA, thereby saving purchaser the cost of an additional title premium. The fee for the endorsement is a nominal $25, a substantial savings as measured against the title premium of $35,398 for a $10 million fee policy on a property located in Nassau County.

Bifurcated Transaction. In a bifurcated transaction, the purchaser will take fee title to the real property from the seller and, at a future date, close its transaction with the IDA and transfer fee title into the IDA so as to be eligible to receive IDA assistance. At the acquisition of the property from the seller, the purchaser will purchase title insurance for its own behalf in the amount of its purchase price.

There are no available endorsements to the purchaser's policy similar to the IDA endorsement that would grant the IDA the benefits of purchaser's title insurance policy retroactive to the original date of the purchaser's policy. Therefore, at the time of the conveyance from the purchaser to the IDA, the purchaser must purchase another title insurance policy for the benefit of the IDA.

Assuming the amount of the policy is $10 million, the purchaser must incur another title premium of $35,398. The purchaser should remember to purchase the IDA Endorsement at this time to lock in its coverage at the subsequent transfer back to it from the IDA.

In this bifurcated transaction, the purchaser must pay a double title insurance premium, to wit, the title insurance it purchases on the acquisition and the title insurance for the benefit of the IDA on the IDA's acquisition of the fee.

Suggestions for Reform. Why should the mechanics of the IDA bifurcated transaction trump the substance of the transaction resulting in the payment of two title insurance premiums? The essence of the transactions is the same except that, in the bifurcated transaction, an intervening conveyance to the purchaser occurs.

The authors suggest that TIRSA make available to a purchaser contemplating a future IDA transaction an endorsement similar to the IDA endorsement. If such an endorsement were available, it would relieve the purchaser from paying two title insurance premiums.

Another suggestion to avoid paying a full double title insurance premium in a bifurcated transaction is for TIRSA to permit the issuance of a title policy for the benefit of the IDA in an amount less than the contract price or market value. The IDA's exposure in a transaction is typically less than either of these amounts. Such an amount logically might be the value of the PILOT Agreement.

Other thoughts the authors have to mitigate title insurance costs in a bifurcated transaction are to allow for reissuance rates, similar to the reduced rates on a mortgage refinance, or for a title company to hold the title policy "open" pending the closing of the IDA transaction, at which time a single premium would be paid even though the policy would have been effective during that time.

Real Estate Transfer Tax
Article 31 of the New York State Tax Law (Tax Law) mandates the payment of a real estate transfer tax on the conveyance of real property. The tax is at a rate of $2 for each $500 of consideration.
The State of New York and its agencies and public corporations, including IDAs, are exempt from the payment of the transfer tax. Also, transactions involving conveyances to the State of New York and its agencies and public corporations are exempt from the payment of the transfer tax. The amount of real estate transfer taxes paid will be different in a simultaneous transaction and a bifurcated transaction involving an IDA.

Simultaneous Transaction. In a simultaneous transaction, no transfer tax will be due on the transaction because the transfer is to a public corporation. This substantial savings ($40,000 for a $10 million transaction), which would normally be paid by the seller, should be recognized by a purchaser in negotiating the deal. Upon the subsequent transfer of fee title from the IDA to the purchaser, a transfer tax is payable. The transaction is not exempt under the Tax Law, and although the IDA is exempt from the payment of the tax, the grantee purchaser remains liable for payment of the transfer tax. However, the consideration for the transfer is typically $1 and, therefore, no transfer tax is paid.

Bifurcated Transaction. In the bifurcated transaction, three transfers of the real property occur: seller to purchaser, purchaser to IDA, and IDA to purchaser. No exemption applies to the first transfer and, therefore, in a transaction where $10 million in consideration is paid, a transfer tax is due in the amount of $40,000.

For the remaining two transfers, the results in a simultaneous transaction apply. That is, the transfer from the purchaser to the IDA is exempt from the payment of transfer tax pursuant to statute, and because of the nominal consideration in the conveyance from the IDA to the purchaser in the last transfer, no transfer tax will be due.

Summary

Although IDA benefits are very valuable and should be considered in every commercial real estate transaction, real estate purchasers and developers and their counsel should be diligent in structuring the transaction to minimize costs to the parties.

As discussed above, substantial savings can be realized if all facets of the transaction (purchase and IDA financial assistance) are closed simultaneously. Closing the acquisition of the property and subsequently closing on the IDA benefits results in a double title insurance premium and the payment of real estate taxes.

[i] N.Y. GEN. MUN. LAW §858 (McKinney 2005)

[ii] Id.

[iii] Id. §862

[iv] Id

[v] Id. §874

[vi] N.Y. TAX LAW §§253-253-C (McKinney 2005).

[vii] Id.

[viii] Id.

[ix] Id.

[x] N.Y. GEN. MUN. LAW §966 (McKinney 2005).

[xi] Id.

[xii] Id. §§864, 866

[xiii] Title Insurance Rate Service Association Rate Manual (9/1/93), Third Reprint April 24, 2001.

[xiv] Id.

[xv] Id.

[xvi] If the real property is located in the Peconic Bay Region, an additional transfer tax of 2 percent of the consideration above a threshold amount is also payable (NY TOWN §64-e (McKinney 2005)). The analysis of the state real estate transfer tax also applies to the Peconic Bay Region transfer tax.

[xvii] N.Y. TAX LAW §1402 (McKinney 2005).

[xviii] Id. §1402(a).

[xix] Id. §1402(b).

[xx] Id.

[xxi] Id. §1404(a).

[xxii] Id.

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