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COMMERCIAL DEVELOPMENT OF MUNICIPAL PROPERTY AS A SOURCE OF REVENUE

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As decreasing revenue sharing and declining property values devastate municipal finances, there are regrettably few alternatives available to balance a budget when cuts reach essential services. Some municipalities, however, may have the opportunity to realize income from the sale of surplus property to a commercial developer. The sale results not only in income from the transaction, but additional tax revenue to the municipality when the formerly public property is placed on the tax rolls.

Unfortunately, the potential loss of surplus property to the municipality for future use can impede such a transaction. An alternative, however, exists through the use of a long-term lease of the property creating transactional cash flow and tax revenue, while preserving ownership of the parcel in the municipality.

Sale or Lease – Can You Do It?

Before addressing the question of a sale or lease, the governing body must consider whether it owns land that will not be required in the near future to accommodate the needs of the community. In order to secure interest of a developer, and the legal basis to place the surplus property in question on the tax rolls, the lease may need to be for as long as 75 years.

Assuming that surplus property does, in fact, exist, the municipality must then determine with counsel its legal capacity to lease property to a commercial developer. State, Federal and local laws and regulations must be analyzed before proceeding.

Once the foregoing issues are settled, care should be taken to assess the impact of commercial development of municipal property so that it is consistent with the municipality's long-term plans, the character of surrounding neighborhoods, and the competitive effect development would have on neighboring commercial properties.

In addition, the municipality should carefully review the use of lease revenue. Will the money be used to supplement the general fund, long-term maintenance, or capital improvements? Should the lease payments be applied to such expenditures, or invested, with interest earnings providing the expendable funds?

Who Should Develop the Property?

Once the decision has been reached to proceed with the lease of municipal land, the governing body must then consider whether the municipality should lease the entire parcel to a master developer or otherwise act as the master developer itself. As most municipalities lack the

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experience and/or resources necessary to develop commercial property, I recommend that a master developer be selected. Criteria for selection should include the capacity to perform, demonstrated financial strength and the willingness to commit resources to carry out the project; capability to design, construct and manage the property and subleases related thereto; demonstrated management reputation, experience and capability of managing a long-term project; and, the provision of preliminary design concepts for the property in question; .

The Legal Structure

The municipality must take care to assure that the chosen legal structure is appropriate for the transaction. One state agency, Schoolcraft College, elected to lease surplus property to a 501(c)(4) development authority, which thereafter leased the property to a master developer. The development authority provided protection for the College from potential liability arising from the development, and created a mechanism permitting the transmission of income received by the authority from its sub-lessee to the College without tax consequences.

Long term control of a development authority was addressed through a management structure favoring appointees of the college.

The development agreement, whether entered with the developer by an authority or the municipality itself, is essential to the transaction. The developer could be assigned the responsibility for planning and design, financing the project, and maintaining the same. Lease payments could be based simply on a ground-lease basis, with a negotiated amount paid as the land is developed, or based on a percentage of the rents realized by the tenant/developer through sub-lease agreements (for instance, the developer would pay the municipality a percentage of the rents collected from sub-tenants on the improved property).

The development agreement must be negotiated in a manner necessary to protect the municipality from abusive development while providing the Developer with the freedom necessary to proceed with the development in a commercially reasonable manner. Too much control in favor of either party can impede the development.

Challenges

Citizens and non-participating developers may complain that the selected developer and/or its sub-lessees have an unfair competitive advantage by locating on non-taxable property. Note, however, that the property would, in fact, be added to the tax rolls for the duration of the long-term lease. The issue is easier to address than the assertion that commercial development of municipal land will suppress other commercial development in the community. The use of long-term market research can help address that concern.

In addition, the municipality may face challenges from the community regarding traffic congestion and the exact use of the property. The fact that the municipality is the actual owner of the property can lead to intense public pressure.

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