FOR CONSIDERATION

September 15, 2011

TO: The Directors

FROM: Kenneth Adams

SUBJECT: White Plains (Westchester County) – Mortgage Subordination

RE: Authorization to (i) Approve the Subordination of ESD's $5 Million Loan with LC White Plains Retail, LLC to Facilitate Additional Financing From its Senior Lender in the Amount of Up To $6 Million, and (ii) Allow ESD Staff to Take All Related Actions.

SUMMARY

The Directors are asked to approve the authorization for ESD to subordinate its $5 million loan with LC White Plains Retail, LLC (the "Borrower" or "LC") to facilitate additional financing of up to $6 million for the renovation costs related to the attraction of a new tenant, Toys R Us/Babies R Us Superstore. ESD's existing loan is already subordinate to the senior loan from the Union Labor Life Insurance Company (the "Senior Lender" or "ULLICO") with a current loan balance of approximately $120 million and this proposed refinancing will bring that amount to $126 million. This action is expected to add over 100 jobs at the City Center Mall (the "Mall"), increase cash flow of the property and the value of the collateral.

BACKGROUND

The New York State Urban Development Corporation ("UDC") d/b/a Empire State Development ("ESD") closed on a $5 million loan with the Borrower in June 2002 (the "Loan"). The Borrower's managing membership interest was then held by Entertainment Properties Trust ("EPT"), with a minority stake held by the Cappelli Group, LLC, and City Center Group LLC ("City Center"). LC is now 67% owned by LRC Industries, Inc., which is controlled by Mr. Louis R. Cappelli, and 33% owned by City Center.

The Loan was funded through the Metropolitan Economic Revitalization Program ("MERF") and finance the construction of an approximately 386,000 square foot retail and entertainment center, situated on 3.6 acres, known as the City Center at White

Plains. City Center hosts several large retail tenants including ShopRite, National Amusements and Barnes & Nobel. In addition, there are two 35-story, 552 room luxury rental apartment towers above the retail complex and a 2,300-car municipal garage. The ownership of City Center is held by City of White Plains, the White Plains Urban Renewal Agency, and the Westchester County Industrial Development Agency, which acquired the property from LC White Plains, LLC, to facilitate a PILOT agreement through a sale-leaseback agreement in 2004. The term of the lease is 99 years. The interest-only Loan is secured by a second mortgage lien on the sublease held by the Borrower and personal guarantees of Mr. Louis R. Cappelli and Mr. Louis L. Ceruzzi, Jr. The interest rate on the Loan was set at 5% per annum, and the Loan matured on June 30, 2004.

When the Loan matured, LC was obligated to either pay off the loan or convert it to a permanent loan and begin making principal payments but failed to do either. LC also had an option to extend the interest only payments for two, six-month periods but declined to exercise those options. It is ESD's view that the Loan has been in default since June 30, 2004 and that it is within ESD's authority to charge the default interest rate of 10%. It should be noted, however, that ESD cannot compel the Borrower to convert to permanent financing, and because of a highly restrictive standstill agreement with the Senior Lender, ESD is barred from demanding and/or receiving any principal, foreclosing on its mortgage or pursing any other remedies until the Senior Lender is paid in full.

On August 13, 2009, the Borrower, through its agent, Cappelli Enterprises, Inc. ("CE"), agreed to convert the Loan to a permanent loan, payable over five years, with a twenty year amortization, at an interest rate of 5% (the "Agreement"). The Borrower also agreed to diligently seek the consent of its Senior Lender to allow for a principal repayment to ESD. LC failed to live up to the Agreement for several reasons. First, despite many attempts, the Senior Lender delayed and ignored all requests, from both LC and ESD, because it was not in ULLICO's interest to allow principal payments to ESD. Second, LC was distracted by a bitter legal dispute between its two members, which eventually led to a split. Lastly, Mr. Cappelli suffered a brain aneurism in late 2009.

In June 2011, ESD again attempted to compel the Borrower to convert the Loan by sending LC the legal documents for it to execute (the "Conversion Documents") and requesting that they seek and obtain Senior Lender consent for ESD's principal payments. Thus far, LC has declined to execute the Conversion Documents, but its August payment included a principal payment of $11,660.90.

<u>LC's REQUEST</u>

On August 30, 2011, ESD received a request from the Borrower seeking permission to subordinate ESD's loan to approximately $6 million in new funding from ULLICO to help it attract Toys R Us as a major tenant and build-out 56,000 square feet of remaining vacant space on the second floor of City Center (the "Lease Space"). The use of the $6 million in proceeds will be applied as follows: $4 million for renovation, approximately $1.2 million for real estate tax and insurance escrow and $625,000 for loan modification fee. ULLICO will also push forward the maturity date five years from the existing October 7, 2011 date, and leave the interest rate fixed at 5.65% (the "Refinancing"). ULLICO's loan will be interest only for 5 years and 50% of excess cash flow will be obligated to help reduce the loan principal.

ULLICO agreed to the proposed refinancing and modifications on July 8, 2011, and Toys R Us executed a letter of intent to Lease Space for a fifteen year term, with five successive options of five lease years, for an initial fixed rate of rent of $1,288,000, or $23 per square foot, for the first five lease years and 10% rent increases in each of the successive five lease years (the "Toys R Us Transaction"). Toys R Us will also be paying its pro rata share of its taxes, which comes to $448,000, or $8 per square foot, per year. If the subordination request is approved, ESD's security position would be subordinate to approximately $126 million Refinancing held by ULLICO.

<u>THE BENEFITS OF TOYS R US AND REFINANCING PROPOSAL</u>

The Toys R Us Transaction provides several benefits. First and foremost, Toys R Us will become the third largest tenant at the Mall, after National Amusements (theaters) and ShopRite. Its tenancy not only brings the Mall to near full occupancy, but also provides stability with its long-term lease after three of the Mall's previous tenants, Office Max, Circuit City and Filenes Basement either went out of business or filed for bankruptcy. Second, it will mean the retention of over 100 jobs in the area, which brings the Mall's total employment to 750 jobs. Third, this significant lease-up of the Mall is estimated to increase the market value of the Mall, by $22 million, to $156 million. Lastly, LC's cash flow situation will improve with the infusion of $1.7 million in additional annual rental income, which will be increased by ten percent every five years. This additional free cash flow allows LC to pay down principal faster, which is also better for ESD because ESD's ability to enforce repayment of the Loan principal is based on ULLICO's principal pay down.

The Refinancing is critical in two ways. First, without the refinancing, the Toys R Us Transaction will not take place, and all of the benefits will be lost. It will be highly unlikely that the Borrower will find another lender, in this economic climate, to take a subordinate position. Even if the Borrower did, ESD would still be asked to subordinate to the new lender. Second, it pushes the current October 7, 2011 ULLICO maturity date out five years and the $120 million that would have been due.

<u>RELATED PROJECT ISSUE</u>

The principal and guarantor of LC, Mr. Cappelli, is also the guarantor of another interest-only loan with ESD. In January 1998, ESD closed on this $4 million loan with New Roc

Associates, LP ("New Roc") to help finance the development of a 400,000 gross square foot buildable area of retail, entertainment, sports facility and supermarket complex at the former abandoned Macy's site in downtown New Rochelle, known as the New Rochelle Center. The development includes an IMAX theater, a 60,000 square foot game arcade, 125,000 square feet of retail, chain restaurants, a Marriott Residence Inn and a 98 unit co-op complex. The New Roc loan was secured by a second position on New Roc's leasehold interest and a personal guaranty of Mr. Cappelli. This loan carried an interest rate of 5.5% through maturity, which occurred on February 1, 2000.

As with the LC Loan, the New Roc loan was expected to be paid off or converted to a permanent loan at maturity, but New Roc failed to do so. Because of a standstill agreement similar to that of the LC loan, ESD could not compel New Roc to do either. To resolve this issue, the amended terms for this loan were also included in the Agreement, whereby an agent of New Roc agreed to obtain senior lender approval for the conversion to permanent financing, including an immediate $700,000 principal pay down. New Roc, however, failed to get senior lender approval.

On June 18, 2010, , as a result of a legal settlement, Mr. Cappelli transferred all of his membership interest in New Roc to the entities related to Entertainment Properties Trust ("EPT"), a NYSE publically traded REIT with a market cap of almost $2 billion. ESD made several unsuccessful efforts to communicate with EPT's representatives, including its CEO, Mr. David Brain. EPT is fully aware of the power of the standstill agreement that is in force and ESD believes that EPT and its senior lender, Archon Financial, L.P., will not take any action to make or allow for any principal payments to ESD unless it is in their best interest. Because Mr. Cappelli transferred his rights over to EPT, he has no influence or control over New Roc or its senior lender, and less with EPT, after a bitter dispute. As such, resolution of the New Roc loan should not be linked to the LC subordination issue at hand.

THE OVERALL ADVANTAGES FOR ESD

There is no doubt that $6 million is a significant amount and that any added subordination will increase risk. However, that risk is outweighed by the significant benefits provided by this transaction. First, ESD will begin to have principal paid down which otherwise would not have been possible for the foreseeable future because of the standstill agreement. With senior lender approval and LC's execution of the conversion documents, LC will begin making monthly principal and interest payments to ESD of $33,188.67, and after five years, ESD's principal would be reduced to approximately $4,194,643. Second, the value of ESD's collateral position on the leasehold interest is estimated to increase by 16.4%, from $134 million to $156 million, whereas the amount ESD is subordinate to increases by 5%, from $120 million to $126 million. Third, according to Mr. Cappelli, LC's net operating income is estimated to increase to $9.7 million from $7.7 with Toys R Us, and the excess cash flow after paying the debt services for ULLICO ($6.8 million) and ESD ($400,000) will be used to pay down

ULLICO principal, which also helps ESD in the long term. Fourth, Toys R Us will retain over 100 jobs in the area for over 15 years. Lastly, it should be pointed out that LC has made timely interest payments in the past with the cumulative amount of over $2.2 million, and an interest rate of 5% in this depressed market is a good rate.

ENVIRONMENTAL REVIEW

ESD staff has determined that the requested authorization constitutes a Type II action as defined by the New York State Environmental Quality Review Act and the implementing regulations of the New York State Department of Environmental Conservation. No further environmental review is required in connection with the authorization.

REQUESTED ACTION

The Directors are requested to (i) approve the subordination of ESD's $5 million loan with LC White Plains Retail, LLC for an additional financing from its senior lender in the amount of up to $6 million with the maximum subordination amount not to exceed $126 million, and (ii) authorize ESD staff to take all related actions. This approval will be contingent upon the Borrower obtaining senior lender approval for making principal payments to ESD, contingent upon consummation of the Toys R Us Transaction, executing all relevant documents to the satisfaction of ESD counsel related to the Loan conversion and paying required fees.

RECOMMENDATION

Based on the foregoing, I recommend approval of the attached resolution.

ATTACHMENT

Resolution

September 15, 2011

White Plains (Westchester County) - Authorization to (i) approve the subordination of ESD's $5 million loan with LC White Plains Retail, LLC for an additional financing from its senior lender in the amount of up to $6 million, and (ii) authorize ESD staff to take all related actions.

RESOLVED, that on the basis of, and subject to, the materials presented to this meeting (the "Materials"), a copy of which is hereby ordered filed with the records of the Corporation, relating to ESD's $5 million loan (the "Loan") with LC White Plains Retail, LLC, ESD staff is hereby authorized to subordinate the Loan to facilitate additional financing of up to $6 million from its senior lender with a maximum amount of senior debt not to exceed $126 million and take other related actions, and be it further

RESOLVED, that the President and Chief Executive Officer of the Corporation or his designee(s) be, and each of them hereby is, authorized to take such action and execute such documents as may be necessary or appropriate to carry out the foregoing resolution.

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