

## **Request for City Council Committee Action from the Department of Community Planning and Economic Development - CPED**

**Date:** November 30, 2010  
**To:** Council Member Lisa Goodman, Chair, Community Development Committee  
**Subject:** Longfellow Station – Proposed Change in Development Entity and Project

**Recommendations:** 1) Consent to the assignment to and assumption by Sherman Associates Inc. or an affiliate of the existing agreements between City and Longfellow Station I, LLC, Longfellow Housing Limited Partnership and/or Capital Growth Real Estate LLC, including without limitation, the HLAf Site Acquisition Agreement, the DEED, LCDA, and TBRA Funding Agreements, as amended, the Escrow and Disbursing Agreement, the AHTF Loan Agreement, the Section 106 Memorandum of Agreement, the Redevelopment Contract and related collateral and security agreements; 2) Authorize execution of amendments to the existing agreements or amended and restated agreements reflecting the project and timeline revisions described in the report; and 3) Authorize execution of such other documents and agreements as are necessary to implement the project.

**Previous Directives:** 1) December 2005 – approved a resolution authorizing submission of applications to the Metropolitan Council for Hiawatha Corridor Land Assembly Fund proposals; 2) March 2006 - approved acceptance and appropriation of Metropolitan Council Hiawatha Light Rail Land Assembly Fund Grants of \$3,500,000 for projects along the Hiawatha Light Rail line, including the Longfellow Station Project; 3) June 2006 – authorized submission of an application for Metropolitan Council Livable Communities Demonstration Account (LCDA) funding; 4) October 2006 – authorized submission of an application for a Hennepin County ERF brownfield grant; 5) December 2006 – approved up to \$400,000 from the Affordable Housing Trust Fund; 6) February 2007 - accepted and appropriated \$934,523 Metropolitan Council Livable Communities Demonstration Account LCDA grant and \$90,000 Hennepin County ERF grant; 7) May 2007 – authorized submission of an application for Metropolitan Council Livable Communities Demonstration Account (LCDA) funding; 8) August 2007 – adopted a resolution approving the Longfellow Station Redevelopment Plan; 9) December 2007 – approved up to an additional \$1,000,000 from the Affordable Housing Trust Fund; 10) January 2008 - accepted and appropriated \$500,000 in Metropolitan Council Livable Communities Demonstration Account LCDA funding; and 11) February 2008 - approved Project Analysis Authorization; 12) December 2008 – approved up to an additional \$500,000 from the Affordable Housing Trust Fund; and 13) September 2009 – approved proposed TIF financing, redevelopment agreement terms, and Great Streets loan of up to \$300,000.

Prepared by: Jerry LePage, Senior Project Coordinator (612) 673-5240

Approved by: Charles T. Lutz, CPED Deputy Director

Thomas A. Streitz, Director of Housing Development

Presenter in Committee: Jerry LePage, Senior Project Coordinator

### **Financial Impact**

- No financial impact



Based on its review of the preliminary mortgage application, the Minneapolis HUD office raised concerns about the developer's rent level assumptions and about several environmental issues in the 38<sup>th</sup> and Hiawatha area (i.e. railroad, power poles, and noise). HUD indicated that these environmental factors were obstacles to its participation and would likely require the forwarding of waiver requests to the HUD-Washington office, assuming that the project could satisfy HUD's underwriting standards. Over the next few months, HUD and the developer's team continued their discussions about appropriate rent levels which would be the determining factor in the sizing of HUD's mortgage. However, HUD maintained its position that the rents advocated by the developer were too high.

In March 2010, HUD completed its initial underwriting and issued to the developer an "Invitation to Apply" for 221 (d)(4) insurance, which is equivalent to a preliminary financing commitment. Since HUD's invitation reflected its position on rents, the maximum mortgage amount, however, was less than what was needed, thus creating a new financing gap. Given the outcome with HUD and burdened by several years of holding costs on the land, Capital Growth reached the point where it had exhausted its own resources, and its financial capacity to complete the project was in question. Consequently, Capital Growth made a decision to seek a partner who could bring in equity to the project and also assist in moving it to closing and construction.

In mid-June 2010, Capital Growth approached George Sherman of Sherman Associates about the possibility of becoming a partner. Over the past four months, Capital Growth and Sherman Associates have been discussing a plan to move the project forward that have also included negotiations with the two banks who hold mortgages on the land and the various vendors/consultants who have worked on the project. Sherman Associates involvement has been predicated on the idea that its role would not be as an equity partner but as the new developer, assuming full control and responsibility for the project from Capital Growth. The settlement agreement, which has now been reached by these parties, provides for this transfer of responsibility to Sherman Associates, and also discounting of the existing mortgages and outstanding vendor accounts payable.

In early June, demolition also started on the existing structures on the Longfellow Station site. The environmental remediation and demolition should be completed in winter 2011. These activities have been funded with resources received from the Metropolitan Council (TBRA and LCDA grants), Minnesota DEED (Contamination Cleanup and Redevelopment grants), and Hennepin County (ERF and TOD grants).

Start of construction on the public plaza area adjacent to the commercial building is scheduled to occur before the end of December. This will satisfy the December 31<sup>st</sup> construction start deadline set by the Metropolitan Council related to its LCDA funds.

### **Revised Development Plan**

Based on its due diligence analysis of the project and its own development experience. Sherman Associates is proposing some revisions to the development plan for Longfellow Station. A mixed use project is still being proposed but with some reconfiguration in the physical plan.

- The project will still include a 10,000 sq. ft. commercial component. However, it will be located in a different building, rather being incorporated into the first floor of the residential building, in order to simplify financing and construction.
- There will be a slight reduction in overall number of housing units - from 196 units to about 180 units. However, despite this reduction in total units, Sherman is indicating that the number of affordable units will be very similar to the last version of Capital Growth's development plan. Sherman's proposal calls for 38 units affordable at 50% MMI, 26 units affordable at 60%, and 18 units affordable at 80%, and 98 market rate units.
- More residential parking spaces have been added in order to increase the parking ratio to 1:1. The previous parking ratio was 0.7 spaces/1 unit, which was raised as a concern by HUD.

Sherman Associates has conducted discussions with HUD, the Longfellow neighborhood, and other stakeholders/funders about its proposal and has received support for its revised development plan. The revised site plan and project elevations are attached as **Exhibit 1**.

In 2008, the original Land Use Application was approved by the City Council, which also included a re-zoning from an I2 classification to a C3A classification. However, due to the proposed revisions, a new Land Use Application is required. Sherman Associates has already submitted this application which will be considered by the City Planning Commission at its December 13<sup>th</sup> meeting.

### Finance Plan

The estimated total development cost of Sherman Associates revised plan is \$31.5 million. The City's state, regional and county partners have committed substantial resources to the project in recognition of its consistency with shared policy goals of locating higher-density mixed-use developments within Hiawatha Light Rail Transit station areas. To date, over \$8 million in grant and deferred loan funding has been approved from these non-City funding sources. At the end of last year, these funding partners reaffirmed their support by renewing their funding commitments and agreeing to necessary time extensions for the project. Additional project information is provided on the Project Data Worksheet (**Exhibit 2**).

Sherman intends to utilize the same HUD financing commitment for the housing component that was secured by Capital Growth. Local HUD staff have indicated to Sherman Associates and CPED staff that they would view favorably a mortgage application if it were based on HUD's stipulated rent levels, and would also then be willing to forward the required environmental waivers to HUD-Washington with their recommendation for approval.

The following table summarizes the funding sources for the project.

Proposed Sources	Type	Amount	Approved
HUD 221 (d)(4) Mortgage	Loan	14,600,000	
Commercial component financing	Loan	750,000	
TIF pay-go note	TIF	2,612,000	X
Twin Cities Community Land Bank/LISC	Loan	3,516,977	

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City AHTF (2006)	Loan	400,000	X
City AHTF (2007)	Loan	1,000,000	X
City AHTF (2008)	Loan	500,000	X
Metro Council LCDA (2006)	Grant	934,523	X
Metro Council LCDA (2007)	Grant	410,000	X
DEED Redevelopment Grant	Grant	480,000	X
City Great Streets Program	Loan	300,000	X
Family Housing Fund	Loan	50,000	X
MHFA (2007)	Loan	1,850,000	X
MHFA (2008)	Loan	1,000,000	X
Hennepin County TOD (2007)	Grant	100,000	X
Hennepin County TOD (2008)	Grant	200,000	X
Hennepin County ERF	Grant	90,000	X
DEED Environmental Cleanup Grant	Grant	265,000	X
Metro Council TBRA	Grant	295,200	X
Developer escrow, construction credits, other		489,800	X
Additional gap funding needed		1,650,000	
TOTAL		31,493,500	

A new source of funding on this list is a loan of approximately \$3.5 million through the Twin City Community Land Bank (TCCLB) and Local Initiatives Support Corporation (LISC). It is anticipated that this will be a 7-10 year loan that will be sourced in part from Living Cities funds recently awarded to Minneapolis. In addition to assisting the Longfellow Station project, the making of this loan will have the added benefit of helping to build TCCLB's capital capacity through the interest and fees that will be earned.

It is also important to note that the development budget **does not include a developer fee**, either paid upfront or on a deferred basis. Sherman Associates has indicated that the project in its revised form simply cannot support any additional costs. Therefore, it will forgo a fee so that current funding sources can be stretched as far as possible. Sherman has stated an interest in owning the project long term and believes that it will eventually add value to its real estate portfolio.

The current sources and uses for Longfellow Station show a funding gap of approximately \$1.65 million. This gap reflects primarily the impact of the following factors:

**On the revenue side:**

- Decrease in residential revenues consistent with HUD-stipulated rents.
- Decrease in the projected tax increment from \$3.25 million to \$2.6 million due primarily to an 18-unit reduction in the number of housing units.

**On the cost side:**

- Increased costs for additional parking spaces in order to achieve a 1:1 parking ratio, as required by HUD.
- Additional costs associated with revisions to the project development plan, land use application, etc.

CPED staff is currently working on a strategy to secure the necessary funding to close this \$1.65 million gap. This is a challenge since there are few funding sources available that have not already been utilized. Therefore, CPED and Sherman Associates are having discussions with some of the current funders (Hennepin County, MN Housing, Family Housing Fund) about the possibility of increasing their funding levels, and are also contacting other sources (Land Bank and LISC) about their level of participation in the project. The City and the developer may also make another request to HUD for higher rent levels, which could increase the maximum mortgage amount and further narrow the funding gap. Every effort will be made to reduce the funding gap from other sources and to keep any request for additional City funding, if required, to the absolute minimum needed to close the gap.

In February or March, CPED will be returning to the City Council with a report that will include an updated finance plan to address this funding gap and a request for any additional Council actions that may be necessary to allow the project to proceed to a closing and a start of construction by April 2011.

### **Commercial Component**

HUD has indicated that it is unwilling to underwrite the commercial component as part of the 221 (d)(4) mortgage. Therefore, Sherman Associates will be seeking separate private financing for the construction of the commercial building.

The 38<sup>th</sup> Street LRT station area is designated as a support area through the Great Streets program. In September 2009, the City Council approved Capital Growth's application for a \$300,000 loan from the Great Streets Gap Financing Program. When HUD issues its firm mortgage commitment (which is expected by February), CPED staff will complete its underwriting of the loan given the revised retail configuration, financing, and negotiations with Sherman Associates on the specific terms of the Great Streets loan. Recommendations regarding the proposed terms will be included in the staff report that will be presented to the City Council in early 2011.

### **Project Timeline**

March 2010	Commencement of environmental remediation activities
June 2010	Commencement of demolition activities
December 10, 2010	City Council action re proposed change in development project and entity
December 13, 2010	City Planning Commission consideration of Land Use Application
December 2010	Installation of plaza footings/foundation
Winter 2011	Completion of environmental remediation and building demolition;
Jan./Feb. 2011	HUD issuance of Firm 221 (d)(4) Mortgage Commitment

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Feb./March 2011      Final City Council actions on project financing

April 2011            Closing on HUD mortgage and the start of construction

December 2011      Projected substantial completion of construction