Request for City Council Committee Action from the Department of Community Planning & Economic Development

Date: December 13, 2011

To: Council Member Lisa Goodman, Community Development Committee

Subject: Plaza Verde Loan Restructure

Recommendation: Authorize restructuring three loans with NDC REDI, LLC as described in this report and execution of appropriate documents.

Previous Directives: On October 10, 2003, the City Council authorized a $250,000 Empowerment Zone loan to the Neighborhood Development Center for the renovation of 1508 E Lake St, the former Antiques Minnesota building. On May 28, 2004, Council authorized a $250,000 CEDF (CDBG) loan to the Neighborhood Development Center also for the renovation of 1508 E Lake St.

Department Information

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Financial Impact

- Action is within the Business Plan
- Financial Impact: Delays repayment of CEDF/CDBG loan principal and interest payments and shifts balloon payment up 8 years from 2024 to 2016 to coincide with terms of new private financing. Shifts an EZ loan balloon payment, due December 31, 2011, out five years to 2016. Interest will continue to accrue. Increases likelihood of repayment.

Community Impact

- Neighborhood Notification: Informational letter and emails sent to Midtown Phillips Neighborhood
- City Goals: Jobs & Economic Vitality - Strong commercial corridors, thriving business corners
- Comprehensive Plan: 4.1.2 Seek out and implement long-term redevelopment projects that catalyze revitalization and private sector investment. 4.2.5 Encourage small business opportunities, such as appropriate home occupations and business incubators, in order to promote individual entrepreneurs and business formation.
- Living Wage/Job Linkage: NDC signed a Job Linkage Agreement in 2004. They have submitted annual reports from 2005 to 2010, including total employment by vendor, new living wage hires, and Minneapolis resident hires.

Background
In 2004, the Neighborhood Development Center (NDC), in partnership with In the Heart of the Beast Puppet and Mask Theater (HOBT) and the Latino Economic Development Center (LEDC), renovated the Antiques Minnesota building at 1508 East Lake Street into a mixed-use office/retail development known as Plaza Verde. The project returned three floors (34,000 square feet) of office, retail, and event space to active use on one of Minneapolis's busiest commercial corridors. The project also redeveloped an adjacent parking lot.

In 2004, the Antiques Minnesota building was the second largest vacant property in the Midtown Phillips neighborhood, second only to the Sears building, and the shuttered windows and uncontrolled parking lot had dragged down the value, vitality, and growth potential of the intersection and neighborhood for several years. Given its size and prominent location, the property was a high concern among neighborhood groups, residents, and the area business association. At the request of HOBT, NDC acquired the building in December 2003 and began renovation in 2004. Today there are seven small businesses and two nonprofits in the building, providing thirty-nine jobs. Of those 39 jobs, Minneapolis residents hold 27.

The Plaza Verde project accomplished many of the goals envisioned, including:

- renovation of a blighted building and uncontrolled parking lot that served as a magnet for crime;
- restoration of an historic building that is an integral part of the neighborhood fabric;
- replacement of street level windows to activate the sidewalk;
- establishment of rental space for cultural events, meeting substantial demand in the Latino community;
- opportunity for wealth creation for immigrant entrepreneurs; and
- momentum for a growing Latino commercial district.

The total project cost was $4.26 million. The largest funding source for the project was the infusion of a $1.7 million New Market Tax Credit (NMTC) Equity Investment. The Plaza Verde project was the first NMTC deal completed in the State of Minnesota and among the first in the nation. The chart below lists the private and public financing sources. The City's investments were a pay-as-you-go, privately financed Tax Increment Finance (TIF) Note; a Community Economic Development Fund (CEDF) CDBG loan; an Empowerment Zone (EZ) loan; and a forgivable Neighborhood Revitalization Plan (NRP) loan from Midtown Phillips.

NDC proposed the Plaza Verde project in response to a 2003 Commercial Corridors Request for Proposals (RFP) issued by the MCDA and the City of Minneapolis Empowerment Zone. Through the RFP process, the MCDA selected the project for a CEDF loan and the Empowerment Zone awarded it an EZ loan.

Table 1. Original Project Sources

Equity	Amount
Wells Fargo CDC NMTC Investment	$1,715,250
Met Council TRBA Grant	232,000
Pohlad Foundation Grant	100,000
Private Debt	
Wells Fargo Loan (1st position, due 2011)	685,000
Northwest Area Foundation TIF Loan (due 2022)	408,000
Partners for Common Good Loan (due 2011)	250,000
NDC REDI Loan (due 2011)	225,000
HOBT Loan (due 2034)	10,000
Public Debt	
City of Minneapolis CEDF Loan (due 2024)	250,000
City EZ Loan (due 2011)	250,000
Midtown Phillips NRP Loan (forgivable)	136,398
Total Project Cost	**$4,261,648**

New Market Tax Credit Structure and Unwind
New Markets Tax Credits (NMTC) are used to attract investment capital to operating businesses and real estate projects located in low-income communities. The tax credits allow investors to receive its pre-negotiated return on investment over a seven-year period. The Wells Fargo, Partners for Common Good, NDC REDI and EZ loans were all structured as seven-year loans to match the NMTC period. The use of NMTC requires a complicated financing structure that placed the City's loans in subordinate positions with security not in the real estate, but in a Pledge of Cash Flow Distributions.

When the City approved the loans, there was no anticipation that they would be paid in full at seven years. All parties understood that when the federal NMTC-period expired in year seven (2011), the project would undergo major refinancing. After much discussion with existing lenders and new, prospective lenders, a new loan equal to the amount of the project's obligations due in 2011[1] is not possible. The project has not performed as well as originally projected, but it has met all of its payment obligations to date, and through a combination of concessions, temporary deferrals, and a new first mortgage loan, NDC is prepared to successfully restructure the project, even in today's tight commercial lending environment.

Given the project's operating history, stabilized net operating income (NOI) of $105,000, and $1.375 million appraised property value, prospective lenders are considering a new $950,000 five-year, first mortgage. NDC received a commitment letter from one lender for a $950,000 new first mortgage on November 30, 2011. The new loan and an established sinking fund ($42,000) will allow NDC REDI, LLC to repay the Wells Fargo first position loan ($685,000) and Partners for Common Good second position loan ($250,000), establish a six month debt service reserve (approximately $40,000, new lender requirement), and pay fees associated with the NMTC structure (under negotiation). The remaining debt will be refinanced as part of the overall project refinancing underway, as described in this report.

NDC Request
There are several requirements that any new lender will have in order to be comfortable with a new $950,000 first mortgage. A requirement that most affects the repayment of the City's loans is a 1.2 debt coverage ratio, allowing subordinate debt payments ***only*** when project net income is in excess of 120% of the new first mortgage lender's annual debt service payments. To accommodate this, and other requirements of the new first mortgage lender, NDC has requested the following revised terms for the City of Minneapolis CEDF and EZ loans:

1. limit repayment in the next five years to annual payments out of excess cash flow and
2. subordinate to new first mortgage lender with the loans secured by a traditional real estate mortgage.

The annual excess cash flow payments will be based on the project's annual net operating income (NOI) less the annual first mortgage and reserves payments (to total 120% of the first mortgage payment). The City's amended loan documents will require any cash above this amount be distributed to two remaining subordinate lenders (NDC and the City) as a percentage of each lender's original loan amount. The City lent 69% of the subordinate debt that will remain for NDC and the City. Each of the City's loans will share half of the City's share of the annual payment received. In other words, annual payments on each of the City's loans will be 34.5% of the excess cash in the project at the end of each year. If the project performs in line with NDC 's projected Five Year Cash Flow Proforma (Attachment A), the City will receive $40,000 in payments over the five years on each loan ($80,000 total). Interest will continue to accrue on the two City loans during the five-year period and the excess cash payments will first be applied to accrued interest. The Five Year Cash Flow Proforma is based

[1] Wells Fargo Loan ($685,000), Partners for Common Good Loan ($250,000), EZ Loan ($215,665), NDC REDI Loan ($225,000) totals $1,375,665, plus NMTC asset management fees (being negotiated)

on the project's recent history, existing leases, and prospective tenant interest, giving City staff confidence that there will be some level of cash available for payments during the five-year period.

The City's amended loan documents will also adopt a new contract end date, with full balloon payments on both loans due in 2016. The new five-year loan term will coincide with the new first mortgage loan and bump up the CEDF balloon payment date by eight years from 2024 to 2016. The term of the EZ loan will be extended five years to 2016. If a take out of the City loans by a private lender is not feasible in 2016, the City is in an improved position to restructure the loans with payments based on the project's recent history.

NDC, as property manager, is working aggressively to meet their five-year projections. These projections are more reliable than the original proforma developed in 2004. Thirteen of the nineteen revenue line items are based on existing language in current leases. When the project was funded that was true for only eight, none of which had signed leases, only letters of intent. Expenses are also based on seven years of operating history. The two biggest uncertainties in the proforma are the projected leases for the third floor. NDC is actively looking for office tenants for the HOBT space and a new operator to improve leasing and performance of the ballroom space. HOBT has decided to exit their lease when new tenants are secured. NDC has prospects for both spaces and expects new tenants in 2012.

This refinancing will also change the loan collateral from a Pledge of Cash Flow Distributions, as dictated by the NMTC structure, to a traditional real estate mortgage subordinate to the new first mortgage loan. This provides the City with improved loan security. The City's mortgage will be with Bloom Lake Historic Partners, LLC- the legal entity that owns the real estate and will be the borrower on the City's revised loan agreements. Bloom Lake Historic Partners, LLC's two members will be NDC and LEDC. LEDC currently leases office space in the building.

Staff Recommendation
In response to NDC's request, staff recommends authorizing changes to the loan documents consistent with the request. The tables below show the proposed loan terms. The Development Finance Committee reviewed and supported this proposed restructuring on December 1, 2011.

Tables 2. and 3. Loan Term Comparisons

CEDF LOAN		
	Current Loan Status	Proposed Restructured Terms
Outstanding Loan Balance (as of 11/22/11)	$251,875	$251,875
Interest Rate	3.00%	3.00%
Loan Term (months)	240	147
Amortization Term (months)	240	na
Quarterly P & I Payment (10/1/11 - 4/1/24)	$4,167	$0
Balloon Date	7/1/2024	10/1/2016
Balloon Payment	$109,055	$292,473
Annual Excess Cash Payment	none	34.5% of excess cash
Security	Pledge of Cash Flow Distributions	Subordinate Mortgage

EZ LOAN		
	Current Loan Status	Proposed Restructured Terms
Outstanding Loan Balance (as of 10/01/11) *includes $15,000 of principal forgiveness for EZ job creation*	$215,665	$215,665
Interest Rate	3.00%	3.00%
Loan Term (months)	67	124
Amortization Term (months)	240	na
Annual Interest-Only Payment (7/31/10 - 7/31/11)	$3,740	$0
Balloon Date	12/31/2011	10/1/2016
Balloon Payment	$205,302	$250,769
Annual Excess Cash Payment	none	34.5% of excess cash
Security	Pledge of Cash Flow Distributions	Subordinate Mortgage

One difference between NDC's original proposal and the recommended terms by staff is having ranked loan positions for collateral security (see Table 4 below). NDC's request was to place all the remaining subordinate debt (CEDF, EZ, NDC REDI, LLC) on par in a subordination agreement. City staff has agreed to recommend each subordinate loan to take excess cash payments on par, but negotiated ranked loan positions in exchange for agreeing to allow NDC to pay off the Partners for a Common Good loan in full. Allowing NDC to pay off one subordinate loan in full improves project stability by simplifying project refinancing, excess cash flow payments, and future project debt.

Table 4. Debt Structure as Proposed in Refinancing

Proposed Debt After Restructure	Amount	Current Security	Proposed Security
New First Mortgage Loan	$950,000	na	Mortgage (1st)
City EZ Loan	215,665	Pledge of Cash Flow Distributions	Mortgage (2nd)
City CEDF Loan	251,875	Pledge of Cash Flow Distributions	Mortgage (3rd)
NDC REDI Loan (Wells Fargo EQ2)	225,000[2]	Pledge of Cash Flow Distributions	Mortgage (4th)
NRP Loan (fully forgivable in 2019)	90,932	Pledge of Cash Flow Distributions	Mortgage (5th)
Northwest Area Foundation TIF Loan	408,000	Pay-go TIF Note	no change
HOBT Loan (payable 2034)	10,000	none	none
Total Project Debt After Restructure	**$2,129,234**		
2011 Appraised Property Value	**$1,375,000**		

The third and final outstanding loan the City has in the Plaza Verde project is a Midtown Phillips NRP loan. It is a fully forgivable loan. The only change to this loan will be entering into a subordinate mortgage on the property. A current provision of the Loan Agreement is the right of first refusal for the Heart of the Beast Puppet and Mask Theatre (HOBT) to lease space in the building. HOBT has voluntarily decided to end their lease in the building when a new tenant is found for their space.

Table 5. NRP Loan Term Comparison

NRP LOAN		
	Loan Terms	Proposed Restructured Terms
Loan Amount	$136,398	$136,398
Annual Interest Rate	0.00%	0.00%
Loan Term (months)	180	180
1/3 forgivable	7/1/2009	7/1/2009
1/3 forgivable	7/1/2014	7/1/2014
1/3 forgivable	7/1/2019	7/1/2019
Security	Pledge of Cash Flow Distributions	Subordinate Mortgage
NRP (Midtown Phillips) Provision	Right of first refusal for HOBT to lease space	Right of first refusal for HOBT to lease space

[2] Principal amount may increase if the new first mortgage and sinking fund are unable to pay all fees associated with the NMTC structure collapsing.

NDC Requests to Other Lenders

NDC has requested that Wells Fargo forgo a $318,000 put/call fee and asked the tax credit asset manager to reduce its $218,888 in accrued asset management fees. Wells Fargo has verbally agreed to forgo the entire put/call fee and NDC continues to negotiate a reduction in the asset management fees with the tax credit asset manager. The $250,000 NDC REDI loan is an EQ2 loan from Wells Fargo. It will be restructured in a manner similar to the CEDF and EZ loans in a subordinate position to the new first mortgage, EZ, and CEDF loans and eligible for annual excess cash flow payments at 31%.

Risk Assessment

There are risks associated with both restructuring the loans as outlined above as well as not restructuring the loans as proposed. Deferring all required loan payments and accepting payments based on available excess cash, risks receiving zero payments in five years and further delaying or jeopardizing full or partial repayment of its loans if the project does not perform as hoped. However, it provides the City with the opportunity to accelerate the balloon payment of the CEDF loan by eight years from 2024 to 2016, requires payment if the project's financials improve, and reiterates the City's preference that a private lender refinance the City loans in 2016. If a take out by a private lender is not feasible in 2016, the City will be in an improved position to restructure the loan at that time with payments based on the project's operating performance from 2012 to 2016. Restructuring also increases the strength of the City's collateral, replacing the NMTC-dictated Pledge of Cash Flow Distributions with a conventional real estate mortgage. Any recourse the City could take under the Pledge document is complicated and likely fruitless.

Staff believes a more serious risk is not restructuring the loans. NDC has stated they will be forced to default on both loans, as well as their other financing, if they are not restructured. If the project were to default, it would change NDC's conversations with current and prospective lenders, hampering any refinance and seriously threatening the continued operation of the project.

Attachments

Attachment A: 5-Year Cash Flow Pro Forma