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

Date: September 23, 2014

To: Council Member Lisa Goodman, Chair, Community Development & Regulatory Services Committee

Subject: Mercado Central Loan Deferral

Recommendation: Authorize the deferral of monthly loan payments on the City's CEDF/CDBG loan to Mercado Central, LLC for two years, from August 1, 2014 through July 1, 2016; direct staff to execute amendments to the appropriate loan documents consistent with this report; and direct staff to closely monitor the financial performance of the market and determine whether critical milestones are achieved during the deferral period.

Previous Directives: The MCDA Board of Commissioners approved a $320,000 Community Economic Development Fund (CEDF) loan and $30,000 in Non-Profit Development Assistance on December 3, 1997.

Department Information

Prepared by: Rebecca Parrell, Senior Project Coordinator (673-5018)
Approved by: Charles T. Lutz, Deputy Director, CPED ______________
Catherine A. Polasky, Director of Economic Development, CPED ______________
Presenters in Committee: Rebecca Parrell, Senior Project Coordinator

Reviews

Development Finance Committee (DFC): Reviewed staff recommendation on September 18, 2014.

Financial Impact

Action is within the Business Plan
Other financial impact: Approval of the staff recommendation delays the repayment of $49,378.56 in loan principal and interest payments

Community Impact

Neighborhood Notification: NA
Zoning Code: NA
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: NA

Background

In the fall of 1996, several groups came together to redevelop the southwest corner of Bloomington Avenue and Lake Street into a Latino marketplace. A group of emerging Latino leaders in Minneapolis, recognized the need to address and overcome barriers to Latinos' full participation in the economy, and inspired by the opportunity for entrepreneurship, they created the vision for a Latino-themed public market that could promote economic opportunities for Latino immigrants. With tremendous community, philanthropic, and public support this group partnered with Project for Pride in Living (PPL), the Whittier Community Development Corporation (Whittier CDC), and the Neighborhood Development Center (NDC) to open Mercado Central.

The Mercado project assembled seven parcels, including two separate two-story buildings, a smaller one-story building, and four additional parcels to create an adjacent, off-street parking lot. All together, the project created 28,000 square feet of commercial space on two floors, with storage and meeting space in the basement. The ownership LLC was originally structured as a wholly-owned subsidiary of PPL. In 2004, after an infusion of capital from the McKnight Foundation, the LLC ownership changed to PPL with a 40% ownership share, Whittier CDC with a 25% ownership share, NDC with a 25% ownership share, and the Cooperativa Mercado Central (a co-operative comprised of the entrepreneurs in the market) with a 10% ownership share. Additionally, a Buy-out Option Agreement was signed by all parties, providing a pathway for the Cooperativa to buy the shares of the other ownership entities. Since 2004, Whittier CDC closed their operations and transferred their ownership shares to PPL. The Cooperativa has not purchased any of PPL's or NDC's shares.

When the Mercado Central opened in 1999 it dramatically transformed the formerly blighted corner into a hub of commerce that inspired further investment up and down Lake Street. Now, fifteen years later, Mercado Central remains a cooperative with 34 business members still pursuing the original mission- to provide a high quality retail space for Latino vendors, promote the sale of their products, incubate Latino businesses, and support the continuing development of the larger Latino business community.

Project Financing

The costs associated with property acquisition, relocation, demolition, rehabilitation, and market build-out totaled approximately $2.6 million (see Table 1).

Table 1. Project Financing

SOURCES	
Equity	
PPL Equity	$618,603
Mercado Equity	$100,000
Federal OCS Grant	$350,000
MCDA Non-Profit Admin Grant	$30,000
Foundation Funding	$488,000
Total Equity	$1,586,603
Debt	
MCDA CEDF/CDBG Loan	$320,000
PPNA NRP Loan	$200,000
Phillips NRP Forgivable Loan	$109,410
Marquette Bank Loan	$440,000
Total Debt	$1,069,410
TOTAL SOURCES	**$2,656,013**

The project currently has three City of Minneapolis loans outstanding (see Table 2). The Phillips NRP Forgivable Loan is fully forgivable on December 28 of this year, if the loan is not in default. The PPNA NRP Loan is scheduled to begin payments on January 1, 2025, after the final scheduled payment on the CEDF/CDBG Loan. The CEDF/CDBG Loan has principal and interest payments that are due on the first of each month through December 1, 2024, and this loan is the primary subject of this report.

Table 2. Long-term Debt Remaining in Project

Loan	Original Principal	Interest Rate	Outstanding Balance	Payments	Maturity Date
MCDA CEDF/CDBG Loan	$320,000	2.5%	$226,213	$2,057.44 monthly	12/1/2024
PPNA NRP Loan	$200,000	1.0%	$218,000	$1,270 P&I payment (1/1/25-12/1/34), $145,000 balloon	2/1/2035
Phillips NRP Forgivable Loan	$109,410	0.0%	$109,410	Fully forgivable, if not in default	12/28/2014
Long-term Debt Subtotal	**$629,410**		**$553,623**		

Until recently, the project had been able to meet its financial obligations and make all scheduled payments on the City's CEDF/CDBG Loan. Within the last year or two, various financial difficulties developed. And despite the limited debt service on the property, the Mercado has recently had inadequate cash flow to meet all their obligations and has had no ability to set aside reserves for needed capital investments.

Loan Payment Deferral Request

In July 2014 CPED received a request from the Mercado Central Board of Directors to defer all monthly loan payments on the CEDF/CDBG loan for one year. This request also included information describing the project's current challenges and proposed remedies. Factors that contributed to the current financial problems include:

- a more expensive operating structure approved in 2013, which was not accompanied by increased rents;
- a relatively high vacancy rate; and
- higher than budgeted expenses for contracted cleaning, maintenance and repair (due to vandalism), and natural gas (due to extremely cold weather and higher rates).

These factors have contributed to rising accounts payable that are no longer manageable. Therefore, the LLC is moving forward with a turnaround strategy to achieve positive cash flow and drastically reduce accounts payable. A group of PPL and NDC staff, Cooperativa members, and consultants are working aggressively on all aspects of a workout plan to ensure the market's success into the future.

To stabilize the Mercado's financial situation, the LLC is working to grow revenues through a combination of increasing occupancy levels and raising rents. They plan to implement expense savings by working more cooperatively against vandalism, utilizing more cost-effective vendors, transferring some responsibilities to Cooperativa members, changing the management structure, and requesting deferral of monthly loan payments on the City of Minneapolis CEDF/CDBG Loan. These actions together show that the project can achieve positive cash flow within one year, but will need another year to have enough cash flow to resume making monthly loan payments on the CEDF/CDBG loan (see Exhibit A).

Reaching a monthly cash flow that can support monthly expenses and repay the City loan is one critical piece of the financial picture at Mercado Central, but equally important is clearing up the accounts payable and preparing for upcoming needed capital improvements. The Mercado is not able to generate enough funds through their monthly revenue streams to pay the outstanding accounts payable balance and address the building's needs. Without outside financial assistance, the project will not be able to continue operating successfully. NDC and PPL leadership are focused on raising $200,000 to cover the project's immediate and short-term needs and will continue to do so throughout this workout period.

The LLC's loan deferral request also addressed NDC's and PPL's desire to position the Mercado for an ownership change in the near future. The Cooperativa members and/or the Latino community would eventually like to assume full ownership of the project. This is in keeping with the original vision of the project, as outlined in the 2004 Buy-out Option Agreement. In order for the project ownership transition to be feasible, the following conditions are necessary:

1. achieve positive operating cash flow that can make scheduled debt payments and fund reserves,
2. payoff all delinquent accounts payable, and
3. secure funds for needed capital improvements.

The Department of Neighborhood and Community Relations (NCR) has hired two consultants to assist with achieving these three conditions and the long-term ownership reorganization of the Mercado. Services they are providing include Cooperativa board training, Cooperativa development, improved member relations, financial management consulting, and property management work.

Staff Recommendation and Risk Analysis

Staff recommends approving a two year deferral of all required loan payments on the CEDF/CDBG Loan from August 1, 2014 through July 1, 2016. Monthly payments will be scheduled to resume on August 1, 2016. The 2.5% interest rate will be applied during this deferral period and will increase the future monthly payment amount by $558 from $2,057 to $2,615 per month.

Staff recommends the deferral for several reasons, chief among them:

- the borrower has kept up-to-date on loan payments thus far,
- the borrower has kept the City informed of the project's challenges and their proposed steps to overcome them,
- requiring payment during this period of restructuring would put a great strain on the project's ability to continue operating, and
- stabilizing the project for eventual new Latino ownership helps achieve the project's original mission of supporting the economic health and growth of the Latino business community.

Staff believes that while some of the assumptions used to create the pro forma are more optimistic than others, they all appear to be reasonable and based on the project's current and historic revenues and expenses. The pro forma attached as Exhibit A has been developed by NDC in consultation with the Board of Directors of the Cooperativa. The primary ways the pro forma increases revenues is by raising rents and leasing vacant spaces. Specifically it shows:

- instituting a four percent (4%) rent increase in January 2015, followed by an additional two percent (2%) rent increase in January 2016 and
- leasing two vacant first floor spaces by January 2015 and leasing two vacant second floor spaces by January 2016.

The most significant changes to decrease expenses include:

- Switching management companies- the Neighborhood Development Center managed the market from 1999 to 2012. In 2012 a private management firm took over some management functions and in 2013 took over full management of Mercado Central. The transition back to NDC, in October 1, 2014, will bring the contract management fee down from $3,900 to $2,000 per month. Additionally, some management functions will be shared by the Cooperativa members and NCR consultants.

- Switching contract cleaning companies- with new management, the Cooperativa believes that there is the opportunity for monthly savings of $1,500 in contract cleaning expenses.
- Cleaning supplies and repairs- with new management, the Cooperativa believes that cleaning supplies and repairs costs can be reduced to $5,000 per month by working cooperatively against vandalism and instituting new expense control measures.

Given the operational changes planned, the cash flow pro forma shows that over the next 12 months the facility will operate slightly above breakeven and that after 24 months the project will have sufficient cash flow to make the new monthly payments on the CEDF/CDBG loan, and have a small amount remaining for reserves. Staff is recommending a two year deferral rather than a one year deferral because the pro forma doesn't show the project achieving a consistent monthly cash flow to cover the City's monthly debt payments until month 16, and it is possible it will take longer than 16 months, given the assumptions. The recommended deferral is a critical component of the pro forma's projections, needed to help the project succeed. However, if any component(s) of the workout plan do not materialize as projected, it will be very challenging for the project to stabilize and resume making debt payments. Therefore, staff believes that a two year deferral is an appropriate recommendation to give Mercado Central enough opportunity to regain its financial footing. Given the thin margins for success, staff is also recommending that the new management team, in consultation with the Cooperativa, provide CPED with monthly progress reports showing how the actual revenues and expenses compare to those budgeted and projected in the pro forma. Additionally, CPED staff will closely monitor the financial performance of the market and determine whether critical milestones are being achieved during the deferral period.

If the City were to choose not to defer the loan at this time, it is highly likely that the City's loan would go into default, as bills required to keep the Mercado operating would be prioritized. Staff believes that the Mercado has potential to succeed under the current turnaround plan, and believes that providing time to realize the plan is in the best interest of the Mercado, Cooperativa businesses, and intersection, and offers the best option for securing full repayment of the City loan. In addition, if the CEDF Loan were to go into default that would trigger a default provision on the 15 year Philips NRP forgivable loan that otherwise would be forgiven on December 28, 2014.

The Development Finance Committee reviewed staff's recommendations at their September 18, 2014 meeting.

EXHIBIT
A: 24-Month Pro Forma (August 2014 – July 2016)