

**City of Minneapolis**  
**Request for Committee Action**

**To:** Community Development & Regulatory Services  
**Date:** 11/10/2015  
**Referral:** Ways & Means  
**From:** Community Planning & Economic Development  
**Prepared by:** David Frank  
**Presented by:** David Frank  
**File type:** Action  
**Subcategory:** Contracts & Agreements

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**Subject:**

Reopen Nicollet at Lake Street Project

**Description:**

1. Authorize purchasing 30 West Lake Street for \$5,275,000, pursuant to the attached Purchase Agreement, closing on December 1, 2015.
2. Delegate authority to the CPED Director to negotiate, sign and implement an option agreement to purchase the leased fee estate of 10 West Lake Street for an amount not to exceed \$8,000,000 subject to the terms and conditions described below.
3. Adopt a resolution appropriating up to \$6,275,000 within the CPED budget to provide temporary funding for the above described actions.

**Previous Actions:**

1. On April 25, 2014, the City Council approved the *Lake and Nicollet Redevelopment Plan*, adopting a project area of 30 properties, designating the area as blighted, and identifying 9 of the 30 parcels as sites the City may acquire, including 10 West Lake Street and 30 West Lake Street.
  2. Through the budget approval process on December 14, 2011, the City Council directed CPED and Public Works to create a Project Team comprised of representatives from CPED, Public Works, and Finance to advance the reopening of Nicollet Avenue at Lake Street.
  3. On October 2, 2009, the city Council adopted *The Minneapolis Plan for Sustainable Growth*, which includes a strategic direction to reopen Nicollet at Lake.
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**Ward/Address:**

Ward 10  
10 W Lake St and 30 W Lake St

**Background/Analysis:**

**History**

The intersection of Nicollet Avenue and Lake Street is said to have reached its peak in the early 1950's, after which the area slowly started to suffer from high vacancies, low rents, and marginal businesses. In 1972, the City Council established the Nicollet-Lake Development District, acquired property, and demolished buildings before there were any development proposals in hand. Five years went by before the City partnered with Kmart Corporation to develop at the intersection. In 1977, Kmart received permission to close Nicollet Avenue for the construction of their store and parking lot at 10 West Lake Street. The adjacent SuperValu grocery store was developed at the same time at 30 West Lake Street.

By 1998, the negative repercussions of having closed Nicollet Avenue and placed retail shopping to the rear with expansive parking lots at the sidewalk were felt by the community and recognized by public officials and planners. Reopening Nicollet at Lake has been a priority of the City Council and community since this time. In a formal action in 1998, the Minneapolis City Council approved the formation of the Nicollet-Lake Task Force to examine reopening Nicollet Ave and redeveloping the intersection. Representatives on the task force included the area business association; neighborhood groups; Midtown Community Works representatives; landscape architects; and city staff from planning, public works, and economic development. The Task Force met to discuss key issues and opportunities, review land use options and create conceptual development alternatives for reopening Nicollet Avenue. They developed Urban Design Principles for the study area, and Kmart put forth their requirements for staying in the redevelopment with a new store, which included a one story 107,000 square foot building, parking in front of the store, and no store closure during construction.

In February 2001, Sherman Associates submitted a proposal to redevelop the area. The proposal envisioned a mixed-use project with housing along the Midtown Greenway, Kmart and the grocery store relocating to front Lake St, and smaller stores fronting Nicollet Ave and Lake St. During the negotiations, Kmart discontinued participating with Sherman, but he moved forward and the City Council directed staff to begin a preliminary TIF analysis of Sherman Associates' proposal without Kmart. The proposal was dependent on tax increment sufficient to support pay-go notes for store construction and public bonding for parking ramp construction. The MCDA Board of Commissioners authorized continued analysis of the Sherman Associates' proposal and granted them exclusive development rights for six months. In December 2002, the City Council approved Sherman's request for a Preliminary Project Analysis (PPA), but after the analysis was complete in 2003, the project was financially unable to move forward, and no redevelopment contract was signed.

Twelve years have passed since Sherman's proposal, and the market in the area is much different; however, the City's goals for redevelopment remain largely the same. On April 25, 2014, the City Council approved the *Lake and Nicollet Redevelopment Plan*, designating the area as blighted and included both 10 West Lake Street and 30 West Lake Street as parcels the City may acquire.

### **Policy Support and Development Objectives**

Reopening Nicollet is the key policy objective of two City Council-adopted small area plans: *Nicollet Avenue: The Revitalization of Minneapolis' Main Street* (2000) and *The Midtown Minneapolis Land Use and Development Plan* (2005). The former provides general guidance for investing in Nicollet Avenue throughout south Minneapolis, while the latter includes more-detailed guidance for land use change at Lake and Nicollet and throughout the Midtown stretch of Lake Street. Both plans emphasize the importance of reopening Nicollet as a means to re-establishing the street grid and setting the stage for new development, and both plans are amendments to and articulations of *The Minneapolis Plan for Sustainable Growth* (2009), the City's comprehensive plan.

*The Minneapolis Plan for Sustainable Growth* designates a future land use of Mixed Use on both 10 W Lake Street and 30 W Lake Street. The properties are also subject to the policies of the following land use features:

- **Major Retail Center** at Lake and Nicollet, indicating an area that can accommodate large-scale retail along with small-scale retail, residential, and office uses. New development, including large-scale retail, should incorporate principles of traditional urban design, including buildings that reinforce the street wall, have windows that provide "eyes on the street", and principal entrances that face the public sidewalks.
- **Commercial Corridor** designation on Lake Street and Nicollet Avenue, which reinforces these streets as focal points for retail and encourages mixed-use development of at least two stories.

- **Activity Center** in a four-square-block area around Lake and Nicollet, indicating policy support for a variety of commercial and residential land uses that generate activity all day long and into the evening.

Considered together, these adopted plans offer the following development guidance for 10 W Lake Street and 30 W Lake Street:

- High-density multistory mixed-use buildings (some combination of retail/office/housing)
- Retail should front both sides of re-opened Nicollet and Lake Street
- Large-format retail will likely be part of the mix, and needs to be built according to traditional urban design standards
- A mix of housing types, tenure, and affordability levels
- Shared, structured parking
- Green space along the west side of Nicollet between Lake Street and the Midtown Greenway
- New 29<sup>th</sup> Street on south side of the Midtown Greenway, built with a “people and bikes first” design

### **30 West Lake Street (Grocery Site)**

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The 30 West Lake Street parcel is 2.88 acres with 150 parking spaces and a single-story, 26,496 square foot, vacant retail building, constructed in 1977 and most recently occupied by a SuperValu grocery store with some fixtures remaining. As of September 30, 2015, independent appraiser, CB Richard Ellis, found the fee simple value of the property to be \$2,700,000 (\$21.53/square foot).

In 2014, the City had preliminary discussions with Mr. John Leighton of Public Markets, Incorporated, the owner of 30 West Lake Street, regarding the purchase of his leased fee interest in the property, but he found an interested buyer willing to pay more and left discussions with the City. The higher bidder has stepped away, but interest in the site remains strong. In September 2015, Mr. Leighton offered to sell the property to the City for a sale price of \$5,275,000 firm (\$42.06/square foot).

Given the parcel’s strategic location adjacent to the parcel required for reestablishing the street grid at Lake Street and Nicollet Avenue, it is a key parcel for acquisition to allow implementation of the larger vision for the area and achieving many of the *Lake and Nicollet Redevelopment Plan’s* objectives, including: improving transportation connections, promoting transit-oriented and sustainable development, eliminating blighting influences, increasing business activity and density, and increasing the number of housing units. The CPED Director signed a Purchase Agreement for the offer price to support the redevelopment plan’s goals.

The \$5,275,000 purchase price is for the land, the SuperValu Lease, and any improvements and fixtures not owned by SuperValu. Key terms of the signed Purchase Agreement include:

- a non-refundable \$25,000 earnest payment;
- City-paid closing costs, except deed tax and seller’s own attorneys’ fees;
- a December 1, 2015 closing date; and
- contingencies for the benefit of the City to be satisfied or waived by Wednesday, November 25, 2015 or the agreement may be terminated.

The key contingency is City Council approval and appropriation of funding for the purchase.

Others include City acceptance of the:

1. results of any environmental and geotechnical investigation,
2. condition of title and survey, and
3. form and content of the SuperValu Lease

Staff has obtained updated title and survey work and no serious issues were flagged. Staff ordered an update to the Phase I Environmental Site Assessment completed on June 3, 2014. The updated assessment revealed evidence of the following, and recommended a Phase II:

- possible groundwater and/or soil contamination;
- remnants of a structure that occupied the Site, prior to the current building;
- businesses that formerly occupied or adjoined the Site may have included: coal storage, manufacturing, engraving, plating, printing, cleaners and launderers, filling/service stations, garages, auto body painting and repair, undertaker, battery services, and chemicals.

The staff assessment of the Phase I is that the identified conditions are manageable and can be addressed with the redevelopment of the site.

The City has reviewed the SuperValu lease, which the City would assume upon purchase of the property. The lease includes the following terms:

- Expiration of current term on June 22, 2017; no extension options are available;
- Lessee (SuperValu) is responsible for taxes, insurance, and maintenance;
- Lessee (SuperValu) pays monthly rent of \$7,550.51;
- Lessee (SuperValu) has right to assign or sublet without Lessor consent;
- Lessor (City) cannot lease any Lessor-owned properties to any retail food store within 1 mile radius;
- Lessor (City) is obligated to repair or rebuild if damaged by fire/other casualty; and
- Permissible use is defined as “retail mercantile or any permissible other lawful business.”

Staff assessment of the lease is that there are a number of terms which would favor the City, but like any lease, there is risk to the landlord.

If acquired, the future intention would be to sell the property for higher-density, mixed use redevelopment, consistent with adopted land use plans. It is reasonable to envision selling the property for redevelopment at a price per square foot that is close to the City’s \$42/square foot purchase price. However, it will be necessary to first address the existing reciprocal easement and maintenance agreement (“REA”), which precludes redevelopment of the parking area “so long as either Parcel A [Kmart] or Parcel B [SuperValu] shall be used for one or more retail commercial establishments.” The term of the SuperValu lease expires in 2017, but the leases on the Kmart site have extension options to 2053. Staff has not yet had any discussions with the owners/occupants of the Kmart site about the REA. Staff is not seeking any condemnation rights associated with this land and is not asking that the Council approve the use of condemnation for this parcel.

## **10 West Lake Street (Kmart Site)**

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### **Ownership**

The 10 West Lake Street parcel is 7.08 acres and occupied by a single-story Kmart store. The property ownership on 10 West Lake Street, is multi-layered and complex. The listing below is a simplified version of the ownership structure. The interests are listed from leased fee/ground ownership first to operating lease tenant last.

### Leased Fee Estate/Ground Lease Landlord

Lawrence Kadish (syndicated to multiple owners of undivided percentage interests as Tenants in Common, hereinafter identified as “Kadish”)

### Ground Lease Tenant & Operating Lease Landlord

Troy Coolidge No. 42 LLC (a subsidiary of Sears Roebuck & Company, hereinafter identified as “Sears”)

### Operating Lease Tenant

Sears Holding Corporation (hereinafter identified as “Kmart”)

The City has had extensive and productive discussions with Mr. Kadish, but has been unable to date to make progress with Sears/Kmart regarding the purchase of their ground and operating lease interests. At this time, many questions about Sears' and Kmart's intentions, positions, or price for their stakes in the property are unanswered. Sears/Kmart has said repeatedly and consistently that they wish to remain as tenants on the site. Because of this, it may be the case that the City is unable to reach agreement.

The City and Mr. Kadish have discussed him providing the City (or its assigns) with a one to two-year option to purchase the leased fee estate for \$8,000,000 (approximately \$25.96 per square foot of land). Staff is seeking a delegation of authority to the CPED Director to negotiate the final terms of an Option Agreement consistent with the general terms outlined within this report. If a final deal is reached with Mr. Kadish, staff is seeking a further delegation of authority to the CPED Director to sign and implement the Option Agreement as further described below.

Key terms of the proposed Option Agreement include:

- an Option Due Diligence Period of at least 90 days;
- a non-refundable \$800,000 option payment due within 1 day after the Option Due Diligence Period, provided the City does not first terminate the agreement;
- a requirement for Mr. Kadish to obtain 100% of the Tenants' in Common interests at no cost to the City;
- City-paid closing costs, except deed tax, one-half of customary closing fees and seller's own attorneys' fees;
- an exercise date deadline of one to two years from December 1, 2015, depending on the agreed length of the option; and
- the ground and operating leases remain in place.

As of October 15, 2015, independent appraiser, Shenehon Company, found the appraised value of 10 West Lake Street to be \$42 per square foot, rounded to \$12,950,000 total, as a hypothetically unencumbered fee simple interest. Shenehon based this value on the property's highest and best use as vacant for a future high-density mixed-use development with ground-level commercial supporting upper-story multifamily residential.

As noted above, however, ownership of the subject property is not unencumbered; it is split among (1) a leased fee estate, (2) a ground leasehold, and (3) an operating lease interest, and it is encumbered by the REA. Shenehon Company cannot assign distinct dollar value figures to the separate ownership interests without more complete information, including the operating lease. Since staff does not have the necessary information to make an unconditional recommendation to the Council, staff has proposed an Option Due Diligence Period prior to payment of the option price. During the proposed Option Due Diligence Period, Kadish would be required to provide the City with certain due diligence information, including the operating lease, to allow the City to obtain an allocation of the appraised value to the leased fee estate from Shenehon Company, conduct environmental and geotechnical investigations, review a title commitment, and complete a land survey. At the end of the Option Due Diligence Period, based on the review, outcomes, and findings of this work, the CPED Director could terminate the Option Agreement, in which case the \$800,000 will not be due, or proceed to pay the \$800,000 non-refundable option price. If the appraised value of the leasehold estate or other information is determined to be materially different than what is outlined in this report, however, staff will report back to the City Council prior to the expiration of the Option Due Diligence Period.

Staff has reviewed the ground lease, which the City would assume if the property is purchased. Key ground lease terms include:

- Tenant (Sears) holds renewal options to 2053;
- Tenant (Sears) is responsible for taxes and insurance;

- Tenant (Sears) assumes full and sole responsibility for the condition, renovation, operating repair, replacement, maintenance, and management of the premises;
- Tenant (Sears) pays monthly base rent of \$9,629.67 (\$115,556 per year) and additional rent in an unknown amount;
- Tenant (Sears) has right to assign or sublet without Lessor (City) consent;
- Based upon staff's current understanding of the ground lease, in the event of condemnation proceedings for less than the entire premises (i.e. Nicollet Avenue right-of-way), it appears that the operating tenant (Kmart) has the option to decide whether to terminate the lease as to the remainder or leave the lease in full force and effect on the remainder. Leaving it in full force and effect would result in Kmart controlling the remainder development parcels. This understanding may change depending on review of the Option Due Diligence information.

Subject to the review of further documents, the terms of the ground lease appear to weigh heavily in the Tenant's favor. Again, however, this is not clear.

The multilayered ownership of the subject property greatly complicates acquiring 100% of the property ownership interests. Most importantly, is whether Sears/Kmart will be a willing seller. As noted above, Sears/Kmart has said repeatedly and consistently that they wish to remain as tenants on the site. If the City and Kadish sign an Option Agreement and Sears/Kmart is willing to sell all of its interests voluntarily, the City could buy out their lease interests and close on the leased fee estate, either with City financial resources OR timed with the selection of a private redevelopment team to pay the remaining acquisition price. This would leave either the City or a City-approved developer as the sole owner of the property, fully unencumbered. In this scenario staff would return to the City Council for authorization to exercise the Option Agreement and purchase the property with City funds or with a development partner.

At this time, the City has not received any indication that Sears/Kmart is interested in negotiating a voluntary sale. However, staff is not requesting condemnation authority at this time and it is not clear whether or not condemnation is feasible under any reasonable scenario. If, in the future, condemnation becomes a prudent course of action for the City, staff will evaluate that option and seek additional authorization from the City Council.

If Sears/Kmart is not willing to voluntarily sell its interests, the City could still choose to exercise the option to purchase the leased fee estate from Mr. Kadish to become the ground lease landlord with Sears/Kmart. After which, the City could continue to work to negotiate to acquire the leaseholds willingly from Sears/Kmart. As the landlord, the City will have a direct line of communication to Sears/Kmart, which may make negotiations easier, but Sears/Kmart cannot be forced to discuss their future intentions on the property nor their price for their interests, and indeed, they have said consistently that they wish to remain as a tenant on the site. If Sears/Kmart chooses to continue with business as usual and not negotiate a sale, there may be no reasonable alternative but to wait until Sears/Kmart chooses not to renew the leases (2023, 2033, or 2043) or the leases expire (2053).

### **Funding Source**

While both properties are physically located within the City's Common Project, the Lake and Nicollet Redevelopment Plan ("Redevelopment Plan") is currently not incorporated into the Common Project. Therefore, tax increment from the Common Project cannot currently be used for acquisition of the properties. However, a modification to the Common Project and Redevelopment Plan will be presented for City Council review and approval that will incorporate the Redevelopment Plan into the Common Project. If the modification is approved, tax increment from the Common Project will then be eligible to provide the final funding source for the purchase price and related costs of the Grocery Site and the option price and related costs on the Kmart Site. To facilitate the real estate closing in December, the Development Account (Fund 01SDA) would provide a temporary source of funding.

As of November 2015, there is approximately \$10.0 million in uncommitted funds in the Development Account available for this temporary purpose. Approximately \$4.9 million is recommended to be used in the Mayor's 2016 Recommended Budget. Upon approval of the Common Project and Redevelopment Plan modifications, it is recommended that the Development Account funding be replaced with tax increment from the Common Project. By the end of the year there will be approximately \$15 million in uncommitted Common Project funds on hand that are available for eligible uses.

**Financial Review:**

**Additional appropriation required.**

**30 West Lake Street:**

Authorize the appropriation of up to \$5,375,000 in the Development Account fund (01SDA) for the purchase price (\$5,275,000) and all associated due diligence and closing costs (\$100,000) from the available fund balance as a temporary source until the City Council approves the modification to the Common Project and Redevelopment Plan, at which time tax increment of the Common Project will reimburse the Development Account fund.

**10 West Lake Street:**

Authorize the appropriation of up to \$900,000 in the Development Account fund (01SDA) for the option price (\$800,000) and all associated due diligence costs (\$100,000) from the available fund balance as a temporary source until the City Council approves the modification to the Common Project and Redevelopment Plan, at which time tax increment of the Common Project will reimburse the Development Account fund.

Fund 01SDA / Department 8900320

**Future budget impact anticipated.**

Monthly rent of \$7,550.51 received from SuperValu under the lease for the Grocery Site will be deposited to the Common Project – Uncertified Area (Fund 01CAZ) contingent upon approval of the plan modification described above. Additionally, since it is currently not known how long the City will retain ownership of the Grocery Site, whether the City will exercise the Option Agreement on the Kmart Site, or how the \$7.2 million acquisition price of the leased fee estate will be funded, it should be assumed that the \$6,275,000 in City funds described above will not be reimbursed in the near future and will not be available for other projects and purposes.

**Approved by the Permanent Review Committee.**

**Meets Small and Underutilized Business Program goals.**

**Attachments:**

1. Purchase Agreement between Public Markets, Incorporated and the City of Minneapolis for 30 West Lake Street
2. Area map