



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

Date: May 2, 2006

To: Council Member Lisa Goodman, Community Development Committee

Subject: Amendment to terms of \$1.25 million loan to 2700 East Lake LLC (Coliseum Building)

Recommendation: Staff recommends that principal and interest payments be deferred for an additional four months and then interest only payments be made for twelve months to accommodate a lower than projected building cash flow.

Previous Directives: **November 1999**, City Council approval of \$625,000 Commercial Corridor Loan. **June 2000**, City Council approval of the Redevelopment Plan and Tax Increment Plan for 2700 East Lake Street. **October 2000**, City Council approval of the Coliseum Financing Plan including Empowerment Zone funds. **August 2001**, approval of sewer access payment. **November 2001**, City Council approval of additional \$250,000 Commercial Corridor Loan. **March 2003**, MCDA Executive Director approval of loan subordination to accommodate new, higher first mortgage amount and reduction in the TIF note interest rate from 10% to 5%.

Prepared by: Susan Thompson, Business Finance **Phone:** x5232

Approved by: Chuck Lutz, Deputy Director CPED _____

Permanent Review Committee (PRC) Approval Not Applicable X

Presenter in Committee: Susan Thompson, Business Finance

Financial Impact (Check those that apply)

- No financial impact (If checked, go directly to Background/Supporting Information).
- Action requires an appropriation increase to the Capital Budget or Operating Budget.
- Action provides increased revenue for appropriation increase.
- Action requires use of contingency or reserves.
- Business Plan: Action is within the plan. Action requires a change to plan.
- Other financial impact (Explain): Revenue will be deferred but not reduced
- Request provided to department's finance contact when provided to the Committee Coordinator.

Community Impact (use any categories that apply)

Neighborhood Notification: April 19, 2006. A portion of the loan is Longfellow NRP Funds

City Goals: The amendment to the terms of the loan to the Coliseum Building is consistent with the goals of maintaining the infrastructure of the City's services and in promoting community and private partnerships to support strong communities.

Comprehensive Plan: The existing Coliseum Building is in compliance with the policies of the Minneapolis Plan.

Zoning Code: The existing building is in compliance.

Other: N/A

Background/Supporting Information:

The Coliseum Building, at 2700 East Lake Street in the ninth Ward, was purchased by Fred Lehmann, 2700 East Lake Street LLC, in December 2000. The building is a three-story, 77,000 square foot brick structure built in 1917. The total project cost of acquisition and rehab exceeded \$5 million. Current tenants include Denny's Restaurant, Chicanos Latinos Unidos in Servicio (CLUES), La Clinica, and small professional services offices. Originally, the Minneapolis Police Department was a tenant in the basement but canceled their lease in 2001, shortly after they moved in, due to a moisture problem.

Financing Overview

Original financing terms, originated in **December, 2001**:

First Mortgage:	\$2,321,627 (To be taken out by CRF upon construction completion)
TIF Note:	920,000 (\$1.1 million placed with a consortium of 5 area banks, 10%)
Commercial Corridors (CPED):	625,000 (4%, 20 years, no payments for 5 years, interest accrued)
Longfellow NRP:	325,000 (4%, 20 years, no payments for 5 years, interest accrued)
Empowerment Zone:	<u>300,000</u> (4%, 20 years, no payments for 5 years, interest accrued)
Total:	\$4,466,627

Refinance in **April, 2003**:

The project ran into significant cost over runs, partly due to the area ways under Lake Street. Originally, the Police Department occupied the basement level. However, the area way caused a moisture leak into the basement and the Department complained of mold and climate issues. Lehmann tried to remedy the problem through several construction amendments but, in the end, the problem could not be remedied to the Police Department's satisfaction and they cancelled their lease. This loss of rental income (projected to be \$90K+ in year one) and other cost over runs, prevented the Community Reinvestment Fund from taking out the construction financing as planned and prompted Lehmann to seek alternative first mortgage financing. Lehmann refinanced with American Bank and CPED subordinated to the new first mortgage of \$3,470,000. In addition, as an acknowledgment of lower property tax revenue due to property tax compression, the City reduced the TIF note interest rate from 10% to 5%. All other loan terms remained the same and repayments on the public financing were set to begin in June, 2006.

Current Financial Status:

In 2005, the building ran an operating loss but was in a positive cash flow position. The project is current on all financial obligations. However, the following events are all happening in the next 6 months which have the capacity to effect the building cash flow:

- First mortgage balance of \$3.2 million matures on April 15th, 2006.

- The CPED loan balance of \$1.5 million (\$1.25 million plus \$250,000 in 5 years of accrued interest) is scheduled to start repayment on June 26th.
- Two major tenants' leases expire on August 31st.
- Lake Street construction including the area way (which affects the ability to lease the basement) is supposed to begin in May.

When the developer began negotiations with American Bank for an extension or renewal of the first mortgage loan, the Bank was unwilling to do so without some forbearance on the CPED loan, due to pending lease renewals and the Lake Street reconstruction. After reviewing several cash flow scenarios and participation in negotiations with the bank, developer, leasing agent (Master Development), the property management company (Facility Management Partners, McGough Construction's property management division) and CPED, the bank agreed to a six month loan extension (October 15th) contingent on the following amendment in CPED loan terms:

Principal and Interest deferral for four months (June – September) to coincide with the Bank extension, interest continues to accrue, and interest only for a period of 12 months Full principal and interest payments to begin in October, 2007.

The extension and deferral until October, 2006 allows the developer to finalize the leases and potentially get the area way construction started (this is dependent on public works timeline). The interest only provision should see the project through to the completion of the major portion of the area way and street reconstruction, removing barriers to marketability of the basement and third floor spaces, as well as provide them with an operating and capital reserve during the construction period.

The building was appraised at approximately \$4.55 million at the time of closing in 2000, assuming the income approach, which included approximately \$100,000/year from the Police Department. The current tax assessed value is \$3,275,000. Because the building is not currently fully leased and the street is about to be torn up in both the front and side, there is reason to believe that the current value is less than the original appraised value. The CPED loan to value ratio based on the assessors "market value" and including the senior debt (\$3.2 million American Bank, \$1.040K Associated Bank/TIF and \$1.5 million CPED/NRP/EZ) is 175%.

Conclusion:

Overall, the finance plan is dependent on fully leasing the building. The payment deferral and interest only payments will allow the project to stay in a positive cash flow position and therefore, increase the success of the project. There is both a professional leasing company and property management company in place. The professional management should increase the chance of success as well. If they are unsuccessful leasing and default on the first mortgage, there is not enough value at this time to be paid in full from the sale of the building. Therefore, we recommend the changes to the repayment schedule.