

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

**Date:** March 31, 2009

**To:** Council Member Lisa Goodman, Chair, Community Development Committee

**Referral to:** Council Member Paul Ostrow, Chair, Ways and Means Committee

**Subject:** Great Streets Gap Financing Loan;  
\$200,000 to ADC Commercial Real Estate, Inc.;  
Purchase and Redevelopment of an Existing Building at 1927-29 S 5<sup>th</sup> Street

### Recommendation:

- a) Authorize a \$200,000 Great Streets Gap Financing Loan to ADC Commercial Real Estate, Inc., a real estate entity controlled by the African Development Center (ADC), for the purchase and redevelopment of the property at 1927-29 S 5<sup>th</sup> Street and authorize the appropriate City staff to execute the loan agreement and any related documents;
- b) Amend the 2009 General Appropriation Resolution by increasing the appropriations in the Community Planning and Economic Development agency funds.
  - 1) 01CPZ – Common Project Reserve Fund (01CPZ-8900320) by \$200,000 from available fund balance; and
  - 2) 01CAZ – Common Project - Uncertified Fund (01CAZ-8900320) by \$200,000; and,
- c) Increase the 2008 Revenue Budget for the Community Planning and Economic Development agency Fund 01CAZ – Common Project - Uncertified Fund (01CAZ-8900900-382801) by \$200,000.

**Previous Directives:** There have not been any previous directives related to ADC Commercial Real Estate, Inc. The African Development Center (ADC) has no loan history with the City of Minneapolis but this organization does partner with the City to administer its Alternative Financing Program and has been awarded a business district support grant and a contract to administer a façade improvement grant through the Great Streets Program.

### Department Information

Prepared by: Judy Cedar, Senior Project Coordinator (612-673-5025)

Approved by: Catherine A. Polasky, Director of Econ. Dev. \_\_\_\_\_

Charles T. Lutz, Deputy Director \_\_\_\_\_

Presenter in Committee: Judy Cedar

### Financial Impact

None - Common Project funds are allocated to the Great Streets Program.

### Community Impact

- Neighborhood Notification: The West Bank Community Coalition (WBCC) and the West Bank Business Association (WBBA) were notified of this loan application March 2, 2009. ADC will make a presentation to the neighborhood group March 11, 2009 and to the business association on March 19, 2009.
- City Goals: Connected communities and One Minneapolis

- Sustainability Targets: Approval of this loan helps support efficient growth by reuse of a vacant building within Cedar Riverside.
- Comprehensive Plan: 4.4 Minneapolis will continue to provide a wide range of goods and services for city residents, to promote employment opportunities, to encourage the use and adaptive reuse of existing commercial buildings, and to maintain and improve compatibility with surrounding areas.
- Zoning Code: Project will comply with zoning.
- Other: Living Wage and Job Linkage requirements apply.

African Development Center (ADC) has applied for a Great Streets Gap Financing Loan of \$200,000 (total project costs estimated at \$1,522,250) for a project in Cedar Riverside. ADC intends to purchase and rehabilitate the buildings at 1927-1929 South 5<sup>th</sup> Street (the former North Country Co-op and office buildings). Sources of funding, besides the Great Streets gap financing, include private financing using New Markets Tax Credit investment, a 2% loan from the City, developer equity, and a Great Streets façade grant.

### **Project Summary**

Applicant for City Financial Assistance: ADC Commercial Real Estate, Inc., a real estate entity controlled by the African Development Center (ADC), for the purchase and redevelopment of the property at 1927-29 S 5<sup>th</sup> Street

Loan Request: \$200,000 Great Streets Gap Financing; Seven (7) year term of interest-only payments coinciding with the term of the private financing, with a balloon payment of principal in year 7; initial four percent (4%) interest rate.

Property Address and Seller: 1927-1929 South 5<sup>th</sup> Street owned by North Country Co-op in Cedar Riverside Neighborhood, Ward 2

Background Info on the Property: The primary building, at 1929 South 5<sup>th</sup> Street, is a one-story, masonry building built in 1926 and measures 66.10 feet x 99.73 feet, containing 6,592 square feet. The structure was built for an ice cream factory. Most recently, this building is vacant and unused. Adjacent 1927 South 5<sup>th</sup> Street is a two-story expansion. The expansion building measures 36 feet x 68.83 feet and is 2,478 square feet/floor, or 4,956 square feet in total. The two-story addition is an office building that is partially occupied with business tenants. There is no off-street parking associated with these parcels. Total finished area of the two buildings is 11,548 square feet. Total area, including unfinished spaces, is 13,042 square feet. The parcel fronts on 5<sup>th</sup> Street South at 109.12 feet and has a depth of 107 feet along 20<sup>th</sup> Avenue South. The total site area is 11,676 square feet. The exterior of the building is painted concrete block and brick. The City (MCDA) purchased 1927-1929 South 5<sup>th</sup> Street in 1983. MCDA sold the property in 1986 to CSP Partners and also helped to finance, in 1997, a subsequent purchase and rehabilitation of the building by North Country Co-op. The grocery store shut its doors in 2007 with an outstanding balance of \$32,802.77 on the MCDA loan. This debt was not covered as part of the sale of the property to ADC but the City will be repaid this principal balance if and when the gap financing takes out the bridge loan associated with this \$200,000 loan.

Non-public Lender: Sunrise Community Banks through Midwest Minnesota Community Development Corporation (MMCDC) Investment Fund 4, LLC using a New Markets Tax Credit financing structure.

Use of Funds: Purchase and rehabilitation of the former North Country Co-op building located at 1927 South 5<sup>th</sup> Street to provide for the relocation and expansion of the African Development Center (from 1808 Riverside Avenue also in Ward 2) and continuation of existing lease space at 1927 South 5<sup>th</sup> Street.

Use of Property: In the words of Bamson Fadipe, ADC’s board chair, “I’d like ADC to create a statewide brand not as a nonprofit per se, but as an adult education center, a niche financial institution.” Central to the fulfillment of this vision is a service center building anchored in the heart of the state’s African population and capable of supporting a statewide operation for years to come. The use of the property would include such things as a small deli, office space, conference facilities, workshop classroom spaces, and tenant spaces.

Longer term, the organization plans to redevelop the site for a larger scale mixed-use development project in keeping with goals for density and commercial activity along the Riverside Avenue commercial corridor stated in the recent Cedar Riverside Small Area Plan.

Bridge Loan: The closing for this project occurred on March 3, 2009 using a bridge loan from the seller, North Country Co-op Grocery, as ADC awaits approval of this gap financing request. The closing occurred prior to consideration of this loan request due to a foreclosure proceeding for 1927-1929 South 5<sup>th</sup> Street by North Country Development Fund with a redemption term that ended on March 5, 2009. The seller, North Country Co-op, has an outstanding debt with the City of \$32,802.77, plus interest. This loan is in default; the last payment made was on November 2, 2007, shortly before the grocery went out of business. North Country Co-op has agreed to pay the balance of this City loan when the Co-op’s bridge loan is paid off by ADC using proceeds from the Great Streets loan.

**Company/Borrower**

African Development Center (ADC) is a 501(c) (3) nonprofit organization established in 2004 to provide training, micro-lending, and technical assistance to guide African immigrants and refugees in Minnesota along the path to economic prosperity. Hussein Samatar is the Executive Director and founder of this organization. Prior to the creation of ADC, Mr. Samatar worked as a senior lender for the Neighborhood Development Center and as a commercial lender with Wells Fargo and Northwest Banks.

The organization has experienced rapid growth since its inception in 2004, with revenues growing from \$10,000 to \$850,000 over a four year period of time. ADC maintains a website that includes annual reports, 990 tax forms, and audited financial statements (see [www.adcminnesota.org](http://www.adcminnesota.org)).

ADC has no loan history with the City of Minneapolis. However, the organization partners with the City to administer its Alternative Financing Program, a profit-payment based, Shari compliant small business loan program. The City also granted Great Streets Business Support funds to ADC in 2008 to benefit Cedar Riverside businesses with ADC’s educational and financial consulting programs. Recently, the City Council awarded a contract to the organization to administer a Great Streets façade improvement matching grant program.

**Financing Overview**

The financial package for this project includes the Great Streets Gap Financing, 2% Loans from the City, New Markets Tax Credit (NMTC) financing, a Great Streets Façade Grant, and an equity contribution from ADC. The funding sources total \$1,522,250 with total City participation of \$357,500, or approximately 23%. Of the City funds, only the proposed \$200,000 Great Streets Gap Financing is considered within this report. The 2% Loans are funded by and approved through CPED’s Two Percent (2%) Loan Program. The \$7,500 Great Streets Façade Grant will also be considered separately for consistency with the guidelines of that program.

Sources of Funds	\$	Uses of Funds	\$
NMTC Financing	1,020,000	Purchase Property	815,000

CPED Great Streets Gap Financing*	200,000	Closing and Related Fees	19,743
CPED Great Streets Façade Grant	7,500	2 Yrs DS Reserve Deposit	100,000
CPED 2% Program	150,000	Construction	444,159
ADC Equity	25,000	Construction Financing	25,898
ADC Contribution to Debt Service Reserve	100,000	Contingency	16,367
Tenant Rents during Construction	19,250	ADC Moving Expenses	15,000
Interest on Project Escrow Account	500	Professional Services	43,000
		RE Taxes thru build-out	15,583
		Operating Expenses during Construction	27,500
<b>Total Sources</b>	<b>1,522,250</b>	<b>Total Uses</b>	<b>1,522,250</b>
*Seller is providing a bridge loan to cover the costs of the gap financing. The closing for this project occurred March 3, 2009, and the gap financing is intended to take out the bridge loan from the seller.			

The proposed terms for the Great Streets Gap Financing of \$200,000 include interest-only payments for seven (7) years with a balloon payment of the principal in year 7. The interest rate would initially be four percent (4%) for the first three (3) years and would reset in year four (4) to Prime minus 0.25% with a floor of 4.00%.

The terms of the loan coincide with that of the NMTC financing. The interest-only payments allow ADC to meet the projected debt service coverage ratio covenants from the NMTC lenders. Since the interest rate for the NMTC financing is expected to reset in year four (4), the interest rate for Great Streets Gap financing would also reset to maintain the interest rate spread between the two loans.

ADC is in the process of developing a capital campaign strategy and has convened a committee of community and philanthropic leaders to oversee that campaign. The goal is to raise \$5-6 Million to pay for this, Phase I, of ADC's project and to provide funding for Phase II (which consists of the redevelopment of 1927 South 5<sup>th</sup> Street site). ADC has expressed the intention to pay off principal of the Great Streets Gap Financing prior to the year seven (7) balloon payment, depending on the success of ADC's capital campaign. Fifty percent (50%) of all capital campaign monies raised in a year would be pledged against the principal outstanding on the Great Streets Gap Financing. Subsequent interest-only payments would be adjusted accordingly. Another 25% of the Capital Campaign funds will be used toward the repayment of the 2% loan of \$150,000. The remaining 25% will be held in reserve for the larger Phase II development project that ADC envisions for the site. ADC will provide CPED financial statements each year that show the results of their capital campaign.

The NMTC financing is provided by the Sunrise Community Banks – including Park Midway, Franklin and University Banks – in cooperation with Midwest Minnesota Community Development Corporation. Sunrise Community Banks are providing approximately \$806,000 in loans that leverage NMTC investment for a total NMTC loan amount to ADC of \$1,020,000. The NMTC financing requires interest-only payments for a period of seven (7) years and will have an interest rate of 4.967% for the first three years, which reflects the blended rate between the Sunrise Community Banks loan and the NMTC investment. The interest rate on the Sunrise Community Bank portion of the NMTC loan will reset from

5.25% to Prime plus three quarters percent (0.75%) in years four (4) through seven (7) with a floor of 5.25%. A portion of the NMTC loan, approximately \$806,000, is expected to be refinanced in year 7. The remainder of the NMTC principal, approximately \$273,000, is expected to be forgiven because of the subsidy provided by the New Markets Tax Credit investment.

### **Guarantors**

There are no guarantors beyond the capacity of ADC to cover debt. Sunrise Community Banks has required a reserve of two years worth of debt service on the NMTC financing portion. The banks are also requiring ADC to maintain a loan loss reserve to cover potential bad loan write-offs (15% of loan values) initially set at \$30,000.

### **Collateral**

The City is subordinate to Sunrise Community Banks for repayment of mortgage in the case of foreclosure. An appraisal from October of 2008 shows an opinion of market value of \$1,030,000. The after construction value is estimated at \$1,400,000. A promissory note and mortgage will be executed in exchange for the Great Streets \$200,000 loan with subordination to the mortgages of the NMTC financing in the amount of \$1,170,000 (including the 2% loan amount of \$150,000).

### **Risk Assessment and Discussion of Development Finance Committee Review**

The greatest strength of ADC is this nonprofit's services and support to immigrants and refugees from Africa. The organization offers loans, financial classes and one-on-one consulting to immigrants wishing to start a business or purchase a home. This project will allow ADC to expand and significantly increase their visibility in the Cedar-Riverside neighborhood from a tucked-away upper floor office to a prominent ground floor corner. Increased space and visibility will anchor the organization in Cedar Riverside and enable ADC to serve a greater number of clients from the Minneapolis area. Also, the project will rehabilitate and occupy a building in the Cedar Riverside neighborhood that is currently vacant.

From a financial perspective, providing the Great Streets loan to the project carries some risk to the City. In its review, the Development Finance Committee identified seven concerns. The following addresses each of these concerns:

- **Lack of Equity** – In addition to a small equity investment of \$25,000 directly to the property acquisition at closing, ADC has deposited additional equity of \$100,000 into a reserve account with the bank, equivalent to two years of primary debt-service. This represents an 8% equity investment into the project. At the conclusion of the seven year, interest-only period of time, the New Markets Tax Credits will be forgiven, in part, thus reducing the amount of debt and increasing the amount of equity by 18%. ADC plans to raise additional equity and pay down debt to the City through capital campaign contributions. ADC proposes to use 50% of all capital campaign revenues each year to reduce the principal owing on the Great Streets gap financing loan. As the principal is paid down, ADC's equity will increase.
- **Structure for Capital Campaign Lacking** – ADC has hired Smith Partners to develop a capital campaign strategy, and has convened a campaign committee comprised of community and philanthropic leaders. The committee will solicit a capital campaign manager through an RFP process, to be on contract summer 2009. ADC has demonstrated its ability to raise significant grant funds for their operational costs and feels confident that their capital campaign efforts will be successful.
- **Full Occupancy of Lease Space Risk** – ADC allows for a 5% vacancy rate in their proforma. Because of our economy, office vacancy rates are much higher, in general. The current vacancy rate is higher due to the closure of the grocery store and the lack of maintenance as a result. ADC believes that they will have no problems finding occupants for full occupancy of the office spaces at 1927 South 5<sup>th</sup>

Street due to high demand in the Somali community for the office rental space. The organization has four deli & coffee shop businesses who are interested in the deli space at 1929 South 5<sup>th</sup> Street. ADC also intends to hire a property management firm (Mutual Management) that is located right across the street and has a representative who is able to communicate effectively with ADC's clients. ADC feels confident that many of their business clients (25-30) will be interested in leasing office space at this location.

- Tax Exemption Status - ADC intends to file for tax exempt status and this would help with their cash flow. It is not clear if ADC could achieve total tax exemption (due to the income-producing revenue spaces) or when they might achieve tax exempt status. Therefore, ADC has submitted a proforma (attached) that shows cash flow with ADC paying real estate taxes on the property.
- Proforma does not reflect year zero – The construction phase of the project (year zero) is not included in the proforma reviewed by the DFC so it is unclear how debt will be covered during construction and lease up. ADC intends to lease up the office spaces as they are remodeled to allow for an increase in occupancy and revenues over the construction phase of the project. ADC submitted a revised proforma that shows cash flow during construction (attached).
- No security for the loan – The City is in a subordinate position to Sunrise Community Banks for this project. There is insufficient equity in the project over the next seven years to demonstrate that the City loan would be repaid in second position to the banks. Again, ADC fully intends to pay down the principal on this Great Streets loan over the next seven years by using capital campaign funds. They are unable to commit to regular principal payments, however. The City will receive a report of their campaign funds each year and 50% of those funds will be used to pay down principal. The primary private lender is requiring the organization to obtain a "key person" life insurance policy for Executive Director Hussein Samatar as additional security for their loan. We are exploring the additional costs to the organization to adding the City loans to the policy, and will recommend this route if the costs are not excessive.
- Cash flow issues with bad loan losses – ADC experienced write-offs in 2008 due to bad loans in their loan portfolio. It is possible that they will continue to experience losses due to bad loans, creating issues with debt service coverage for this project. The bank has required a 15% loan loss reserve, or \$30,000, to cover the instance of cash flow issues related to bad loan write-offs going forward. ADC has a portfolio of 110 loans and experienced write offs for three of those last year (less than 3%). The maximum exposure for ADC on each micro loan is \$25,000. The real estate development entity and finances are entirely separate from the organization's loan portfolio.

#### **Attachment**

10-Year Cash Flow Projection – without tax exempt status (enclosed pdf)