



Request for City Council Committee Action from the Department of Community Planning and Economic Development - CPED

Date: November 6, 2007

To: Council Member Lisa Goodman, Community Development Committee
Council Member Paul Ostrow, Ways and Means/Budget Committee

Referral to: Development Finance Committee

Subject: Deferral of Midtown Global Market Bridge Loan and new Market Consultant Services Loan

Recommendation: (1) Approve the deferral of the Midtown Global Market Bridge Loan payments as further described in this report. (2) Approve a new, matching \$100,000 Market Consultant Services Loan as further described in this report. (3) Increase the 2007 appropriation in Fund FNA0 (Neighborhood Development Account) by \$100,000 from fund balance. (4) Authorize the execution of necessary documents.

Previous Directives: (1) On August 19, 2005, the City Council approved a \$2 million bridge loan to NDC REDI II LLC, for the acquisition and construction of the Midtown Global Market, a component of the Midtown Exchange redevelopment. The terms of the loan include a 2% annual interest rate with interest only payments through 2007 (approximately 30 months) and 30-year amortization thereafter, maturing with a balloon payment in 2012 at the end of the New Markets Tax Credit (NMTC) period.

Prepared by: Rebecca Brown, Project Coordinator, 673-5018

Approved by: Charles T. Lutz, Deputy Director _____

Presenter in Committee: Rebecca Brown

Financial Impact

- Action requires a \$100,000 appropriation increase to the Capital Budget
- Other financial impact: delay of loan repayment
- Action is within the Business Plan

Community Impact

Neighborhood Notification: NA

City Goals: One Minneapolis * Connected communities * A premier destination

Sustainability Targets: Economically vibrant neighborhood commercial districts such as Lake Street, create attractive urban neighborhoods for infill development, support efficient growth, and reduce the need for car travel to obtain necessary goods and services.

Comprehensive Plan: 1.1 Promote opportunities and activities that allow neighbors and residents to get to know each other better
1.2 Encourage both private and public development that provides gathering spaces in city neighborhoods
1.8 Take steps to eliminate discrimination against protected classes and promote a wider understanding of the value of diversity in our community
2.8 Develop the existing economic base by emphasizing business retention and expansion
2.9 Strengthen long-term confidence in the economy by building innovative public to private sector partnerships
4.1 Encourage reinvestment along major corridors
4.3 Encourage redevelopment on Commercial Corridor that enhances street character and expands the range of good and services offered
4.4 Provide a wide range of goods and service for city residents, to promote employment opportunities, encourage the use and adaptive reuse of existing commercial buildings, and to maintain and improve compatibility with surrounding areas

Zoning Code: NA

Living Wage/Business Subsidy Agreement: Exempt

Job Linkage: Extension of Original Bridge Loan Agreement

Loan Background

As planning for the Midtown Global Market (MGM) progressed in 2005, there was a financing gap. The Neighborhood Development Center, lead developer of the market, approached the City to assist in filling the gap. The City stepped in with a \$2.0 million Bridge Loan, \$1 million from the Neighborhood Development Account and \$1 million from the Residential Finance Program. Without this Bridge Loan, the Midtown Global Market project would likely not have moved forward.

The Bridge Loan closed on September 20, 2005, with the following terms:

- Annual interest rate: 2%
- Interest-only quarterly payments through 2007 (approximately 30 months)
- Principal and interest payment schedule based upon a 20-year amortization schedule and the outstanding principal balance as of January 1, 2008.
- Maturity: Balloon payment of remaining outstanding balance due September 2012 (end of the New Markets Tax Credit period)

City staff and MGM management anticipated that repayment of the Bridge Loan would come from a \$2.7 million federal Economic Development Administration (EDA) grant. If the EDA grant was not secured, the bridge loan was to be repaid through other fundraising sources and net operating income from the project. The project did not receive the EDA grant, and the market has been able to secure only \$900,000 in fundraising to lower the outstanding Bridge Loan principal to \$1.1 million.

Supporting Information

The Midtown Global Market is a groundbreaking project that brings new immigrant and long-standing businesses together in a dynamic, global atmosphere. Opening May 16, 2006, the Midtown Global Market now features 48 local entrepreneurs, selling ethnic foods, specialty

groceries, and arts and crafts. In August 2007, the market was 81 percent leased. Twenty percent are business startups while 60 percent are second-step businesses with another location in Minneapolis or St. Paul. Ninety percent of the entrepreneurs are people of color, and nearly 90 percent are low- or moderate-income residents of Minneapolis or St. Paul. The 48 businesses employ over 200 people. MGM has an average 3,600 customer visits each day.

Four not-for-profit organizations are members of the entity that owns the market: the Neighborhood Development Center (NDC), African Development Center, Latino Economic Development Center, and Phillips Powderhorn Cultural Wellness Center. The owner-member organizations and MGM staff have worked hard to ensure the market's success from the beginning, and they continue to push for improvements and progress. In the first year of operation, the market opened on time in the face of a tight schedule, met challenging goals for diversity of tenants, and provided financing and technical assistance to help tenants get started. They have accomplished much in the first year and have secured strong tenant involvement, which will advance the successful implementation of new improvement strategies for the future.

Substantial planning went into creating the idea, vision, and financial proforma for the market. When making projections for the market's financials, market staff used what was considered a conservative estimate of \$12 million in annual sales to calculate rent thresholds. During the first eight months the market was open, vendors generated \$4.2 million in gross sales- \$3.8 million below the amount needed to average \$1 million per month for \$12 million in the first year. Low sales are one reason why some market vendors have been unable to pay original rents and why market management issued rent reductions. MGM issued 25 percent rent reductions to grocery tenants and 15 percent to non-grocery tenants. Grocery stores received larger reductions for several reasons. In typical shopping centers, grocery tenants pay less per square foot as anchor tenants. They generate larger customer counts and initiate more frequent visits to the market. In addition, they have smaller profit margins than other retail establishments because they need larger sales figures to earn a similar profit.

With rent reductions in place, the market has had less revenue for paying operating expenses and debt service. The chart below shows the price changes from the original rents to the reduced rents.¹

Chart 1: Comparisons of Monthly Charges for Rent and Common Area Maintenance (CAM)

| | August 2006 | | August 2007 | |
|----------------------------|---------------------------|---------------------------|---------------------------|---------------------------|
| | MGM (grocery space) | MGM (cooking space) | MGM (grocery space) | MGM (cooking space) |
| Base Rent & CAM | \$20.44/sq ft | \$24.44/sq ft | \$14.35/sq ft | \$20.26/sq ft |

The base rent and Common Area Maintenance charges on Lake Street, from the Mississippi river to the lakes, vary from \$8 to \$31 per square foot. Recently rents in the area near Chicago Avenue and Lake Street are between \$17 and \$19 (Lake Street Council).

Recent Activity

This past May, the market staff, owner organizations, and board members began working with consultants on an *Eighteen Month Strategic Plan* to help the market reach self-sufficiency in the

¹ The prices per square foot do not include hood operating charges for cooking spaces and will vary for spaces that are both non-cooking and non-grocery.

coming years. The McKnight Foundation contributed grant funds to pay for the plan. Part of the contribution for the strategic plan included visits from two public market experts: David O'Neil from Reading Terminal in Philadelphia and Colleen Welsh from Granville Island Public Market in Vancouver. Their insights are valuable contributions to the work and knowledge of the market board and staff (see Exhibit D).

The key strategies incorporated into the Strategic Plan, for improving market sales, include:

- Implement extensive improvements to improve customer experience, from the first to the last impression – including parking, exterior appearance, merchandising, customer service, way finding, et cetera
- By 2009 achieve tenant mix of: 50 percent Grocery & Fresh Food, 35 percent Food Service, 15 percent Gifts and Apparel from Around the World. This doubles the space dedicated to fresh and specialty foods in the ethnic and locally-grown categories, adding more variety and competition to the market *(Currently the market is expanding existing tenants that fit this direction and plan to lease to additional tenants that fit the desired mix. Farm in the Market is expanding from one stall to three, Jakeenos Italian Deli is doubling their square footage, and Holy Land Deli and Grocery is adding 800 square feet for a new halal butcher.)*
- Improve tracking and analysis of customer and sales data
- Provide group and individual business assistance to tenants as needed to improve management, merchandizing, size of space and other factors necessary to improve profitability. Consider group methods to lower tenant's cost of business.
- Seek ways to improve function of board and management as needed
- Develop vibrant outside public space that invites neighborhood into market
- Develop marketing strategies for the grocery audience, including business campuses, local residents, and building residents

In the past few months, market management has already begun to implement cost-cutting measures to lower their operating expenses. They negotiated three years of interest forgiveness on a U.S. Bank EQ2 loan, a more favorable maintenance contract, and consolidated operating expenses from their LISC New Markets Tax Credits Community Development Entities. They also laid off their part-time marketing coordinator to begin cutting marketing costs by 50 percent for 2008. They are decreasing marketing costs in part because daily customer visits to the market have been higher than projected, but sales per customer are lower. One reason may be because the market is considered more of an event and entertainment venue or restaurant and food court than a true public market, where the majority of space is dedicated to fresh food sales.

Public markets across the nation are adamant that they succeed because of their fresh food vendors. Fresh foods attract regular customers who come to buy. Market management is confident that shifting the focus and emphasis to fresh foods and improving customer experience will help the Midtown Global Market become a frequent grocery stop. In the immediate vicinity of the market are many potential customers. There are about 1,800 employees in the Midtown Exchange Complex, 9,322 residents within a ½-mile of the market, and 44,332 residents within 1 mile (2000 U.S. Census).

By switching to majority fresh foods, they expect the Midtown Global Market will begin to reflect the sales per customer figures other public markets report. The market is reaching for approximately \$300 - \$400 in sales per square foot; a figure that is significantly less than larger more established public markets.

Requests for Financial Assistance

The Midtown Global Market is requesting financial assistance from many different entities. During this tight financial situation, as the market works through the start-up years, they are requesting assistance from seven philanthropic institutions and private individuals, as well as their private lenders: U.S. Bank and Wells Fargo. The Minnesota State Legislature authorized a \$1.1 million grant to the market for assistance necessary to retain minority business enterprises. The funds will be split, \$700,000 for debt payments and \$400,000 for strategic rent reductions and build-out of key fresh food spaces. Market customers will benefit from a \$700,000 grant from Hennepin County for a validated parking system.

MGM requested the following from the City:

- (1) Deferral of existing Bridge Loan payments (\$66,867 per year) and
- (2) A new \$300,000 recourse loan to the Neighborhood Development Center to provide professional consulting services to the market

In regards to the second request, the Neighborhood Development Center has hired Mr. John Wheeler, former President of the Mall of America, as the organization's Real Estate Director to provide professional consulting services to the market. MGM will contract with NDC for his professional services and expertise to help ensure the successful implementation of new strategies to increase sales, rent collections, and leasing, as well as strengthen the market management team.

Mr. Wheeler has over 30 years of experience in real estate development and management, 18 years with the Mall of America. He will bring support to the management team by emphasizing and overseeing the implementation of the new strategic direction, developing the management team to carry out the strategies, and being a key component in problem solving. He has significant experience in each of these areas, as well as in managing security, changing perceptions of security, and expanding trade areas through improved focus on target markets. He was Midtown Global Market Board member before being hired and as such, was actively involved in formulating and planning the new strategies. The Neighborhood Development Center expects 80 to 95 percent of Mr. Wheeler's time to be spent at MGM for the first four months of his contract in 2007 and 2008. In 2009, his time is expected to diminish at MGM.

Staff Recommendation

Bridge Loan

The original Bridge Loan matured with a balloon payment in September 2012, which is the end of the New Markets Tax Credit period when all equity investments and debt will be refinanced. Given the unique nature of the project, inclusion of New Markets Tax Credits, and limited history of operating revenue and expenses, it is reasonable to keep the balloon payment date consistent with the original terms. The City entered the loan agreement as a short-term lender, bridging a gap until further funding was secured. By keeping the balloon payment, the City remains a short-term lender, and when the balloon is due, the market will have five more years of history to inform a decision on future repayment.

In literature on public markets, experts are clear that public markets require public and foundation support to cover start-up costs, but once operational markets are expected to become self-sufficient. The Midtown Global Market did not begin with enough support to cover their start-up costs. In fact, they opened with \$6.6 million in long-term debt. In less than one year, the market has made significant payments to reduce the outstanding balance to \$3.7 million, with an additional \$472,500 payment scheduled for September 2007. None of these payments, however, came from operating revenue. All payments were from fundraising sources.

Staff proposes the following terms for restructuring the Bridge Loan (Exhibit A):

- Defer principal and interest payments from January 1, 2008 to October 1, 2012, with 2% interest accruing
- Require a balloon payment of the full principal and interest balance on October 1, 2012

Market Consultant Services Loan

It is important to stress the unique nature and large magnitude of the Midtown Global Market project. Achieving the challenging proforma projections requires the professional expertise of an experienced manager. The Neighborhood Development Center (NDC) has found and seized that expertise by hiring Mr. John Wheeler. Not to aid NDC in funding the assistance needed to nurture the market to self-sufficiency could risk the market failing to meet goals or becoming unable to repay the Bridge Loan.

Staff does not propose funding \$300,000 at the market's request, but does propose \$100,000 to pay for consulting services from John Wheeler, as needed to reach positive cash flow without subsidies. Staff recommends the following terms for the Market Consultant Services Loan (Exhibit B):

- \$100,000 loan to the Neighborhood Development Center (to be matched by fundraising assistance from the Minneapolis Chamber of Commerce)
- 2% interest rate
- Principal and interest payments deferred from October 1, 2007 to October 1, 2012, with 2% interest accruing
- Balloon payment of the full principal and interest balance on October 1, 2012 (to coincide with the refinancing of the Bridge Loan at the end of the New Markets Tax Credit period)

Finance Review

Staff reviewed the market's Projected 5-Year Cash Flow Proforma (Exhibits C1 and C2). The proforma shows the following key numbers (line 80):

- (\$26,000) cash flow with \$795,000 in private and public fundraising in 2007
- \$41,000 cash flow with \$470,000 in private and public fundraising in 2008
- \$106,000 cash flow with \$300,000 in private and public fundraising in 2009
- \$19,000 cash flow with no subsidies in 2010
- \$46,000 cash flow with no subsidies in 2011

These results include contributing a minimum of \$25,000/year to operating/replacement reserves. The market will reach these cash flow goals by achieving the following benchmarks:

1. Rent and CAM revenue will increase by 15% in 2008, 15% in 2009, 12% in 2010, and 11% in 2011.
2. Total sales will increase from \$10.75 million in 2007 to \$13.0 million in 2008 to \$15.6 million in 2009.
3. Occupancy will increase from 80% 2007 to 85% in 2008 to 90% in 2009.
4. Customer counts will increase from 1.3 million in 2007 to 1.4 million in 2008 (an 8% increase) and to 1.5 million in 2009 (5% increase).
5. Sales per visit will increase from \$8.20 in 2007 to \$9.20 in 2008 (12% increase) and to \$10.50 in 2009 (14% increase).

Risk Assessment

In September 2012, two balloon payments are due totaling \$1.32 million. The cash flow proforma does not indicate that the market will have \$1.32 million available to cover the balloon payments in 2012. It does project \$250,000 in net operating income in 2011, but only \$46,000 in

cash flow after debt service is paid (not including any payments on the City Bridge Loan or Market Consultant Services Loan). It is possible that the City will take a long-term lending position in 2012, at the end of the New Markets Tax Credit period when refinancing is required. The proforma supports the market's ability to make some principal and interest payments. A New Markets Tax Credit refinancing has not occurred yet in Minneapolis and how it will unfold is unknown.

Repayment is highly dependent on a number of factors, most notably the aggressive benchmarks for revenues, sales, occupancy, and customer counts listed above. Whether the market is able to reach the benchmarks will depend on how successfully the market implements the new strategies.

Given the importance of implementing the new strategies, requiring payments on the Bridge Loan in the next few years creates a risk of accepting debt payments that otherwise could be directed to improving the implementation of the new strategies. In addition, without the Market Consultant Services Loan to pay for expert consultant services, the likelihood of successfully implementing the strategies and achieving the benchmarks will drop sharply and the further diminish the market's future ability to pay back either loan.

Public Benefits

The Midtown Global Market provides many social and economic benefits. The market gives the community in the Chicago-Lake area additional opportunities to earn money and spend money within their local economy by promoting entrepreneurship; creating jobs for the area workforce; and providing quality food, needed services, and amenities. The market also serves as a public gathering space, welcoming the diverse community that lives in nearby neighborhoods. Since the market opened, it has also had positive impacts on the perception of safety in the area and the actual crime rate.

Conclusion

The Midtown Global Market is an incredible new asset for south central Minneapolis. The market is also unique in its size, scale, mission, and timing, which together makes the market an untested concept in the nation. As the market matures in the start-up years, many of the first projections are changing and the market is working to adapt to the unexpected. By having an experienced, private-sector real estate professional working with the market, the possibility for future success is expanded. The deferral of Bridge Loan and Market Consultant Services Loan payments for five years is another important contribution the City can make to help ensure the Midtown Global Market remains in our community for generations to come.

Exhibits

- A. Bridge Loan Repayment Schedule
- B. Market Consultant Services Loan Repayment Schedule
- C1. Projected 5-Year Cash Flow Proforma
- C2. Projected Revised Master Lease Payment Schedule
- D. Midtown Global Market 2007 – 2009 Strategic Plan