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

Date: September 1, 2009

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

Subject: Grain Belt Office Building Request for Proposals for redevelopment

Recommendation: Direct staff to reopen the Grain Belt Office Building Request for Proposals, issued June 9, 2009, for an additional 30 days, ending October 16, 2009.

Previous Directives: The MCDA Board of Commissioners approved the acquisition of 1215 Marshall Street N.E. on December 17, 1989. In August 2000, the MCDA Board and City Council approved an amendment to the Grain Belt Development Objectives, a modification to the Grain Belt Redevelopment Plan, and an authorization to issue a housing RFP. In February 2001, the MCDA Board selected the Sheridan Development Company LLC (SDC) as the developer of the Grain Belt Housing Project and awarded it six-month development rights. In July 2001, the Board approved a one-year extension of the development rights, and approved additional extensions in July 2002 and in February 2003. On June 2003, the Board approved the finance plan and redevelopment contract terms for Phase I of the Grain Belt Housing Project. On September 26, 2003, the Council adopted the Grain Belt TIF Plan and related Plan modifications. On November 5, 2004, the Council approved an amendment to the redevelopment contract business terms for Phase I of the Grain Belt Housing Project. On December 23, 2005, the Council approved an amendment to the redevelopment contract to extend certain performance deadlines. The Office Building was severed from the Grain Belt Housing Project and an appropriation of $65,000 was approved to cover costs related to issuing a Request for Proposals (RFP). On May 26, 2006, the Council approved the sale of the Phase I housing site to the developer and modified the development timetable in July 2006 but the project was never initiated. In August 2006, the CPED Director authorized the issuance of a Request for Proposals for the Grain Belt Office Building at 1215 Marshall. The selected developer withdrew the Offer to Purchase in May 2007 before a land sale report could be presented to the City Council. A subsequent Invitation to Submit an Offer was issued with a deadline of December 2007, and the City received one proposal from Kristina Oman. City Council rejected a sale to Kristina Oman in May 2009 and directed staff to reissue a Request for Proposals.

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Financial Impact
Action is within the Business Plan

Community Impact
Neighborhood Notification: Sheridan Neighborhood Organization (SNO) reviewed the proposals received in response to the RFP on July 27, 2009. On August 24, 2009, SNO

reviewed a proposal received from an interested party after the deadline specified in the RFP.

City Goals: Connected communities

Sustainability Targets: The eventual sale and reuse of this historic structure helps support efficient growth by reuse of a vacant historic structure within the Minneapolis Brewing Company Historic District. In addition, any developer would be required to abate asbestos, stabilize lead-based paint, and rectify water intrusion that threatens the structural stability of this historic asset.

Comprehensive Plan: Prior to any sale of this parcel, the proposed reuse will be evaluated for consistency with the Comprehensive Plan.

Zoning Code: The parcel is mostly zoned Neighborhood Commercial District C1. The most likely reuse of the historic Office Building is commercial office space and this is permitted under the C1 zoning category. A small area of the parcel (the northeasterly portion) is zoned Residential R-5. A rezoning has been initiated to eliminate the split zoning and to classify the entire parcel as a commercial district.

Living Wage/Business Subsidy Agreement: N/A

Job Linkage: N/A

Other: The rehabilitation and reuse of this structure is subject to Heritage Preservation Commission review. The redevelopment of this structure may also trigger State Historic Preservation Office review should the buyer seek historic tax credits to finance the rehabilitation.

Request for Proposals for the Grain Belt Office Building
The Grain Belt Office Building is part of the 14-acre Grain Belt property acquired by the City in 1989. Following the successful rehabilitation of the larger Brew House and Bottling House, the City initially offered the Office Building for sale with the adjacent vacant parcel for housing redevelopment in 2000. After several failed attempts to sell the entire property for housing development, the 18,991 square foot historic Office Building was separated from the site and a Request for Proposals (RFP) to rehabilitate the building for commercial uses was issued in August 2006. A preferred developer was selected, but withdrew the proposal before a request to authorize the land sale could be brought to the City Council for review.

In December 2007, offers were solicited for the building through an invitation to developers to purchase the property at fair market value, and Kristina Oman offered $400,000 for the property to rehabilitate it as an event and wedding center. This was the sole offer received. In the course of Ms. Oman's due diligence on the property, staff learned that the property had developed serious water infiltration problems. An appraisal by Nicollet Partners that took into account the costly investments the building required to address water infiltration, stormwater treatment and roof deterioration set the fair market value at a negative figure. Given these costs, Ms. Oman revised her offer to $1.00 and staff presented the offer for consideration to the Community Development committee on April 28, 2009 with a recommendation to sell. Expressing concerns with regard to fairness and transparency that the property had not been offered specifically for sale for $1.00 through the original solicitation, the Council rejected the offer to purchase and directed staff to issue a new RFP for the building with a 30-day response period.

The City of Minneapolis issued an RFP for the Grain Belt Office Building on June 9, 2009. As directed by the City Council, the RFP clearly indicated that the City-established Fair Reuse Value (the asking price) is currently $1.00 due to the extraordinary expected costs to rehabilitate the property given the need to address water infiltration issues, replace most if not all of the roof, and to disconnect the site's stormwater from the City sanitary sewer system. In accordance with City Council direction, the RFP was open for a period of 30 days and all proposers were required to demonstrate resources of equity and submit a letter of intent to finance by a lender.

Staff recommends re-opening the RFP for an additional 30 days through October 16, 2009 for reasons articulated below.

The RFP was sent to over 600 developers and was advertised in Finance and Commerce. Proposals were due by July 13, 2009. Two proposals were submitted by this deadline. One from Grainbelt Ballroom LLC (Ballroom) and one from Vesper Development (Vesper).

- Grainbelt Ballroom LLC (Ballroom) submitted a proposal to buy the property for $1.00 and rehabilitate the building as a wedding and event center. The owner and operator would be Kristina Oman. The proposed project budget was $2,000,202 (attached), for a full rehabilitation of the building including addressing water infiltration issues, replacing the roof, abating asbestos and lead paint, and connecting to the City's stormwater system. In accordance with the requirements of the RFP, Oman submitted a letter of intent from Coulee Bank to finance the project up to $2,000,000 (attached). After submitting her proposal, Oman received two construction bids for environmental and water infiltration remediation that pushed the project cost beyond what she believed the proposed use could support. Oman withdrew her proposal in a letter dated July 17, 2009 (attached).

- Vesper Development (Vesper) submitted a proposal to buy the property for $100 and reactivate it for classroom space for Vesper College, an unaccredited environmental architecture school currently located in Southeast Minneapolis. The proposed project budget (attached) of $535,100 for the rehabilitation of the Office Building for reuse by the college and leased office space, users to be determined. Vesper Development is a partnership consisting of Vesper College, Gene P. Tierney, John Oien and Dan Noyes. Vesper submitted a financing proposal letter from Central Bank for a three-year loan of between $350,000 and $450,000 (attached). The proposal does not identify a source for the gap of between $85,000 and $185,000 between the proposed construction costs and the loan amount.

Proposal Review

Staff reviewed the two proposals submitted, additional confidential financial documentation as requested, and the financial status of other properties owned by members of the proposer team within Minneapolis.

Both proposed uses are consistent with the City goals of reactivating the property, preserving the historic fabric of the building and site, returning the property to the tax base and creating jobs. In terms of these goals, both the Ballroom and Vesper proposals are weakest on the job creation component. The jobs created for an event center (caterers, photographers, florists, musicians) are generally part time and relatively low paying. The Vesper proposal did not cite jobs as a public benefit of their proposal.

Financial viability of the end use, financing of the construction, and the level of investment proposed in the property were all key considerations in reviewing the proposals.

The Ballroom proposal appeared to be a viable end use with sound financing and a reasonable level of investment to rehabilitate the property. The proposal acknowledged the need to immediately address water infiltration, stormwater issues, and the roof condition. Staff believes that the cost estimates were slightly low, and this was borne out by the subsequent bids received that resulted in the withdrawal of the Ballroom proposal.

The Vesper proposal does not appear to be viable on any of these points:

1) No demonstrated viability of end uses -
   - The primary user of the building would be Vesper College, with leased office space occupying approximately half of the building (9,000 sq ft). It is not clear how financially viable Vesper College is as an anchor tenant. The school offers an MFA in Environmental Architecture. The proposal states that Vesper College is pursuing accreditation through the National Association of Art and Design. In the United States, most state architecture registration boards require a degree from a professional degree program accredited by the National Architectural Accrediting Board, a different group.
   - Vesper did not provide any market analysis demonstrating the demand for the leased office space, comparables for the proposed lease rates, area or like-property vacancy rates, or any description of how the space might be leased, i.e. to sole proprietors or to one or more companies. The proposal statement of demand states only "The majority of the property will be leased to Vesper College. The balance of the space will be filled with small entities and individuals. The intended theme of the property is sustainability and environmental architecture and we expect significant demand from organizations that work in fields related to that theme."
2) Inadequate construction or long-term financing – As noted above, the proposal included a proposal letter from Central Bank for construction financing through a three-year loan of between $350,000 and $450,000. Not only does the proposal not indicate a source for the $85,000 to $185,000 gap for construction financing, but the operating proforma does not include debt service as an expense and a document calculating "returns" that does include debt service payments assumes a 25-year term on a loan of $450,000, a period significantly longer than a typical commercial real estate loan.
3) Insufficient investment in the building – Vesper proposes an initial investment of $535,100, with $213,000 focused on site drainage mitigation and $100,000 on asbestos and lead paint containment and abatement. The Vesper team does not have demonstrated real estate development experience and it is unclear how the cost estimates were formulated, but they are inconsistent with estimates for certain elements developed by City consultants (these reports were included as attachments to the RFP for the benefit of all interested parties), and the cost estimates provided in the Ballroom proposal. Immediately necessary improvements such as replacing at least sections of the roof are not included in this proposed investment, and are deferred to a Phase 2 at an unspecified period in the future.

The preliminary staff recommendation was to continue to hold the property - though the holding costs exceed $50,000 annually and its condition continues to deteriorate – because the Vesper proposal did not appear viable.

Additional Interest Expressed

Following the staff and neighborhood review of the proposals submitted by Ballroom and Vesper and the withdrawal of the Ballroom proposal, but before a staff report had been prepared for the City Council that would recommend continuing to hold the property, a third party expressed strong interest in the property for use as a flagship corporate headquarters for a renewable energy company. As the recommended result of the RFP process was expected to be to hold the building, the proposed use is precisely the sort of green company with significant jobs that we seek to attract to Minneapolis, and the renewable energy company expressed a desire to learn by August or September whether the City would pursue working with the company on selling the property for redevelopment, CPED management and staff suggested that the company submit a proposal to the City for redevelopment of the property consistent with the requirements of the recent RFP. Curt Hoffman of Owatonna Properties, on behalf of R3 Verdant Technologies (R3 Verdant) submitted a proposal on August 14, 2009.

R3 Verdant Development, a new partnership comprised of R3 Verdant Technologies, Owatonna Properties, DJR Architecture and PCL Construction Services, would own and redevelop the building, and lease to R3 Verdant Technologies (R3), a waste-to-energy company, as the sole tenant. R3 plans to use the building as its corporate headquarters for 30-50 full-time employees.

Founded in 2007, R3 Verdant Technologies plans to develop energy facilities co-located with landfills, which will use anaerobic digestion technologies to process municipal solid waste to produce energy, biofuels, and other reusable byproducts. R3 is currently negotiating a land lease for a site for their first energy facility in the Upper Midwest and negotiating a power purchase agreement with a Midwest utility.

The project budget (attached) indicates an investment of $500,000 for Year 1 immediate construction activities including addressing water infiltration, exterior stabilization, parking lot development, retaining wall and minor interior improvements. Subsequent Year 2 investments of $1,500,000 would be made while the building is occupied. This would include mechanical and electrical, skylight restoration, historic rehabilitation and major renovations to the basement. The initial improvements would be funded by one of the development partners (PCL Construction). According to the proposal, the subsequent improvements would be financed by revenues from operations. Company principals have indicated that the financing for both phases could be provided through a source committed to company start up costs and intend to provide a letter committing to that full investment. The proposal indicated that financing for the company's plants would be provided by National Standard, a venture capital broker based in Atlanta, GA (attached), as an ownership investment with a leaseback structure. That financing is contingent upon securing a Power Purchase Agreement with a utility company to purchase energy produced by R3, or securing a state bonding agreement. R3 is actively engaged in negotiations on both of these fronts.

While an R3 Verdant Technologies corporate headquarters located within the Grain Belt Office Building would be extremely positive for the Grain Belt activity center, rounding out an emerging hub of creative and green business enterprises in the Brew and Bottling Houses, providing additional local market demand for area restaurants and cultural venues, adding 30-50 high-paying professional jobs and restoring the building to its historic splendor, the proposal provided few financial details on the company or the development project, and staff was unable to evaluate the specific uses of funds, the financing structure and feasibility of the project, the adequacy of the project budget, proforma assumptions, or the financial roles and responsibilities of the three principals and the financial intermediary.

The proposal was prepared over a very short period of time (one week), and the development team is still working to assemble cost estimates for the renovation plan. The R3 Verdant Technologies principals favored this expedited proposal submission and review process in order to meet their overall timeline objectives for establishing their company headquarters in the coming months.

There is some risk of losing R3 as a prospect both for the Grain Belt property and Minneapolis generally if the RFP process and timeline are extended, given the company's desire to move quickly on a property acquisition.

Recommendation

In terms of information provided to assess the financial readiness and viability, R3 Verdant and Vesper are roughly equivalent, though the R3 Verdant team has the advantage of greater real estate development experience, better-defined building rehabilitation plans, more jobs on site, a proposed sole anchor tenancy and the purported ability to finance all needed project elements if the company itself is able to move forward with the core business of waste to energy production.

CPED recommends reopening the RFP an additional 30 days (ending October 16, 2009) to allow both Vesper and R3 Verdant additional time to provide information demonstrating financial viability and readiness. This proposed course carries the risk that one or both of the two remaining interested parties will withdraw their proposal or not submit the required additional information. While we do not anticipate that additional interested parties will emerge during this extension, the RFP will formally be open to additional proposals.

Given that proposers appear inclined to phase the building rehabilitation, raising concerns that key rehabilitation elements may be deferred, the RFP will be amended to emphasize a strong preference for a rehabilitation project that is completed within one year of the sale. The RFP will be amended to list construction items required within one year of sale and prior to occupancy:

- rainleader disconnect
- water infiltration remedies
- roof replacement (central section roof is critical)
- abatement and/or stabilization of asbestos, lead-based paint and other environmental hazards
- code compliance (including functional mechanical systems and windows)

Amendments will also make it clear that the $1.00 advertised price of the property is for an "as is" sale, without further City financial participation in addressing concerns with the property (including the stormwater disconnection and possible environmental remediation needs). The fair market value will be re-evaluated and modified by the appraiser in the instance of City financial participation in water infiltration remedies, abatement remedies, stabilization work to the building, or any other City investments in the Office Building Historic Site.

The announcement for the reopening of the RFP for an additional time period will emphasize the importance of detailed information including a workable site plan, the scope of work proposed, sources and uses of funding, a construction budget, evidence of financing commitments, and clearly articulated roles and responsibilities of various partners in the project. Consistent with recent Council direction, the announcement will also require all respondents include a list of all real estate owned (solely or in partnership) within the City of Minneapolis by all individuals within the partnership so staff can evaluate real property tax payment status, frequency of permits pulled related to repairs and improvements of the various properties, and current code violations.

Site Details

The Grain Belt Office Building, located at 1215 Marshall Street in Northeast Minneapolis, is a two-story building built in 1893. In 1910, a one and one-half story addition was constructed using identical materials as the original construction. In 1989, the Minneapolis Community Development Agency purchased 14 acres of the Grain Belt complex, including the Office Building, for $4,850,000. The Council approved Development Objectives for the site in 1996, amended in 2000. The Office Building was initially leased, but been vacant for almost 10 years.

The Office Building is one of seven historic structures within the Minneapolis Brewing Company Historic District that was listed on the National Register of Historic Places in 1990. The six other structures (Brew House, Boiler House, Warehouse, Bottling House, Wagon Shed and Shops) plus the one historic feature (rail spur) are redeveloped and no longer under City of Minneapolis ownership.

The Grain Belt Office Building and parking area (34 spaces) are in the process of being platted as a single parcel distinct from the adjacent vacant land proposed for future multifamily housing development.

Factors Influencing Fair Market Value

Nicollet Partners appraised this property for sale "as is" and determined that it was encumbered by several factors:

- The estimate for abatement of the building (asbestos, lead based paint, tar and mold) is $200,000.
- Drainage issues require significant site grading, including the re-grading of portions of City-owned land adjacent to this purchase site. Extraordinary drainage issues include groundwater seeping up through the basement; surface runoff from outside the site draining towards the building; undersized downstream piping system causing sewer backup and lack of storm sewer infrastructure in Marshall. Estimated costs to treat drainage issues exceed $400,000.
- Limited availability of on-site parking limits the range of commercial uses for the building, or requires a developer or end user to negotiate leased parking access in the area.

The appraisal references information from various sources including:

- a 2008 Loucks Associates assessment of water infiltration,
- a 2006 Groundwater & Environmental Services, Inc. Asbestos and Hazard Survey Report, and
- a 2006 R.J. Rykken Consulting Summary of Environmental Investigations.

The fair market value will be re-evaluated and modified by the appraiser prior to sale authorization to capture changed market conditions and in the instance of City financial participation in water infiltration remedies, abatement remedies, stabilization work to the building, or any other City investments in the property.

Challenges Specific to the Site

The Department of Public Works requires that any sale be contingent upon a Rainleader Disconnect Plan that receives final Project Design Review approval. Stormwater from the building is currently directed into the City's sanitary sewer system. The roof drains must be disconnected before 2010 and discharge onto grade. Window well drains that receive storm water must be disconnected from the sanitary sewer by December 31, 2009 (either by a developer or by the City). Drainage cannot flow over public sidewalk areas.

One issue with a sanitary sewer disconnection plan is that there is not a readily available storm sewer for connection. The closest storm water connection runs along 13th Avenue NE and is 189.05 feet away from the northernmost boundary of the subject parcel. Public Works staff believe that the site's stormwater could potentially be treated on site. CPED and Public Works continue to explore options related to the Rainleader Disconnect Project to find the most efficient and economical remedy.

There is a closed MPCA leak site located on the property, associated with underground fuel tanks south of the building that have been removed. The MPCA recently reopened the file and requested additional testing. Results of these tests are pending.

Property Stewardship
In the event that no viable proposal is forthcoming, CPED staff proposes developing a scope of work to stabilize the building prior to additional offers for sale for redevelopment. Initial estimates indicate that minimal stabilization work will be between $300,000 and $500,000. Ongoing property management costs that do not address the underlying issues or halt the building's deterioration exceed $50,000 annually.

Attachments: Grain Belt site map
Project budgets for Ballroom, Vesper, and R3 Verdant
Financing letters for Ballroom, Vesper, and R3 Verdant
Grainbelt Ballroom proposal withdrawal letter