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

Date: December 13, 2011

To: Council Member Lisa Goodman, Community Development Committee

Subject: Plaza Verde Loan Restructure

Recommendation: Authorize restructuring three loans with NDC REDI, LLC as described in this report and execution of appropriate documents.

Previous Directives: On October 10, 2003, the City Council authorized a $250,000 Empowerment Zone loan to the Neighborhood Development Center for the renovation of 1508 E Lake St, the former Antiques Minnesota building. On May 28, 2004, Council authorized a $250,000 CEDF (CDBG) loan to the Neighborhood Development Center also for the renovation of 1508 E Lake St.

Department Information

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Financial Impact

- Action is within the Business Plan
- Financial Impact: Delays repayment of CEDF/CDBG loan principal and interest payments and shifts balloon payment up 8 years from 2024 to 2016 to coincide with terms of new private financing. Shifts an EZ loan balloon payment, due December 31, 2011, out five years to 2016. Interest will continue to accrue. Increases likelihood of repayment.

Community Impact

- Neighborhood Notification: Informational letter and emails sent to Midtown Phillips Neighborhood
- City Goals: Jobs & Economic Vitality - Strong commercial corridors, thriving business corners
- Comprehensive Plan: 4.1.2 Seek out and implement long-term redevelopment projects that catalyze revitalization and private sector investment. 4.2.5 Encourage small business opportunities, such as appropriate home occupations and business incubators, in order to promote individual entrepreneurs and business formation.
- Living Wage/Job Linkage: NDC signed a Job Linkage Agreement in 2004. They have submitted annual reports from 2005 to 2010, including total employment by vendor, new living wage hires, and Minneapolis resident hires.

Background

In 2004, the Neighborhood Development Center (NDC), in partnership with In the Heart of the Beast Puppet and Mask Theater (HOBT) and the Latino Economic Development Center (LEDC), renovated the Antiques Minnesota building at 1508 East Lake Street into a mixed-use office/retail development known as Plaza Verde. The project returned three floors (34,000 square feet) of office, retail, and event space to active use on one of Minneapolis's busiest commercial corridors. The project also redeveloped an adjacent parking lot.

In 2004, the Antiques Minnesota building was the second largest vacant property in the Midtown Phillips neighborhood, second only to the Sears building, and the shuttered windows and uncontrolled parking lot had dragged down the value, vitality, and growth potential of the intersection and neighborhood for several years. Given its size and prominent location, the property was a high concern among neighborhood groups, residents, and the area business association. At the request of HOBT, NDC acquired the building in December 2003 and began renovation in 2004. Today there are seven small businesses and two nonprofits in the building, providing thirty-nine jobs. Of those 39 jobs, 27 are held by Minneapolis residents.

The Plaza Verde project accomplished many of the goals envisioned, including:

- removal of a blighted building and uncontrolled parking lot that served as a magnet for crime;
- restoration of an historic building that is an integral part of the neighborhood fabric;
- replacement of street level windows to activate the sidewalk;
- establishment of rental space for cultural events, meeting substantial demand in the Latino community;
- opportunity for wealth creation for immigrant entrepreneurs; and
- momentum for a growing Latino commercial district.

The total project cost was $4.26 million dollars. The largest funding source for the project was the infusion of a $1.7 million New Market Tax Credit (NMTC) Equity Investment. The Plaza Verde project was the first NMTC deal completed in the State of Minnesota and among the first in the nation. The chart below lists the private and public financing sources. The public sources came primarily from the City of Minneapolis. The City's investments were a pay-as-you-go, privately financed Tax Increment Finance (TIF) Note; a Community Economic Development Fund (CEDF) CDBG loan; an Empowerment Zone (EZ) loan; and a forgivable Neighborhood Revitalization Plan (NRP) loan from the Midtown Phillips Neighborhood.

Table 1. Original Sources

Equity	**Amount**
Wells Fargo CDC NMTC Investment	$1,715,250
Met Council TRBA Grant	232,000
Pohlad Foundation Grant	100,000
Private Debt	
Wells Fargo Loan (1st position, due 2011)	685,000
Northwest Area Foundation TIF Loan (due 2022)	408,000
Partners for Common Good Loan (due 2011)	250,000
NDC REDI Loan (due 2011)	225,000
HOBT Loan (due 2034)	10,000
Public Debt	
City of Minneapolis CEDF Loan (due 2024)	250,000
City EZ Loan (due 2011)	250,000
Midtown Phillips NRP Loan (forgivable)	136,398
Total Project Cost	**$4,261,648**

New Market Tax Credit Structure and Unwind

NDC proposed the Plaza Verde project in response to a 2003 Commercial Corridors Request for Proposals (RFP) issued by the MCDA and the City of Minneapolis Empowerment Zone. Through the RFP process, the MCDA selected the project for a CEDF loan and the Empowerment Zone awarded it an EZ loan.

The use of NMTC required a complicated financing structure that placed the City's loans in subordinate positions with security not in the real estate, but in a Pledge of Cash Flow Distributions. The repayment schedules for both the CEDF and EZ loans were structured to accommodate the constraints associated with the use of NMTC, which limited repayment in the first seven years. The project has not performed as well as originally projected, but it has met all of its payment obligations to date.

When the City approved the loans, all parties understood that at the end of the NMTC period in year seven (2011), the project would undergo major refinancing. After much discussion with existing lenders and new, prospective lenders, a new loan equal to the amount of the project's obligations due in 2011[1] is not possible. However, through a combination of concessions, temporary deferrals, and a new first mortgage loan, NDC believes they can successfully restructure the project, even in today's tight commercial lending environment.

Given the project's operating history, stabilized net operating income (NOI) of $105,000, and $1.375 million appraised property value, prospective lenders are considering a new $950,000 five-year, first mortgage. NDC received a commitment letter from one lender for a $950,000 new first mortgage on November 30, 2011. The new loan and an established sinking fund will allow NDC REDI, LLC to repay the Wells Fargo first position loan and Partners for Common Good second position loan, establish a six month debt service reserve (new lender requirement), and pay fees associated with the NMTC structure. There are several additional requirements that any new lender will have in order to be comfortable with a $950,000 first mortgage. A requirement that most affects the repayment of the City's loans is a 1.2 debt coverage ratio, allowing subordinate debt payments only when debt coverage on the first mortgage exceeds 120%.

NDC Request

To successfully unravel the NMTC structure and accommodate the requirements of a new first mortgage lender, NDC has requested the following terms for the City of Minneapolis CEDF and EZ loans:

1. defer all required payments on the CEDF and EZ loans for five years, aligned with the new first mortgage term, and reexamine the project's capacity to pay back the loans at the end of the five years;
2. accept annual excess cash payments when net income is in excess of 120% of the first mortgage lender's annual debt payments based on the City's share of the remaining, original subordinate debt; and
3. subordinate to a new first mortgage lender with the loans secured by a traditional real estate mortgage.

The request to defer required loan payments for five years and reexamine the project's capacity at the end of the five-year period provides the City with the opportunity to bump up the CEDF balloon payment date by eight years from 2024 to 2016. A balloon payment in 2016 provides the opportunity for NDC to refinance the City's loans in 2016, making the full balloon payments. If a take out by a private lender is not feasible in 2016, the City is in an improved position to restructure the loan with payments based on the project's recent history. The current schedule was drafted before the project broke ground, and will likely not be an ideal schedule in 2016.

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[1] Wells Fargo 1st Mortgage, Partners for Common Good Loan, EZ Loan, NDC REDI Loan, and NMTC asset management fees

The annual excess cash flow payments will be based on the project's annual net operating income less the first mortgage and reserves payments (to total 120% of the first mortgage payment). Any excess cash remaining will be distributed to the two subordinate lenders (NDC and the City) as a percentage of each lender's original loan amount. The City lent 69% of the subordinate debt that will remain. If the project performs in line with the Five Year Cash Flow Proforma (Attachment A), NDC projects the project will have excess cash available to make five annual payments on the City's loans totaling $80,000. The proforma is based on the project's recent history, existing leases, and prospective tenant interest.

NDC, as property manager, is working aggressively to meet their five-year projections. These projections are more reliable than the original proforma developed in 2004. Thirteen of the nineteen revenue line items are based on existing language in current leases. When the project was funded that was true for only eight, none of which had signed leases, only letters of intent. Expenses are also based on seven years of operating history. The two biggest uncertainties in the proforma are the projected leases for the third floor. NDC is actively looking for office tenants for the HOBT space and a new operator to improve leasing and performance of the ballroom space. HOBT has decided to exit their lease when new tenants are secured. NDC has prospects for both spaces and expects new tenants in 2012.

The loan collateral will change from a Pledge of Cash Flow Distributions, as dictated by the NMTC structure, to a traditional real estate mortgage with Bloom Lake Historic Partners, LLC, the legal entity that owns the real estate and will be the borrower on the City's revised loan agreements. This provides the City with improved loan security. Bloom Lake Historic Partners, LLC's two members will be NDC and LEDC. LEDC currently leases office space in the building.

Staff Recommendation
In response to NDC's request, staff recommends authorizing changes to the loan documents consistent with the three requests. The proposed loan terms are shown in the tables below. The Development Finance Committee reviewed and supported this proposed restructuring on December 1, 2011.

Tables 2. and 3. Loan Term Comparisons

CEDF LOAN	Current Loan Status	Proposed Restructured Terms
Outstanding Loan Balance (as of 11/22/11)	$251,875	$251,875
Interest Rate	3.00%	3.00%
Loan Term (months)	240	147
Amortization Term (months)	240	na
Quarterly P & I Payment (10/1/11 - 4/1/24)	$4,167	$0
Balloon Date	7/1/2024	10/1/2016
Balloon Payment	$109,055	$292,473
Annual Excess Cash Flow Payment	none	34.5% of excess cash
Security	Pledge of Cash Flow Distributions	Subordinate Mortgage

EZ LOAN	Current Loan Status	Proposed Restructured Terms
Outstanding Loan Balance (as of 10/01/11) *includes $15,000 of principal forgiveness for EZ job creation*	$215,665	$215,665
Interest Rate	3.00%	3.00%
Loan Term (months)	67	124
Amortization Term (months)	240	na
Annual Interest-Only Payment (7/31/10 - 7/31/11)	$3,740	$0
Balloon Date	12/31/2011	10/1/2016
Balloon Payment	$205,302	$250,769
Annual Excess Cash Flow Payment	none	34.5% of excess cash
Security	Pledge of Cash Flow Distributions	Subordinate Mortgage

One difference between NDC's original proposal and the recommended terms by staff is having ranked loan positions for collateral security (see Table 4 below). NDC's request was to place all the remaining subordinate debt (CEDF, EZ, NDC REDI, LLC) on par in a subordination agreement. City staff has agreed to recommend each subordinate loan to take excess cash payments on par, but negotiated ranked loan positions in exchange for agreeing to NDC paying off the Partners for a Common Good loan in full. Allowing NDC to pay off one subordinate loan in full improves project stability by simplifying project refinancing, excess cash flow payments, and future project debt.

Table 4. Debt Instruments Remaining After Refinance

Proposed Debt After Restructure	Amount	Current Security	Proposed Security
New First Mortgage Loan	$950,000	new loan	Mortgage (1st)
City EZ Loan	215,665	Pledge of Cash Flow Distributions	Mortgage (2nd)
City CEDF Loan	251,875	Pledge of Cash Flow Distributions	Mortgage (3rd)
NDC REDI Loan (Wells Fargo EQ2)	225,000[2]	Pledge of Cash Flow Distributions	Mortgage (4th)
NRP Loan (fully forgivable in 2019)	90,932	Pledge of Cash Flow Distributions	Mortgage (5th)
Northwest Area Foundation TIF Loan	408,000	Pay-go TIF Note	no change
HOBT Loan (payable 2034)	10,000	none	none
Total Project Debt After Restructure	**$2,129,234**		
2011 Appraised Property Value	**$1,375,000**		
Loan to Value	**155%**		

The third and final outstanding loan the City has in the Plaza Verde project is a Midtown Phillips NRP loan. It is a fully forgivable loan. The only change to this loan will be entering into a subordinate mortgage on the property. A current provision of the Loan Agreement is the right of first refusal for the Heart of the Beast Puppet and Mask Theatre (HOBT) to lease space in the building. HOBT has voluntarily decided to end their lease in the building when a new tenant is found for their space.

Table 5. NRP Loan Term Comparison

NRP LOAN		
	Loan Terms	Proposed Restructured Terms
Loan Amount	$136,398	$136,398
Annual Interest Rate	0.00%	0.00%
Loan Term (months)	180	180
1/3 forgivable	7/1/2009	7/1/2009
1/3 forgivable	7/1/2014	7/1/2014
1/3 forgivable	7/1/2019	7/1/2019
Security	Pledge of Cash Flow Distributions	Subordinate Mortgage
NRP (Midtown Phillips) Provision	Right of first refusal for HOBT to lease space	Right of first refusal for HOBT to lease space

[2] Principal amount may increase if the new first mortgage is unable to pay all fees associated with the NMTC structure collapsing.

NDC Requests to Other Lenders
NDC has requested that Wells Fargo forgo a $318,000 put/call fee and asked the tax credit asset manager to reduce its $218,888 in accrued asset management fees. Wells Fargo has verbally agreed to forgo the entire put/call fee and NDC continues to negotiate a reduction in the asset management fees with the tax credit asset manager. The $250,000 NDC REDI loan is an EQ2 loan from Wells Fargo. It will be restructured in a manner similar to the CEDF and EZ loans in a subordinate position to the new first mortgage, EZ, and CEDF loans and eligible for annual excess cash flow payments at 31%.

Risk Assessment
There are risks associated with both restructuring the loans as outlined above as well as not restructuring the loans as proposed. Deferring all required loan payments and accepting payments based on available excess cash, risks receiving zero payments in five years and further delaying or jeopardizing full or partial repayment of its loans if the project does not perform as hoped. However, it provides the City with the opportunity to accelerate the balloon payment of the CEDF loan by eight years from 2024 to 2016, requires payment if the project's financials improve, and reiterates the City's preference that a private lender refinance the City loans in 2016. If a take out by a private lender is not feasible in 2016, the City will be in an improved position to restructure the loan at that time with payments based on the project's operating performance from 2012 to 2016. Restructuring also increases the strength of the City's collateral, replacing the NMTC-dictated Pledge of Cash Flow Distributions with a conventional real estate mortgage. Any recourse the City could take under the Pledge document is complicated and likely fruitless.

Staff believes a more serious risk is not restructuring the loans. NDC has stated they will be forced to default on both loans, as well as their other financing, if they are not restructured. If the project were to default, it would change NDC's conversations with current and prospective lenders, hampering any refinance and threatening the continued operation of the project.

Attachments
Attachment A: 5-Year Cash Flow Pro Forma