

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

Date: May 3, 2011

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

Subject: Longfellow Station – Public Hearing on Preliminary Approval of up to \$17,000,000 in Tax Exempt Multifamily Housing Revenue Entitlement Bonds

Recommendations: 1) Approve the attached Resolution giving Preliminary Approval of up to \$17,000,000 in Tax-Exempt Multifamily Housing Revenue Entitlement Bonds; 2) Authorize early advance of the HOME loan to finance property acquisition by the Settlement Agreement deadline; and 3) Authorize release of the forgivable note, mortgage and declaration securing the HLAFF funds at the HOME loan closing.

Previous Directives: 1) December 2005 – approved a resolution authorizing submission of applications to the Metropolitan Council for Hiawatha Corridor Land Assembly Fund proposals; 2) March 2006 - approved acceptance and appropriation of Metropolitan Council Hiawatha Light Rail Land Assembly Fund Grants of \$3,500,000 for projects along the Hiawatha Light Rail line, including the Longfellow Station Project; 3) June 2006 – authorized submission of an application for Metropolitan Council Livable Communities Demonstration Account (LCDA) funding; 4) October 2006 – authorized submission of an application for a Hennepin County ERF brownfield grant; 5) December 2006 – approved up to \$400,000 from the Affordable Housing Trust Fund; 6) February 2007 - accepted and appropriated \$934,523 Metropolitan Council Livable Communities Demonstration Account LCDA grant and \$90,000 Hennepin County ERF grant; 7) May 2007 – authorized submission of an application for Metropolitan Council Livable Communities Demonstration Account (LCDA) funding; 8) August 2007 – adopted a resolution approving the Longfellow Station Redevelopment Plan; 9) December 2007 – approved up to an additional \$1,000,000 from the Affordable Housing Trust Fund; 10) January 2008 - accepted and appropriated \$500,000 in Metropolitan Council Livable Communities Demonstration Account LCDA funding; and 11) February 2008 - approved Project Analysis Authorization; 12) December 2008 – approved up to an additional \$500,000 from the Affordable Housing Trust Fund; 13) September 2009 – approved proposed TIF financing, redevelopment agreement terms, and Great Streets loan of up to \$300,000; and 14) December 2010 – approved the assignment and assumption by Sherman Associates Inc or an affiliate of the existing agreements between City and Longfellow Station I, LLC, Longfellow Housing Limited Partnership and/or Capital Growth Real Estate LLC.

Prepared by: Jerry LePage, Senior Project Coordinator (612) 673-5240

Approved by: Charles T. Lutz, CPED Deputy Director _____

Thomas A. Streitz, Director of Housing Development _____

Presenter in Committee: Jerry LePage, Senior Project Coordinator

Financial Impact

- No financial impact

Community Impact

- Neighborhood Notification: The Longfellow Community Council (LCC) has been notified that this report is being considered by the City Council. Over the past eight months, Sherman Associates has working with LCC and its committees regarding its development plan.
- City Goals: This project addresses the following goals: A Place To Call Home, Eco-Focused, Many People-One Minneapolis, Jobs & Economic Vitality, Livable Communities-Healthy Lives, and A City That Works.
- Sustainability Targets: Affordable housing preservation. Increased density of development along and usage of a light rail transit line.
- Comprehensive Plan: Section 4.1 Minneapolis will encourage reinvestment along major urban corridors as a way of promoting growth in all neighborhoods; Section 4.3 Minneapolis will support development in Commercial Corridors where it enhances the street's character, improves its ability to accommodate automobile traffic and foster pedestrian movement, and expands the range of goods and services offered; Section 4.9 Minneapolis will grow by increasing its supply of housing; Section 4.10 Minneapolis will increase its housing that is affordable to low and moderate income households; Section 4.11 Minneapolis will improve the availability of housing options for its residents; 4.15 Minneapolis will carefully identify project sites where housing redevelopment and/or housing revitalization are the appropriate responses to neighborhood conditions and market demand. In July 2007, the Minneapolis City Planning Commission reviewed a Redevelopment Plan for the site for consistency with The Minneapolis Plan and recommended City Council approval of that plan.
- Zoning Code: In May 2008, the City Council approved the original Land Use Application which included a re-zoning from an I2 classification to a C3A classification. In December 2010, the City Planning Commission approved a new Land Use Application from Sherman Associates, based on its revised development plan.
- Living Wage/Business Subsidy Agreement Yes _____ No X
- Job Linkage Yes _____ No X
- Other: N/A

Supporting Information

In December 2010, the City Council approved the transfer of the Longfellow Station project and the City's funding commitments from Capital Growth Real Estate LLC to Sherman Associates. During the fall of 2010, Capital Growth and Sherman Associates had agreed on a plan to move the project forward that included negotiations with the two banks who hold mortgages on the land and the various vendors/consultants who have worked on the project. Pursuant a formal Settlement Agreement reached by all of the parties, Sherman Associates became the new developer of Longfellow Station and will assume full control and responsibility from Capital Growth. Under this agreement, there was also a discounting of the existing mortgages and outstanding vendor accounts payable to improve project feasibility.

In summer 2010, demolition also started on the existing structures on the Longfellow Station site. The environmental remediation and demolition was completed in March 2011, with some residual cleanup and final clearance of the site by the Minnesota Pollution Control Agency. These activities have been funded with resources received from the Metropolitan Council (TBRA and LCDA grants), Minnesota DEED (Contamination Cleanup and Redevelopment grants), and Hennepin County (ERF and TOD grants).

As part of its assumption of the project, Sherman Associates also took over responsibility for securing the primary mortgage financing through the HUD 221 (d)(4) insurance program. Due to the instability in the finance markets and the onset of the recession, HUD became the only viable first mortgage option, although it was also beginning to take a more cautious financing

approach given the challenging economic climate. In March 2010, HUD completed its initial underwriting and issued to the developer an "Invitation to Apply" for mortgage insurance. However, HUD's invitation reflected a more conservative position on rents, leading to a reduction in the maximum mortgage amount and creating a new financing gap.

In addition, the Minneapolis HUD office raised concerns about several environmental issues in the 38th and Hiawatha area (i.e. proximity to railroads, proximity to power poles, and noise levels). HUD indicated that these environmental factors were obstacles to its participation and would likely require some waivers from the HUD-Washington D.C. office. Over the past six months, the City, Hennepin County, and Sherman Associates have worked very hard to respond to HUD on these environmental issues, which are inherent for pioneering TOD projects such as Longfellow Station being developed in areas transitioning from industrial uses. HUD concerns about these environmental issues have now been addressed, and the City and Sherman Associates are awaiting official notification from the local HUD office that it is ready to proceed with the firm underwriting of the mortgage insurance.

Development Plan

Based on its due diligence analysis of the project and its own development experience, Sherman Associates has made revisions to the development plan. Longfellow Station will still be a mixed use project but there has been some reconfiguration in the physical plan.

- The project will still include a 10,000 sq. ft. commercial component. However, it will be located in a different building, rather than being incorporated into the first floor of the residential building, in order to simplify financing and construction. Sherman Associates has created two entities, Longfellow Station Limited Partnership and Longfellow Station Commercial LLC to undertake the housing and commercial components, respectively, of the project.
- There will be a slight reduction in overall number of housing units - from 196 units to about 180 units. Despite this reduction in total units, the number of affordable units in Sherman's proposal will be very similar to the last version of Capital Growth's plan. Sherman's plan calls for 36 units (20%) affordable at 50% MMI, 108 units (60%) affordable at 60%, and 36 units (20%) at market rate.
- More residential parking spaces have been added in order to increase the parking ratio to 1:1. The previous ratio was 0.7 spaces/1 unit, which was a concern raised by HUD.

In December 2010, the City Planning Commission approved the new land use application from Sherman Associates based on this revised development plan. The development site plan and elevations are attached as **Exhibit 1**.

Finance Plan

The estimated total development cost of Sherman Associates' revised plan is \$32.1 million. The City's state, regional and county partners have committed substantial resources for site clean up and demolition and project development in recognition of its consistency with shared policy goals of locating higher-density mixed-use projects within Hiawatha Light Rail Transit station areas. Over \$8 million in grant and deferred loan funding has been approved from these non-City funding sources by these funding partners, who have also reaffirmed their support by agreeing to critical and necessary time extensions for these commitments. To date, approximately \$3 million in these non-City funds has already been expended for acquisition, contamination clean up, and the demolition of the old Purina Mill structures, in order to prepare

the site for development. Additional project information is provided on the Project Data Worksheet (**Exhibit 2**).

Sherman intends to utilize the same HUD financing commitment for the housing component that was secured by Capital Growth. Local HUD staff have indicated to Sherman Associates and CPED staff that they will support 221 (d)(4) mortgage insurance based on the rent levels stipulated by HUD in its Invitation to Apply. However, HUD will not be underwriting the commercial component of the project. Sherman Associates will be securing separate private financing for the construction of the commercial building.

The following table summarizes the funding sources for both components of the project.

Proposed Sources	Type	Commercial Component	Housing Component	Total	Committed
Housing Revenue Bonds – HUD 221 (d)(4) Mortgage Insurance	Loan		13,632,367	13,632,367	
TIF pay-go note	TIF		1,894,741	1,894,741	X
Commercial component - private loan financing	Loan	1,495,236		1,495,236	X
Commercial component - equity	Equity	615,000		615,000	X
Low Income Housing Tax Credits	Equity		5,785,201	5,785,201	
City AHTF (2006)	Loan		400,000	400,000	X
City AHTF (2007)	Loan		1,000,000	1,000,000	X
City AHTF (2008)	Loan		500,000	500,000	X
Metro Council LCDA (2007)	Grant	500,000		500,000	X
City Great Streets Program	Loan		300,000	300,000	X
Family Housing Fund	Loan		150,000	150,000	X
MHFA (2007)	Loan		1,850,000	1,850,000	X
MHFA (2008)	Loan		1,000,000	1,000,000	X
Hennepin County TOD (2008)	Grant	200,000		200,000	X
Hennepin County TOD (2011)	Grant		483,750	483,750	
Hennepin County AHIF (2011)	Loan		500,000	500,000	
Deferred developer fee			1,000,000	1,000,000	X
Additional gap funding needed			780,000	780,000	
TOTAL SOURCES		2,810,236	29,276,059	32,086,295	

In February, Sherman Associates submitted applications to Hennepin County for almost \$1 million: \$500,000 in Affordable Housing Incentive Fund (AHIF) funds and \$483,750 in TOD funds. The County is expected to make its AHIF and TOD funding decisions within the next 6 weeks.

The current sources for the project show an estimated funding gap of \$780,000. CPED and Sherman Associates are continuing to pursue a strategy to secure the necessary funding to close this gap, which has been a challenge since there are few funding sources available that have not already been utilized. Every effort is being made to reduce the funding gap from other sources and to keep any request for additional City funding, if required, to the absolute minimum needed. Sherman is exploring the possibility of additional funding from Minnesota

Housing, which has already committed \$2.85 million. If any additional City assistance is needed to close the funding gap, a possible source would be the City's TOD Set Aside Fund.

Due to the switch to housing revenue bond financing, Sherman Associates will be including in its development budget a developer fee of \$2.45 million (approximately 9% of total net TDC) in order to help meet the basis requirements for the bonds, maximize the 4% tax credits, and meet the requirements of the tax credit investor. However, \$1 million of this developer fee will be deferred and left in the project as a funding source.

In August or September, CPED will be returning to the City Council with a report that will address the remaining funding gap and request for any additional Council actions that may be necessary to allow the project to proceed to a closing and a start of construction before the end of the year.

Housing Revenue Bond Information

Sherman Associates has submitted an application for housing revenue entitlement bond (HRB) financing and is requesting the issuance of up to \$17 million in tax-exempt housing revenue entitlement bonds for the first mortgage of approximately \$13,632,367 and the TIF note of approximately \$1,894,741 (totaling \$15,527,108). The additional \$1,472,892 in bonding authority will allow for additional bond debt should interest rates change. If the project does not use this additional authority, it will be available for other CPED projects.

Sherman was not originally intending to use housing revenue bonds as part of its primary financing. However, Sherman has now decided to pursue this approach in order to take advantage of lower interest rates and to secure equity through the syndication of the automatic 4% tax credits, and thereby help to narrow the funding gap. HUD has also indicated that the use of City-issued bonds, rather than HUD-issued bonds, will expedite HUD's underwriting process and will allow the project to close sometime this fall. The bonds, which will have a 42-year term, will be insured by HUD through its 221 (d)(4) insurance program and will be rated AAA. The Sturges Company will underwrite and place the bonds. The current status of the 2010/2011 HRB Entitlement allocation is shown below.

2010 HRB Entitlement	\$120,608,911
Less: Riverside Plaza	\$ 69,950,000
2010 HRB Balance	\$ 50,658,911
Plus: 2011 HRB Entitlement	\$ 45,326,000
Total Available HRB	\$ 95,984,911
Less: Longfellow Station	\$ 17,000,000
HRB Entitlement Remaining	\$ 78,984,911

Bond Purchaser/Underwriter	The Sturges Company
Bond Counsel	Best & Flanagan
Council Member Informed	Yes, Ward 12

Acquisition Closing

The Settlement Agreement that was reached between Capital Growth, Sherman Associates, and the other parties, requires a closing on the purchase of the Longfellow Station property by Sherman Associates no later than June 1, 2011. This transaction would involve the pay off of the mortgages held by Bank Mutual and Americana Bank and would put Sherman in title to the property. If the purchase does not occur by this deadline, the Settlement Agreement will terminate and the deal with Sherman will likely collapse.

To accommodate the deadline in the Settlement Agreement, Sherman Associates proposes to use the HOME loan to finance property acquisition in advance of the construction closing. The City would include a provision in its HOME loan agreement with the developer that would allow an early disbursement of the \$1.9 million in HOME funds, which have already been approved for this project, and a release of the existing mortgage for \$980,000 in Hiawatha Land Assembly (HLAF) funds, which has been in the third lien position to the two bank mortgages. In exchange, the City's overall security position on its investment would be strengthened since the existing first and second bank mortgages would be extinguished and the City's HOME mortgage and declaration of restrictive covenants would become the first lien on the property.

Project Timeline

May 2011	Completion of environmental remediation and building demolition
June 2011	Acquisition closing
August 2011	HUD issuance of Firm 221 (d)(4) Mortgage Commitment
August/Sept. 2011	Final City Council actions on project financing (including Final HRB approval and gap funding)
Nov./Dec.2011	Closing on HUD mortgage and the start of construction