Document No. 2004-013M

Request for MCDA Board of Commissioners Action
From the Department of Community Planning & Economic Development

Date: February 3, 2004

To: Chair of MCDA Board, Lisa Goodman

Prepared by: Bill Tetzlaff, Senior Project Coordinator, 612-673-5168
Presenter in Committee: Bill Tetzlaff, Senior Project Coordinator 673-5168

Approved by: Chuck Lutz, Deputy CPED Director

Subject: Request for Extension of Reduced Lease Arrangement for Hey City Theater

RECOMMENDATION: Approve extension of the existing lease of 824 Hennepin by SGH Entertainment (successor to Hey City Theater Company) through February 28, 2005 at the current reduced monthly rental rate of $9,375, with sharing of excess profits

Previous Directives: February 10, 1995 the City Council and MCDA Board approved the acquisition of 824 Hennepin, financing for its renovation, and its lease to Hey City Theater Company.

Financial Impact (Check those that apply)

___ No financial impact - or - Action is within current department budget.
(If checked, go directly to Background/Supporting Information)
___ Action requires an appropriation increase to the Capital Budget
___ Action requires an appropriation increase to the Operating Budget
___ Action provides increased revenue for appropriation increase
___ Action requires use of contingency or reserves
__x_ Other financial impact (Explain): Leveraged Investment Fund and Contract for Deed payments will continue to be made, CEDF repayment will continue to be delayed.
___Request provided to the Budget Office when provided to the Committee Coordinator

Community Impact
Ward: 5

Neighborhood Notification: NA

City Goals: Helps to "Create an environment that maximizes economic development opportunities within Minneapolis by focusing on the City's physical and human assets," specifically, in maintaining entertainment amenities.

Comprehensive Plan: Furthers the achievement of Policies 6.5 and 6.6 under Leisure and Culture, "…promote the economic and creative vitality of arts activities based in the city…as a unique arts environment that responds to local specialty interests," and "…continue to support the role of arts in tourism and community pride," respectively.

Zoning Code: In compliance. This property is located in the B4S-2 Downtown district where theaters are permitted, and is located in the Downtown Entertainment Area identified in Chapter 543 of the zoning code.

Living Wage/Job Linkage: N/A

Background/Supporting Information

In 1995 the MCDA acquired the 824 Hennepin building from Hirshfield's Paint and Wallcoverings, renovated and stabilized the building and leased it to Hey City Theater Company. Loans from the Leveraged Investment Fund (LIF) and CEDF were used to fund the renovation and related expenses. Additional leasehold improvements to convert the building to theater use were funded by the purchaser. The lease was structured so that the monthly payment, $11,041.67, was sufficient to cover repayment of the LIF loan, contract for deed payments to the seller, and special assessments (now paid off), fund a repair reserve, pay the MCDA some administrative costs and provide partial repayment of the CEDF loan.

After completion of the conversion of the building to theater re-use, the business opened with "Tony and Tina's Wedding." This and several subsequent productions proved moderately successful, due in part to the mounting of Tony and Tina's in several other cities. However, after September 11, 2001 business declined dramatically, causing Hey City to become delinquent in making its lease payments and ultimately requesting a restructuring of its lease. A restructured lease with reduced payments was ultimately approved by the MCDA Executive Director (see attached Report to the Executive Director dated March 25, 2003). All delinquent lease and real estate tax payments were paid as part of this restructuring.

Upon approval of the restructured lease, Tony and Tina's was remounted and proved moderately successful through the first nine months of 2003, allowing SGH to stay current on its lease payments. However, SGH still has a sizable outstanding bank loan, guaranteed by John and Sandy Hey, principals of SGH, which had been used for building renovations necessary to present other theatrical productions in the building. This debt is expected to be re-negotiated to allow the business to continue operations.

Tony and Tina's Wedding has or will shortly be closed, and "Beehive," which ran at the former Campus Theater some years ago, will begin production shortly. SGH projects that at 55% occupancy the show will be profitable, and at 70% occupancy they will sufficiently recoup their investment to allow the show to continue through the summer. They are planning to do six shows per week.

SGH believes that continuing to be able to pay the reduced lease rate for the next year is critical to its ability to achieve and maintain a minimal level of profitability, and is requesting an extension of the amended lease through February 28, 2005. CPED and Finance Department staff have reviewed SGH financial statements and projections for the new show and confirm that this lower rent appears warranted. This rent, $9375 per month, provides for the continued repayment of the LIF loan and CD. The outstanding balances of this loan and debt are approximately $85,152 and $238,649 respectively.

It may be worth noting that at about the time SGH made its most recent request it was discovered that, due to miscalculations by both parties, a payment shortfall of $2041.67 existed. SGH was notified of this shortfall on December 12 and made payment on December 16.

If this lease extension is granted as requested, staff recommends that a provision be included that requires that any net income after repayment of the private bank loan, if that should be achieved, be shared equally (50% to SGH and 50% to the City of Minneapolis). If that bank loan is repaid from some other source, that source should be reimbursed before this provision is triggered. These payments would be credited to repayment of the CEDF loan.

March 25, 2003

REPORT TO THE EXECUTIVE DIRECTOR

FROM: Wayne Olson, x5090

SUBJECT: Hey City Stage Company workout staff authorization

Approved:

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Department Manager

____________________________________ ________
Chuck Lutz, Deputy Executive Director Date

PREVIOUS DIRECTIVES: On February 10, 1995 the Board of Commissioners authorized a number of recommendations with regards to the purchase, refurbishment and leasing of the property at 824 Hennepin Avenue. A copy of that report is attached.

NEIGHBORHOOD GROUP NOTIFICATION: NA

IMPACT ON MCDA BUDGET: The action by the Executive Director will have a budget impact as described in the report below.

RECOMMENDATION: In accordance with Administrative Bulletin dated February 20, 1997 the Executive Director authorizes staff to implement the terms of the negotiated work out (as described below) and authorizes staff to execute the necessary agreements with regards to the leasing of the property at 824 Hennepin Ave S.

Background

The former Hirshfield's building at 824 Hennepin Ave South had been vacant since 1990, when the company relocated its operations. The majority of the re-use proposals for the building at the time were adult-oriented in nature. In 1992, the owner of another adult oriented business in downtown Minneapolis submitted a purchase agreement for this property. The rejection of this purchase offer by Hirshfield's prompted the public sector to purchase the property outright.

At that time, complex terms were negotiated that included a 10 year renewable lease with Stagetime Productions (now Hey City Stage Company, herein referred to as “Hey City”), $690,000 of public funds for tenant improvements funded from $500,000 of Leveraged Investment Fund (“LIF”) secured by a personal guarantee from John and Sandy Hey, plus $190,000 from CEDF.

The sources for purchasing the $506,000 property was another $100,000 of CEDF as a down payment to Hirshfield’s, and the remaining $406,000 on Contract for Deed, also to be recouped from lease payments by Hey City. Another $100,000 from CEDF was needed for carrying costs and contingency. The tenant would contribute $219,000 in tenant improvements and $150,000 leasehold improvements (escrow). Therefore, the total sources for the project in tabulated form:

Use	Source	Terms
$100,000 Down payment	CEDF	3.1% for 15 years, recouped from lease payments
$190,000 building repair	CEDF	Same as above
$100,000 other/conting.	CEDF	Same as above
$500,000 building repair	LIF	6% for 10 years
$406,000 purchase	Contract for Deed from Hirschfield’s	8% at 15 years
$219,000 additional tenant improvements	Hey City	
$150,000 escrow	Hey City	

Sources were to be recouped through monthly lease payments of $11,041.67 from Hey City, broken out as follows:

Use	Amount
CD payment	$3,822.61
LIF	$5,551.17
Repair Reserve	$657.00
MCDA Admin	$690.00
CEDF repayment	$277.89
Other	$43.00

Since that time, a number of productions have had successful runs at Hey City, to the benefit of Hennepin Avenue businesses and City-wide arts communities.

Starting in March of 2002, Hey City lease payments ceased. By mid-year 2002, the lease payments were in arrears, and no payments were forthcoming. Late in the 3rd quarter of 2002, John and Sandy Hey notified the staff at a meeting at the Agency that Hey City was nearly bankrupt. At that time, Hey City sought Agency assistance in alleviating its dire financial situation. Hey City was technically in default of its lease agreement and continues to be so until these new terms are implemented.

Current Picture

By November of 2002, after considerable staff analysis, two options became apparent. The first was a combination of actions that would ultimately remove Hey City from the theater, put the building solely into the ownership of the MCDA, and force the search for a new tenant/purchaser of the property. The other option was to develop a workout strategy that would allow Hey City, or an operating sub-entity, to negotiate new terms for a lease that would allow continued operation of the building as a theater for the public benefit of Hennepin Avenue vitality. No positive outcomes could be developed for the first option; therefore, staff continued with developing the second option.

In the short term, since their financial problems affected their ability to pay full rent during September, 2002 and following, an amendment was agreed to by SGH, LLC (a subsidiary of Hey City) and MCDA. The agreement allowed the theater to operate at minimal rent to produce a revenue generating project (a remount of Tony-n-Tina's Wedding) while a long-term workout strategy was devised. Since that agreement, SGH, LLC has paid, in full, its reduced rent obligation for 824 Hennepin Avenue through February of 2003. In addition, the approximate $32,000 in property taxes were also brought current by John Hey on behalf of Hey City.

For the long term, this report describes the terms whereby the outstanding rent would be paid in full and credited against the personal guarantee of John and Sandy Hey. In addition, rent would be reduced to allow Hey City to continue to operate a remount of a successful production (ongoing), as well as allow Hey City to develop new product for the theater. For the benefit of the Executive Director, the terms are summarized below.

Terms of Agreement

- The original lease dated February 28, 1995 will remain in place, with amendments as follows by and between Hey City and MCDA. (Discussion occurred whether a new set of documents should be drawn up for the agreement. The current lease was deemed satisfactory.)

- Beginning March 1, 2003, reduce the rent from $11,041.67 per month to $9,375 per month for 1 year through February 28, 2004 paid by Hey City.

- Credit the full amount of the payment from Hey City (to bring the lease payments current from the date of their last payment in March, 2002 through February 28, 2003) against the outstanding balance of John and Sandy Hey's personal guarantee ($121,458.37 effectively reducing the amount remaining on the Personal Guarantee to $83,859 through July of 2005).

- Going forward, credit against the outstanding balance of the John and Sandy Hey's personal guarantee by $6988.25 per month until the start of a new lease in March, 2004 if negotiated. It would effectively terminate the personal guarantee as of February 28, 2004, and therefore leave the remaining LIF balance unsecured (i.e., $6988.25 x 12 = $83,859, the remaining balance of the personal guarantee) for one year until March of 2005.

- Beginning with the March 1, 2004, payment date, lease payments will return to $11,041.67 per month. At that time, the difference of $1666.67 (March 2004 payment less the current proposed payment of $9375) will be credited toward the CEDF outstanding loan balance to be repaid in full under the terms originally defined (3.1% over 15 years).

- Property taxes are still paid under the terms of the lease. That is, the tenant pays property taxes and is credited any taxes in excess of $27,500.

Fiduciary impact

Currently the Agency has three outstanding loans that the lease payment covers. The current balance on these loans is as follows:

Loan	Amount	Monthly Payment
CD	$245,256	$3,823
LIF	$149,506	$5,551
CEDF	$390,000	Begins March, 2004

Under the current scenario, the monthly obligation is $9,374. The newly structured payment of $9,375 will cover the current debt obligations, excluding the CEDF repayment. The Contract for Deed will be entirely repaid as of February 2010, with the $3,823 monthly payment (8%, 15 years). The LIF loan will be repaid in January of 2006, with the $5,551 monthly payment (6%, 10 years).

Accounting history shows no payments to CEDF from fund CBE. Therefore it can be assumed that the CEDF loan amount is still $390,000. Assuming the negotiated lease remains as proposed in this report, repayment of that loan would begin in March, 2004 and end in approximately June of 2010. In other words, the $11,041 March 2004 lease payment less the $9375 proposed lease payment leaves $1667 to be applied to the CEDF loan outstanding balance starting in March, 2004.

As the other loans pay off, their payments will be combined with the $1667, which in turn will pay down the CEDF obligation more rapidly. In detail, the LIF loan will be entirely repaid in January 2006, therefore that payment amount can be combined with the CEDF payment ($5,551+$1,667=$7,218). The CD will be entirely repaid in January 2010, and that payment amount can also be combined with the CEDF payment ($7,218+$3,823=$11,041) leaving the entire $11,041 payment obligated for the remaining 6 months to the repayment of the CEDF.

In addition, the agreement would allow the maximum payment to buy down John and Sandy Hey's personal guarantee at a quicker rate than the loan's maturation. Therefore, there is a securitization risk for the remaining LIF indebtedness after the 12-month buy down. (The approximate remaining unsecuritized LIF balance after March of 2004 would be approximately, $85,152.)

Therefore, under the terms of this agreement the budget impact to the Agency is as follows (admin costs not contemplated):

Use	Amount
CD payment	$3,822.61
LIF	$5,551.17
CEDF repayment	$1,666.67 (3/04)

Executive Director Authority

The MCDA does not have a policy in effect that grants the Executive Director authority to workout a delinquent lease outside the bounds of the approved Board report. Changes in the lease terms that affect rent, lease period, other monetary issues, etc., require Board approval. If the Hey City lease was an ordinary lease we would have no choice but to get Board approval for a workout with Hey City. But, the Hey City lease is not an ordinary lease.

The Hey City lease was based on the MCDA investment in the Hey City building, with a lease rate calculated to pay the outstanding contract for deed payments to Hirschfield's, the amount of the MCDA internal LIF loan funds advanced to pay project costs and extra amounts, if available, to pay-off an internal CEDF funds account loan and an annual tax rebate to Hey City for any tax amount over $27,500. Also, Hey City gave the MCDA a personal guarantee for repayment of the LIF loan funds advanced for the project. These are not typical lease terms that are based on the fair market rental rate of the property and require no personal guarantee.

Since the Hey City lease is structured to pay the Hirschfield's CD and repay the LIF loan, it is legal counsel's opinion that the Hey City lease is more of a loan repayment obligation than a lease and as such, the MCDA Policy Statement Regarding Approval of Loan Repayment Deferral, Loan Restructuring and Delinquent Loans as authorized in Administrative Bulletin No. 24, dated February 20, 1997, is applicable to the Hey City workout. Pursuant to Admin Bulletin No. 24, the Executive Director has the authority to (i) defer loans with an outstanding balance of less than $200,000 for up to 1 year; (ii) restructure loans that have an outstanding balance less than $20,000, or, the change results in a potential reduction in revenue of $20,000 or less over the life of the loan, or, change the collateral or other security for a loan if the Executive Director finds that as a result of the change it is more likely that the MCDA's loan will be repaid or there is expected to be no material impact on the likelihood of repayment of the MCDA loan; and (iii) may write-off a loan with an outstanding principal balance of less than $20,000. These are the limits of the authority the Executive Director has to workout problem loans.

In the case of the Hey City lease, the change in rent over the time period is under $20,000 and therefore the Executive Director may act on this staff report.

Summary

The financial difficulties facing Hey City Stage Company (and its successors and assigns) is troubling. However the greatest public interest, at this point, is to figure out a scenario whereby the theater can continue operations to contribute to the vitality of Hennepin Avenue and the theater district. The public would not be served with a dark, vacant building in this space. Due to the improvements, considerable cost and risk would be incurred by implementing Draconian measures, such as removing the tenant all together etc. There is an acceptable level of risk going forward with the terms as outlined above. Future productions at the theater, long term viability of a remounted production and seasonal downturns are all sources of risk. Yet those risks still do not outweigh the costs associated with other solutions.

It should also be made clear that the Executive Director will be acting under Administrative Policy No. 24 in the fashion described above. The argument for operating under the Policy is based on the assumptions outlined by legal counsel, and recounted in this report.

cc: Councilmember Natalie Johnson Lee
Communications
Virginia Parent