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

Date: August 24, 2004

To: Council Member Lisa Goodman, Community Development Committee
Council Member Barbara Johnson, Ways & Means/Budget Committee

Refer To: MCDA Board of Commissioners

Prepared by: CPED Staff

Presented by: Lee Sheehy, CPED Director, Phone 612-673-5125

Approved by: Chuck Lutz, CPED Deputy Director _________

Subject: **Midtown Exchange Project — Financing and Related Actions; Authority for Execution of Documents**

RECOMMENDATION:

1. **Authorize appropriate City and MCDA officials to execute Amendment No. 1 to the Midtown Exchange Redevelopment Contract and related documents with Ryan Companies US, Inc. and Assigned Developers based upon the amendments recommended in this report:**

    a. **Support Sherman application for Challenge program funds from MHFA**
    b. **Approve the attached resolution authorizing the issuance of up to $3.5 million in general obligation (G.O.) or revenue TIF bonds to support the housing component of the project;**
    c. **Authorize the City Finance Officer to make the necessary revenue and appropriation increases to the 2004 General Appropriation Resolution to facilitate (i) the issuance and expenditure of the G.O. or revenue TIF bonds and (ii) an increase in the principal amount of the Leveraged Opportunity Fund loan of up to an additional $300,000 for environmental remediation, as described in this report (resolution will be provided at Committee).**
    d. **Increase interest rate on parking ramp TIF note**
    e. **Align parking lease terms with Allina lease term**
    f. **Authorize appropriate MCDA officials to address title issues with respect to the Midtown Greenway by conveyance of certain parcels to the Hennepin County Regional Railroad Authority (HCRRA) and execution of a Grant and Declaration of Easements Agreement.**

g. **Extend the closing deadline from September 1, 2004 to September 30, 2004.**

Previous Directives:

- October 24 1997—Board authorized grant applications to and receipt of $4,600,000 from Metropolitan Council Tax Base Revitalization Account
- December 3 1997—MCDA Board of Commissioners ("Board") authorized a $2,000,000 Leveraged Investment Account loan and a $200,000 NRP Loan to STA Associates, Inc.
- April 24 1998—Board authorized grant applications to and receipt of $4,600,000 from Metropolitan Council Tax Base Revitalization Account
- July 17 1998—Board approved $500,000 in MILES funding for retrofit items
- Fall of 1998—Board authorized Federal Empowerment Zone designation to include the project area and receipt of $3,000,000 from HUD for the Zone
- October 30 1998—Board authorized grant applications to and receipt of $4,600,000 from Metropolitan Council Tax Base Revitalization Account
- March 25 1999—Board approved Empowerment Zone funding for retrofit items, pollution abatement and a childcare facility
- April 9 1999—The Board appropriated $650,000 in FUND CBG and waived 3% City admin fee
- June 1999--$433,300 grant from the Minnesota Department of Employment and Economic Development (DEED) was awarded to the project for the parking ramp
- June 1999—Board authorized application to HUD for an $8,500,000 Economic Development Initiative grant and loan for parking ramp construction contingent on application for a $6,500,000 Section 108 loan
- July 19 1999—Board directed staff to proceed with ramp construction financing and development plans and require STA to meet certain conditions before ramp construction could begin
- March 12 2001—City Council confirmed a settlement in lieu of foreclosure between MCDA and STA Associates, Inc., and STA Development Corporation regarding the Great Lake Center, and authorized the necessary steps to implement the settlement, including the direction to refer the appropriation requests to City Council to secure the funds needed for the settlement
- August 10 2001—Board confirmed the settlement terms in lieu of foreclosure for a lender to lender workout with Marquette Bank regarding the Great Lake Center project
- June 10 2002—City Council approved a resolution to set up funds to receive and spend rental income from the project on property management and professional services for the project
- August 26 2002—Board approved sale of 2815 10th Ave S to Project for Pride in Living for $5,000
- September 13 2002—City Council adopted resolutions approving the Lake Street Center Redevelopment and Tax Increment Finance Plans
- September 13 2002—Board approved the sale of the northern portion of the Lake Street Center property to Allina Health System for $5.2 million
- October 28 2002— Board approved the purchase of equipment from MDI for use at the Lake Street Center buildings
- December 30 2002—Board authorized the preparation of a Request for Redevelopment Proposals for the Lake Street Center

- April 8 2003—Board authorized the Deputy Executive Director to send out the Request for Proposals (RFP) for the Lake Street Center Project
- July 29 2003—Board approved a process for rating and recommending a developer for the Lake Street Center Project
- October 24 2003—Board ranked two development teams for the project
- November 10 2003—Board authorized the appropriate MCDA officials to execute and deliver all necessary documentation required to repay the remaining Marquette and NRP loans for Lake Street Center prior to December 31, 2003
- December 29 2003—City Council authorized the transfer of most MCDA programs and assets (excluding real estate) to the City
- January 6 2004—City Council granted Ryan Companies 6 months exclusive development rights for the former Sears site
- February 3 2004—City Council concurred with housing as a land use at Midtown Exchange and up to $13 million in appropriate funding, subject to final agreement on a housing mix and financing plan
- May 14 2004—City Council:

1. approved the term sheet for Ryan Companies' Midtown Exchange project
2. authorized preparation of a redevelopment agreement and related documents consistent with such terms
3. approved the project employment and contracting goals set forth in the term sheet
4. authorized the tax increment financing plan modification to be prepared concurrently with project analysis
5. authorized sub-grant of existing TBRA funds to Ryan Companies for environmental testing and remediation at Midtown Exchange
6. waived City Procurement Policy to allow United Properties to continue management of the former Sears properties until transfer of property to the Developer

- June 18 2004—City Council

1. Authorized appropriate City and MCDA officials to execute a Redevelopment Contract and related documents with Ryan Companies US, Inc. and Assigned Developers based upon the Amended and Restated Term Sheet approved by the City Council on May 14, 2004Approved resolution adopting Modification No. 1 to the Lake Street Center Redevelopment Plan and Modification No. 1 to the Lake Street Center Tax Increment Financing Plan
2. Authorized appropriate City officials to execute loan, grant, sub-recipient and related documents for the financing: a)Approved resolutions authorizing the issuance of 3 pay-as-you-go tax increment financing notes for the office/commercial, rental housing, and parking ramp components of the project and tax increment revenue bonds or notes for the 1928 building rental or ownership housing components of the project; Authorized the City Finance Officer to make the necessary revenue and appropriation increases to the 2004 General Appropriation Resolution to facilitate the issuance and expenditure of tax increment revenue bonds or notes; b)Approved the terms of the parking ramp and/or environmental loan(s); Amended the 2004 General Appropriation Resolution by increasing the Community Planning & Economic Development Agency Fund CLC-CPED Leveraged Opportunity Fund (CLC0-890-8933) appropriation by $1,100,000;c)Accepted the anticipated Met Council (TBRA) and Hennepin County (ERF) environmental grants and authorized the Hennepin County (ERF) and DEED loans; f) Amended the 2004 General Appropriation Resolution by increasing the Community Planning & Economic Development Agency Fund SMN-CPED State Grants & Loans (SMN0-890-8933) appropriation by $2,100,000 and Increased the 2004 Revenue Budget for the Community Planning & Economic Development Agency in Fund SMN-CPED State

Grants & Loans (SMN0-890-8490) by $2,100,000; d) Accepted the anticipated HUD 108 loan and EDI grant; Amended the 2004 General Appropriation Resolution by increasing the Community Planning & Economic Development Agency Fund FGO-CPED Federal Grants & Other (FGO0-890-8933) appropriation by $8,500,000 the amounts awarded and increased the 2004 Revenue Budget for the Community Planning & Economic Development Agency in Fund FGO-CPED Federal Grants & Other (FGO0-890-8490) by $8,500,000;e) Authorized execution of a sub-recipient agreement with Ryan for the $433,334 parking ramp grant from DEED; and f) Amended the 2004 General Appropriation Resolution by increasing the Community Planning & Economic Development Agency Fund EDP-CPED Defaulted Properties (EDP0-890-8490) appropriation by $2,200,000 to affect the transfer of land sale proceeds to Fund CLC (CPED Leveraged Opportunity Fund), and increased the 2004 Revenue Budget for the Community Planning & Economic Development Agency in Fund CLC-CPED Leveraged Opportunity Fund (CLC0-890-8490) by $2,200,000

3. Approved the termination of the Ionex Corporation lease
4. Authorized the parking ramp lease and sublease outlined in the report
5. Authorized assignment and assumption of the MCDA interest in Redevelopment Contract and related agreements by the City
6. Preliminary approval to issue up to $21 million in tax-exempt multifamily housing revenue bonds for the rental-housing component.

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
_X__ Action requires an appropriation increase to the Operating Budget
_X__ Action provides increased revenue for appropriation increase
___ Action requires use of contingency or reserves
_X__ Other financial impact (Explain): The development of this property will reduce the City's property inventory, increase its tax base, increase job opportunities for City residents, retain and enhance a historically significant building, enable emerging businesses to grow, improve public transit, and create new and site-sensitive connections to the Midtown Greenway.
___Request provided to the Budget Office when provided to the Committee Coordinator

Community Impact: The redevelopment of one of the largest buildings in Minneapolis, the former Sears site, will have a significant impact for the betterment of south central Minneapolis. Its opening will create a large office market where none currently exists. The project will bring the first hotel to Lake Street and create new job opportunities for area residents. Approximately 363 housing units in the project will create a 24-hour presence which will improve the street vitality and safety. The Global Market will provide new opportunities for emerging businesses to expand, drawing shoppers to the neighborhood from the larger metropolitan area. Lastly, connections to the Midtown Greenway will further serve to create a desirable point for residents to migrate for shopping and recreation.

Ward: 8

City Goals:

- Build communities where all people feel safe and trust the City's public safety professionals and systems.
- Maintain the physical infrastructure to ensure a healthy, vital and safe City.
- Deliver consistently high quality City services at a good value to our taxpayers.
- Create an environment that maximizes economic development opportunities within Minneapolis by focusing on the City's physical and human assets.
- Preserve and enhance our natural and historic environment and promote a clean, sustainable Minneapolis.
- Promote public, community and private partnerships to address disparities and to support strong, healthy families and communities.
- Foster the development and preservation of a mix of quality housing types that is available, affordable, meets current needs, and promotes future growth.

Comprehensive Plan

2.9. Minneapolis will strengthen long-term confidence in the economy by building innovative public to private sector partnerships.
2.6. Minneapolis will focus resources and efforts on connecting residents to living wage jobs.
4.1. Minneapolis will encourage reinvestment along major urban corridors as a way of promoting growth in all neighborhoods.
4.4. Minneapolis will continue to provide a wide range of goods and services for city residents, to promote employment opportunities, to encourage the use and adaptive reuse of existing commercial buildings, and to maintain and improve compatibility with surrounding areas.
4.9 Minneapolis will grow by increasing its supply of housing.
4.12 Minneapolis will reasonably accommodate the housing needs of all of its citizens.

Zoning Code: On May 17th, the Planning Commission approved necessary land use applications and conditional use permits required for this development. A summary of these actions is attached at the end of this report

Living Wage/Job Linkage: The project is exempt from the City's living wage/business subsidy act policies because Ryan is paying greater than 70% of the current year's assessed value for acquisition and site preparation costs. The redevelopment contract for the project will require that certain tenants of Ryan and other Assigned Developers of commercial space participate in the job linkage program.

The City Council approved the term sheet for Midtown Exchange project on May 14, and on June 18 the Council approved a number of project financing provisions. Since these approvals, substantial progress has been made including:

- Ryan executed its lease with Allina;
- Ryan entered into a development contract with Sherman Associates to develop the 1928 building rental and ownership housing components of the project;
- The parties signed the Redevelopment Contract on August 17, 2004 after extensive discussions on a number of issues. Both the City and Ryan are moving ahead aggressively with the project.

- Ryan has commenced work on the project, hereby waiving Ryan's closing contingencies (recognizing that Allina and Sherman agreements with Ryan have contingencies) and providing a performance guaranty backed by $38 million of assets.

Since June, as the construction plans have become more complete, Ryan has received better information on the costs of the project. Projected costs have risen due to refinement in design, historic preservation, regulatory review, and significant material cost increases in the market. The developer has absorbed several million dollars of additional costs and is now seeking City support in restructuring the City's previous financing commitments and amending other terms of the Redevelopment Contract as noted in this report. Assuming City Council approval, these revised terms would be incorporated into Amendment No. 1 of the Contract.

1. **Financial Analysis Summary**

Attachment A represents the current Sources and Uses of Funds for the Midtown Exchange project. Since May 2004:

- The projected budget has increased from $178.6 million to $187.6 million
- Private sources have increased $10 million
- Public sources have decreased $1 million (not including the recommended loan increase of up to $300,000 for environmental work)
- The make-up of the public contribution has shifted as follows:

  - Pay-go TIF notes and bonds reduced from $22.5 million to $20.1 million
  - CPED loan from the Leveraged Opportunity Fund shifted from parking to environmental ($735,000)
  - Proposed use of up to $3.5 million general obligation TIF bonds for rental housing (out of a total of $20.1 million TIF notes or bonds issued)
  - Proposed City gap funding (AHTF, NRP & EZ) request increase to $5.25 million (up from $4.25 million) includes proposed use of NRP funds of up to $2 million

Project components with budget increases are:

- Rental housing increased $5.7 million
- Sherman for-sale housing increased $3.7 million
- PPL housing increased $.02 million
- Parking ramp increased $3 million.

Project components with budget decreases are:

- Office/retail component decreased $1.7 million,
- Hotel decreased $1.7 million.

The office/retail cost decreased because there is more significant public space on the first floor and Greenway levels which have reduced the square footage available for office and retail. Also, site costs that were previously only attributed to office and retail have now been appropriately allocated across all building components. The hotel room count has decreased from 180 rooms to a 136 rooms; therefore the hotel is smaller and the cost is less.

Of the project's total development cost, from May to August 2004, private investment increased from $134 million to $144 million and public investment decreased from $44 million to $43 million. The public investment decreased because a portion of the ramp will be tax-exempt that reduces available tax increment. Also, the sizing of the pay go TIF notes is refined to be more in line with tax increment available. Comparative financial ratios have <u>improved</u> from May 2004 to August 2004. They are:

Midtown Exchange	May 2004	August 2004
Private to City Investment	4.72 to 1	5.40 to 1
Private to Public Investment	3.04 to 1	3.33 to 1
All historic investments		
Private to public	2.46 to 1	2.69 to1

2. Housing Component

The projected housing budgets (for rent and for sale combined) have increased $9.6 million since May. The reason for the increased costs include:

- Rising construction costs for housing interiors above projections caused by design improvements. These improvements include an underground tunnel from parking, relocation of an elevator core, an additional light well and finish upgrades that will help generate higher rents.
- Rising costs of HVAC, electrical and mechanical work needed for the shell improvements for the housing component.
- A negative National Park Service (NPS) determination on historic window replacement that may cost an additional $1.5 million. The NPS determination is being appealed.

CPED staff analysis shows that the projected $178/sq. ft. total development cost (TDC) for the Sherman rental housing component is in the middle of the range of costs in comparison to six other City-funded conversion (non-housing use to housing use) projects proposed or completed recently. The average TDC for those projects was $187/sq. ft and ranged from $131/sq.ft. to $287/sq.ft. It is also of note that the other housing conversions were not held to the strict standards required of a project on the National Historic Register. Prior to closing, a professional construction estimator will review final construction figures.

Housing Gap

In May, the Council was advised that the housing components in the 1928 building required an interim standby line of credit of up to $11.55 million to cover potential timing and/or funding gaps at closing. At that time, the gap was $15.05 million. Since May, the project has received funding awards from the AHTF ($1.8 million) and Hennepin County ($300,000). These and any additional awards from the City's AHTF, EZ, or NRP programs, and from any other lenders such as MHFA, FHF, FHLB and Hennepin County will further reduce the interim standby line of credit.

Rental Housing in 1928 Building	**May 2004 221 units**	**August 2004 223 units**	
Total Development Cost	**$40,723,150**	**$46,424,172**	
SOURCES:			
4% LIHTC Equity	8,900,000	12,009,172	Fall 2004
Historic Tax Credit Equity	6,900,000	7,400,000	Fall 2004
Housing Revenue Bonds	10,265,000	10,265,000	Fall 2004
Tax Increment Financing	3,035,000	3,000,000	Fall 2004
G.O. or Revenue TIF Bond	0	3,000,000	Fall 2004
Minneapolis /CPED AHTF/NRP/EZ	4,250,000	5,250,000	$1,800,000 (AHTF) committed
MHFA	3,000,000	3,000,000	Fall 2004 Application
Metropolitan Council	1,000,000	500,000	Fall 2004 Application
Private Foundations	1,925,000	0	
Family Housing Fund	450,000	600,000	Fall 2004 Application
Federal Home Loan Bank	330,000	0	
Hennepin County	668,150	1,400,000	Fall 2004 Application
TOTAL SOURCES	**$40,723,150**	**$46,424,172**	

Ownership Housing in 1928 Building	**May 2004 82 units**	**August 2004 89 units**	
Total Development Cost	**$21,615,000**	**$25,263,350**	**Status**
Sources			
Housing Sales	17,900,000	20,663,350	
Garage Proceeds	$500,000	In above	
Tax Increment Financing	1,465,000	In rental	
MHFA	500,000	500,000	Fall 2004 RFP
Hennepin County TOD	750,000	300,000	Spring 2004 RFP
Metropolitan Council	500,000	1,500,000	Fall 2004 RFP
Empowerment Zone	0	300,000	Fall 2004 RFP
Foundations	0	2,000,000	
Total sources	**$21,615,000**	**$25,263,350**	

The developer seeks a restructuring of the approved city funding commitment to help address budget increases.

a. **Acknowledge that Sherman will seek to utilize $5.25 million in City sources for the rental housing component of the project, an increase from the $4.25 million acknowledged in May 2004. Sherman Associates, or any other Assigned Developer of the rental-housing component, can apply in future rounds for a combined additional $3.45 million from the City's Affordable Housing Trust Fund, NRP and EZ sources.**

These funds would come from a combination of Affordable Housing Trust Funds ($2,750,000, of which $1,800,000 has already been approved), Empowerment Zone ($500,000) and NRP funds (up to $2,000,000). Awards are based on the City's competitive RFP process. As stated above, any such awards would further reduce the City's interim standby line of credit.

b. **Support Sherman Associates' application to the Minnesota Housing Finance Agency for $3 million in 2004 Economic Development and Housing Challenge Program funds for the Midtown Exchange rental housing component**

The purpose of MHFA's Economic Development and Housing Challenge Program ("Challenge Program") is to provide funding to assist in the provision of affordable permanent rental housing that supports economic development and redevelopment activities or job creation/preservation within a community by meeting locally identified housing needs. The funding is available on a statewide basis through MHFA's Multifamily Super RFP. There is currently $5 million available statewide. Awards are based on the City's competitive RFP process.

Over the past 4 years (2000-2003), City projects have received approximately $7.8 million in Challenge Program funds (an average of $1.95 million/year). Sherman Associates recently submitted an application to MHFA for $3 million in 2004 Challenge funding. If MHFA decides to provide an award of this magnitude in one funding cycle, it would likely mean City projects may not be able to receive any or as much Challenge funding during the next 3 years.

In addition to the Challenge Program, MHFA has several other programs from which they fund multifamily rental projects. Awards are made based on a competitive RFP. MHFA staff review applications and determine which, if any, source of funding to use. MHFA staff recommendations are subject to final MHFA Board approval.

City staff participate in the MHFA selection process by identifying City funding priorities. It is expected that the Midtown Exchange rental housing component will be consistently ranked as a high priority.

c. **Authorize the issuance of up to $3.5 million in general obligation (G.O.) or revenue TIF bonds. (Resolution will be provided at Committee meeting).**

The G.O. bond proposal provides City assistance to help address the financing gap resulting from additional housing costs. General obligation bonding may provide the project up to $550,000 resulting from reduced interest costs versus revenue bond financing. To help mitigate construction period risk, the TIF bonds may be issued after substantial completion of construction.

City staff is currently exploring options that will help mitigate the repayment risk to the City of using G.O. debt. This includes using a combination of taxable and tax-exempt debt. If taxable debt is used, the bonds would carry a debt service guaranty from the developer to cover any shortfalls in payments.

Tax increment generated by the for-sale housing will provide the repayment of the general obligation or revenue TIF bonds, the proceeds of which will help fill the financing gap in the rental housing component. Ryan will deal with additional costs either through value engineering, increased borrowing or scope reduction.

3. Parking Component

There are three changes to the details of the parking component. The first change aligns the rate of the TIF note to market expectations of risk and the second two changes align the leases associated with parking for Allina to the actual term of the Allina Lease.

a. Increase the pay-go parking ramp TIF note interest rate from 6.5% to 9.5%

The initial interest rate was set at 6.5% because it was equal to Ryan's first mortgage lending rate. Subsequently, lenders have told Ryan that the market perceives the note as more risky because it is dependent upon the future value of tax increments (Years 21-27 of the project) which is more uncertain than first mortgage, therefore requiring a higher rate of return for investors. While this 9.5% rate reflects the market perception of risk in the deal, it also will result in a reduction in the principal amount of the note. If Ryan decides to sell the note on the secondary market, this will allow it to do so more easily.

b. **Amend lease term on the east parcel from 30 years to 32 years**

Since there is a 2-year construction period, the lease of the east parcel for parking would be extended to match Allina's lease term. Allina's lease commences in 2006 for 20 years with two five-year renewals.

c. **Extend the parking lease to the City and the sub-leased to Allina by up to 5 years**

The parking that is sub-leased from the City to Allina allows Allina to achieve tax savings that they would have received had they owned rather than leased their parking space (as they would have in proposals competitive to the Minneapolis proposal). Ryan and Allina had agreed to a tax savings amount of $150,000 per year for ten years (approximately $1.1 million in net present value). The parking lease term will be established to provide an equal present value savings to Allina.

d. **Environmental: Increase environmental loan up to $300,000 from the Leverage Opportunity Fund**

This loan would finance only a demonstrated funding gap for environmental cleanup costs. In the June report to the City Council, CPED staff outlined the range of environmental costs. Since that time, the environmental aspects of the project have been bid and the current budget for cleanup is:

<u>Environmental Remediation Sources</u>:	**<u>Timing</u>:**
$250,000 Met Council Grant	Approved
$750,000 Met Council Grant	Approved
$250,000 Hennepin County Grant	Approved
$1,035,000 City Loan	$735,000 approved and additional $300,000 requested
TOTAL SOURCES $2,285,000	
<u>Uses:</u>	**<u>Timing:</u>**
$2,250,000- $2,500,000	Remediation to occur 8/04-1/05

**Note: Ryan has authorization for the following loans but has no source with which to repay them:

$250,000 Hennepin County Loan (EPA)	Approved-Appropriation pending
$750,000 DEED loan (EPA)	Approved

4. Miscellaneous Provisions

a. **Extend the closing date from September 1 to September 30, 2004**

This reflects the reality of time needed to complete the complex real estate and financing transactions. The Redevelopment Contract has been signed and Ryan will be at the site undertaking pollution remediation in advance of closing. This work will likely begin the week of August 16.

b. **Complete real estate transaction with Hennepin County Regional Rail Authority (HCRRA)**

To facilitate closing on the Midtown Exchange project, the MCDA must clear up various title issues and establish certain easements with respect to the Train Shed, the basement area of the 1964 building and the Elliot Avenue Bridge that lie within the Midtown Greenway. In particular, the MCDA will convey to HCRRA the parcels legally described as (i) Tract F of Registered Land Survey No. (to be completed by closing), and (ii) the North 20 feet of all that portion of 29th Street, vacated, which lies between Northerly extensions of the East line of Block 3, Allan and Anderson’s Second Addition to Minneapolis, but retain and/or obtain the encroachment, demolition, construction, access, drainage and other easement rights described in the Grant and Declaration of Easements Agreement negotiated with HCRRA. The parcels to be conveyed are identified on the Attachment B.

Attachment A – Sources and Uses of funds for Midtown Exchange
Attachment B – Map of Parcels to be conveyed to HCRRA