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

**Date:** **November 30, 2010**

**To:** Council Member Lisa Goodman, Chair, Community Development Committee
**Referred to:** Council Member Betsy Hodges, Chair, Ways and Means Committee

**Subject:** Great Streets Real Estate Development Gap Financing: Proposed Loan Origination Fee

**Recommendation:** **1) Approve staff recommendation to authorize a one percent (1%) loan origination fee for Great Streets Real Estate Development Gap Financing Loans and 2) Adopt underwriting guidelines for Great Streets Real Estate Development Gap Financing Loans**

**Previous Directives:** April 27, 2007, the City Council created the Great Streets program, including gap financing for catalytic commercial real estate development offered on an ongoing basis through an online application form.

**Department Information**

Prepared by: Kelly Hoffman, Senior Project Coordinator (612-673-5079)
Approved by: Catherine A. Polasky, Director of Econ. Dev. ____________
Charles T. Lutz, Deputy Director ____________
Presenter in Committee: Kelly Hoffman

**Financial Impact**

None - CDBG funds are allocated to the Great Streets Program. Action is within the Business Plan.

**Community Impact**

- Neighborhood Notification
- City Goals: A world-class city and 21st century economic powerhouse
- Sustainability Targets: This loan program supports efficient growth by often reusing vacant blighted buildings.
- Comprehensive Plan: 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.
- Zoning Code: N/A
- Living Wage, Business Subsidy, and Job Linkage apply to individual loans.

**Project Summary**

Staff recommends authorizing a one percent (1%) loan origination fee for Great Streets Real Estate Development Gap Financing Loans pursuant to the terms described herein.

The Real Estate Development Gap Financing Loan is one of the components of the Great Streets Neighborhood Business District program. This loan provides funding for *catalytic* projects where investment will likely spur additional development projects. These projects have one or more public benefits including job creation, job retention, blight removal, and tax base enhancement. These are projects that may also add neighborhood amenities and contribute to the overall vitality of a business district. As “gap financing”, these loans are for projects that cannot otherwise move forward “but for” the Great Streets investment. A project must be located in an area designated as eligible for Great Streets funds to be considered (see Attachment A).

Financing gaps are typically present where the construction costs outweigh the market lease rate or sales price, typically in more challenged markets. The Developer (Borrower) must demonstrate that the debt and equity they have available are not sufficient to complete the project. To date, loans have typically been within the range of $200,000 - $450,000. Loan terms have varied but may include below market interest rate, extended amortization, and interest-only periods. Loans are funded using CDBG dollars allocated to the Great Streets program through the annual budget process. Generally, loan applications are reviewed by staff, the Development Finance Committee (if over $200,000), and approved by the City Council.

This program has been instrumental in promoting development, especially given the current economic recession and corresponding tight credit markets. Developers are still reporting difficulty accessing significant private capital to complete projects, especially those projects that are perceived as higher risk.

Great Street gap financing loans that are approved or closed include:

| **Project/Borrower** | **Great Streets Loan Amount** | **Leveraged funds** |
|---|---|---|
| Seward Co-op | $150,000 | $9,800,000 |
| Master Engineering | $350,000 | $350,000 |
| African Development Center | $200,000 | $1,165,000 |
| Juxtaposition Arts | $165,000 | $700,000 |
| Resource Inc | $125,000 | $200,000 |
| Emerge (North Branch Library) | $350,000 | $3,500,000 |
| Chicago Avenue Fire Arts Center | $425,000 | $185,000 |
| Catalyst Community Partners | $450,000 | $925,000 |
| Delisi/Catalyst Five Points LLC | $450,000 | $2,650,000 |
| Bystrom (phase I - Touchstone) | $600,000 | $4,900,000 |
| Lyndale Green | $245,000 | $13,584,229 |
| Longfellow Station | $300,000 | $31,493,500 |
| Total | $3,810,000 | $69,452,729 |

**Rationale for fee**

With increasing budgetary constraints and decreasing resources available for staff costs, imposing an administrative fee would generate flexible funds to support program delivery. These types of fees are not uncommon and many municipalities and redevelopment authorities impose loan origination fees or application fees. For example, Hennepin County recently imposed a 4.5% application fee for the Transit Oriented Development (TOD) program, paid only if the applicant successfully receives a grant. The City's Brownfields program also has an application fee.

Because of the need to identify administrative funding sources and to recoup administrative costs associated with the review and processing of loan applications, staff is recommending implementation of an origination fee of 1%. This fee structure was chosen because it can be directly tied to the actual amount of staff time it takes to process the loan, which is required, pursuant to state law. The largest Great Streets loan has been $600,000 and staff does not anticipate future loans exceeding this level. Given that the largest potential origination fee collected would have been $6,000 and costs are over $6,000 (see below), staff feels the fee is in compliance with state law and City policies.  Loans of this type are more typically in the $200,000 - $450,000 range.

Estimate of staff costs per loan:

| **Staff** | **Average # of hours/loan** | **Typical Hourly Rate*** | **Total** |
|---|---|---|---|
| Sr. Project Coordinator | 60 | $63.08 | $3,784.80 |
| City Attorney | 20 | $91.58 | $1,831.60 |
| Development Finance Analyst | 10 | $61.35 | $613.50 |
| **TOTAL** | | | $6,229.90 |

* Includes salary, benefits, and indirect costs.

Given the average staff time spent per loan, a loan of $450,000 (upper end of range) would generate a loan origination fee of $4,500, which would only reimburse the City approximately 72% of the cost of reviewing and processing the loan application. This does not include ongoing monitoring during construction and processing draw requests. These would vary depending on the size and scope of the project, but could add another 10 – 20 hours of time for a Sr. Project Coordinator and, in some cases, other staff such as Construction Management.

Members of the Development Finance Committee reviewed this proposed origination fee and recommended approval. DFC members noted that 1% is the industry standard for a fee.

Note that fees collected for the CDBG-funded loans will be considered program income. Beginning in 2008, fifty percent of all CDBG program income is applied to reducing the City's letter of credit with the federal government, related to the redevelopment of Block E.

Due to Federal regulations of the HUD CDBG program, the origination fee must be paid using another source and cannot be capitalized as part of the loan. The origination fee would be due at closing.

**Proposed Underwriting Guidelines**

CPED staff recommends adopting underwriting criteria for Great Streets Real Estate Development Gap Financing loans. The goal of the underwriting criteria is to clarify decision making criteria for potential borrowers and comply with federal regulations related to Community Development Block Grant funding, as applicable. The following are the proposed underwriting guidelines:

**1) The project meets the programmatic goals of the Great Streets program**.

The Great Streets real estate development gap financing program supports commercial real estate development projects that are believed to be catalytic and there are public benefits such as blight removal, tax base enhancement, job creation, etc. The public benefit will be commensurate with the public investment.

**2) Project costs are reasonable.**

Applicants are required to submit project cost estimates. City staff reviews project plans and costs for reasonableness, including land acquisition costs. Particular attention will be paid to non arms length transactions, for example, when the borrower procures goods or services from itself of from another party with whom there is a financial interest or family relationship.

**3) Sources of the project financing are committed.**

City funds will be committed only after evidence that there is at least preliminary commitment of all other sources of funds required to complete the project. All funds must be committed and available at the time of the loan closing.

**4) To the extent possible, City funds are not substituted for non-public financial support.**

Great Streets real estate development gap financing loans are intended to fill a financing gap and meet the “but for” test. The borrower is expected to maximize all other debt and equity sources and borrow City funds only to the extent necessary to close the financing gap.

**5) The project is financially feasible.**

Projects are reviewed and assessed for financial feasibility by Project Coordinators, Development Finance staff, the Development Finance Committee (loans >$200,000), and approved by the City Council.

Assessment of financial feasibility and ability to repay the loan includes an assessment of:

- financial assumptions with regard to projected rental rates, absorption rate, and occupancy within the context of the specific geographic/market areas
- the appropriateness of the debt coverage
- the size of the loan relative to other financing sources
- the appropriateness of the collateral and security

6) **To the extent possible, the projected return on the owner's equity investment will not be unreasonably high.**

Staff will assess the return on equity for reasonableness and will consider factors such as risk of the project, local conditions, and industry standards.

7) **To the extent practicable, City funds are disbursed on a pro rata basis with other finances provided to the project.**

To minimize the degree to which City funds are placed at greater risk than non-City funds with respect to project completion, City funds, to the extent possible, will be disbursed on a pro rata basis.

The Development Finance Committee (DFC) also reviewed these proposed underwriting guidelines and recommended approval.

These proposed modifications were subject to the 45 day public comment period. The information was sent to the neighborhood groups and business associations and was posted on the City's website. No comments were received.