

DATE: April 16, 2014
TO: Board of Commissioners
FROM: Patrick Quinton, Executive Director
SUBJECT: Report Number 14-15

Authorizing a Loan Modification for Heritage Building, LLC, Secured by the Real Property Commonly Known as The Heritage Building, Located at 3934 NE Martin Luther King, Jr. Boulevard in the Interstate Corridor Urban Renewal Area

BOARD ACTION REQUESTED

Adopt Resolution No. 7047

ACTION DESCRIPTION

This proposed action by the Portland Development Commission (PDC) Board of Commissioners (Board) will authorize a loan modification for The Heritage Building, LLC, (Borrower) owners of the Heritage Building, a commercial office building located at 3934 NE Martin Luther King, Jr. Boulevard in the Interstate Corridor Urban Renewal Area (ICURA) (see site map in Attachment A). If approved, this modification will consolidate the current three loans into one, with a principal amount of \$4,521,074 (or current balance at time of Board approval); provide a six month payment deferral period, followed by one year of interest-only payments and 8.5 years of principal and interest payments; and increase future revenues to the ICURA by allowing for lease-up and stabilization of the property.

BACKGROUND AND CONTEXT

The PDC's activity in the NE Martin Luther King, Jr. Boulevard corridor has been guided by goals articulated in the *Albina Community Plan* (1993), the *Fremont-MLK Vision Study* (2001), and the *NE Martin Luther King, Jr. Blvd. Action Plan* (2008). The combined focus of these plans was to create an environment that would encourage neighborhood business development and a subsequent increase in living wage employment opportunities for the community. The strategies to accomplish this objective included the identification of "nodes" within the ICURA that would reinforce existing business clusters and create attractive, buildable sites for new development. PDC implemented the strategy in part by acquiring blighted, vacant buildings within the corridor and securing local development teams to redevelop the sites to catalyze job creation and encourage additional commercial development in the neighborhood.

The PDC acquired the parcels that are now the Heritage Building in two phases, closing on the former Weimer Warehouse and parking lot in 1999 and the adjacent parking lot in 2001. A Request for Proposals for the purchase and redevelopment of the property was issued in July 2001. The Heritage Building, LLC, team was selected as redeveloper of the property following a public selection and review process.

On January 8, 2003, the PDC Board adopted Resolution No. 5964 authorizing the Executive Director to execute a Disposition and Development Agreement ("DDA") with the developer. The DDA established

the purchase price for the property at \$400,000 and provided PDC loans for the acquisition and construction of the project in the aggregate amount of \$1,000,000. The DDA was amended in December 2003 and November 2004 to extend the final termination date and revise the Schedule of Performance. Due to increases in construction materials and costs, the DDA was amended a final time in May 2005. This amendment decreased the purchase price of the property to \$1 and increased the PDC loans to \$2,450,000.

In September 2005, PDC and the Borrower executed a loan agreement providing \$2,450,000 in two loans for the purchase and redevelopment of the property. The PDC loans were subordinate to a \$1,900,000 senior loan from Albina Community Bank executed on the same date. The project was completed on September 24, 2007, as the economic downturn was unfolding, which resulted in a slow lease-up of the property. The Borrower subsequently defaulted on its loan agreement with Albina Bank, primarily because it could not reach the required debt service coverage ratio, which prevented the loan from converting from construction to permanent. Albina Bank commenced foreclosure proceedings and was prepared to sell the property in July 2008 to satisfy the outstanding obligations. In order to prevent foreclosure, PDC purchased the senior loan for the Heritage Building from Albina in June 2009.

Even in the face of these challenges, the Heritage Building attracted local businesses as tenants. By March 2010, the building was 90 percent occupied and had created more than 35 jobs. The Heritage Building redevelopment revitalized a building that had been vacant for decades and helped to activate a key node of NE Martin Luther King, Jr. Boulevard. The success of the Heritage Building was the catalyst for other new redevelopment projects in the immediate vicinity, such as Shaver Green, an affordable housing project, the Planned Parenthood headquarters, as well as new business locations, including Rhythm Traders, Champions, and Ned Ludd.

Modification Request. In 2013, three major tenants vacated the Heritage Building due to the growth of their businesses and the need for more space. The loss of these tenants reduced building occupancy to 50 percent. Two of the tenants moved to other PDC-sponsored buildings (Eastside Exchange building in the Central Eastside Urban Renewal Area and the Trade Bindery building in the ICURA). This reduction in occupancy negatively impacted the property's cash flow, and the Borrower subsequently defaulted on loan payments for December 2013 and January 2014. The Borrower also was unable to secure financing required to pay off PDC Note C, the former Albina Bank loan. Up to this point, the Borrower had made all payments in a timely fashion.

The proposed loan was structured in a way that minimizes the annual debt service during 2014, which will allow Borrower to build reserves needed to pay for tenant improvements and leasing commissions. Borrower will also be in a better position to replenish the Operating and Capital Reserve account, which was drawn down to make past due payments in December 2013 and January 2014. It is estimated that, by the end of the deferred and interest only payment periods, the Borrower will have filled six of the vacant spaces, bringing in an additional \$16,522 of income each month.

In addition, this modification:

- Allows PDC to secure personal guarantees on the total outstanding loan amount;
- Shortens the loan term; and
- Allows Borrower to stabilize the building and be in a position to refinance the loan with a conventional lender on or before the end of the proposed loan term.

COMMUNITY AND PUBLIC BENEFIT

Public benefits of this loan modification include:

- Generating more than \$38,000 per year in property tax revenues;

- Property has created and supported more than 35 jobs paying living wages, exceeding its job density goal;
- Property supports neighborhood economic development – all tenants are local businesses – and two of the five property owners live in North and NE Portland; and
- Preventing the foreclosure of a significant commercial building on a key Northeast Portland corridor.

PUBLIC PARTICIPATION AND FEEDBACK

There has been no specific public participation related to this proposed loan modification. However, PDC engaged community stakeholders throughout the planning and redevelopment of the Heritage Building, since acquisition in 1999 and in the RFP evaluation and selection of a development team in 2003.

BUDGET AND FINANCIAL INFORMATION

If approved, the loan modification is expected to generate approximately \$602,085 in additional revenues to PDC during the next five years (see ICURA Budget & Financial Information in Attachment B).

RISK ASSESSMENT

There is a risk that it may take the Borrower an extended period to lease-up the building, given market competition in the corridor. To mitigate this risk, the Borrower is prepared to work with a new commercial real estate broker, if necessary.

There is also a risk that the Borrower defaults on PDC payments or fails to comply with other loan requirements. Should this occur, PDC reserves the right to set-up and control a bank account for the receipt of rents and payment of property expenses.

ALTERNATIVE ACTIONS

The Board could decide to direct staff to incorporate new terms or changes to the terms and conditions into the Loan Modification. Alternately the Board could direct staff to begin foreclosure proceedings.

ATTACHMENTS

- A. Site Map
- B. ICURA Budget & Financial Information

Site Map



3944 NE Martin Luther King, Jr. Boulevard

ICURA Budget and Financial Information

Five-Year Forecast Program Requirements Detail

| | Revised- 1 FY 2013-14 | Draft FY 2014-15 | Forecast FY 2015-16 | Forecast FY 2016-17 | Forecast FY 2017-18 | Forecast FY 2018-19 |
|---|--------------------------|---------------------|------------------------|------------------------|------------------------|------------------------|
| Interstate Corridor URA | | | | | | |
| Resources | | | | | | |
| Beginning Fund Balance | 12,852,946 | 5,534,198 | 3,705,992 | 3,248,834 | 2,374,677 | 2,670,429 |
| Fees and Charges | 6,000 | 0 | 0 | 0 | 0 | 0 |
| Interest on Investments | 30,000 | 30,000 | 30,000 | 30,000 | 30,000 | 30,000 |
| Loan Collections | 1,128,829 | 199,399 | 260,667 | 182,747 | 417,542 | 295,954 |
| Long Term Debt | 0 | 0 | 3,000,000 | 0 | 0 | 0 |
| Property Income | 697,040 | 787,292 | 197,040 | 197,040 | 197,040 | 197,040 |
| Reimbursements | 40,112 | 40,112 | 40,112 | 40,112 | 40,112 | 40,112 |
| Short Term Debt | 10,268,467 | 11,488,500 | 11,286,534 | 11,488,500 | 11,488,500 | 11,488,500 |
| Total Resources | 25,023,394 | 18,079,501 | 18,520,345 | 15,187,233 | 14,547,871 | 14,722,035 |
| Requirements | | | | | | |
| Program Expenditures | | | | | | |
| Administration | | | | | | |
| Financial Administration | | | | | | |
| A45101370 Debt Management-ISC | 22,532 | 22,532 | 22,532 | 22,532 | 22,532 | 22,532 |
| Total Administration | 22,532 | 22,532 | 22,532 | 22,532 | 22,532 | 22,532 |
| Business Dev | | | | | | |
| Business Lending | | | | | | |
| L02100370 BIF-General-ISC | 2,500,000 | 3,000,000 | 3,075,000 | 3,075,000 | 3,075,000 | 3,075,000 |
| L02110370 BIF-Cluster Group-Budget-ISC | 300,000 | 0 | 0 | 0 | 0 | 0 |
| L02119370 BIF-Nbrhood Ec Dev-Budget-ISC | 300,000 | 0 | 0 | 0 | 0 | 0 |
| Small Business & Community Dev | | | | | | |
| B55800370 Business Development-ISC | 1,000 | 11,000 | 11,000 | 11,000 | 11,000 | 11,000 |
| B55900370 Community Development-ISC | 80,000 | 70,000 | 70,000 | 70,000 | 70,000 | 70,000 |
| B55710370 Main Street-ISC | 0 | 74,000 | 74,000 | 74,000 | 74,000 | 74,000 |
| G07100370 MAIN-General-ISC | 74,000 | 0 | 0 | 0 | 0 | 0 |
| Traded Sector Business Dev | | | | | | |
| B15100370 Cluster Development-ISC | 1,500 | 0 | 0 | 0 | 0 | 0 |
| T01069370 Lean Manufacturing-ISC | 70,000 | 70,000 | 70,000 | 70,000 | 70,000 | 70,000 |
| Total Business Dev | 3,326,500 | 3,225,000 | 3,300,000 | 3,300,000 | 3,300,000 | 3,300,000 |
| Infrastructure | | | | | | |
| Parks | | | | | | |
| N37017315 Bridgeton-ISC-Adm | 1,500,000 | 0 | 0 | 0 | 0 | 0 |
| N37017415 Dawson Park-ISC-Adm | 1,700,000 | 300,000 | 0 | 0 | 0 | 0 |
| N37017515 Small Scale Improv-ISC-Adm | 50,000 | 0 | 0 | 0 | 0 | 0 |
| Transportation | | | | | | |
| N37032115 Interstate Trans-ISC-Adm | 160,000 | 0 | 0 | 0 | 0 | 0 |
| N37037615 Denver Streetscape-ISC-Adm | 380,000 | 0 | 0 | 0 | 0 | 0 |
| N37037715 Killingsworth Stscape-ISC-Adm | 500,000 | 2,700,000 | 900,000 | 0 | 0 | 0 |
| N37037815 Lombard Investment-ISC-Adm | 70,000 | 1,600,000 | 1,000,000 | 1,000,000 | 0 | 0 |
| Total Infrastructure | 4,360,000 | 4,600,000 | 1,900,000 | 1,000,000 | 0 | 0 |