

PDC

PORTLAND DEVELOPMENT COMMISSION

DATE: July 9, 2008
TO: Board of Commissioners
FROM: Bruce A. Warner, Executive Director
SUBJECT: Report Number 08-99

Authorizing the Executive Director, or his designee, to enter a bid on behalf of the Portland Development Commission at a foreclosure sale to acquire certain real property commonly known as "The Heritage Building" located at 3934 NE Martin Luther King, Jr. Blvd; authorizing a maximum bid amount

EXECUTIVE SUMMARY

BOARD ACTION REQUESTED

Adopt Resolution No. 6619

ACTION SUMMARY

The Portland Development Commission (PDC) and The Heritage Building, LLC (Developer) executed a Loan Agreement on September 29, 2005, for \$2.45 million in funding (PDC Loan) for the purchase and redevelopment of property at 3934 NE Martin Luther King, Jr. Blvd (Property). The lien securing repayment of the PDC Loan is subordinate to a \$1.9 million senior loan from Albina Community Bank (Albina). Both loans are currently in default and Albina has set a foreclosure sale date of July 22, 2008.

This proposed action will authorize the Executive Director, or his designee, to enter a bid at a foreclosure sale to acquire certain real property commonly known as "The Heritage Building" located at 3934 NE Martin Luther King, Jr. Boulevard. The bid shall not exceed the sum of one dollar plus the dollar amount to be derived under the Foreclosure Bid Formula set forth on Exhibit "A" to the resolution. Generally, the Foreclosure Bid Formula will be the total of outstanding principal and accrued interest for the Albina and PDC loans, plus costs and fees incurred beginning when the loan defaults occurred, and ensures that Albina and PDC are repaid in total. The estimated maximum bid using the Foreclosure Bid Formula for a foreclosure sale on July 22, 2008 is approximately \$4.4 million. PDC's specific bidding strategy will be discussed with the Board in an Executive Session scheduled for the July 9, 2008 Board meeting.

If PDC is the successful bidder at the foreclosure sale and is successful in acquiring the Property, Staff will develop a plan for disposition of the Property which could include leasing the remaining space and later selling the Property, or converting some or all of the building to commercial condominiums and offering them for sale.

Developer is in default under both the senior Albina Loan and the PDC Loan because Developer failed to satisfy various requirements necessary for conversion from construction loan to permanent loan. While construction at The Heritage Building is complete, the lease-

up has been slower than projected and is the primary reason that both the loans did not convert from construction to permanent loans. The Developer has secured a letter of interest (term sheet) from Bank of the West (BOTW) to obtain a loan from BOTW to repay the Albina senior debt, but it is unlikely that the Developer can close on the proposed BOTW loan prior to the foreclosure sale currently scheduled for July 22, 2008. As of the date of this report, Albina has declined Developer's request to postpone the date of the foreclosure sale to enable the Developer to close on the proposed BOTW loan to refinance the Albina Loan.

The Board has recently approved modifications to terms of the PDC Loan to accommodate a closing of the proposed BOTW loan to refinance the Albina Loan (Resolution 6602, June 25, 2008).

PUBLIC BENEFIT

PDC's motivation in bidding at the foreclosure sale is to protect its investment in the Property, represented by the \$2.2 million of the PDC Loan which has been disbursed to date.

This action will support the following PDC goals:

- Develop healthy neighborhoods
- Provide access to quality housing
- Help businesses to create and sustain quality jobs
- Support a vibrant Central City (urban core)
- Contribute to a strong regional economy

PUBLIC PARTICIPATION AND FEEDBACK

PDC Staff have notified the Oregon Convention Center (OCC) Urban Renewal Advisory Committee and the Martin Luther King, Jr. Blvd. Advisory Committee of PDC's proposed action to enter a bid to acquire the Property in foreclosure.

COMPLIANCE WITH ADOPTED PLANS AND POLICIES

Not Applicable

FINANCIAL IMPACT

The OCC Urban Renewal Area (URA) FY 2008-09 Adopted Budget and Forecast (OCC URA Budget) includes expenditures for disbursement of the \$287,759 remaining PDC Loan proceeds and do not include expenditures for the acquisition of the Property in foreclosure. To make additional funding available for the acquisition of the Property in foreclosure, the Headquarters Hotel budget will be reduced to make resources available. In a later budget revision, the Headquarters Hotel budget will be replenished with funds expected to be available from Contingency and carryforward from the previous fiscal year.

Generally, the maximum bid amount is expected to equal the sum of outstanding principal and accrued interest under both the Albina Loan and the PDC Loan, plus attorneys fees and

costs incurred by Albina and PDC in connection with Developer’s defaults under the loans, plus trustees fees and other costs of the foreclosure sale, plus one dollar, all as shall be determined as of the date of the foreclosure sale or other liquidation sale which may be arranged for the Property. The maximum bid to be entered on behalf of PDC for a foreclosure sale on July 22, 2008 is estimated at approximately \$4.4 million, as follows:

\$ millions	Principal Amount	Accrued Interest	Costs and Fees	Total
Albina Bank loan	1.83	0.14	0.02	1.99
PDC loan	2.16	0.23	0.00	2.39
Total bid amount	3.99	0.37	0.02	4.38

The net impact to the OCC URA Budget is expected to be approximately a \$1.7 million increase to expenditures in FY 2008-09, which represents the \$2.0 million required to pay the Albina loan balance, accrued interest and other costs incurred by Albina Bank, less the existing Heritage budget. The \$2.4 million included in the bid to cover PDC’s outstanding loan balance and accrued interest would be received by PDC as loan repayment revenue in the OCC URA Budget. A summary of the OCC URA Budget changes required is shown below:

Summary of OCC URA Budget Changes (\$ Millions)	FY 2008-09 Adopted Budget	Estimated Revision	FY 2008-09 As Revised
Resources			
Loan Repayment - Heritage loan	0.0	2.4	2.4
All other	18.5	0.0	18.5
Total Resources	18.5	2.4	20.9
Requirements			
Project 16237 HQ Hotel	4.1	(1.7)	2.4
Project 25535 Heritage	.3	4.1	4.4
All other	14.1	0.0	14.1
Total Requirements	18.5	2.4	20.9

PDC’s motivation in bidding at the foreclosure sale is to protect its investment in the Property, represented by the \$2.2 million of the PDC Loan which has been disbursed to date.

The maximum bid amount is supported by a recent appraisal of the building (as of March 10, 2008), which estimates the stabilized value for the building at \$4.78 million.

If PDC’s bid is successful, Staff will develop a plan for disposition of the property within two to four months. PDC could choose to lease up the remaining space and later sell the property, or to convert some or all of the building to commercial condominiums.

The Financial Summary for the OCC URA has been included as Attachment A.

RISK ASSESSMENT

If this proposed action is approved, there is a risk that another bid will exceed PDC's bid. If another party bids in excess of PDC, PDC would recover its outstanding loan balance and accrued interest but would not control the property.

If this proposed action is approved and PDC's bid is successful, PDC's investment in the building will increase. We acknowledge that our risks will increase while PDC owns and manages the Property, and these risks will be considered in the disposition plan. However, PDC would no longer be in a subordinate position to a senior lender and could directly control the disposition of the building.

WORK LOAD IMPACT

All work done can be handled by existing PDC staff. If the building is acquired in foreclosure, outside services (for example, for leasing assistance) will be considered as part of the disposition plan.

ALTERNATIVE ACTIONS

The other option considered by Staff would be to take no action at the foreclosure sale.

If PDC takes no action, Albina Bank will foreclose its lien and sell the property to the highest bidder. PDC would likely receive little from the proceeds to apply to PDC's outstanding loan balance and accrued interest of approximately \$2.4 million. Also, taking no action could be perceived by the community as a setback to the positive momentum that has built on NE Martin Luther King, Jr. Blvd.

CONCURRENCE

This project has been discussed at several OCC URA Team meetings and at several internal meetings between project staff and representatives from PDC's Finance and Legal departments.

BACKGROUND

History and Context

The Disposition and Development Agreement (DDA) with The Heritage Building, LLC for the rehabilitation of property at 3934 NE Martin Luther King, Jr. Blvd. was approved by the Board on January 8, 2003 (Resolution 5964) and amended three times by Resolution (Numbers 6079, 6199, and 6238) and modified twice by letter agreement; the last minor modification was approved by the Executive Director on August 30, 2005. The Loan Agreement between PDC and the Developer was executed September 29, 2005, to fund the purchase and redevelopment, and is subordinate to a \$1.9 million senior loan from Albina.

This project, which substantially renovated a dilapidated, vacant building and added two new stories to create a total of 16,695 net square feet of office space and 8,215 net square feet of ground floor retail and commercial space, is located in the center of the most underdeveloped stretch of the NE Martin Luther King, Jr. Blvd. Corridor.

Construction completion by the development team is a significant milestone in PDC's work to jumpstart revitalization and redevelopment at catalyst sites along NE Martin Luther King, Jr. Blvd. The project, however, has not been accomplished without its share of challenges and delays. Construction completion was extended due to unexpected discoveries during construction, and total costs are projected to exceed the \$4.74 million budget by \$178,000, and will use the \$272,360 "lender hard cost contingency fund" in the project budget to cover increased construction costs.

In addition to increased construction costs, lease-up of the building has been slower than expected, though interest in the building has picked up substantially in recent months. Slow lease-up is in part due to the market challenges still prevalent on NE Martin Luther King, Jr. Blvd, and in part due to higher lease rates necessitated by current construction costs. Approximately 50% of the building has been leased.

PDC amended its Loan Agreement on September 19, 2007, to approve the use of the \$272,360 "lender hard cost contingency fund" for increased construction costs and extend the construction period of the PDC Loan from March 31, 2007, to December 31, 2007. On October 19, 2007, the Developer and Albina executed Amendment No. 1 To That Certain Addendum to Construction and Business Loan Agreements (Albina Amendment), which extended the construction period for the Albina loan until December 31, 2007. Albina added additional provisions in the Albina Amendment, including hiring a real estate broker and adding a Debt Service Coverage Ratio (DSCR) requirement of at least 1:00 to 1:00 as a condition for conversion to a permanent loan.

The Developer failed to satisfy all of the Conversion Conditions of the Albina loan by December 31, 2007, and the primary Conversion Condition which was not satisfied was the DSCR of at least 1:00 to 1:00. (At December 31, 2007, there were only two tenants in the building and other prospects had not yet committed to lease space.) The Developer did not pay all principal and interest owing on the loan to prevent the commencement of foreclosure proceedings. The Developer was notified February 21, 2008, that Albina intends to sell the property on July 22, 2008, to satisfy the outstanding obligations. PDC issued its own notice of loan default to the Developer on April 11, 2008.

ATTACHMENTS:

- A. OCC URA Financial Summary
- B. Project Summary

CC: L. Bowers, Interim Development Department Director
F. Wearn, Senior Development Manager
S. King, Development Manager
D. Elott, Interim General Counsel
J. Jackley, Executive Operations Manager

Financial Summary

Fund Summary - Five-Year Budget Projections

	<i>Revised FY 2007-08</i>	<i>Adopted FY 2008-09</i>	<i>FY 2009-10 Forecast</i>	<i>FY 2010-11 Forecast</i>	<i>FY 2011-12 Forecast</i>	<i>FY 2012-13 Forecast</i>
Convention Center URA						
Resources						
Beginning Fund Balance	8,500,611	656,604	829,457	1,258,123	1,496,844	57,166
Budgeted Transfers	600,000	642,259	0	0	0	0
Interest - City Invest Pool	62,213	25,000	10,000	10,000	10,000	10,000
Loans - Interest Earned	20,957	97,616	97,616	97,616	94,151	89,666
Loans - Principal Collection	53,206	97,616	97,616	97,616	94,151	89,666
Real Property Sales	1,800,000	2,900,000	2,500,000	0	0	0
Reimbursement	70,000	70,000	900,000	0	0	0
Rent and Property Income	101,986	130,000	0	0	0	0
Tax Increment - L-T Debt	5,504,198	10,989,000	5,536,135	5,719,275	1,198,800	1,423,575
Tax Increment - S-T Debt	1,515,774	2,868,619	3,069,121	282,585	0	0
Total Fund Resources	18,228,945	18,476,714	13,039,945	7,465,215	2,893,946	1,670,073

Requirements

Project Expenditures (does not include Personal Services or Indirect Cost)

Development

16212 - OCC Community Outreach	20,000	20,000	20,000	20,000	20,000	10,000
16217 - Lloyd Area Planning	20,000	0	0	0	0	0
16230 - Lloyd Trans Improve/Streetcar	150,000	0	0	0	0	0
16231 - OCC Streetcar Construction	1,500,000	1,750,000	1,000,000	0	0	0
16237 - HQ Hotel	200,000	4,100,000	0	0	0	0
16241 - OCCURA DOS Program	153,450	125,000	125,000	125,000	125,000	125,000
25525 - MLK Jr Blvd Improvements	550,000	50,000	0	0	0	0
25533 - Vanport Redevelopment	330,000	0	0	0	0	0
25535 - 3934 NE MLK Renovation	165,344	287,759	0	0	0	0
25536 - 3510 NE MLK Fremont Redev	237,117	0	0	0	0	0
25537 - MLK Jr Blvd Gateway Imprvmnts	100,000	150,000	500,000	0	0	0
25605 - MLK Jr Blvd Commercial SiteDev	50,000	30,000	0	0	0	0
25606 - Lloyd Commercial Develop	40,000	20,000	10,000	0	0	0
25607 - MLK Jr Blvd Action Pln Implmnt	20,000	10,000	10,000	10,000	10,000	10,000
25608 - OCC Redevelopment Loan Progra	942,668	1,500,000	2,000,000	1,000,000	0	0
25610 - Bee Car Rental Redevelopment	7,000	7,000	0	0	0	0
25611 - OCC Blk 47/49 Redevel	0	300,000	0	0	0	0
Development Total	4,485,579	8,349,759	3,665,000	1,155,000	155,000	145,000

Economic Development

25521 - OCC Storefront Grants	438,482	250,000	250,000	250,000	250,000	250,000
70016 - OCC Business Finance	2,300,000	1,000,000	1,000,000	500,000	250,000	250,000
70241 - OCC Business Retention	117,298	100,000	100,000	100,000	50,000	50,000
70268 - OCC Business Development	500,000	0	0	0	0	0
70551 - OCC Community Ec Dev	0	500,000	500,000	500,000	500,000	500,000
70751 - OCC Target Industry Devel	0	100,000	100,000	100,000	100,000	100,000
Economic Development Total	3,355,780	1,950,000	1,950,000	1,450,000	1,150,000	1,150,000

Housing

19032 - Piedmont Place/Affordable Hsg	291,421	299,752	2,351,877	0	0	0
25203 - North OCC Housing	11,677	0	0	0	0	0
37921 - Lloyd Hs Policy/Planning	10,000	5,000	0	0	0	0
80002 - MFH - 2nd and Wasco	1,600	1,600	0	0	0	0
80003 - Lloyd Cascadian Phase II	1,100	0	0	0	0	0
80006 - MFH Lloyd Opportunities	176,960	0	0	0	0	0
80007 - OCC Affordable Rental Housing	430,606	608,417	0	2,000,000	900,000	0
80010 - Fremont Housing	140,000	0	0	0	0	0
80026 - Grant Warehouse/Affordable Hsg	500,000	1,600,000	0	0	0	0

Financial Summary

Fund Summary - Five-Year Budget Projections

	<i>Revised FY 2007-08</i>	<i>Adopted FY 2008-09</i>	<i>FY 2009-10 Forecast</i>	<i>FY 2010-11 Forecast</i>	<i>FY 2011-12 Forecast</i>	<i>FY 2012-13 Forecast</i>
Convention Center URA						
80029 - Affordable Homeownership	850,000	0	0	0	0	0
80042 - Miracles Club	0	1,500,000	1,600,000	0	0	0
Housing Total	2,413,364	4,014,769	3,951,877	2,000,000	900,000	0
Central Services						
59163 - OCC Debt Management	23,540	24,717	25,953	27,250	28,613	30,044
Central Services Total	23,540	24,717	25,953	27,250	28,613	30,044
Executive						
60039 - OCC Eastside/Central City Plan	0	75,000	57,000	0	0	0
Executive Total	0	75,000	57,000	0	0	0
Total Project Expenditures	10,278,263	14,414,245	9,649,830	4,632,250	2,233,613	1,325,044
Indirect Cost	3,507,342	3,233,012	2,131,992	1,336,121	603,167	339,170
Total Fund Expenditures	13,785,605	17,647,257	11,781,822	5,968,371	2,836,780	1,664,214
Contingency	4,443,340	829,457	1,258,123	1,496,844	57,166	5,859
Ending Fund Balance	0	0	0	0	0	0
Total Requirements	18,228,945	18,476,714	13,039,945	7,465,215	2,893,946	1,670,073

PROJECT SUMMARY

- Project Name:** Heritage Building
- Description:** The Developer renovated a dilapidated, vacant building and added two new stories to create a total of 20,551 square feet of office and 9,000 square feet of retail and commercial space. The property is located in the center of the most underdeveloped stretch of the NE Martin Luther King, Jr. Blvd Corridor.
- Location:** 3934 NE Martin Luther King Jr. Blvd
- URA:** Oregon Convention Center
- Current Phase:** Construction has been completed and building lease-up is underway.
- Next Milestone:** Property acquisition at foreclosure sale, currently scheduled for July 22, 2008
- Completion Target:** If acquisition is successful, PDC will develop a disposition plan for the property.
- Outcome:** Substantial redevelopment of vacant and underutilized site in prominent location.

Site/Project Map:

