

Oakland Oversight Board

Memorandum

TO: Oakland Oversight Board

SUBJECT: Swan's Market Loan
Subordination

FROM: Fred Blackwell

DATE: March 18, 2013
ITEM: #5

EXECUTIVE SUMMARY

Staff is recommending Oversight Board approval of a resolution approving the resubordination of a secured loan made by the Redevelopment Agency in 1997 for development of the Swan's Marketplace project, to new financing obtained by the project owner, the East Bay Asian Local Development Corporation ("EBALDC") using New Market Tax Credit ("NMTC") equity. EBALDC will be using the new financing to renovate the project. The terms of the new financing require that the Oakland Redevelopment Successor Agency's security interest in the property remain in second lien position.

OUTCOME

Subordinating the loan will increase the likelihood of ORSA receiving debt service payments on the loan and will alleviate the risk of the ORSA loan being wiped out by a foreclosure of the first lien. By refinancing the loan and leveraging NMTC equity, EBALDC will be able to make needed capital improvements to Swan's Marketplace and existing tenant spaces, and fund improvements for those new tenants the Marketplace can attract once renovation is complete. Specifically, the capital improvements funded with NMTC equity financing will (i) increase the income generated from Swan's Marketplace by both increasing total gross rents and decreasing annual operating expenses, (ii) allow EBALDC and its affiliate to pay for required tenant improvements for over 10,000 square feet of space that would otherwise be difficult to lease, and (iii) help support operations and reduce operating expenses in the remaining 31,500 square feet. The new investment will also increase sales and improve property values which directly create fiscal benefits to the taxing entities in the form of increased sales tax revenue and property tax revenue.

BACKGROUND

Project History

In 1999, the former Redevelopment Agency sold the Swan's Marketplace complex, a historic landmark in downtown Oakland, to EBALDC to facilitate the building's adaptive reuse for affordable housing, cohousing and commercial space for nonprofit organizations and small local businesses. At the same time, the Redevelopment Agency made a deferred payment loan of \$1,150,000, of which \$1,113,918 was actually disbursed, to Swans Marketplace Partnership, L.P., a single-project affiliate of EBALDC, to fund restoration and development of the commercial portion of the Marketplace. The terms of the loan had interest accruing at a three

percent simple interest rate per year, with payments made from surplus cash flow generated from the commercial leases of the building. The Redevelopment Agency loan was secured by a second deed of trust on the commercial portions of the property, subordinate to an outstanding loan to EBALDC of \$3,500,000 from its current first lender, StanCorp Mortgage. The Redevelopment Agency and StanCorp entered into and recorded a subordination agreement at the time of loan closing. The Oakland Redevelopment Successor Agency ("ORSA") took over the Redevelopment Agency's interests in the loan when the Redevelopment Agency dissolved in 2012.

Using the Redevelopment Agency subsidy and the other financing, EBALDC was able to successfully rehabilitate Swan's Marketplace into a mixed-use project, including affordable and co-op housing, and the commercial portions of the building are now leased to a number of local nonprofit organizations and small retail businesses. However, EBALDC has not made any payments on the loan as the commercial portions of the project has not generated surplus cash flow. (As noted above, the loan agreement does not require loan payments unless the project generates surplus cash flow.) As a historic building, the structure has high maintenance and repair expenses and needs additional improvements if it is to attract tenants who can afford the rents that are necessary to support operating expenses and debt service. Moreover, EBALDC lost several established tenants because of the lingering effects of the Great Recession. Without additional renovation, the building will not generate sufficient rent to cover expenses and major capital improvements, and certainly not enough to make any payments on the Redevelopment Agency loan. By refinancing the existing first mortgage, EBALDC can make the improvements required to attract new tenants and revitalize the complex. This planned financing is subsidized by the federal NMTC program, which provides a significant amount of additional money for renovation that would not otherwise be obtainable.

ANALYSIS

New Financing

A key component of EBALDC's revitalization plan for Swan's Marketplace is to attract new restaurants and other tenants. The scope of the proposed work reflects improvements that prospective businesses intending to move to the Marketplace have identified as absolutely necessary as a precondition to enter into a lease. To achieve its revitalization plan, EBALDC would like to bring new investment to Swan's Market by using the NMTC program. EBALDC estimates that NMTC funding can generate over \$1.5 million of additional capital for EBALDC's proposed revitalization project. It is important to note that NMTC funding can only be used for improvements to property in low income communities that result in significant measurable community benefits, particularly employment opportunities. Therefore, the tax credit subsidized funds cannot be used for retirement of debt.

Under the revitalization plan, the primary indoor open market space of Swan's will be restored to better serve as the food-centric gathering place for the community and neighborhood. The layout of the small businesses in Swan's will be re-formatted to accommodate a greater flow of traffic, as well as more communal gathering and eating. The new floor plan also will increase visibility

for each business. The renovation will accommodate the expansion of successful businesses and better integration of cross-traffic businesses. Entry doors will be built so that the core market area will be attractive throughout the year. Storage will be increased for businesses. The ground floor retail businesses will be acoustically improved for work conditions of the second floor non-profits and offices. All of this will improve the livability and walk-ability of Swan's Marketplace for the neighborhood and Oakland, and promote continued vibrant use of this significant historic landmark.

Investment of NMTC subsidy into Swan's Marketplace will provide multiple financial benefits. The proposed investment will increase the building's collateral value, operating cash flow, and ability to attract new tenants, and will help existing tenants to prosper. As a result, staff anticipates that the project will generate increased sales tax and property tax revenue for the taxing entities. Without the NMTC investment it is not likely that Swan's Marketplace will generate sufficient cash flow to ever repay the ORSA loan and there is a risk that the loan could be completely wiped out if the economic condition of the Marketplace further deteriorates and EBALDC faces the risk of default under the first loan. Foreclosure of the deed of trust securing the first loan would wipe out ORSA's subordinate loan. With the NMTC investment, it is possible that the Swan's Marketplace could begin to generate surplus cash flow enabling some repayment of the loan to ORSA as early as 2025. The use of the NMTC investment will provide greater financial stability for the project and potential repayments of the ORSA loan without increasing ORSA's financial commitment to the project.

NMTC Structure

The NMTC financing must use a specific structure mandated by federal code to achieve maximize public benefit. In this case to enable the NMTC financing, the existing StanCorp Mortgage first position loan would be converted into a loan to a single purpose entity formed by the tax credit investor. This loan and any other money raised to finance the renovations will be supplemented with the tax credit investor's equity investment. This aggregation of funds will be invested as required by statute in another single purpose entity (referred to as the "sub-CDE") formed specifically to facilitate the Swan's Marketplace NMTC financing. The sub-CDE must be certified and selected by the U.S. Treasury for an allocation of NMTCs and, as required by statute, will loan the funds to Swan's Marketplace Inc., a single purpose affiliate of EBALDC, to be used for the Swan's Marketplace revitalization project. To accommodate the NMTC financing structure, SMP will lease the building to Swan's Marketplace Inc. which will use the NMTC funds to pay for the necessary Marketplace improvements. At the end of the seven-year NMTC compliance period, after the investor has recouped their investment in the form of annual tax credits, EBALDC will have an option to purchase the investor's interest. Like the similar options for Low Income Housing Tax Credits, the price for this option has typically been nominal compared to the equity investment.

Resubordination of ORSA Loan

To make the NMTC financing work, the deed of trust securing the ORSA loan must continue in a subordinate position to the new NMTC loan security, just as the loan was originally subordinated by the Redevelopment Agency to the current first lien financing. The terms of the ORSA loan would not be amended or extended by these actions.

To this end, EBALDC, ORSA, and the financing entities have negotiated the terms of a Subordination Agreement. The title company for the financing entities has indicated that, given the fact that the loan is now an asset owned by ORSA, Oversight Board and DOF approval of the requested subordination is required to have the ORSA loan resubordinated to the new first lien lender.

The requested resubordination is not only beneficial to Swan's Marketplace and its surrounding community, but also would be clearly in the best interests of ORSA and the taxing entities in Alameda County. The revitalization of Swan's Marketplace will increase the chance of repayment of the ORSA loan and will alleviate the risk of the ORSA loan being wiped out by a foreclosure of the first lien. More importantly, the new investment will increase sales and improve property values which directly create fiscal benefits to the taxing entities in the form of increased sales tax revenue and property tax revenue.

COST SUMMARY/IMPLICATIONS

The subordination of the loan provides the best opportunity for repayment of the original loan since the goal of the new financing structure is to increase project revenue and decrease operating costs. To date the project has not generated sufficient cash flow to make repayments, and current performance trends are expected to continue if the improvements discussed above are not made.

For questions regarding this report, please contact Jens Hillmer, Urban Economic Coordinator at 238-3317.

Respectfully submitted,

/s/

FRED BLACKWELL
Assistant City Administrator

Reviewed by:
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Office of Neighborhood Investment

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Urban Economic Coordinator
Office of Neighborhood Investment

OAKLAND OVERSIGHT BOARD

RESOLUTION No. 2013-_____

A RESOLUTION APPROVING RESUBORDINATION OF AN EXISTING COMMERCIAL DEVELOPMENT LOAN FOR THE SWAN'S MARKETPLACE PROJECT TO NEW FINANCING

WHEREAS, in 1998, the former Redevelopment Agency of the City of Oakland (the "Redevelopment Agency"), provided a \$1,150,000 commercial development loan (the "Loan"), of which \$1,113,918 was actually disbursed, to Swans Marketplace Partnership, L.P., an affiliate of the East Bay Asian Local Development Corporation ("EBALDC"), for the Swans Marketplace project in downtown Oakland; and

WHEREAS, the Oakland Redevelopment Successor Agency ("ORSA") stepped into the rights and obligations under the Loan when the Redevelopment Agency dissolved; and

WHEREAS, Swans Marketplace Partnership, L.P., has obtained new permanent financing using New Market Tax Credit ("NMTC") equity that will replace the loan currently in first lien position on the property, and has requested that ORSA subordinate the Loan to this new financing; and

WHEREAS, Swans Marketplace Partnership, L.P., has not been able to make payments to the Redevelopment Agency and/or ORSA from available cash flow; and

WHEREAS, by refinancing the existing first loan and leveraging NMTC equity, the project owner will be able to make needed capital improvements to Swan's Marketplace and existing tenant spaces, and fund improvements for those new tenants the Marketplace can attract once renovation is complete; and

WHEREAS, the new financing will increase the property's collateral value, operating cash flow, and ability to attract new tenants, and will help existing tenants to prosper; and

WHEREAS, the use of the NMTC investment will provide greater financial stability for the project and potential repayments of the ORSA loan without increasing ORSA's financial commitment to the project; and

WHEREAS, resubordinating the Loan to new financing will increase the likelihood of ORSA receiving debt service payments on the loan and will alleviate the risk of the ORSA loan being wiped out by a foreclosure of the first lien; and

WHEREAS, the new investment in Swan's Marketplace will increase sales and improve property values which directly provide fiscal benefits to the taxing entities in the form of increased sales tax revenue and property tax revenue; and

WHEREAS, the terms of the Loan will not be amended or extended by these actions; now, therefore:

Based on the foregoing recitals and the documentation presented to the Oakland Oversight Board at a public meeting, the Oakland Oversight Board does resolve as follows:

SECTION 1. The Oakland Oversight Board finds and determines that the proposed resubordination of the Loan will be of benefit to the taxing entities for the reasons set forth above and in the staff report accompanying this Resolution.

SECTION 2. The Oakland Oversight Board hereby approves ORSA's subordination of the deed of trust securing the Loan to new financing for the Swan's Marketplace project.

ADOPTED, OAKLAND, CALIFORNIA, _____, 2013

PASSED BY THE FOLLOWING VOTE:

AYES- CARSON, GERHARD, LEVIN, ORTIZ, QUAN, SMITH, TUCKER

NOES-

ABSENT-

ABSTENTION-

ATTEST: _____
SECRETARY, OAKLAND
OVERSIGHT BOARD