



Department of Planning & Community & Economic Development

Economic Development Division

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**Office of Business Resources
Office of Real Estate Services**

TO: Community Development Authority and Common Council

FROM: Matthew B. Mikolajewski, Economic Development Division Director

SUBJECT: Tribe 9 Foods - Madison Capital Revolving Fund Staff Report (Legistar # 46437)

DATE: March 7, 2017

The following memo outlines proposed Madison Capital Revolving Fund (“MCRF”) assistance to Tribe 9 Foods, LLC (“Tribe 9 Foods”). Tribe 9 Foods is a recently formed company led by Mr. Brian Durst and majority owned by an investment group called Natural Food Partners (of which Mr. Durst is an investor). Natural Food Partners recently purchased RP’s Pasta of Madison (www.rpspasta.com), Yum Butter of Madison (www.yumbutter.com), and Ona Treats of Colorado (www.onatreats.com). Through this acquisition, these three formerly independent firms have combined to become Tribe 9 Foods. Principals of the three former companies will retain minority ownership and play a role in running the new Tribe 9 Foods.

Mr. Durst desires to grow all three brands in a single, combined facility. Tribe 9 Foods is currently considering multiple locations, including a leased facility at 2901 Progress Road in Madison.

City staff have negotiated two MCRF loans totaling \$650,000 to purchase food manufacturing equipment for Tribe 9 Foods. Loan # 1 would be for \$250,000, bearing 0% interest for a term of 6 years. On the anniversary of each year following issuance of a certificate of occupancy, \$50,000 will be forgiven if certain job requirements are met. These job requirements include the maintenance/creation of 35 full-time equivalent positions paying a living wage at the end of Year 1 (RPs Pasta and Yum Butter have approximately 30 full-time equivalent employees in Madison today) to 47 full-time equivalent individuals earning a living wage at the end of Year 5. If the threshold of jobs is met for each of these five years, the total loan amount would be forgiven. If the threshold is not met in any year, the balance will be due the City at the sixth anniversary of the issuance of the loan.

Loan # 2 would be for \$400,000, bearing 2% interest for a term of 6 years with a 10 year amortization. Borrower will make quarterly payments of principal and interest with a balloon payment of the remaining balance due at the sixth anniversary of the issuance of the loan.

The loans will be secured in three ways. The first will be a mortgage on the food manufacturing equipment purchased through the use of the MCRF loans. The City will not subordinate this mortgage. The equipment will be purchased new for approximately \$750,000. At a minimum, the residual value is estimated to be \$375,000.

The second will be a personal guarantee from one of the Tribe 9 investors in the amount of \$325,000. As a condition for issuing the loan, the City will verify that the net worth of the individual is sufficient to honor

this guarantee. This personal guarantee will decline over time commensurate with the Loan # 1 forgiveness outlined above.

The final form of security will be a subordinated mortgage on the remaining equipment of Tribe 9 Foods. Tribe 9 Foods will use private bank debt, in part, to purchase additional equipment. This lender shall retain a first-position mortgage on this other equipment; however, the City will reserve a subordinated right to collect on this equipment if necessary.

The Economic Development Division (“EDD”) retained Madison Development Corporation (“MDC”) to assist with the underwriting of this project. MDC was a lender to the former RPs Pasta, and therefore already familiar with one aspect of the new company. MDC has experience underwriting dozens of similar business expansion projects, and their level of expertise was useful to City staff in considering this opportunity.

On balance, MDC’s report was very favorable. Strengths of the company include the fact that the former RPs Pasta is profitable, with continued revenue growth anticipated for all three brands due to several new contracts with national retailers. Cash available for debt service on private and MCRF debt is projected to be twice of what would be needed for repayment (a debt coverage ratio in excess of 2.0).

The MDC report also highlighted the fact that the new investors in Tribe 9 Foods are bringing significant working capital to the new company, which will help to facilitate growth. At the same time, the management team of the former companies will remain with Tribe 9 Foods with substantial minority ownership to insure continuity with regard to each product line and continued success of the new company in the long-term.

MDC did note a couple of potential weaknesses with the new firm. Tribe 9 Foods is a new entity, and Yumbutter and Ona Treats have historically recorded operating losses. This weakness can be mitigated by RP’s Pasta being able to carry Yumbutter and Ona Treats until these product lines are better established; however, there exists a risk that actual revenue may not meet projections.

MDC also noted that the collateral value of all company assets is likely at or below the private debt on the Project. City staff mitigated this weakness by insuring that we retain a first-position mortgage on the food manufacturing equipment being purchased through the MCRF loan, coupled with a partial personal guarantee.

Staff is comfortable that the strengths of the company outweigh the weaknesses. Further, the project will support several major objectives and criteria identified in the Madison Capital Revolving Fund Loan Policy (“Policy”). One of the primary program objectives is to “encourage the expansion of new and existing business enterprises that create jobs for unemployed and underemployed people.” Tribe 9 Foods will retain and add manufacturing jobs, an important source of employment within the Madison economy.

The Policy continues that an “evaluation may include consideration of the number of new permanent basic sector jobs created.” A basic sector industry is one that exports products outside of the community; thereby, drawing financial resources back into the area. The Tribe 9 Food brands already sell products nationally, and this is projected to increase as partnerships with national retailers continue.

The Policy also references the City’s economic strategy. The current economic strategy, “Connect Madison,” specifically references Food Systems as an area where the City desires to see targeted business retention and expansion. This project provides a great opportunity to help grow two existing Madison food-based businesses, while welcoming a third to our community. In the future, the facility could be used to manufacture products of other businesses on a contract basis, thereby enhancing the ability of the Madison community to support food start-ups.

The project, does not; however, meet all criteria of the Policy. More substantial areas of difference include the fact that \$650,000 in loans exceeds the usual maximum of \$250,000. Further, MCRF loans are typically not forgivable.

The City usually requires a Loan to Value ratio that does not exceed 90%. Based on the cost of the equipment, the City would meet this 90% loan to value ratio requirement through its first-position mortgage; however, if the City needed to call the mortgage note, the exact value of this equipment relative to the outstanding loan balance at that time is currently unknown.

The City also typically requires a personal guarantee for the full amount. Staff have negotiated a partial personal guarantee. Although the structure of the collateral does not meet the Policy, staff is comfortable that the City's position is well secured given the relatively short-term of the loans. Upon disbursement, the City will have a first-position on new equipment that costs \$750,000 plus a \$325,000 personal guarantee. Even if the equipment is only worth half its initial value, the City should be secured. With a six-year term on each loan, annual debt service and forgiveness will mean that the initial loan balance of \$650,000 will decline rapidly, further reducing the City's exposure.

The Capital Revolving Fund started 2017 with a cash balance of \$1.1 million. When taking into consideration this project, revenue from loan repayments, \$125,000 for the Façade Grant Program, and a \$35,000 loan to the Regent Market Cooperative, the Capital Revolving Fund is projected to end 2017 with a cash balance of over \$500,000. The City has formally withdrawn the previous \$880,000 offered to RPs Pasta and there are no additional applications under consideration at this time.

City staff have negotiated a proposed transaction that we believe will help retain and grow manufacturing jobs in an industry sector of great interest to the City. It will help facilitate the expansion of two home-grown brands while attracting a third. While appreciating the opportunity that this project presents, City staff also acknowledges the risk. Although staff believes Tribe 9 Foods will have the capacity to repay the City's loan as planned, we have negotiated a three-part collateral package to cover any shortfall. Staff therefore recommends approval of the MCRF loan package outlined in this report and the accompanying resolution.