



Department of Planning & Community & Economic Development

Economic Development Division

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Office of Business Resources
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TO: Common Council

FROM: Matthew B. Mikolajewski

SUBJECT: Luna's Groceries Grant (Legistar #66044)

DATE: June 21, 2021

Through Legistar #66044, the Common Council is being asked to provide a \$780,000 grant to Luna's Groceries ("Luna's") within the Rule Enterprises project ("Development") at 1402 S. Park Street. The following memo provides additional background regarding this request.

Development Structure

Rule Enterprises will be constructing an affordable housing project, in partnership with Movin' Out, on a piece of property that Rule Enterprises will purchase from the City of Madison. Rule Enterprises will sell a first floor condo unit in the building to Luna's Groceries, who in turn will complete interior construction within the condo and open/operate a grocery store in the space.

Rule Enterprises will be using WHEDA tax credits to fund the construction of the building. WHEDA requires that Rule Enterprise complete their purchase of the City property by July of this year and commence construction soon thereafter. To do this, Rule Enterprises needs to finalize their financial agreements with their investor. A requirement of finalizing their financing is confirmation that Luna's Groceries will have private financing available to purchase their condo unit either this year or next year at the completion of the construction project, and close on a construction loan for the build out of the grocery. Unfortunately, Luna's Groceries has not yet secured their private financing because they do not have enough cash equity to close on their loans. The purpose of this grant is to help Luna's secure the required cash equity needed to move forward with securing their private financing for the project. In other words, the City's commitment of \$780,000 of cash equity into the transaction will allow Luna's Groceries to secure their private financing, which in turn will allow Rule Enterprises to secure their private financing, which in turn will allow Rule Enterprises to close on the purchase of the property in July, which will maintain the WHEDA tax credits, and allow the project to proceed.

Why should the City of Madison provide this grant?

As noted above, Luna's Groceries needs an additional \$780,000 of cash equity to secure their private financing. Although Luna's Groceries has tried to secure this cash equity elsewhere, they have been unable to do so. With the July WHEDA closing requirement rapidly approaching, it is unlikely that Luna's Groceries will be able to secure this additional support from an entity other than the City. If the City does not support this request, the development project will likely not move forward.

Does it need to be \$780,000?

The amount represents ten percent (10%) of the total \$8.9M loan Luna's Groceries needs, minus funds they have separately secured. The mechanism for disbursement is subject to the final financing structure for the tax credits, but the plan right now is that the \$780,000 would be disbursed in two phases. The first \$460,000 would be disbursed at the time that Rule Enterprises purchases the property from the City and closes on their financing, which will occur next month (July). At this point, Luna's Groceries would own the to-be-constructed white box condo unit. The remaining \$320,000 will be disbursed to Luna's Groceries at the time that they close on their build out financing a year from now (summer/fall 2022). As noted in the resolution, we will work with Luna's Groceries to find alternative sources of cash equity to replace this second \$320,000 disbursement (in full or part). We will; however, be responsible for this entire \$320,000 second disbursement if we are unable to find alternative external sources.

What are the sources of the City's \$780,000 grant?

The resolution calls for using \$170,000 from the former Madison Capital Revolving Fund and \$610,000 from the Small Business Equity and Recovery (SBER) Program. The Madison Capital Revolving Fund was a business revolving loan program that the City operated for many years. Several years ago, the decision was made to wind-down that program in favor of other initiatives more suited to today's economic opportunities and challenges. There are; however, outstanding borrowers continuing to make loan payments to the City. These payments are still deposited into the former Madison Capital Revolving Fund account, and there is currently about \$170,000 of unencumbered funds available.

The Small Business Equity and Recovery (SBER) Program had a 2020 Budget of \$750,000 and a 2021 Budget of \$2.5 million. Expenditures to date include approximately \$2 million for COVID assistance grants and \$100,000 for the Madison Pop Up Shop Program. If \$610,000 is directed to Luna's Groceries, there will still be \$540,000 remaining available for other SBER initiatives through the balance of the year.

What are the risks of providing this grant?

The City would normally underwrite a request for this type of grant close to the time that funding is utilized. The City has not underwritten the financials of Luna's Groceries given the short notice period of this need; however, Luna's Groceries private lender is underwriting the grocery now in advance of providing the loan for the condo unit purchase. There are two potential risks to the success of this transaction that should be considered.

First, the initial \$460,000 disbursement will need to occur next month (July). The City's disbursement of this funding will insure that Rule Enterprises is able to close on their financing, complete the purchase of the property from the City, and begin construction of the project. The City can be generally comfortable that construction of the building will be completed in about a year and that the project will include a "white box shell" condo unit where Luna's Groceries will locate. The risk is that something happens over the next year that prevents Luna's Groceries from moving forward. Although we would not be required to disburse the remaining \$320,000, we also wouldn't have a clear path forward for a securing a much-needed grocery store for the neighborhood. With \$460,000 already invested in the project, the City is exposed to making a future unknown financial commitment to insure a new grocery store for the newly built space.

Second, prior to disbursing the second \$320,000, the City will have some opportunity to review the private lending commitment made to Luna's, as well as Luna's operating pro-forma. Although short of a full

underwriting, the City will have some indication of the ability of Luna's Groceries to succeed at the time of this second disbursement. That said, City risk is not eliminated. Luna's could complete build-out of their space, open for business, and be successful for a period of time; however, there is no repayment or "clawback" ability should Luna's Groceries not continue to be successful. The City has required a 10-year Land Use Restriction Agreement (LURA) of Rule Enterprises that this space be used for a grocery store for at least a decade after construction. It is therefore likely that, should Luna's Groceries falter, a request for additional financial assistance will be directed to the City; or, if Luna's Groceries were to close entirely, that the City be asked to provide new financial support for the new grocer.

The presence of these risks should not discount the fact that there is also a possibility that the entire project will proceed as planned with a successful Luna's Groceries in this development for many years.

What is the risk of not moving forward with this grant?

All indications are that should the City not provide this grant commitment now, the Rule Enterprises Development will not move forward. As the presence of a grocery store in the neighborhood is tenuous, if this Development does not move forward as planned, there is the possibility that the neighborhood will be without a grocery store for an undetermined period of time.

It is not clear how long it would take to identify a new development project with a new grocery store. Based on the results of the Request for Proposals (RFP) for the project and discussions with the grocery industry, there does not appear to be significant demand on the part of grocers to locate at this site. This is due in part to the relatively small number of households in the immediate surrounding area given the proximity to Lake Monona, the UW Arboretum/Lake Wingra, and the Alliant Energy Center. Further, it is not clear how much financial support would be required of the City to make a new project succeed; it could cost more than the total requested of this project to date.

How much funding has the City pledged to this project?

If the Common Council approves this grant, the City will have committed a total of \$3.17 million to this project as follows: \$1.8 million through the Affordable Housing Fund, \$590,000 towards the construction of Cedar Street, and \$780,000 for this grant. Every project is different and it is impossible to compare two projects exactly; however, a \$3.17 million investment in this project is consistent with similar significant redevelopment projects throughout the community that the City has assisted in the past. For example, the Galaxie project on E. Washington Avenue, which includes a grocery store, received a total of \$5.85 million of TIF support for both phases of development.

Staff Recommendation

Recognizing the risks of both moving forward and not moving forward, on balance, staff recommends moving forward with this grant commitment as outlined in the resolution (Legistar #66044).