SANFORD CITY COUNCIL
LAW AND FINANCE COMMITTEE WORK SESSION
Wednesday, September 10, 2014
5:00 P.M. in West End Conference Room
225 East Weatherspoon Street, Sanford, NC

The Law and Finance Committee held a work session on Wednesday, September 10, 2014, at 5:00 P.M. in the West End Conference Room at City Hall in order to discuss the Brick Capital Community Development Corporation Assessment which was recently completed by the UNC Chapel Hill School of Government's Development Finance Initiative ("DFI"). The following people were present:

Law and Finance Committee:

Mayor T. Chet Mann	Mayor Pro Tem James Williams
Council Member Byron Buckels	Council Member Sam Gaskins
Council Member Jimmy Haire	Council Member Norman Charles Post, III
Council Member Rebecca Wyhof	City Clerk Bonnie Davis
City Manager Hal Hegwer	

Absent:

Council Member Charles Taylor
City Attorney Susan Patterson

Work Session

Mayor Chet Mann called the work session meeting to order and welcomed Council Members and guests.

City Manager Hal Hegwer informed everyone that immediately after the work session presentation, the meeting would resume in the Council Chambers.

Community Development Director Marshall Downey explained that due to changes in the economy and reductions in funding sources, Brick Capital Community Development Corporation ("Brick Capital") staff has been challenged to find alternative methods of operation. City Council recently appropriated funds for an assessment to be performed by the UNC Chapel Hill School of Government's Development Finance Initiative ("DFI"). This assessment has now been completed and Marcia Perritt, Manager of DFI, will be making a presentation of this analysis and its resulting recommendations (copy attached as Exhibit).

Ms. Perritt expanded on the history and purpose of the assessment by stating that she works with DFI, which is housed within the Community and Economic Development program at the UNC School of Government. DFI is the technical assistance arm of the School of Government and partners with local governments, community groups and private developers from all over the state on a variety of issues relating to community and economic development. She introduced a fellow staff member, Meisha McDaniels, a Graduate Student in the Kenan-Flagler Business School and School of City Planning, who was quite involved with the assessment and performed much of the statistical work on the project.

The Initiative has been involved in this type of work for about a year and has worked with five other Community Development Corporations ("CDCs") from all over the state. Work on this project began with a portfolio review of all Brick Capital assets. Ms. Perritt informed the Council that CDCs are unusual due to the fact that they tend to have a diverse variety of assets (such as shopping centers, business incubators, affordable housing), whereas a traditional real estate firm typically focuses on one particular type of asset. This attempt to be "everything to everyone" makes it quite challenging for CDCs. The portfolio was analyzed to determine debt and assessed tax and appraised values. Site visits were performed with Director Marshall Downey, Brick Capital Executive Director Kate Rumely, and Community Development Manager Karen Kennedy. An entire day was spent touring properties with Ms. Rumely. A more detailed analysis and financial assessment was then performed of the assets to determine how a traditional real estate company would operate with them.

Ms. Perritt explained that there are four core functions of such a traditional real estate company: development, brokerage, property management, and asset management. She detailed them as follows:

- Development is an area where Brick Capital has excelled, according to the assessment. Development includes market research and obtaining relevant financial data required for a project and verifying that the project will succeed by taking it through the entire process. Brick Capital has a long history of success in this area, as well as having done development on behalf of other organizations.

- Brokerage includes sales, leasing, marketing, recruitment and intake.

- Property management comprises the bulk of a CDC's daily activities and includes day-to-day interaction with tenants, collection of rents and making repairs.

- Asset management includes the overall strategy of long-term decision making, evaluating financial opportunities, review of financial sustainability and researching opportunities which may feed into the other functions.

An additional function which makes it specifically challenging for CDCs is the fact that they also have a mission, a purpose beyond just maintaining financial sustainability and which is not specifically profit-oriented. A CDC combines the four core elements listed above with the addition of a fifth function of fulfilling their mission, which is over and above that of the traditional real estate company.

These five functions constitute the "lens" for the analysis and financial assessment by DFI, which is then used to develop strategies for each individual asset using this framework. The draft recommendations were presented just last Friday, September 5, to Director Downey, Director Rumely and Manager Kennedy. After that meeting, Kate Rumely quickly corrected some assumptions as originally presented at this meeting. This information and feedback was incorporated into the final recommendations, which are being presented at this meeting.

Ms. Perritt noted that, for the most part, Brick Capital's diverse asset portfolio is simply causing the CDC to spread itself too thin. At one time, marketing opportunities made this feasible; however, increased competition, changing market dynamics and the lack of funding no longer allow this option.

One of their recommendations is to focus on one particular class of asset, perhaps a particular mission component (such as affordable housing or economic development).

Another recommendation is to liquidate assets not essential to this core strategy in order to acquire capital for investment in the strategic assets. Brick Capital's assets were identified and classified later in the presentation.

The final recommendation of DFI is to outsource brokerage and property management. These responsibilities are too burdensome for CDCs and their day-to-day work; outsourcing them would increase flexibility and limit their opportunity costs.

The three categories properties used for classification by DFI are as follows:

- "Non-Essential Assets" are defined as those assets which are not financially sustainable and will produce no revenue in the long-term. There may also be a mismatch between skills required to manage these assets and the skills of the CDC staff. An example would be a business center with no staff resources available for incubation services. Other non-essential assets may no longer be relevant to the mission or perhaps the mission could be carried forward by other organizations. An example would be affordable renting housing assets which are not financially viable but the need is still there and could be better served by the Housing Authority or Habitat for Humanity, which is better positioned to carry out this mission.

- "Strategic Assets" may have some qualities associated with non-essential assets (such as not being very high-performing), but they do present some type of important mission impact or potential for transformation of the community which is best served by CDC. These strategic assets often have revenue potential which is under-realized.

- "Mission Oriented Assets" frequently produce little revenue but do break even cost-wide. Their mission impact is so great that it is best for the CDC to retain them.

Assets of Brick Capital identified by and included in the Assessment were as follows:

- Makepeace Street Office property
- Affordable Single-Family Housing Rentals ("Affordable Housing")
- Supportive Housing Rentals

- W.B. Wicker School property ("Wicker School")
- Vacant Lots
- Vacant Land

Total tax assessed value of these assets is $4,171,812 and there is approximately $2,365,900 in debt. Occupancy rates vary from 50% (on commercial rental property) to 85% (at the Wicker School). Ms. Perritt noted that Brick Capital does all of its own leasing and property management in house.

Summaries of and recommendations for Brick Capital assets are as follows:

- Makepeace Street Office property: This property was formerly the site of the Brick Capital office. It is currently approximately 50% occupied with approximately $187,932 debt and has an annual operating deficiency of $27,000. This is considered a "problem property" by DFI since it is negatively impacting Brick Capital's cash flow. Its current operating expenses are approximately $14 per square foot while its rent is only approximately $10 per square foot. Even if it were fully occupied at the current rental rate, it would still lose approximately $12,000 annually. It was offered for sale in the last year with limited success.
  - Recommendation: This asset is classified as "non-essential". The rental rate needed for the property to break even of $14.50 per square foot is excessive for the Sanford market. Similar commercial properties in Sanford are currently renting for $7-12 per square foot, so raising the rent would simply be untenable. This property should be sold or auctioned at a reserve price which minimally covers the debt. Selling this property would eliminate payment of property taxes and allow CDC staff to focus on other needs. There is currently a lease in place with one tenant and the property also has an official "HUB Zone" Designation ("Historically Underutilized Business"). These facts should enhance marketability. An adjacent property owner has purchased other properties in this area and may be a potential buyer. It is also recommended that brokerage be outsourced.

- Affordable Housing Rentals: This category includes four single-family houses located in the Brick Capital Redevelopment area surrounding the Wicker School which were originally intended for homeownership. Brick Capital and the City of Sanford have both made extensive investments in this area and contributed significantly to its improvement. The total assessed tax value of these homes is $330,000 and there is approximately $200,000 in debt. They have had an annual operating loss of approximately $23,000, which has had a substantial negative impact on Brick Capital's cash flow. Rent is approximately $6-$7 per square foot or approximately $650-$715 per month. These homes were marketed for sale in 2007, near the beginning of the economic downturn. They have been marketed as "affordable rentals" since that time. Three of the four houses are currently occupied. They tend to have minimal turnover since there is demand for this type of housing in this neighborhood. A rental rate of $11 per square foot is needed in order to break even, which is excessive for this market area. If rates are raised to this level, the units are no longer "affordable" housing; however, current rental rates are not sustainable by Brick Capital.

- Recommendation: Although the recommendation is to sell or convey these assets, there is potential to retain them if restrictive covenants are placed or if policy measures are taken by the City which would ensure that they are occupied by tenants who will assist in continuing to move the neighborhood forward in the right direction. The final recommendation by DFI, however, is that these properties be sold.

The question was posed by Council Member Gaskins as to whether these properties could be profitable to an outside investor. Ms. Perritt explained that this would depend on whether the investor could cut costs overall, including debt and the associated cost (loan amount, interest rate, monthly payment). There is an opportunity for an investor to have lower costs, which would make ownership potentially profitable.

- Supportive Housing Rentals: These properties serve "special populations" and additional services are provided above housing. There are eight individual properties with 22 total units, four of which are located in Pittsboro. The two primary buildings are the Lee-Harnett Haven Housing I and II. Total assessed tax value of these properties is approximately $1.3 million, with only $75,000 debt which is not deferred. There is more debt, but it is in the form of a North Carolina Housing Finance Agency 0% interest loan which will be deferred after 30 years so long as it remains "affordable" housing. Financial performance varies among these properties but overall, there is a positive cash flow of $8,000 annually, which is an unusual trend for Brick Capital. There is even increased opportunity for improvement due to strong demand for this type of product with its their minimal turnover and high occupancy. Brick Capital's partnership with other organizations, including the Housing Authority and other non-profits, contributes to this success with occupancy; there is also a long waiting list.

  Ms. Perritt explained that typical tenants of these properties are individuals with special needs, disabilities, and those deemed most vulnerable according to lists of Project Based Rental Assistance and Section 8 Housing.

  - Recommendation: There is opportunity for Brick Capital to increase income from these properties. Although profitability is not the goal of CDCs, it does ensure continued operation and allows for mission fulfillment by remaining sustainable. Ms. Perritt noted that utilities on these properties are extremely high, even in comparison to other CDCs for similar properties. Including payment of the tenants' cost of utilities with rent offers no incentive for tenants to reduce consumption patterns. It was recommended that new leases not include utilities, which would significantly reduce operating costs. There is also a strong need to outsource property management and leasing of these properties. There are other companies who specialize in these services for similar tenants and with this type of housing. The cost impact would not be substantial since the opportunity cost to Brick Capital is so high. Property management is extremely involved and prevents Brick Capital from focusing on its strength of property development. The recommendation is for retaining this asset, since it is mission oriented and could become more revenue-producing with a reduction of operating costs and by outsourcing property management, which is a huge opportunity cost and has prevented Brick Capital from focusing on what it does best long-term.

The question was posed by Council Member Haire as to whether excluding utilities would pose a hardship on some tenants who may have difficulty in obtaining utilities as a result of credit problems. Ms. Perritt answered that perhaps the Housing Authority could assist with this issue and that there are mechanisms for other entities to assist with tenant utilities. Mr. Haire noted that there are approximately 50 tenants who are living at the Palomino Hotel at a rental rate of $600 monthly; many of these tenants are there primarily as a result of difficulties with obtaining utilities. Ms. Perritt suggested that rental amounts could be adjusted to account for differences in whether utilities are included or excluded and that other non-profit partners could assist with resolving this issue.

- Wicker School property: This was a major historic redevelopment project which now has three major tenants and business lines: (1) Small Business Suites (located on the bottom floor, which was originally intended for a small business incubator); (2) Childcare facility; and (3) Central Carolina Community College's ("CCCC") Lifelong Learning and Dental Hygiene Program. The office of Brick Capital is also located here.

  This property is nearly breaking even on costs. The average current rental rate is $10.65 per square foot (ranging from $6-12 per square foot, depending on tenancy type and location); operating costs are $11 per square foot. The annual operating deficit is currently $11,000, which is less than other Brick Capital assets but it is still under-performing.

  - Recommendations (itemized by business lines):
    - Small Business Suites: These are extremely inefficient. Their expenses run $30,000 compared to income of only $18,000. Even if fully occupied at the current rental rate, income would increase to only $23,000. Expenses should be reduced and/or rent should be increased. The break-even rent is $10.65 per square foot and current rent is $6 per square foot. Even if rent could be increased somewhat, it is likely that other tenants at the Wicker School would still have to cross-subsidize this rent. Given the configuration of the spaces (including the fact that they have no windows), potential rent will likely be less than $7 per square foot for this type of commercial space. One option for increased occupancy would be to have one tenant for this entire floor. Providing a business incubator is not suited to Brick Capital's mission and may be more suited to organizations housed within CCCC (such as the Small Business Technology Development Center). Perhaps doctors' or attorneys' offices would be a better fit for this configuration of small,

separate suites located within a centralized location. Another recommendation is that Brick Capital downsize its offices or relocate in order to make this entire floor available to one tenant, which would in turn command a higher rent. It is also recommended that utilities no longer be included in the rent, giving tenants responsibility for their own utilities. It was noted, however, that this is not currently possible since utilities are not metered out separately. It was also recommended to increase marketing of this property and to find partners who can identify any niche industry cluster which could be targeted as being suited to this space. The City could possibly offer better support to Brick Capital by leasing space in the small business suites property if swing space or other additional office space is needed by City staff.

- Childcare facility: Their share of rental income does not cover their full operating costs. Utilities are also included in their rent. One major recommendation is to remove utilities from the rent, as previously recommended on other Brick Capital properties. The current lease is effective through 2017 and the new lease is currently being signed, making a rent increase impossible at this point. If this lease is not renewed or when a new tenant is located, rent should be increased and utilities should not be included.

- CCCC: They occupy the majority of space at the Wicker School property. This partnership shows positive net operating income of approximately $10,000 annually and, according to the assessment, is a great deal for CCCC. Perhaps they could pay a higher rent and cover more operating expenses. Rent is $11 per square foot but should be $12 per square foot or more. Brick Capital recently negotiated a three year lease agreement with CCCC which, unfortunately, did not include a 3% annual increase, which is fairly standard in other leases. Upon future lease renewals, this should be renegotiated and Brick Capital should have some leverage in ensuring that CCCC pays more market rent for the cost of operating the space. Utilities should not be included in the rent and should be paid directly by CCCC, along with security expenses and all common area maintenance costs. Since CCCC occupies the entire first floor, they have a greater burden for utilities in comparison to the other tenants. The Dental Hygiene has many pieces of expensive equipment which likely load the system. Although records indicate $10,000 in net operating income, this is likely not representing the true cost of utilities attributable to CCCC.

It was acknowledged by Ms. Perritt that having CCCC as a tenant is a tremendous asset at the Wicker School property. This property is indeed a strategic asset of Brick Capital and a shining example of historic redevelopment to other CDCs. Taking a one-time abandoned asset with great sentimental value to the community which is located in the center of a neighborhood and redeveloping it was a wonderful project.

She also acknowledged that CCCC is clearly invested in the Wicker School property, as evidenced by its location of the programs and associated equipment; however, the partnership is also strategic to CCCC since their location in the neighborhood makes it convenient to potential students of their programs. These factors combine to make it a "win-win" situation for both the Wicker School and CCCC. Ms. Perritt was unable to locate other leases which CCCC may have in place with other private tenants. Amenities offered at the Wicker School site, including outfitting, parking, security and maintenance, make the rent extremely reasonable and attractive to CCCC. As with the other properties, Ms. Perritt recommended that property management be outsourced due to the excessive opportunity cost. Examples were cited, including alarm issues which required Executive Director Kate Rumely's direct involvement, as well as her involvement in rent negotiations, which require her acting in the role of Landlord.

Recently the Auditorium behind the Childcare facility reached an age which qualifies it for historic preservation tax credits, making it a potential redevelopment opportunity which could help to add value to what Brick Capital has already accomplished at the site and also could serve as a marketing tool to another agency.

Council Member Rebecca Wyhof asked how difficult it would be to calculate and meter utilities for individual tenants and spaces with the current configuration. Mayor Mann stated that separating meters is an expensive process. One option would be to meter individually for the Childcare facility, CCCC and the Business Suites, but there would still be problems due to the current wiring configuration. Another alternative would be charging a base rent with an additional utility fee, which would be calculated based on square footage if individual metering were cost prohibitive.

Mayor Mann noted that the County likely has been a major influence in holding the rental rate of CCCC steady with no increases in the last few years and suggested that the County be advised of the specific assessment recommendations regarding CCCC.

Council Member Sam Gaskins inquired as to which governmental agency is currently offering historic preservation tax credits regarding the Wicker School Auditorium. Ms. Perritt answered that the tax credits have been at the federal level, in some configuration. State tax credits have recently been eliminated and are now being restructured, which may be in the form of grants but with similar results. She also suggested that this may be a project suited for a private investor or possibly CCCC.

Vacant lots: These lots were originally intended for home construction.

- Recommendation: It is recommended that the lots be sold or conveyed to other partners in Sanford who share the common goal of preserving the affordable housing stock in the community, such as the Housing Authority or another non-profit housing agency with a larger portfolio of affordable rentals which could operate them more efficiently. Part of the issue is that Brick Capital does not have the economy of scale to manage this efficiently. These properties, although classified as "non-essential", do have a mission which could be carried forward through another organization.

- Vacant Land- There are two tracts of vacant land:

  - 16 acres on Washington Avenue- This land was conveyed by the City to Brick Capital in 2006 for affordable housing.
    - Recommendation: DFI suggests that this tract be re-conveyed to the City. Timber harvesting is recommended as soon as possible to help shore up reserves while non-essential assets are being liquidated. This property could be developed by another party as affordable housing or perhaps it could be integrated into the Endor Furnace Trail project, which would also enhance the value of the Wicker School property and surrounding neighborhood. With the conveyance back to the City of Sanford, the decision as to its ultimate use will be determined by the City.

  - 11 acres at 1600 Washington Avenue- This property was purchased from the City of Sanford in 2006 with the intention of developing a solar facility. There have been some negotiations with potential development partners interested in pursuing this project, but nothing has been finalized. Development of innovative projects is an area at which Brick Capital has been successful in the past but unfortunately, there are too many other responsibilities and functions they are currently performing to devote the time and effort needed for a project such as this.
    - Recommendation: This property is identified as a non-essential asset and should (a) be conveyed to the City or (b) have development partners identified in order to pursue the solar facility project. Conditional zoning, which is already in place allowing this use, enhances marketability to a potential partner since this administrative hurdle is not a problem.

A final summary of DFI's framework identified Brick Capital's assets is as follows:

- Non-Essential Assets: Single-Family Affordable Rentals
  Makepeace Property
  Vacant land
  Vacant lots
- Strategic Asset: Wicker School Campus
- Mission-Oriented Asset: Supporting Housing

Ms. Perritt summarized the DFI Assessment by restating the following key themes:

- Brick Capital's diverse portfolio makes it difficult to manage assets to their most productive use;
- Across the board, Brick Capital tenants are not paying full costs of occupancy; passing utility costs along to tenants will decrease overall operating expenses and help maximize their net operating income or to at least break even;
- Brick Capital should sell or convey some of their non-essential assets (Makepeace Street Office property, Single-Family Affordable Rentals, vacant lots and vacant land) and focus on high-impact, mission-driven projects (Supportive Housing, Wicker School property);
- Outsource property management and leasing since there are high opportunity costs. This will give Brick Capital the freedom necessary in order to focus on their strength of acting as a developer.

Ms. Perritt referred to a timeline included in the assessment which indicates anticipated time frames for completion of these recommendations. She concluded her presentation by stating that DFI recommends Brick Capital first dispose of non-essential assets, which should result in approximately $488,890 in capital funds to invest in the remaining strategic and/or mission-oriented assets.

Mayor Mann thanked Ms. Perritt for her presentation. City Manager Hegwer also thanked her on behalf of the City for the thorough and professional presentation.

Ms. Perritt reiterated that CDCs statewide are dealing with similar challenges at this time, including decreased funding, changing markets and thinly-stretched leadership. By comparison to other CDCs, Brick Capital is in relatively good condition. Although there are challenges to be worked through, there is room for a turnaround if their focus is narrowed. She also noted that DFI was impressed with the degree of cooperation shown by Ms. Rumely.

Ms. Rumely stated that she felt the assessment was also thorough and acknowledged the depth in which it was conducted. She also noted that the rental calculations and associated analyses were tremendous sources of information and that the spreadsheet data will be extremely useful by Brick Capital, both now and in the future. She summarized by stating that Brick Capital will benefit greatly from the assessment.

Ms. Kennedy confirmed that no meeting has been held by the Brick Capital Board since the assessment has been received but that one will be held soon.

Brick Capital Board Member Bill Wilson informed everyone that there were several other Brick Capital Board Members present for this meeting and that the recommendations would be carefully and quickly reviewed. He also extended his appreciation to the DFI staff on behalf of Brick Capital.

City Manager Hegwer stated that he was pleased that both Council and several Brick Capital Board members were present for the presentation. He was also pleased to hear of the opportunities available, including the historic designation of the Wicker Auditorium Gym and potential future partnerships in some of the opportunities.

Council Member Gaskins asked if there is a source for locating prospective partners for the solar facility project. Ms. Perritt answered that an Addendum would be included in the assessment with some information on this. She also explained that a local commercial realtor who is knowledgeable about this market area would also be a great source of assistance on these projects.

Council Member Haire mentioned that there was a group currently negotiating with landowners in eastern North Carolina and Harnett County for solar facility properties. These groups are discussing potential 20 year leases for properties located near the electrical sub-stations.

Mayor Mann stated that the assessment provides direction for Brick Capital's future mission. He was pleased that the Brick Capital board will be meeting soon to gather feedback and come to a consensus as to how to proceed and stated that County officials will also be consulted regarding the parts of the assessment in which they have involvement.

After confirming there were no additional questions or comments, Mayor Mann stated that the workshop portion of the Law and Finance Meeting was concluded.

Adjournment

Council Member Sam Gaskins made the motion to adjourn and reconvene as the Law and Finance meeting in the Council Chambers Room at 6:00 P.M. Seconded by Council Member Norman Charles Post, III, the motion carried unanimously.

Respectfully Submitted,

T. Chet Mann

T. Chet Mann, Mayor

ATTEST:

Bonnie Davis

Bonnie Davis, City Clerk