

REPORT TO CRA/LA BOARD OF COMMISSIONERS

ON

THE LOS ANGELES DEVELOPMENT FUND (“LADF”) AND THE RECENT KROGER  
NEW MARKETS TAX CREDIT (“NMTC”) TRANSACTION

January 20, 2011

## **PURPOSE**

To update the CRA/LA Board of Commissioners (“Board”) on the New Markets Tax Credit Program and the Los Angeles Development Fund (“LADF”) and inform the Board about LADF’s recent closing of a \$27.5 million New Markets Tax Credit (“NMTC”) transaction with The Kroger Co.

## **REPORT**

### **1. Background on NMTCs and LADF**

The NMTC program is a federal tax initiative designed to promote economic development in low-income communities. The program was enacted as part of the Community Renewal Tax Relief Act of 2000. After the program’s initial 5-year term, it has been renewed annually. The NMTC program is administered by the Community Development Financial Institutions Fund (“CDFI Fund”) and the Internal Revenue Service, both arms of the Treasury Department.

Only a Community Development Entity (“CDE”), a designation awarded to an entity by the CDFI Fund, can apply for an allocation of NMTC. CDEs must have a primary mission of serving low-income communities or low-income persons. The above-referenced LADF is a California nonprofit organization created by the City of Los Angeles in 2007 to apply for and manage the City’s NMTC Program. The LADF has been designated a CDE and maintains accountability to residents of low-income communities through representation on its Advisory Board.

In October 2007, LADF was awarded a \$75 million allocation of new markets tax credits. LADF has used this allocation to generate investment capital to provide flexible, low-cost financing products to qualified projects in low-income communities within the City of Los Angeles. LADF reserves a portion of its tax credit allocation for each approved qualified project. LADF then sells the tax credits generated from the reserved allocation to investors in exchange for cash. The money raised from sale of tax credits is used to provide low-cost financing to developers to build. Cash generated from the sale of NMTCs can fill the financing gap on eligible projects and can often times cover up to 20% of a project’s total development costs, depending on market rate prices for the tax credits.

The tax credit purchaser does not get all of the tax credits upfront. Rather, they claim the tax credits over seven years, resulting in a seven-year NMTC compliance period.

LADF is governed by a five-member Governing Board of Directors. Each Board member serves on an ex-officio basis, while serving in his or her respective position within the City. The Board of Directors is composed of: the General Manager of the Los Angeles Community Development Department (“CDD”), the Chief Executive Officer of the CRA/LA, the City Administrative Officer, the Chief Legislative Analyst, and the Chairperson of the Industrial Development Authority (“IDA”).

In September 2008, the LADF Board of Directors approved CRA/LA to serve as its management agent; in February 2009, the City authorized CRA/LA to serve in this management capacity.

CRA/LA provides administrative and management services to LADF and is responsible for overseeing all aspects of the NMTC program.

LADF start-up costs were funded by advances of \$43,750 and \$130,179 from IDA and CRA/LA, respectively. Since February 2009, LADF operating costs have been funded with draws totaling \$400,000 on a \$700,000 non-revolving line of credit with CRA/LA. With the closing of the Kroger transaction, LADF will reimburse IDA and CRA/LA for these start up costs and repay all outstanding balances to CRA/LA, plus interest, under the line of credit.

Based on the remaining fee income collected at close of the Kroger transaction, plus recurring asset management fees related to closed transactions and fee income expected to be collected upon investment of the remaining allocation, LADF is expected to be self-sustaining going forward.

In December 2009, LADF closed its first NMTC transaction, providing \$20 million of its NMTC allocation for construction of a new YWCA Job Corps Center in downtown Los Angeles. The total project cost for this Center is \$73.6 million and financing involved LADF partnering with Enterprise Community Investment, Inc., the Local Initiatives Support Corporation ("LISC"), and Bank of America to provide sufficient NMTC allocation.

## 2. Overview of Kroger Project

The Kroger transaction entails the interior and exterior rehabilitation of four Food4Less stores located in low-income communities in the City of Los Angeles. The total building square footage of the four stores to be rehabilitated is 169,302 square feet, as follows:

- (a) Food4Less Store #375 (CD 1): 31,200sf of GBA  
1091 S. Hoover Street, Los Angeles, CA 90006

Year built 1964/ Last Renovated 1994

A major rehabilitation totaling \$2.9 million (\$93psf) of the interior of Store #375 began on May 24, 2010 and was completed on August 13, 2010. The interior work was completely funded by Kroger, but store sales could not support any rehabilitation of the exterior.

The scope of exterior work consists of façade improvements, resurfacing and upgraded lighting for the parking lot, the addition of landscaping, and buffering of the loading dock.

LADF, via the NMTC structure, will provided \$1 million for external renovation. Without the benefit of the NMTC financing provided by the LADF, no exterior renovation would have been done to this store.

Exterior renovation is scheduled to begin February 2011 and be complete on May 2011

- (b) Food4Less Store #770 (CD 1, Westlake Recovery Redevelopment Project Area):  
57,500sf of GBA  
1700 W. 6th Street, Los Angeles, CA 90016

Year built 2001/ Not previously renovated

The rehabilitation of Food4Less Store #770 is a \$3 million investment (\$52psf) to update the store interior, including fixtures and equipment.

The scope of work consists of improvements of the beverage, front concourse, bakery, deli, produce, dairy, and meat sections of the store. Upgrades that will be made to the store include new exterior paint, new floor tiles, new rack shelving, remodeled restrooms, new entrance doors, and new self-service bakery cases and deli islands.

Construction will begin January 2011 and complete April 2011.

- (c) Food4Less Store #314 (CD 7 – Pacoima/ Panorama City Project Area): 53,362sf of GBA  
8530 Tobias Avenue, Panorama City, CA 91402

Year built 1996/ Not previously renovated

The rehabilitation of Food4Less Store #314 is a \$4 million investment (\$75psf) to update the building, including fixtures and equipment.

The scope of work consists of improvements of the front concourse, bakery, and deli sections in the store and new produce and meat sections. Upgrades that will be made to the exterior of the store include new exterior paint and improved exterior signage.

Without the benefit of the NMTC financing provided by LADF, no renovation would have been done to this store.

Construction is scheduled to begin March 2011 and be complete by May 2011.

- (d) Food4Less Store #370 (CD 14): 27,240sf of GBA  
4910 Huntington Drive South, Los Angeles, CA 90032

Year built 1962/ Last Renovated 1994

The rehabilitation of Food4Less Store #370 is a \$5 million investment (\$184psf). This store will receive major renovation. The interior will be gutted and completely replaced, including demolishing a portion of the building to construct a mezzanine floor which will house back office and employee facilities.

This store is one of the smallest in the Food4Less portfolio. Due to site restrictions, expansion of the footprint is not possible and creation of the mezzanine will allow for an internal expansion of the sales floor with a concomitant improvement in the shopping experience for the community.

The scope of work consists of improvements in front concourse, new flooring and new checkout. In addition, space will be created for new bakery service, new deli service, a new meat/carniceria department and expansion of the produce section. Exterior upgrades include new exterior paint and new architectural finishes, new and expanded

entrance doors, resurfaced parking lot, new lighting and security cameras, and significant landscaping.

Additionally, Kroger staff has worked diligently with the community and the City Council district office to improve the streetscape and façade along Huntington Drive, a main commercial corridor in El Sereno.

Without the benefit of the NMTC financing provided by the LADF, no renovation would have been done to this store.

Construction is scheduled to begin June 2011 and complete November 2011.

This investment of NMTC in the Kroger Food4Less transaction protects high-paying union supermarket jobs and will create quality retail shopping venues for local low-income residents, improve the physical appearance of the community, augment current efforts to improve targeted neighborhood commercial hubs, and boost the City's efforts to ensure access to quality, healthy food for underserved communities. This investment partnership will serve as a model to other larger food corporations that Los Angeles' low income communities merit high quality supermarkets and that the City of Los Angeles is a partner in making these critical investments.

### 3. Community Benefits of Kroger Project

#### Job Retention and Creation

- **Job retention:** The four Food4Less stores currently employ 274 employees, with an average pay of \$12.09 per hour, and offer benefits to all employees, including part time employees who are contractually guaranteed at least 20 hours of work per week. Upgrading these stores is critical to Kroger efforts to maintain a customer base and keep these stores open, and is therefore critical to job retention. Employment at the four stores consists of:
  - #314 – 22 FT, 46 PT employees
  - #370 – 16 FT, 36 PT employees
  - #375 – 11 FT, 37 PT employees
  - #770 – 33 FT, 73 PT employees

At least 2/3 of employees in any given store are union employees.

- **Increased labor hours:** Kroger estimates that investment in a complete store rehabilitation increases sales by approximately 15%. Labor expenses average 9% of store sales and, as sales increase, so do labor hours. Certain stores have experienced sales increases above the original 15% projections.

The union contract with Food4Less includes a sliding scale that sets a minimum number of full-time employees based on sales revenue; so in addition to more labor hours, the

increased sales expected from the rehabilitations may lead to an increase in the number of full-time employees.

- **Local hiring:** Food4Less is committed to local hiring, including for higher management positions, as a means to build a strong community connection, ensure employee quality of life, and support the communities that are its consumers. Approximately 65% of employees live within a 3 mile radius of the store where they are employed. Food4Less participates in local job fairs, has hiring kiosks in stores, and shares resumes from interested parties across local stores.

NMTC transaction documents include the requirement that during the 7-year compliance period, Kroger list all job openings at the four stores with the City of Los Angeles CDD administered WorkSource and OneSource centers serving the community in which the applicable store is located. Annual reports to support compliance are required.

- **Construction jobs:** The total rehabilitation investment of \$13 million will generate approximately 107 construction jobs. Without the NMTC investment, Kroger would have only invested \$3 million of new cash equity by renovating only store #770 at 6<sup>th</sup> Street and Burlington Avenue. This work would have generated approximately 25 construction jobs. Furthermore, transaction documents require Kroger to engage a General Contractor (“GC”) for each store who agrees to make Best Efforts to fill 40% of trades with qualified M/WBE subcontractors located within the City of Los Angeles. Kroger and the pool of bidding GCs will work with the Los Angeles Minority Business Opportunity Center (“LA MBOC”) and the Mayor’s Office of Economic and Business Policy to organize pre-bid meetings which will be mandatory for GCs who wish to bid on the renovation of the subject stores.

Preliminary meetings between representatives from Kroger’s pool of five prequalified GCs who will be bidding on these projects and staff from Food4Less, LADF and LA MBOC were held in December 2010.

### **Community Investment**

As a member of the community, each neighborhood Food4Less store participates in local events by providing gift certificates, food, and broader charitable programs such as offering free turkeys for Thanksgiving. During the seven-year compliance period, Kroger is required to report on its annual community contributions within the City of Los Angeles in general, and specifically within the local community of each of the four stores. Although there is no increase in community contributions required, it is expected that tracking and reporting the contributions made at each store, as well as the introductions to Food4Less Community Affairs staff made at the community meetings, will increase Kroger’s accountability and responsiveness to community needs for corporate contributions.

### **Community Outreach**

Community outreach is an added benefit of this project. Community meetings have been held in each of the three City Council districts in which the stores are located. In attendance were representatives from Kroger's Community Affairs, Real Estate, and Operations divisions. They presented the proposed rehabilitation plans and requested input about how to make the stores true community assets. These meetings provided an opportunity to build bridges between distressed communities and Kroger.

At each meeting, the community voiced its concerns about maintenance of the site and vicinity as well as operations at the stores. Kroger committed to address these concerns. More importantly, the store operations managers were present as well as the regional operations manager, and lines of communication were opened between community leaders and the store operators.

### **Leveraging other Public Dollars**

A comprehensive economic development and redevelopment strategy uses targeted investments as a catalyst for investment in surrounding properties. Supermarkets are often the key anchor for a neighborhood-serving retail center. Major rehabilitation of a Food4Less will draw new customers and revitalize a commercial area and is likely to spur investment by neighboring retailers that seek to pick up new customers. The four stores in the NMTC pool are at the center of efforts to revitalize neighborhood retail hubs. It is expected that major rehabilitation of the local grocery store will augment the effects of the investments CRA/LA and the City of Los Angeles have planned for these areas:

- Store #314 is in the Center of the Panorama City commercial center. January 1, 2010 marked the launch of the Panorama City Business Improvement District, the result of community and City efforts to focus on revitalization of this commercial area. The area will shortly see major infrastructure investments. CRA/LA has budgeted \$5.4 million to invest in streetscape improvements along Van Nuys Boulevard, immediately east of the store location and plans to begin construction later this year. CRA/LA is also partnering with DWP, and foresees sharing in the \$1.1 million cost to underground the utilities immediately north of the store location. In addition, CRA/LA recently secured a \$250,000 grant from CalTrans that will be used to study transportation patterns of pedestrians, vehicles, and buses and make recommendations to improve efficiency and safety along Van Nuys Boulevard in Panorama City.
- Store #375 at Olympic Boulevard and Hoover Street is located in the heart of a commercial district that is the focus on revitalization efforts, including a new affordable housing development and increased community activity through a Neighborhood Watch program and the Neighborhood Council. The Community Plan Update for this area is also considering a design overlay that would have requirements for the exterior of commercial properties. The NMTC will fund exterior renovations to the store, allowing for a direct connection to these new design standards.

- Store #370 in El Sereno is at the heart of the Huntington Drive commercial center. Councilmember Huizar's office has partnered with CRA/LA to identify \$800,000 in streetscape improvements along Huntington Drive, which fronts this store. The City has developed monument signs to welcome the community to this commercial district and has developed a Business Watch. The Neighborhood Council has invested in trash receptacles as part of a clean-up campaign.

This Food4Less is an anchor in this commercial corridor and the complete renovation is a critical boost to the City and community's efforts to revitalize the area and attract local shoppers that currently spend their dollars in other communities. In addition, the closest large chain grocers near the El Sereno store are Albertsons, Costco, and Fresh & Easy (all located about two miles east in Alhambra). The scarcity of supermarkets in this area makes this Food4Less a significant retailer to the local community.

#### 4. Related CRA/LA Activities

##### **City of Los Angeles' Food Retailers Incentive Program**

In June 2006 City Council members Perry and Parks presented a motion to create an interdepartmental working group to identify incentives to attract supermarkets and sit-down restaurants to South Los Angeles. The result of this working group was development of the Food Retailers' Incentive Program, which channels the City's host of economic development incentives and offers a priority to food retailers in participation. CRA/LA has taken the lead on marketing the Food Retailers' Incentive Program.

To market this Program, CRA/LA has developed marketing materials, identified opportunity sites, pursues ongoing outreach to food retailers, participates in conferences, panels and community forums, and is actively engaged with community-based organizations focused on the issue of food access.

**The Kroger NMTC investment is a direct result of this effort to outreach to Food Retailers.** While exploring options to finance rehabilitation of underperforming stores that could not support Kroger's minimal internal rate of return ("IRR") for additional investment, Kroger staff learned of the Food Retailers Incentive Program. Kroger staff contacted CRA/LA staff to learn more and they were eventually directed toward LADF and the NMTC program.

This NMTC investment is intended to be the first of a multi-phased partnership with Kroger to reinvest in stores located in underserved communities. This partnership sends a strong message to the food retail community that the City is committed to bringing access to quality food.

Within the City of Los Angeles' commitment to access to quality food there has been a focus on supporting markets that provide union jobs. To date, most of the grocers opening new stores in Los Angeles' underserved markets are independent non-union entities. The City has supported the opening of these stores because they bring needed retail and quality food to the community.



However it is important to seize an opportunity to support investments by retailers that offer union and other higher-paying jobs and to ensure that these stores stay a strong player in the competitive landscape.

### **FUTURE**

LADF has \$27.5 million remaining of the \$75 million NMTC allocation awarded in 2007. Despite current challenges in the capital markets, the LADF has a number of promising qualified projects in its pipeline and staff expects to fully invest the LADF's remaining allocation by the end of 2011.

The tax bill approved by Congress and signed by President Obama on December 17, 2010, included a \$3.5 billion NMTC allocation per year for 2010 and 2011. Although LADF did not apply for a 2010 allocation, staff expects that LADF's application for the 2011 allocation round will be highly competitive.

There is no news as to when the application round for 2011 will be opened, but historically applications have been issued in April/May with awards granted in the fourth quarter of the year. LADF staff therefore expects to be awarded additional NMTC allocation to continue its investments in the City of Los Angeles' low-income communities.

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