DATE: August 19, 2015
TO: Board of Commissioners
FROM: Patrick Quinton, Executive Director
SUBJECT: Report Number 15-52

Authorizing a Disposition and Development Agreement to Convey 1.79 Acres of Real Property in the Interstate Corridor Urban Renewal Area to Majestic Realty Company for $502,160; Authorizing a Master Lease Agreement with Majestic Realty Company for Approximately 5,125 Square Feet of Commercial Space in the Interstate Corridor Urban Renewal Area; Authorizing a Special Authority Grant to Majestic Realty Company for $122,705 as Part of the Disposition and Development Agreement to Convey 1.79 Acres of Real Property in the Interstate Corridor Urban Renewal Area to Majestic Realty Company

BOARD ACTION REQUESTED

Adopt Resolution Nos. 7139 – 7141

ACTION DESCRIPTION

The proposed actions by the Portland Development Commission (PDC) Board of Commissioners (Board) will authorize the Executive Director to execute (i.) a Disposition and Development Agreement (DDA) between PDC and Majestic Realty Company (MRC) for the conveyance of a 1.79 acre PDC-owned parcel (Property) to MRC for the consideration of $502,160; (ii.) a Master Lease Agreement (MLA) between PDC and MRC for approximately 5,125 square feet (SF) of commercial space; and (iii.) a Special Authority Grant to MRC in the amount of $122,705. The Property is located in the Interstate Corridor Urban Renewal Area (URA) and is bounded by NE Martin Luther King, Jr. Boulevard (NE MLK Blvd.), NE Alberta, NE Garfield, and NE Sumner streets (see Attachment A for a map of the Property).

MRC is proposing to construct an urban retail shopping center consisting of approximately 25,000 SF of gross leasable area in two separate buildings: Building B will contain approximately 16,800 SF including a 15,000 SF anchor grocery store leased by Natural Grocers, and Building A will contain approximately 8,450 SF of commercial/retail space for lease (Project) (see a Project Summary in Attachment B). There will be approximately 90 parking spaces with access proposed from NE Alberta and NE Sumner streets. The single-family residence that will be conveyed to MRC will be deed-restricted to its current use for a period of five years.

If approved, these actions will activate a long-vacant lot, deliver a healthy food grocer to a part of Northeast Portland that is lacking such services, and provide opportunities for local businesses and employment.
BACKGROUND AND CONTEXT

The Property (as well as the full block to the north) was assembled by PDC in multiple parcel acquisitions beginning in 1997, following the Albina Community Plan (ACP) goal of assembling land along commercial corridors to bring employment and needed goods and services to the northeast community. One action identified in the ACP was to “revive commerce on NE MLK Blvd. by fostering the development of strong commercial nodes at key intersections.” Following this direction, in 2000 PDC and the community developed the King Neighborhood Commercial Strategy (Strategy), which outlined a development vision and concept for new, multi-phased commercial and residential development between NE Alberta and NE Killingsworth streets. Two phases of development have been completed to date; the actions before the PDC Board will complete the implementation of the Strategy, as summarized below.

Phase I: Vanport Square

Vanport Square Phase I is a 36,000 SF commercial condominium project on NE MLK Blvd. between NE Sumner and NE Emerson streets completed in 2008 by Vanport Partners, LLC. The project consisted of 16 independent commercial condominium units in two buildings: a 21,000 SF renovation of the former Marco Machine Works and a newly-constructed 15,000 SF three-story building.

Phase II: Vanport Housing

The second phase of the Vanport Square project was completed in December 2012 and consisted of 10 single family homes along NE Garfield Street, adjacent and to the west of Phase I. The second phase was completed by a different developer, Lisac Brothers Construction, Inc., and all units have been sold.

Phase III: Martin Luther King, Jr. Boulevard – South (MLK Alberta)

The third phase of the Vanport Square project, renamed MLK Alberta, is envisioned to be a commercial development on the block immediately to the south of Vanport Square between NE Alberta and NE Sumner streets. There have been multiple attempts and proposals over the past 10 years to redevelop the Property, yet none has moved forward. The Property has significant redevelopment challenges in that there is a public easement running through the middle of the Property that cannot be built upon, limiting the size and configuration of any future building footprint. In addition, the Property sits between a busy thoroughfare (NE MLK Blvd.) and a residential neighborhood street (Garfield Street); consequently traffic, access, and parking all pose constraints and must be addressed.

In 2011, on behalf of then-Mayor Sam Adams, PDC released the Grocery Store Request for Information (RFI). The purpose of the RFI was to bring grocers to areas that the City of Portland Bureau of Planning and Sustainability designated as underserved. The Property is located within one of those underserved areas, and in late 2011 MRC approached PDC stating its interest and ability to secure a grocery store as an anchor for the site. MRC is headquartered in southern California and holds a diverse portfolio of more than 70,000,000 SF of industrial, office, and retail space. MRC is unique in that it retains ownership of its projects over the long term, maintaining responsibility for leasing, management, and maintenance. In late June 2012, based on MRC’s extensive experience and relationship with an anchor grocer, PDC and MRC entered into a 60-day Memorandum of Understanding (MOU). During this period, MRC was tasked with performing a market and demographic analysis, conceptual site programming, and obtaining a letter of intent from the anchor grocer tenant. The MOU expired in August 2012 without MRC obtaining a formal letter of intent.

In March 2013, MRC came to PDC with a letter of intent, signed by a prominent national grocer, clarifying its interest in entering into a long-term lease and locating a new store on the Property. At the time, the grocer, subsequently identified as Trader Joe’s, required that its identity and interest remain under strict confidentiality until the land purchase was certain and it had negotiated the terms of a lease. PDC subsequently entered into another 60-day MOU with MRC in May 2013 with the intent of
working in earnest toward a specific set of deliverables and a DDA. During this period, MRC was tasked to further investigate the development concept, costs, and schedule of the Project to include the grocer as an anchor tenant.

MRC and PDC negotiated the terms of a DDA for the conveyance of the Property and development of the proposed shopping center including Trader Joe’s as the anchor grocer. The PDC Board authorized the Executive Director to execute the DDA through Resolution No. 7044 on November 13, 2013. Members of the local community subsequently expressed concerns with the process by which the DDA was negotiated, the terms of the DDA, and the potential for the Project to result in gentrification. Trader Joe’s decided to withdraw from the Project and, as a result, the DDA was not executed.

In response to community concerns, Mayor Charlie Hales convened a group of North/Northeast Portland community stakeholders in March 2014 and committed to development of the Property that would benefit local residents, support neighboring businesses, introduce Portlanders to a high-quality, affordable grocer, and revitalize a parcel of land that has sat dormant for 15 years. Mayor Hales directed PDC to (i.) continue the development process with MRC and Colas Construction as the prime contractor to find a new anchor tenant; and (ii.) work with the Portland Housing Bureau (PHB) to allocate an additional $20,000,000 of tax increment funds for affordable housing in the Interstate Corridor URA.

In spring 2014, MRC began negotiations with Natural Grocers, a Colorado-based grocer with stores in 17 states. Natural Grocers currently has eight locations in Oregon, including four in the Portland metropolitan area. Natural Grocers is founded on the principles of providing nutrition education and supporting the efforts of non-profits in the community toward the betterment of health and the environment, offering quality natural products at affordable pricing for customers, and providing employees excellent benefits and opportunities to grow within the company.

To advance the Project, PDC pursued an inclusive approach with MRC and community partners that included further due diligence on the design, costs, financing, and negotiation of a DDA for a revised development with Natural Grocers as the anchor tenant. In order to provide the community with a formal mechanism for input as the Project moved forward, PDC staff convened a Project Working Group (PWG) composed of community partners to provide advice and feedback on two crucial components of the Project: development of a Cooperation, Coordination, Project Implementation and Community Benefits Agreement (CBA); and building and site design.

**Project Description**

PDC has worked with MRC to finalize a detailed Project design and associated budget and pro forma outlining projected costs, revenues, expenses, fees, and returns for the Project. The shopping center consists of approximately 25,000 SF of gross leasable area in two separate buildings. Building B will contain approximately 16,800 SF including a 15,000 SF anchor grocery store, and Building A will contain approximately 8,450 SF of commercial/retail space for lease. There will be approximately 90 parking spaces with vehicular access proposed from NE Alberta and NE Sumner streets. Key design changes resulting from community input include retaining the single-family house located on NE Garfield Street; incorporating a retail tenant on the southeast corner of Building B with an entry facing NE Alberta Street and/or NE MLK Blvd.; glazing on the east façade of Building B that will enable a demonstration kitchen to be visible to passersby; a plaza located between the two buildings with seating, landscaping, and space for a Martin Luther King, Jr. Heritage Marker; and space for two art installations that will be culturally-specific to the North/Northeast Portland community. To offset the increased costs for implementing these community-requested design changes, PDC will provide MRC a $122,705 grant after the project is complete.
Purchase Price
An appraisal commissioned in December 2012 set the “As-Is Market Value” of the Property at $2,870,000, stating that the highest and best use of the subject site is a mixed-use development with retail and residential uses. Development of a full-service grocery on the site means that the property cannot be used for the appraised highest and best use. In order to induce MRC to accommodate the neighborhood’s deep, longstanding desire to locate a full-service grocery on the site, PDC is proposing to reduce the purchase price to $502,160. This purchase price has been arrived at by evaluating the Project’s pro forma which indicates that the revenue stream is unable to support new construction without a reduction in land sale price. MRC is accepting a below-market projected return of six percent on cost and only 30 percent of their equity investment is returned after 10 years.

Community Benefits Agreement
The PWG was originally formed in November 2013 and additional members were added in September 2014 to provide broader representation of community stakeholders as they develop the CBA that was finalized in April 2015. The CBA is supported by key community members and the entire development team. The CBA includes commitments and obligations regarding the construction contracting, grocery store workforce hiring, design, community space, supply chain, and retail tenanting. Specific to the retail tenanting, PDC has committed to secure a master lease from MRC for 50 percent of the non-grocer retail space for a term of 10 years and to dedicate a minimum of $500,000 for the purpose of offering reduced base rent rates and/ or tenant improvement cost support. PDC will also work with a community Tenanting Advisory Committee (TAC) when selecting subtenants from the community; details on the TAC membership are to be determined.

Disposition and Development Agreement
The key terms of the negotiated DDA include:

- Purchase price of $502,160;
- PDC is providing a $122,705 grant to MRC to offset increased costs associated with community requested design changes and will be master leasing 50 percent of the non-grocer retail space;
- MRC to provide $75,000 earnest money deposit due within five days of the effective date and non-refundable at the end of the due diligence period;
- MRC may elect not to proceed with the transaction if matters are not acceptable to MRC at the end of the 30-day due diligence period;
- Closing to occur within eight months of the effective date;
- Prior to closing, MRC must have:
  - All land use approvals and permits secured, with no appeals filed;
  - All financing necessary to construct the Project closed, or MRC has obtained commitments for such financing;
  - PDC approval of final project budget, which shall be an updated and revised estimate of sources and uses of funds, cash flow, and budget;
  - Evidence of necessary equity commitments;
  - Registered the Project for Leadership in Energy and Environmental Design (LEED) Silver certification; and
  - Provided a copy of an executed lease with Natural Grocers;
- MRC to construct two privately-owned buildings which will be a total of approximately 25,000 SF and approximately 90 parking spaces;
- The single-family dwelling to be retained and not demolished by MRC and properly maintained and offered for residential occupancy for a period of five years;
- Application of PDC policies: Business Equity, Workforce Equity, and Green Building;
• Application of prevailing wage rate; and
• MRC to commence construction within 20 months of the effective date and complete construction within 28 months of the effective date.

Master Lease Agreement

The key terms of the MLA include:

• PDC to lease 50 percent of the non-grocer commercial space (approximately 5,125 SF) for 10 years with a five-year option;
• The base rent is market rate under the same terms and conditions MRC gives to tenants in adjacent commercial space (excluding Natural Grocers) but not less than $29/SF triple net (NNN) and escalated five percent every two years;
• MRC to deliver the premises as a cold shell and for rent to commence the earlier of 90 days after delivery to PDC or a subtenant opening for business; and
• PDC to pay its own utilities which will be separately metered, and its pro rata share of NNN expenses such as property taxes, general liability insurance, maintenance, operation, replacement, utilities, and security of the common areas of the shopping center.

COMMUNITY AND PUBLIC BENEFIT

Public benefits of executing this DDA, MLA, and implementing the associated CBA include:

• The Property will be redeveloped with an anchor grocer (a use long sought and desired by neighborhood residents) and retail space for lease to neighborhood-serving businesses that will activate the nearby blocks, potentially catalyze further redevelopment along NE MLK Blvd. and NE Alberta Street, and include locations for culturally-specific heritage markers and public art;
• Approximately 5,125 SF of retail space will be master leased by PDC and, in association with a TAC, will be subleased to local businesses that will be provided with financial and technical assistance in order to support local businesses and job growth and enable wealth creation opportunities for people of color and low-income community members;
• The single-family residence on NE Garfield Street will be retained, providing a continuing residential occupancy opportunity;
• MRC is investing more than $2,000,000 of its own funds to bring this Project to fruition;
• The Project is estimated to generate more than $87,000 per year in property tax revenues;
• PDC’s Equity Policy will apply to the construction of the Project, ensuring fair and equitable opportunities for Portland’s diverse populations, promoting prosperity in all segments of Portland’s diverse communities, and expanding competition in the market;
• PDC’s Green Building Policy will apply, ensuring that the building is LEED Silver certified;
• Oregon Prevailing Wage Law will apply to construction of the Project;
• Development of the Property will complete PDC’s involvement in the redevelopment of two full blocks at a key commercial corridor, as called for in the Albina Community Plan and the King Neighborhood Commercial Strategy;
• Natural Grocers will provide community space and a demonstration kitchen and has committed to providing employment, training, and advancement opportunities to community members, especially to low-income people and people of color;
• MRC has selected Colas Construction, a local, certified Minority Business Enterprise, to be the general contractor for the project, which will enhance wealth building and employment opportunities for local businesses and people of color; and
• Development and implementation of the CBA has promoted communication and cooperation and established goals and standards for the project to ensure benefits accrue to the community.
PUBLIC PARTICIPATION AND FEEDBACK

PDC staff has conducted public participation on the entire Vanport site dating back more than a decade. More recently, PDC formed the PWG in September 2014 to provide input on the project design and to develop the CBA. The PWG consists of 20 members, including the project development team (MRC, Natural Grocers, and Colas Construction), Worksystems, Inc., Metropolitan Contractors Improvement Partnership, Micro Enterprise Services of Oregon (MESO), representatives of the King and Boise neighborhoods, other interested community partners, and representatives of PDC. PDC hosted more than 10 meetings of the PWG which resulted in the completion of the CBA in April 2015.

The CBA is supported by key community members and the entire development team. However, some members of the PWG did not sign the CBA citing concerns with the content and process of negotiating the CBA and other issues including gentrification and commercial affordability.

The CBA is an unprecedented partnership that will provide increased economic opportunities for the local community and represents a dramatic change in the structural approach to community economic development. The CBA provides opportunities for ongoing community engagement and mutual accountability between the signatories.

BUDGET AND FINANCIAL INFORMATION

The Interstate Corridor URA fiscal year 2015-16 Adopted Budget (see Attachment C) includes funds for expenditures including disposition-related expenses and site maintenance, as well as $502,160 in revenue from the Property sale. The budget also include funds for expenditures related to development of the Property, including the $122,705 grant, the $500,000 minimum commitment made by PDC in the CBA related to the MLA, and an additional amount of up to $1,700,000 in funds to cover PDC’s estimated maximum liability associated with the MLA.

RISK ASSESSMENT

Entering into the DDA creates significant risks for PDC. The primary risk is that the proposed development would not be realized if MRC decides to terminate the transaction or otherwise is not able to successfully redevelop the Property. These risks are partially mitigated by the non-refundable earnest money payment, PDC’s pre-conveyance ability to terminate the transaction if closing does not occur in a timely manner, and PDC’s post-conveyance ability to reenter and take possession of the Property.

The MLA creates potentially significant risks for PDC associated with the ongoing financial success of the shopping center and PDC’s ability to successfully market and sublease the space. PDC has modeled several tenanting scenarios and estimates the costs associated with the MLA will range from $700,000 to $2,300,000 over the 10-year period. PDC has already committed a minimum of $500,000 for this purpose in the CBA. Therefore, this analysis indicates a potential additional expense ranging from $200,000 to $1,700,000 over the 10-year period. Extending the lease by five years would result in higher costs. The risks and associated costs include:

- Base Rate. PDC has agreed to pay MRC $29.00/SF NNN in base rent, escalated five percent every two years. PDC’s estimate of the average market rate for retail space in the NE MLK Blvd. corridor is approximately $17.00/SF NNN, although location, adjacent commercial uses, and new construction affect rent levels. The highest reported rents in the corridor are approximately $26.00/SF NNN. Therefore, there is a significant likelihood that PDC will need to subsidize the base rent in order to lease the space to local businesses.
- NNN Expenses. PDC has agreed to pay MRC the NNN expenses associated with the leased space. MRC has not provided an estimate for these expenses and, therefore, these costs are
unknown. Although NNN leases are common, there is a possibility PDC may not be able to pass on all of these costs to the subtenants.

- **Vacancy Rate, Tenant Improvements, and Broker Fees.** PDC will be master leasing the space and will begin paying rent 90 days after delivery of the space. Since the space is being delivered by MRC as a cold shell, PDC will need to provide tenants with a tenant improvement allowance and will incur broker fees to lease the space. PDC is at risk to the extent PDC is not able to tenant all of the space. In addition, tenant turnover associated with leasing the space to tenants that do not run successful, stable businesses and are not able to pay the required rent (and NNN expenses) will result in higher vacancy rates and increased tenant improvement expenses and broker fees to retenant the space.

- **Community Preference for Non-Credit Tenants.** In accordance with the CBA, PDC will work with a TAC to identify a leasing strategy targeting local businesses rather than national or regional credit tenants. Introducing community input into a tenanting strategy emphasizing non-credit tenants, while aligned with PDC’s social and equity goals for the project, creates greater financial risk for PDC as TAC-preferred tenants may require lower lease rates and may result in higher levels of payment delinquency, default, and turnover.

- **Natural Grocers May Cease Operations.** As with all lease agreements for shopping centers, there is a risk anchor tenant Natural Grocers will cease operations. This would have a detrimental impact on PDC’s master lease and tenants. This is a calculated risk PDC is making based upon MRC’s and Natural Grocers’ experience and investment in the project.

**ALTERNATIVE ACTIONS**

The PDC Board could decide to:

- Direct PDC staff to incorporate new terms or changes to the terms and conditions into the DDA, MLA, and/or Special Authority Grant;
- Direct PDC staff to renegotiate specific terms and conditions; or
- Terminate the disposition process.

**ATTACHMENTS**

A. Property Map  
B. Project Summary  
C. Interstate Corridor URA Financial Summary
Project Summary

Project Name: MLK Alberta – Majestic Realty Company Disposition and Development Agreement, Master Lease Agreement, and Special Authority Grant

Description: 1.79 acres made up of eight vacant parcels (72,931 SF) and one parcel with a residence (5,000 SF) zoned Central Employment with Design Review Overlay (EXdh).

Location: Northwest corner of NE MLK Blvd. and NE Alberta Street

URA: Interstate Corridor

Current Phase: Disposition and Master Lease

Next Milestone: Closing/Conveyance and Tenanting Strategy

Completion Target: Closing by May 2016; Construction Complete by January 2017

Outcome: Conveyance of MLK-South to Majestic Realty Company for the development of an urban retail center anchored by Natural Grocers and retention of the single-family house as a residential occupancy opportunity, and a Master Lease Agreement for PDC to master lease approximately 5,125 SF of commercial space for ten years.

Phase I Commercial; Phase II Housing; Phase III Anchor Grocer + Retail Center
# URA Financial Summary

## Five-Year Forecast Program Requirements Detail

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**Attachments:**
- A45101370 Debt Management-ISC
- B5600370 Business Development-ISC
- B5600370 Community Development-ISC
- T0160370 Lean Manufacturing-ISC

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*Board Report – Authorizing DDA, MLA, and Special Authority Grant with MRC*

*August 19, 2015*
## Five-Year Forecast Program Requirements Detail

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<td><strong>Total Property Redevelopment</strong></td>
<td></td>
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<td>2,434,350</td>
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<td><strong>Total Program Expenditures</strong></td>
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<td>5,401,773</td>
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<td>481,957</td>
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<td><strong>Transfers - Indirect</strong></td>
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<td>11,017,190</td>
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<td><strong>Total Requirements</strong></td>
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<td>40,191,564</td>
<td>28,025,035</td>
<td>28,225,174</td>
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