

0220-01024-2749

**TRANSMITTAL**

TO

City Council

DATE

5/22/15

COUNCIL FILE NO.

FROM

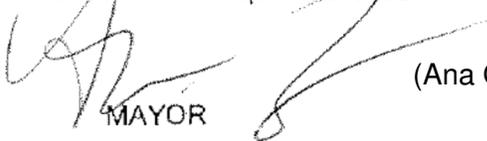
The Mayor

COUNCIL DISTRICT

9

**REQUEST AUTHORITY TO NEGOTIATE AND EXECUTE A \$1.7 MILLION LOAN  
AGREEMENT WITH TECHSHOP LOS ANGELES, LLC TO FUND THE ESTABLISHMENT  
OF A TECHSHOP IN LOS ANGELES**

Transmitted for further processing. See the  
City Administrative Officer report attached.



MAYOR

(Ana Guerrero)

MAS:LJS: 02150088C

REPORT FROM

## OFFICE OF THE CITY ADMINISTRATIVE OFFICER

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Date: May 18, 2015

CAO File No. 0220-01024-2749

Council File No.

Council District: 9

To: The Mayor

From: Miguel A. Santana, City Administrative Officer



Reference: Economic and Workforce Development Department transmittals dated April 15 and April 29, 2015

Subject: **REQUEST AUTHORITY TO NEGOTIATE AND EXECUTE A \$1.7 MILLION LOAN AGREEMENT WITH TECHSHOP LOS ANGELES, LLC TO FUND THE ESTABLISHMENT OF A TECHSHOP IN LOS ANGELES**

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### SUMMARY

In two separate Transmittals dated April 15 and April 29, 2015 (Transmittals), the Economic and Workforce Development Department (EWDD) requests to do the following:

1. Hold a Public Hearing in accordance with Government Code Section (Section) 53083 relative to the proposed economic investment of \$1.7 million in TechShop Los Angeles, LLC (TechShop);
2. Negotiate and execute a loan agreement in the amount up to \$1.7 million with TechShop to create living wage jobs and support microenterprise;
3. Approve a \$1.2 million allocation in Economic Development Fund (EDF) monies from the 40th Program Year (PY) Housing and Community Development Consolidated Plan (Con Plan, C.F. 13-1395), which would be in two parts: a) \$700,000 as a traditional loan for the establishment of TechShop, and b) \$500,000 as a service repayment conditional loan to provide no-cost memberships to income qualified individuals and micro-enterprises; and,
4. Utilize the recently approved \$500,000 in Community Development Block Grant (CDBG) from the PY 41 Con Plan as a service repayment conditional loan to provide additional no-cost memberships to income qualified individuals and micro-enterprises (C.F. 14-1382).

Please note that the EWDD states that the two Transmittals are essentially the same. The April 29, 2015 is an updated Transmittal which includes several corrections to the April 15, 2015 Transmittal. The EWDD states that the establishment of TechShop is anticipated to create approximately 540 individual/entrepreneurs, 30 permanent living wage jobs and 15 construction jobs. TechShop will be subject to all other applicable U.S. Department of Housing and Urban Development (HUD) and City-adopted policies and regulations and will be monitored by the EWDD on an annual basis during the term of the loan. The Housing Community and Investment Department has reviewed TechShop and determined that the proposed use of the \$1.7 million in CDBG funds appears to be an eligible activity per the HUD guidelines. The underwriting analysis was prepared by

the EWDD. The budget for the establishment of TechShop in Los Angeles is \$3.71 million (Attachment B of the Transmittals). This Office recommends approval of the \$1.7 million loan to TechShop to create living wage jobs and support microenterprise.

### Background

TechShop, Inc. is a privately-owned, for-profit business, founded by Jim Newton in the San Francisco Bay Area in October 2006. Since then, the company has launched a total of eight locations throughout the nation and anticipates opening two new locations, in St. Louis and Los Angeles, by the end of 2015. The management team is comprised of Jim Newton (the Corporate Secretary), three other executive officers and an advisory board. The company's combined current membership is over 6,000 (an average of 750 memberships per location). TechShop Los Angeles, LLC is a wholly owned subsidiary of TechShop, Inc. and is privately owned and operated. It would be the first scaled workshop and prototyping studio to open in Southern California. It would take up 20,000 square feet of ground floor space at The Reef (formerly LA Mart), strategically located adjacent to the LA Trade Tech campus at 1933 South Broadway.

TechShop members have unlimited access to a wide variety of machines and tools including milling machines, lathes, sheet metal equipment, welding equipment, high-tech computer design tools, plastic and woodworking equipment, industrial sewing machines, electronic circuit design and fabrication stations, and other supporting tools. By using a membership-based model, TechShop drastically reduces the costs to its members for access to sophisticated tools and machinery they might not otherwise be able to afford to use for prototyping and short-run manufacturing. TechShop has standardized and proven membership policies, structures, and pricing guides as well as classes and course materials at all of its facilities.

### Community Development Block Grant Funds

The \$1.7 million in CDBG loan funds would be structured into two financial instruments: 1) a \$700,000 traditional loan and; 2) a \$1 million service repayment conditional loan. The \$700,000 loan will be secured with State Uniform Commercial Code (UCC-1) filings against the equipment as well as a corporate guaranty from TechShop, Inc. The guaranty lasts the term of the loan. It will extinguish when the loan and note extinguish. The EWDD requests a \$1.2 million allocation in EDF monies from the PY 40 Con Plan for TechShop. Of that amount, the \$700,000 loan would be for the establishment of TechShop, which anticipates creating at least 20 new living wage full-time positions on site within the first two years (meeting the public benefit criteria of one job created/retained per \$35,000 in CDBG funds) and potentially up to 30 jobs total during the term of the loan. The majority of the jobs are semi-skilled positions and more than 51 percent of the positions will be made available to low and moderate-income persons. TechShop will engage with partner organizations to establish the necessary linkages to meet these stated hiring and workforce needs. The \$700,000 primary loan would pay for start-up operating expenses, engineering and architect costs, and the purchasing of equipment, software and other eligible costs. The loan would have a 4.5 percent interest rate for a term of 10 years, fully amortized. If the loan agreement is approved, the start date of the economic development subsidy will be May 2015 (or the earliest possible date upon execution of the loan agreement) and should be fully repaid by May 2025.

The \$1 million service repayment conditional loan would be comprised of: 1) \$500,000 from P Y 40 Con Plan (balance of the \$1.2 million allocation from the EDF) and; 2) the recently approved \$500,000 from the P Y 41 Con Plan. The public benefit is the assistance to micro-businesses through the 540 (pre-paid) memberships that are being offered. Membership rates are currently available at \$125 per month or \$1,500 per year. The annual membership cost (\$1,500) plus the \$350 class credit equals \$1,850 per year multiplied by 540 memberships total to \$999,000 in actual costs. Therefore, the \$1 million economic subsidy is based on actual membership costs including the class credits. This secondary loan would be forgiven over a five-year period subject to meeting milestone requirements, as outlined in this report, the Transmittals and the loan agreement. The milestone requirements include: 1) initiating a total of 540 one-year memberships for a five-year period; 2) providing training credit of \$350 for each awarded one-year membership, which will equate to approximately five classes; 3) meeting annual reporting requirements; and 4) successfully tracking members for at least one year after their membership expires. All costs of marketing/processing of the memberships and continued reporting are not covered.

If the \$1.7 million loan agreement is approved, the EWDD would be authorized to take such actions as may be necessary to carry out the loan agreement, including but not limited to executing the loan documents and taking the following actions: 1) approving revisions to the project budget, so long as the changes do not increase the amount of the loan or otherwise have a material adverse impact on the feasibility of the project; and, 2) making reasonable modifications to the loan documents, as long as such changes do not adversely affect the receipt of any material benefit by EWDD.

### Economic Development Fund

The EDF has a current unspent CDBG balance of \$5 million and was funded in the PY 39 and 40 Con Plans (C.F.14-1382). The EDF was created to leverage private sector investment in under-served communities and create jobs. The monies can be structured as a service repayment conditional loan, below-market rate loan, or direct funding of public improvements. The Techshop loan would be the EWDD's first major investment utilizing the EDF. Pursuant to Section 53083, the City must hold a noticed public hearing. In accordance with State imposed requirements, the economic impact and project analysis has been incorporated into the Economic Development Subsidy Report (Attachment D of the Transmittals). It was also posted on the EWDD's website on April 9, 2015. The date of the public hearing will be published on the City Council agenda.

On May 16, 2014, the EWDD released a report back to the City's Economic Development Committee regarding a Citywide Strategic Plan for economic development, which among other things, included a discussion of the EDF's purpose and eligibility (C.F. 13-1090). On March 27 and April 2, 2015, the Council and Mayor, as part of the approval of the PY 41 Con Plan, instructed the EWDD, with the assistance of the Mayor's Office, City Administrative Officer and Chief Legislative Analyst, to report with recommendations to establish EDF guidelines in accordance with the policies of the proposed Economic Development structure (C.F.14-1382). The EWDD states that it is currently working on the transmittal to establish EDF guidelines. It expects to release the transmittal to the Mayor's Office this month (May 2015).

### TechShop Los Angeles Budget

The EWDD prepared the underwriting analysis for the \$3.71 million TechShop budget (Attachment B of the Transmittals). The start-up costs for TechShop would be financed as follows:

- \$1,740,000 in loan and tenant improvement allowances from their landlord;
- \$120,000 from investor loans;
- \$150,000 in founding memberships; and,
- \$1,700,000 from the City.

Its revenue primarily comes from sales of memberships and income from classes and events. TechShop also earns revenue from various fees for services and consulting. Based on the proposed funding sources for start-up and working capital, the Projected Operating Pro Forma shows that the debt coverage ratio for all loans is 2.51 in year two with a total repayment debt schedule of \$250,576 annually (Attachment C of the Transmittals). Based on its analysis of TechShop's financial position and projected net cash flow (after debt service) of \$377,424 in year two and \$381,424 in year three, the EWDD states that the risk that the TechShop loan would not be repaid is low.

### **RECOMMENDATIONS**

That the Council, subject to the approval of the Mayor:

1. Hold a Public Hearing in accordance with Government Code Section 53083 regarding the proposed economic investment of \$1.7 million in TechShop Los Angeles, LLC (TechShop) to create living wage jobs and support microenterprise;
2. Authorize the General Manager of the Economic and Workforce Development Department (EWDD), or designee, to negotiate and execute a loan agreement with TechShop in an amount not to exceed \$1.7 million, subject to the review and approval of City Attorney as to form and legality;
3. Approve an allocation of \$1.2 million to TechShop from the Economic Development Fund in the Community Development Trust Fund, \$700,000 to be utilized as a traditional loan and \$500,000 as a service repayment conditional loan for the establishment of TechShop;
4. Approve the utilization of \$500,000 as a service repayment conditional loan to TechShop to provide no-cost memberships to income qualified individuals and micro-enterprises, as recently approved as part of the 41st Program Year (PY) Housing and Community Development Consolidated Plan (Con Plan, C.F.14-1382);
5. Authorize the General Manager of the Housing Community Investment Department, or designee, to amend the PY 41 Con Plan as necessary, in accordance with the adopted City's Citizen Participation Plan relative to the recommendations contained in this report and the loan agreement for the establishment of TechShop in Los Angeles;

6. Authorize the Controller to:

a. Establish a new account within the Community Development Trust Fund No. 424 and transfer appropriations as follows:

	Account	Title	Amount
From:	43L241	Economic Development Fund	\$1,200,000
To:	43XXXX	TechShop Los Angeles	\$1,200,000

b. Increase account 43XXXX-TechShop Los Angeles within the Community Development Trust Fund No. 424 as funds are made available and up to \$500,000;

7. Authorize the General Manager of EWDD, or designee, to prepare Controller instructions for any necessary technical adjustments subject to the approval of the City Administrative Officer, and instruct the Controller to implement these instructions; and,
8. Authorize the General Manager of EWDD, or designee, to execute conforming documents and take such other actions as may be necessary to carry out the loan agreement consistent with implementation of these approvals.

**FISCAL IMPACT STATEMENT**

There is no impact to the City's General Fund. The Economic and Workforce Development Department (EWDD) proposes to loan up to \$1.7 million in Community Development Block Grant (CDBG) funds to TechShop Los Angeles, LLC. The loan would be comprised of: 1) \$1.2 million from Economic Development Fund (EDF) from the 40th Program Year Housing and Community Development Consolidated Plan (Con Plan); and \$500,000 in the recently approved 41st Year Con Plan (C.F. 14-1382). Sufficient funds are available in the EDF which has a current unspent CDBG balance of \$5 million.

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