

Industrial Development Authority of the City of Lexington, Virginia

Wednesday, August 8, 2018, 5:00 p.m.

300 East Washington Street

City Hall Conference Room (Second Floor)

1. Call to Order
2. Consideration of a revised Virginia Horse Center debt refinancing request
3. Adjourn

To: Members of City Council and IDA

From: Gary Swink, Finance Director/ Asst. City Manager

Date: July 31, 2018

Re: VHC Financing/Lodging Taxes

The City Manager has requested me to attempt to clarify several issues surrounding the City's transfer of lodging taxes through the IDA to the Virginia Horse Center (VHC) and the request associated with their refinancing. Let me begin with a discussion of the VHC's debt structure.

The VHC's debt outstanding to the USDA as of May 31, 2018 (latest interim financial statement) was \$10,128,837. The loan bears interest at 4.125% and is due in annual installments of \$604,555 ending on February 15, 2047. Payments on the loan are made from the lodging taxes collected by the localities.

The original loan documents required the establishment of a debt service reserve that would eventually equal \$604,555. The Commonwealth of Virginia required that this be fully funded from loan proceeds in 2007. Subsequently, former VHC management used these funds to cover operating deficits. In 2015 the VHC entered a "workout agreement" with the USDA, with one of the conditions being that the VHC had until February 15, 2020 to fund the required debt service reserve. This is the provision that is driving the request for the change in the timing of funding of lodging tax collections.

In July 2015 the VHC borrowed \$450,000 from Cornerstone Bank to be used for deferred maintenance projects. The loan was at 6% interest. Principal and interest payments on the loan have been paid from the lodging tax collections. The final payment on this loan was made on June 15, 2018.

The VHC had two loans with New River Valley Bank bearing interest at 5.5%. The outstanding principal at June 30, 2014 (earliest audit report I have) was \$826,546. The loans had a balloon payment of approximately \$750,000 due on January 15, 2018. Until his death, a benefactor of the VHC was servicing the debt. The VHC refinanced the debt with Cornerstone Bank on November 15, 2017 with a one-year, (renewable for an additional year), \$750,000 loan, bearing interest at 5%. This loan is being refinanced with the new \$1,500,000 loan from Cornerstone Bank. The new loan will be at a seven year fixed rate of 5.85%, with ten year amortization period, with a "balloon" payment at the end of the seven year period. It is anticipated that the debt service for this loan will be paid out of lodging tax collections.

The VHC also has a \$150,000 loan from a board member, bearing no interest. The purpose of the loan was for working capital. The VHC also has a \$150,000 operating line of credit (LOC) with Cornerstone Bank. As of August 2, 2018 the outstanding balance of the LOC was \$150,000 and bears an interest rate of prime plus 2% (currently 7%). Both of these loans will be repaid with cash that Cornerstone currently holds as security for the \$750,000 loan that will be released once the new \$1.5 million loan is closed. Neither interest nor debt service payment of these two loans will be paid out of lodging taxes.

The City collects two percent lodging tax (as does the County) for the express purpose of servicing the original USDA debt. State statute authorizes this additional lodging tax (over the statutory limit) and extends for the entire duration of the debt until 2047. There is no limit on the amount of the two percent collection. The City's collection of the two percent amounted to \$137,138.73 in fiscal year 2018. The City also began collecting another one percent tax for the VHC in 2014. Although originally for a shorter period, the City's current agreement with the VHC to collect the one percent expires in 2024. Between now and 2021, there is no cap on the amount of this one percent. Beginning in 2021, the amount of these collections is capped

at \$61,000 annually. For FY 2018 the City collected \$68,569.37 for the one percent. Total collections for the VHC were \$205,708.10.

Presently, the City remits the collections in a particular month to the VHC in the following month-essentially passing through collected taxes on a cash accounting basis. The funds are deposited into a restricted bank account by the VHC. Funds can only be withdrawn from the account with the City's permission. Authorized expenditures from the account include: "any past due amounts owed to the USDA for the existing debt; the annual debt service payment made to the USDA for the existing debt; replacement of the USDA debt service reserve (if required); and, capital maintenance items for upkeep and improvement of the facilities existing at the time of execution of this agreement (10/28/2015). We get a copy of the bank statement so we can monitor the account.

Previously the County has not been remitting their lodging tax collections directly to the VHC. Instead, they have been remitting their portion (based on lodging tax collections) of debt service directly to the loan provider. The solution reached with the USDA for the funding of the debt service reserve will require the County to set up a restricted bank account and handle their tax collections in a manner similar to the City. The VHC's request is for both the City and County to transfer funds twice a year (July and January) based upon expected (budgeted) collections- essentially changing from the current pass through of cash to an extension of credit, whereby the City would provide cash to VHC based on estimated but uncollected tax proceeds.. At the end of the year, actual collections are to be compared to the amounts transferred and any overage or shortfall will be offset in the following July's remittance. Neither the City nor the County will be ensuring that their funding is adequate to always have \$604,555 remaining in the account. That responsibility is incumbent upon the VHC; however, USDA plans to require their approval prior to any withdrawals from the account. The USDA will be able to require the VHC to take remedial actions if sufficient funds aren't available to cover debt service requirements after each required debt repayment.

Projections by the VHC indicate this is the only way the requirement can be met without proceeds of a loan being used for this purpose. This being the case, their request for the funding change is for the duration of the USDA debt (until 2047). The VHC used in their projections, 100% of the amount collected. The VHC does not propose to compensate the City for this accelerated access to cash based on the City's funding VHC's account based on uncollected tax proceeds.

Adopting this change means the City (IDA) would be accepting a certain amount of risk and the loss of use of funds (investment income). The risk would be that if lodging taxes abruptly fell below budgeted levels, the City would pre-fund monies that wouldn't be collected in that fiscal year; however, the shortfall would be offset in the next payment. Additionally, in all likelihood, the City would budget less collections the following year, thereby, lowering the transfer to the VHC even further. I consider this a fairly small risk. In attempting to quantify this risk, let's consider the effect of lodging taxes falling 15% below budgeted levels. The City would, in that case, fund approximately \$30,000 more than we would collect, which would be deducted from the following July's payment. Due to the offset of shortages and transfers being based upon budget, the risk is a short-term one, rather than a long-term risk. As far as the effect upon the loss of potential interest earnings, I estimate this amount to be approximately \$1,000 annually at current interest rates. An additional risk would be that lodging taxes could drop in the future such that sufficient funds weren't available to service the USDA debt plus maintain the required debt service reserve. In that case, political pressure might be brought to bear upon the localities to potentially extend the period of time that they collect the additional one percent of lodging taxes for the VHC. An additional risk is whether the VHC through improved operating results and fund raising effort will be able to meet future capital needs.

Lastly, City staff believe that any long-term plan for the success of the VHC must include a strong, state partnership (in which the state provides funding), a long-term capital program to ensure the viability and competitiveness of the facility are maintained and a solid plan to increase utilization of the facility to generate necessary revenues.



July 20, 2018

Ms. Janice Stroud-Bickes  
Assistant to the State Director  
Rural Development  
United States Department of Agriculture  
1606 Santa Rosa Road  
Suite 238  
Richmond, VA 23229

Dear Janice:

Thank you once again for all of the time that you and Virginia Rural Development staff have taken over the past two years in developing and finalizing a Letter of Conditions and helping us navigate the Debt Service Reserve Fund. As Sandra Thomas mentioned in her email of July 12, 2018, we will be requesting that the Rockbridge Board of Supervisors at its meeting on July 23 approve County staff creating a separate bank account with USDA signatory power for the occupancy tax collections. This account, along with the already existing separate City of Lexington account, will make up the debt service reserve fund. We will also request that the County agree to fund projected occupancy tax for the next six-month period no later than 7/15 and 1/15 annually. Once these two requests have been approved we will always have at least \$604,555 in the two accounts making up the Debt Service Reserve Fund based upon our projections.

I am writing to let you know that in addition to these two matters, we will be requesting that the Board of Supervisors approve Virginia Horse Center's borrowing of \$1.5 million from Cornerstone Bank. This loan will be used to convert the \$750,000 bridge loan to long-term financing and to provide \$750,000 to be used to address deferred maintenance issues.

This is a change from the direction we had been heading of closing a similar loan with USDA. We have made the decision to proceed with Cornerstone rather than USDA. First, the USDA required that we obtain construction financing so we had to get a loan commitment from a commercial banks. Secondly, and more importantly, we found that USDA's requirement that the additional 1% of occupancy tax be extended for the entire life of the loan was not politically achievable at this point in time.



We understand that USDA will have to approve the Cornerstone loan. As soon as we have the County separate bank account in place and funded, we will send you a copy of the Cornerstone loan commitment letter and evidence that the two bank accounts contain at least \$604,555 so that you can confirm that the debt service reserve fund is in place. If you would like to see the loan commitment letter prior to our having the bank account in place please let me know.

I really appreciate the work of you and your staff in getting us to this place. We look forward to continuing our open, working relationship.

Sincerely,

A handwritten signature in black ink, appearing to read "John D. Nicholson". The signature is fluid and cursive, with a large initial "J" and "N".

John D. Nicholson  
CEO



July 17, 2018

Rockbridge Board of Supervisors  
Economic Development Authority  
Rockbridge County  
150 South Main Street  
Lexington, VA 24450

Ladies and Gentlemen:

The Virginia Horse Center (VHC) requests that the Board of Supervisors consider the following two matters at its July 23, 2017 meeting:

1. Debt Service Reserve Fund - Establish a separate County bank account to hold the proceeds from the 3% of occupancy tax earmarked for VHC debt service and that the County fund that account no later than July 15 and January 15 of each year with the projected occupancy tax collections for the six month period beginning July 1 and January 1 annually. At the end of each fiscal year the amounts deposited will be reconciled with actual collections and any deficit/excess will be deposited or withdrawn.
2. Debt - Approve VHC's borrowing of \$1.5 million from Cornerstone Bank as outlined on the attached Commitment Letter.

### **Background**

VHC had a balloon debt payment due in January 2018 to New River Bank. From September 2016 when the amount due was \$769,388 through November 2017 when the amount paid was \$748,938, VHC worked with USDA to close a \$1.55 million loan that would provide funds to cover the balloon payment as well funds for capital improvements. In connection with pursuing this loan VHC worked with City of Lexington Council and IDA and Rockbridge County Board of Supervisors and EDA to extend the additional 1% occupancy tax for a total of 10 years through July 2024.

When VHC could not close the USDA loan to cover the balloon payment, it borrowed \$750,000 from Cornerstone Bank for a period of one year (with the ability to extend for a second year). The proceeds of this loan, which is due on November 17, 2018, were used to make the balloon payment. So in effect VHC delayed the balloon payment by one to two years and continued to work to obtain long-term financing.



One of the reasons that VHC was unable to close a USDA loan was that USDA required VHC to fund fully a \$604,555 (an annual payment) debt service reserve fund required by the original loan documents. Since VHC did not have resources to do this, USDA was requiring that \$604,555 of the loan proceeds be set aside. Not only did this mean limited funds for capital improvements but also that occupancy tax collections would be used to pay debt service on borrowed money that was not being productively used.

Whether VHC negotiated a long-term debt agreement with the USDA or another lender, the issue had to be resolved because the USDA must approve all VHC debt. As a result, City, County and VHC staff continued to work with USDA to define what it would consider a "debt service reserve fund".

### **Debt Service Reserve Fund**

Based upon our discussions with USDA, we are requesting that the County establish a separate bank account in the County's name into which the entire 3% occupancy tax earmarked for VHC debt service be deposited. This account will continue to be under the control of the County but also will have oversight by USDA to ensure that funds are only withdrawn for approved debt service payments.

The City already has a separate account and will grant USDA oversight to the account. These two account combined will be the Debt Service Reserve Fund (DSRF).

The DSRF must maintain a minimum balance of \$604,555. Based upon our projections we are unable to maintain that balance with the current practice of depositing actual occupancy tax collections monthly because the annual USDA debt service payment is due February 15, during the lowest occupancy tax collection months.

In order to maintain the minimum balance required by USDA, City staff suggested that the localities fund the DSRF on or about July 1 and January 1 annually with the projected occupancy tax collections for the six-month period beginning on that date. At the end of each fiscal year the amounts deposited will be reconciled with actual collections and any deficit/excess will be deposited or withdrawn. Based upon this funding mechanism our projections show that the DSRF will be fully funded for the remaining life of the USDA debt.

### **Debt**

While VHC had originally planned to obtain a long-term loan from USDA it now believes that a \$1.5 million loan from Cornerstone is a better option.



First, the USDA loan would require a construction loan from a commercial bank. USDA would fund the \$750,000 to payoff the Cornerstone short-term loan and the \$750,000 for capital improvements only after the capital improvements were complete. This would necessitate VHC obtaining approval from the localities for two loans and would extend the process for at least 18 months if not longer.

Second, the USDA would require that the City and County extend the additional 1% occupancy tax for the entire life of the new loan – 8 years from when construction is complete and the USDA long-term financing is in place. Since we do not know how long construction will take we cannot say with certainty how much longer this would be but probably another 4 to 5 years after the current end date of 2024.

While the USDA Letter of Condition for its loan requires that the City and the County extend the additional 1% of occupancy tax for the entire life of the loan, the Cornerstone loan will be paid in full by the current expiration date of July 2014. As a result, we are not requesting any discussion of extending the additional 1% at this time.

Cornerstone's long-term interest rate of 5.85% is higher than the USDA rate of 3.875%. However, assuming a 24 month construction loan at 6.5%, and then converting to an eight year USDA loan vs the debt in the attached Commitment Letter, we project that VHC will incur less than \$70,000 in additional interest in the 10 year period under the proposed debt. We believe that this increased cost is more than offset by not having to discuss an extension in the additional 1%.

We appreciate the Board of Supervisors' and Economic Development Authority's consideration of our request to finalize a DSRF and to approve this debt. We look forward finally to resolving this debt and to having additional deferred maintenance funds to invest in the facility. Sandra Thomas and I will be at the meeting on July 23 to answer any questions that you have.

Sincerely,

A handwritten signature in black ink that reads "John D. Nicholson". The signature is written in a cursive, slightly slanted style.

John D. Nicholson  
CEO



P.O. Box 1561  
Lexington, VA 24450  
Phone 540.463.2222  
Fax 540.463.1160  
www.cornerstonebankva.com

June 25, 2018

Virginia Horse Center Foundation  
Attn: Mr. John Nicholson  
487 Maury River Road  
Lexington, VA 24450

Dear Mr. Oare:

CornerStone Bank, N.A. ("Lender") is pleased to offer **Virginia Horse Center Foundation, Inc.** ("Borrower") the following credit facility. This Commitment will become effective upon your acceptance of the terms and conditions outlined in this letter, and your return of an executed copy and a closing in a manner satisfactory to Lender. "Closing", "close", or "closed" as used herein, shall mean the execution, recordation where necessary, delivery to Lender of all documentation required by this commitment letter, and satisfaction of all terms and conditions specified herein in a timely manner.

**Commitment Type:** Term Loan, the "Commitment."

**Amount:** \$1,500,000.00

**Disbursement of Funds** Pay off CornerStone Bank loan number 143008888 with the remaining funds to be held in a deposit account at CornerStone Bank and disbursed with approval by the City of Lexington and the County of Rockbridge authorized representatives at requested intervals.

All disbursements from the deposit account containing disbursed loan funds must be approved for withdrawal or release by a duly authorized agent acting on behalf of the City of Lexington and the County of Rockbridge. An approval from each municipality will be required for all disbursements.

**Purpose:** Capital Improvements to Facilities particularly in the area of Storm Water Management.

**Loan Type:** Balloon note based on an initial seven year fixed rate and a 10 year amortization period.

**Interest Rate:** Fixed at 5.85% through maturity. Interest will be calculated on the basis of a 360 day year based on the actual number of days elapsed.

**Fees:** A \$2,500 origination fee will be payable at closing.

**Repayment Terms:** Principal and Interest payable quarterly with principal payments due annually.

**Collateral:** Collateral 1:  
Assignment of Lodging Tax proceeds collected by the City of Lexington and the County of Rockbridge insofar as they exceed the required debt service on a mortgage held by the USDA.

Collateral 2:  
Aggregate of 19.624 acres from 5 parcels of land on either side of Route 39 also known in the Rockbridge County property records as Tax Map numbers:

61-A-80F (2.229 acres, Zoned C-1)

61-A-80E (2.256 acres, Zoned A-2)

61-A-80D (2.001 acres, Zoned A-2)  
61-A-80A (7.902 acres, Zoned AT)  
61-A-80B (5.175 acres Zoned AT)

**Financial Reports:** The following information will be required:  
*Quarterly*

- Internally prepared financial statements of Borrower within 30 days of quarter-end, to include balance sheet and profit and loss statements, prepared in a form acceptable to Lender.

*Annually*

- Audited financial statements of Borrower prepared by a Certified Public Accountant and delivered within 120 days of fiscal year end.

Borrower agrees to provide Lender any additional financial information on Borrower as may be requested by Lender from time to time.

**Prepayment Premium:**

Borrower agrees that all loan fees and other prepaid finance charges are earned fully as of the date of the loan and will not be subject to refund upon early payment (whether voluntary or as a result of default), except as otherwise required by law. Upon prepayment of the Commitment, Lender is entitled to the following prepayment penalty:

If the loan is prepaid in full by a third party lender within the first five (3) years of origination, a prepayment penalty will be assessed based on the following percentages of the outstanding balance:

If prepaid within first 12 months following origination: a 3% penalty will be assessed.  
If prepaid during months 12 - 24 following origination: a 2% penalty will be assessed.  
If prepaid during months 24 – 36 following origination: a 1% penalty will be assessed.

This prepayment penalty will only be charged in the event the loan is refinanced with another lender. It will not apply to principal curtailments in excess of regularly scheduled amounts.

**Additional Documentation And Requirements:**

This Commitment is subject to the Lender's review and acceptance of the following:

1. *Executed Assignment of Tax Distribution/Performance Agreement between VHCF, City of Lexington, and Rockbridge County in a form acceptable to Lender. The agreement must stipulate that tax revenue collected by the City and the County will not allocated to any expenditures outside of USDA Debt Service, CornerStone Debt Service, and accumulation of Debt Service Reserves without CornerStone's consent.*
2. *A resolution from the VHCF board authorizing the \$1,500,000 loan and naming authorized signers who can sign the closing documents*

**Other Conditions:**

This Commitment is subject to the maintenance by Borrower of a condition satisfactory to Lender and the delivery and/or execution of loan, security, and informational documents satisfactory to Lender. Examples of an unsatisfactory condition include, but are not limited to, a material change in management, an adverse change in financial condition, or any default by Borrower on any obligation to Lender or to a third party.

The Borrower shall maintain depository accounts with Lender.

During the term of the Commitment, there shall be no change in control, ownership, or legal structure of Borrower without the prior written consent of Lender.

In no event shall either Borrower or Lender be liable to the other for indirect, special, or consequential damages which may arise out of or are in any way connected with the issuance of this Commitment.

All costs, expenses and fees incurred to close the Commitment and perfect Lender's security interest will be the responsibility of the Borrower, whether or not the transaction contemplated herein closes, unless the failure to close is due solely to Lender's gross negligence or willful misconduct.

In addition to any other defaults normally specified in Lender's documents, to the extent permitted by law, Borrower agrees that a default under this Commitment will also cause a default under any other loan or obligation of the Borrower to Lender and that a default under any other loan or obligation of the Borrower to Lender will cause a default under this Commitment.

All information and representations made by the Borrower to Lender are and will be accurate at closing.

This Commitment shall be governed by the laws of the Commonwealth of Virginia.

This Commitment is for the sole and exclusive benefit of the Borrower and may not be assigned by the Borrower.

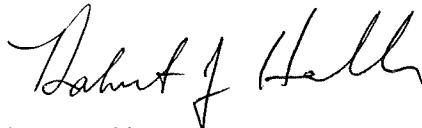
This Commitment and all terms and provisions outlined above shall survive the closing and shall be binding on the Borrower and after such closing.

**Commitment  
Modifications:**

No condition or other term of this Commitment may be waived or modified except in writing signed by Borrower and Lender.

Please call me if you have any questions about the terms of this offer. If this Commitment is not accepted with an executed copy received by Lender by July 15<sup>th</sup>, 2018 and closed by August 15<sup>th</sup>, 2018, this Commitment shall be null and void at the option of Lender. To acknowledge your acceptance, please sign below and return to me. We look forward to working with you. With kind regards, I remain

Very truly yours,



Robert J. Hobbs  
Commercial Lending Officer

Accepted and agreed to this \_\_\_\_\_ day of \_\_\_\_\_, 2018.

**BORROWER**  
Virginia Horse Center Foundation

By: \_\_\_\_\_

Printed Name and Title: \_\_\_\_\_

## ASSIGNMENT OF TAX DISTRIBUTION

THIS ASSIGNMENT is made this \_\_\_\_\_ day of \_\_\_\_\_  
\_\_\_\_\_ 2018 by and  
between **The Virginia Horse Center** (C-Assignor") and **CornerStone Bank, N.A.**  
("Assignee").

WHEREAS, Assignor has executed and delivered to Assignee that certain Promissory Note ("the Note") dated [Date] in the original principal amount of One Million Five Hundred Thousand and no/100 Dollars (\$1,500,000) (the "Note"); and

WHEREAS, Assignor is entitled to receive periodic tax payments (the "Tax Distributions") under that certain arrangement with the City of Lexington, Virginia (the "City") dated [Date] in which Assignor is the intended recipient of the proceeds of a certain lodging and occupancy tax payable to Assignor by the City on a monthly basis; and

WHEREAS, Assignor **desires** to assign to Assignee the balance of the Tax Distributions after deduction of Assignor's obligation to the USDA, up to the sum owed Assignee under the terms of the Note (interest quarterly with principal reduction annually) for application to the unpaid balance of the Note and all renewals, modifications and extensions thereof, and all other indebtedness of Assignor to Assignee (the "Obligations").

NOW, THEREFORE, for good and valuable consideration, the receipt and sufficiency of which is hereby acknowledged, Assignor and Assignee agree as follows:

1. Assignor hereby assigns to Assignee all Assignor's right, title, and interest in the balance of the Tax Distributions after deduction of Assignor's obligation to the USDA, up to the sum owed Assignee under the terms of the Note (interest quarterly with principal reduction annually) for application to the unpaid balance of the Note and all renewals, modifications and extensions thereof, and all other indebtedness of Assignor to Assignee (the obligations).
2. After Assignor receives each Tax Distribution, Assignor will deposit same in a restricted account and on a quarterly basis as contained in the Note, the amount representing the prorated balance after calculating the prorated amount necessary to satisfy the USDA payment which shall remain in said account, pay to Assignee the accrued interest on the Note, or any remaining balance, if any, to reduce the unpaid principal balance of the Note, as appropriate, and the other Obligations under the terms of the Note. It is expressly agreed that Assignor's Note and Obligations shall not be reduced or credited until such time as Assignee receives each final Tax Distribution and deposits same in the restricted account for quarterly distribution. If the City fails or refuses to make a Tax Distribution sufficient to

cover the obligations, Assignee shall receive no payment to reduce the unpaid balance of Note or Obligation. Assignor's duties to Assignee under the Note and Obligations shall not be excused or modified if the City (a) fails or refuses to make a Tax Distribution, or (b) is delinquent in making any Tax Distribution.

3. Assignee shall have no obligation to the City whatsoever other than to accept each quarterly Net Tax Distribution from the restricted account for application-to the indebtedness under the Note. .
4. After the unpaid balance of the Note and any renewals, modifications, or extensions thereof, and after the repayment of all other Obligations and debts of Assignor to Assignee, Assignee agrees to release to Assignor all Assignee's rights created hereby within ten (10) days of the receipt by Assignee from Assignor of such a written request.
5. Assignor agrees to instruct the City to pay the Net Tax Distribution directly to the restricted account for quarterly distributions to be credited against the balance owed by Assignor.
6. This Assignment shall be binding upon and shall inure to the benefit of the parties and their respective successors, assigns, heirs and personal representatives.
7. Assignee's consent to allowing the City to make one or more Tax Distributions to Assignor is not and shall not be deemed to be a waiver of Assignee's right to directly receive all other Tax Distributions.
8. The City agrees and acknowledges that all tax distributions disbursed to Assignor will be used exclusively for debt service associated with the USDA loan and the \$1,500,000 CornerStone loan. Under this assignment, no tax distributions received by Assignor from the City may be used for any other purpose without the consent of CornerStone Bank.

The Virginia Horse Center

ComerStone Bank, N. A.

By: \_\_\_\_\_

By: \_\_\_\_\_

Acknowledged:

The City of Lexington, Virginia

By: \_\_\_\_\_