ESCONDIDO
City of Choice

MEMORANDUM

January 24, 2017

TO: HONORABLE MAYOR AND CITY COUNCIL MEMBERS

FROM: GRAHAM MITCHELL, City Manager
JEFFREY R. EPP, City Attorney

SUBJECT: Springhill Suites Economic Incentive Agreement – Supplemental Information

This Supplemental Staff Report provides the additional information referenced in the January 25, 2017 Staff Report entitled "Business Enhancement Zone (BEZ) project consisting of an Economic Incentive Agreement for the La Terraza Springhill Suites by Marriott Hotel." The information was requested by the members of the City Council Economic Development Subcommittee, and is also information required to fulfill newly adopted Government Code Section 53083, which requires certain information to be made available and a public hearing to be held in connection with providing economic incentives.

Attached is an economic analysis prepared by Keyser Marston Associates, Inc. (KMA). The analysis includes three spreadsheets that assume a 50% TOT economic incentive with no dollar limit (Exhibit A), a limit of $1.8 million (Exhibit B), and a limit of $1.5 million (Exhibit C). KMA's analysis identified a reasonable target unleveraged Internal Rate of Return (IRR) for a project of this nature of 12.5 percent. Based on information provided regarding land and construction costs, as well as anticipated revenue, KMA has estimated that without any economic incentive whatsoever, the project would yield an IRR of 9.3%. At this level, a reasonable developer would likely not undertake the project. Under the three scenarios analyzed, the IRR is between 10.2% and 10.3%.

The proposed Hotel Operator has requested a $1.8 million economic incentive, which would be provided in the form of payments over time, based on the amount of transient occupancy tax collected at the hotel. KMA's analysis indicates that in order to achieve the target IRR, an economic incentive of $1.8 million would be appropriate, and this could likely be achieved with payments over a period of 10 years equal, economic incentive payments were made during the period in an amount of 50% of the estimated transient occupancy tax. However, KMA and the Hotel Operator have differing estimates of the average daily room rate used in the calculations, and the proposed Agreement allows the Hotel Operator to request an additional 2 years to realize the full amount of economic incentive, and the City agrees to grant the additional time unless it would be unreasonable to do so.

In addition to the total amount of economic incentive and the terms and conditions under which it would be provided, members of the City Council Economic Development Subcommittee requested information about other cities and their experience in providing economic incentives to hotel operators and/or developers. Staff has inquired of other cities in the region and has determined that there is a range of assistance cities have offered hotel developers and operators. The range includes no assistance, TOT sharing agreements, sale of land at below market rates, loan paid back over time.

California Government Code Section 53083 requires that City Council hold a noticed public hearing and, prior to the public hearing, provide specific information regarding any proposed economic development subsidy to be provided by the City pursuant to the agreement.

1. **The name and address of all corporations or any other business entities, except for sole proprietorships, that are the beneficiary of the economic development subsidy.**
   Magnolia Hotel, Inc., whose address is: 10660 Scripps Ranch Blvd, Suite 100, San Diego, CA 92131. The economic incentive will benefit such entity, or any others to which the agreement may be assigned, although the agreement limits the terms and conditions under which an assignment can take place.

2. **The start and end dates and schedule, if applicable, for the economic development subsidy.**
   As currently proposed, the economic incentive would commence when the hotel is ready for operations. The end date is 10 years thereafter, unless the full $1.8 million in economic incentive has not been realized, in which case the period can be extended by two years.

   The potential economic development subsidy will be paid by the City from time to time from general funds, but will be measured by the transient occupancy taxes paid by the Operator to the City, and will only be paid after the City's receipt of transient occupancy taxes from the hotel project.

3. **A description of the economic development subsidy, including the estimated total amount of the expenditure of public funds by, or of revenue lost to, the local agency as a result of the economic development subsidy.**
   An amount equal to (and limited by) the transient occupancy taxes actually received by the City from the operation of the hotel project of no more than $1.8 million.

The expenditure of funds by the City, or the revenue lost to the City depends on how the new transient occupancy taxes are characterized. Arguably, no expenditure takes place and no revenue is lost because a net increase to the City's general fund is anticipated as a result of operations of this project. However, if the total amount of transient occupancy tax is used, the share which the Operator received (i.e. cost to City) is one half of that amount or up to $1.8 million.

4. **A statement of the public purposes for the economic development subsidy.**
   The purpose of this economic incentive is to enable this project to be operated in a manner that will provide new transient occupancy tax revenue to the City on an indefinite basis. In addition, the day to day operation of the project will generate jobs, and serve as a catalyst for other hotel development opportunities. Moreover, the amenities and services provided by the project will benefit local businesses, other public entities, and residents of the City. The City's consultants, Keyser Marston Associates, Inc., have confirmed that such a subsidy is appropriate given the projected costs and revenues of the project. The completed project will generate transient occupancy taxes, sales taxes, and increased property taxes, and should provide jobs, for the 10-year subsidy period, and perhaps longer.

5. **The projected tax revenue to the local agency as a result of the economic development subsidy.**
   In ten years (i.e., during the period of the subsidy): $1,948,150 of transient occupancy taxes and $175,000 of property tax revenue.

6. **The estimated number of jobs created by the economic development subsidy, broken down by full-time, part-time, and temporary positions.**
   Full-time: 17
   Part-time: 5

Attachment
cc: Jay Petrek, Assistant City Manager

50% FOR 10 YEARS
NO DOLLAR LIMIT

EXHIBIT A

10-YEAR CASH FLOW PROJECTION - 50% FOR 10 YEARS
SPRINGHILL SUITES
CITY OF ESCONDIDO

KMA Assumptions			
Stabilized Occupancy	***76.0%***	***TOT Rebate @***	***50%***
Stabilized ADR	***$130***	***TOT Rebate Not To Exceed***	—
Operating Expenses @	65%	Land Acquisition	$3,500,000
Capitalized Value @	***7%***	Total Development Costs	$17,500,000
Cost of Sale @	***2.5%***	***Escalation @***	***3.0%***

	Year	0	1	2	3	4	5	6	7	8	9	10	Total
I. Gross Revenue (1)													
Occupancy			70.0%	72.0%	74.0%	76.0%							
ADR			$115	$120	$125	$130							
Hotel Room Revenue			$3,085,000	$3,311,000	$3,545,000	$3,787,000	$3,901,000	$4,018,000	$4,139,000	$4,263,000	$4,391,000	$4,523,000	
Other Revenue @			$21,000	$21,000	$22,000	$22,000	$22,000	$23,000	$24,000	$24,000	$25,000	$26,000	
Total Gross Revenue			$3,106,000	$3,332,000	$3,567,000	$3,809,000	$3,923,000	$4,041,000	$4,163,000	$4,287,000	$4,416,000	$4,549,000	
II. (Less) Operating Expenses (1)	65%		($2,019,000)	($2,166,000)	($2,319,000)	($2,476,000)	($2,550,000)	($2,627,000)	($2,706,000)	($2,787,000)	($2,870,000)	($2,957,000)	
III. Net Operating Income			$1,087,000	$1,166,000	$1,248,000	$1,333,000	$1,373,000	$1,414,000	$1,457,000	$1,500,000	$1,546,000	$1,592,000	
IV. Project Cash Flow													
Net Operating Income		($17,500,000)	$1,087,000	$1,166,000	$1,248,000	$1,333,000	$1,373,000	$1,414,000	$1,457,000	$1,500,000	$1,546,000	$1,592,000	
TOT Rebate @ 50% (2)			$154,000	$166,000	$177,000	$189,000	$195,000	$201,000	$207,000	$213,000	$220,000	$226,000	$1,948,000
Net Sales Proceeds (3)												$22,174,000	
Project Cash Flow (with TOT Rebate)		($17,500,000)	$1,241,000	$1,332,000	$1,425,000	$1,522,000	$1,568,000	$1,615,000	$1,664,000	$1,713,000	$1,766,000	$23,992,000	
V. Return on Investment (ROI)													
Without TOT Rebate			6.2%	6.7%	7.1%	7.6%	7.8%	8.1%	8.3%	8.6%	8.8%	9.1%	
With TOT Rebate			7.1%	7.6%	8.1%	8.7%	9.0%	9.2%	9.5%	9.8%	10.1%	10.4%	

VI. Developer Unleveraged Internal Rate of Return (IRR)

Without TOT Rebate	9.3%
With TOT Rebate	10.3%

(1) Assumes escalation at 3.0% beginning in Year 5.
(2) Transient Occupancy Tax (TOT) rate is 10.0% of room revenue. Assumes that TOT rebated to Operator is 50% for Years 1-10.
(3) Assumes 7.0% capitalization rate and 2.5% cost of sale.

Note: Items appearing in bold and italics reflect KMA changes to Developer pro forma.

Prepared by: Keyser Marston Associates, Inc.
Filename: Escondido_Springhill Suites_Appendix A_01-24-17\1/23/2017;mdt

50% PER YEAR
NOT TO EXCEED $1.8 MILLION
NO TIME LIMIT

EXHIBIT B

10-YEAR CASH FLOW PROJECTION - TOT REBATE NOT TO EXCEED $1.8 MILLION
SPRINGHILL SUITES
CITY OF ESCONDIDO

KMA Assumptions			
Stabilized Occupancy	***76.0%***	***TOT Rebate @***	***50%***
Stabilized ADR	***$130***	TOT Rebate Not To Exceed	$1,800,000
Operating Expenses @	65%	Land Acquisition	$3,500,000
Capitalized Value @	***7%***	Total Development Costs	$17,500,000
Cost of Sale @	***2.5%***	***Escalation @***	***3.0%***

		Year	0	1	2	3	4	5	6	7	8	9	10	Total
I.	Gross Revenue (1)													
	Occupancy			70.0%	72.0%	74.0%	76.0%							
	ADR			$115	$120	$125	$130							
	Hotel Room Revenue			$3,085,000	$3,311,000	$3,545,000	$3,787,000	$3,901,000	$4,018,000	$4,139,000	$4,263,000	$4,391,000	$4,523,000	
	Other Revenue @			$21,000	$21,000	$22,000	$22,000	$22,000	$23,000	$24,000	$24,000	$25,000	$26,000	
	Total Gross Revenue			$3,106,000	$3,332,000	$3,567,000	$3,809,000	$3,923,000	$4,041,000	$4,163,000	$4,287,000	$4,416,000	$4,549,000	
II.	(Less) Operating Expenses (1)	65%		($2,019,000)	($2,166,000)	($2,319,000)	($2,476,000)	($2,550,000)	($2,627,000)	($2,706,000)	($2,787,000)	($2,870,000)	($2,957,000)	
III.	Net Operating Income			$1,087,000	$1,166,000	$1,248,000	$1,333,000	$1,373,000	$1,414,000	$1,457,000	$1,500,000	$1,546,000	$1,592,000	
IV.	Project Cash Flow													
	Net Operating Income		($17,500,000)	$1,087,000	$1,166,000	$1,248,000	$1,333,000	$1,373,000	$1,414,000	$1,457,000	$1,500,000	$1,546,000	$1,592,000	
	TOT Rebate @ 50% (2)			$154,000	$166,000	$177,000	$189,000	$195,000	$201,000	$207,000	$213,000	$220,000	$78,000	$1,800,000
	Net Sales Proceeds (3)												$22,174,000	
	Project Cash Flow (with TOT Rebate)		($17,500,000)	$1,241,000	$1,332,000	$1,425,000	$1,522,000	$1,568,000	$1,615,000	$1,664,000	$1,713,000	$1,766,000	$23,844,000	
V.	Return on Investment (ROI)													
	Without TOT Rebate			6.2%	6.7%	7.1%	7.6%	7.8%	8.1%	8.3%	8.6%	8.8%	9.1%	
	With TOT Rebate			7.1%	7.6%	8.1%	8.7%	9.0%	9.2%	9.5%	9.8%	10.1%	9.5%	

VI. Developer Unleveraged Internal Rate of Return (IRR)

Without TOT Rebate	9.3%
With TOT Rebate	10.3%

(1) Assumes escalation at 3.0% beginning in Year 5.
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50% FOR 10 YEARS
NOT TO EXCEED $1.5 MILLION
(KMA COUNTER)

EXHIBIT C

10-YEAR CASH FLOW PROJECTION - 50% FOR 10 YEARS, NOT TO EXCEED $1.5 MILLION
SPRINGHILL SUITES
CITY OF ESCONDIDO

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	Year	0	1	2	3	4	5	6	7	8	9	10	Total
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TOT Rebate @ 50% (2)			$154,000	$166,000	$177,000	$189,000	$195,000	$201,000	$207,000	$211,000	$0	$0	**$1,500,000**
Net Sales Proceeds (3)												$22,174,000	
Project Cash Flow (with TOT Rebate)		($17,500,000)	$1,241,000	$1,332,000	$1,425,000	$1,522,000	$1,568,000	$1,615,000	$1,664,000	$1,711,000	$1,546,000	$23,766,000	
V. Return on Investment (ROI)													
Without TOT Rebate			**6.2%**	**6.7%**	**7.1%**	**7.6%**	**7.8%**	**8.1%**	**8.3%**	**8.6%**	**8.8%**	**9.1%**	
With TOT Rebate			**7.1%**	**7.6%**	**8.1%**	**8.7%**	**9.0%**	**9.2%**	**9.5%**	**9.8%**	---	---	

VI. Developer Unleveraged Internal Rate of Return (IRR)

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With TOT Rebate	10.2%

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