

Attachment A

**KIMPTON HOTEL
PASADENA, CALIFORNIA
ECONOMIC DEVELOPMENT SUBSIDY REPORT
California Government Code
Section 53083**

**PURSUANT TO PROPOSED LEASE AGREEMENT BETWEEN
KHP III PASADENA LLC
AND
THE CITY OF PASADENA**

April 3, 2017

I. INTRODUCTION

A. Purpose of Report

This Economic Development Subsidy Report (Report) was prepared in accordance with Section 53083 of the California Government Code in order to inform the City Council of the City of Pasadena (City) and the public of the proposed economic subsidy provided by the City to KHP III PASADENA LLCs (Developer) as described in the Ground Lease. The term of the proposed Ground Lease is 99 years. The proposed subsidy is included in the form of proposed ground rent and parking between the City and the Developer.

B. Summary of Findings

The City engaged its economic consultant, Keyser Marston Associates, Inc. (KMA), to analyze the financial terms contained in the Agreement. Under the terms of the Ground Lease, the City will provide two Economic Development Subsidies. The total possible amount of the subsidy over a 99 year period is \$14.081 million (present valued at 5%).

C. Description of Area and Proposed Project

Description of Property and Environs

The project site is located at 78 N. Marengo Avenue in the City of Pasadena (City), within the County of Los Angeles. The project site is composed of three parcels on the block bounded by Marengo Avenue to the west, Holly Street to the north, Garfield Avenue to the east, and Union Street to the south. The southwest parcel (Parcel 1) contains the existing vacant YWCA building located at the northeast corner of Marengo Avenue and Union Street. The YWCA building varies in height from two stories to three stories with a maximum height of 44.6 feet. The second parcel (Parcel 2) consists of a surface parking lot east of the existing YWCA building. The third "L-shaped" parcel (Parcel 3), located to the north and east of the existing YWCA building and parking lot, consists of landscaping and public art (Robinson Memorial) along Holly Street and Garfield Avenue. The project site is located within the Civic Center/Midtown Sub-District of the Central District Specific Plan, and is zoned CD-2. The General Plan Land Use designation for the site is Medium Mixed Use. The YWCA building is a historically significant property that is listed as a contributor to the Pasadena Civic Center Historic District on the National Register of Historic Places and the California Register of Historical Resources, and is a City-designated historic monument.

Proposed Project

The proposed project involves the rehabilitation and adaptive reuse of the existing 48,260-square-foot YWCA building located at 78 N. Marengo Avenue and the addition of an 87,342-square-foot, six-story building on the project site, which together would become a 127,912-square-foot, approximately 181-room, Kimpton Hotel having 13 rooms in the existing building and 168 rooms in the new building. The new hotel would be of first class standard and consist of approximately 181 guestrooms and suites, approximately 1,989 square feet of meeting facilities, approximately 5,630 square feet of ballroom space, approximately 1,197 square feet of hospitality parlors, and an approximately 2,350 square-foot, 140-seat restaurant. The height of the building would

be 60 feet high and have a floor area ratio of 1.5. Parking for the new hotel would be valet-only; all parking would be off-site and would be provided at existing parking lots and structures in the nearby area. In addition, a sidewalk cut-back and use of the existing parking lane is proposed along Marengo Avenue for guest drop-off, valet parking, and access to the main entrance of the hotel and restaurant.

D. Proposed Transaction Terms

This section summarizes the salient aspects of the business terms contained in the proposed Ground Lease.

1. No ground rent during the first 50 years of the Ground Lease term; thereafter there shall be a Fair Market appraisal of the rent and rent will adjust to Fair Market Value.
2. City to provide 136 off-site parking spaces at no cost for up to 99 years.
3. In exchange for not receiving ground rental payments, the City will share in 15% of room revenue when KHP exceeds the threshold rooms sales specified in the Ground Lease. The participation will be capped at \$438,720 in the first year and will increase 3.0% annually thereafter. The participation is for the duration of the Ground Lease regardless of the hotel owner.
4. In exchange for not receiving ground rental payments, the City shall receive a one-time sale participation payment equal to 20% of the proceeds exceeding a 14% Internal Rate of Return to the developer. The participation remains in place for the duration of KHP's ownership and applies if less than 100% of the asset is sold.

II. NAME AND ADDRESS OF BUSINESS ENTITY RECEIVING SUBSIDY

The Economic Development Subsidy provided under the Ground Lease will be paid, or otherwise credited, to the Developer, under the name:

**KHP III PASADENA LLC.
101 California Street, Suite 980
San Francisco, CA 94111**

In July of 2012, the City issued a Request for Proposal for the renovation and use of the Premises and an adjacent parcel owned by the City. The Developer responded to the aforesaid Request for Proposal, following which an internal advisory panel of the City recommended to the City Council to begin exclusive negotiations with Developer. The City and Developer then entered into an Exclusive Negotiating Agreement dated May 1, 2013, as heretofore amended (the "ENA"), pursuant to which Developer has the exclusive right, for a limited period of time, to negotiate with the City with respect to the terms of a lease necessary or appropriate for the development of a hotel on the Premises.

III. DESCRIPTION OF ECONOMIC DEVELOPMENT SUBSIDY

The City will provide two economic subsidies: 1) No Ground Rental Lease payments and 2) The City will provide 136 off-site parking spaces to meet the Hotel's peak parking demand. The City will forego lease payments for the first 50 years of the lease that total approximately

\$8.179 million (present valued at 5%). The total cost of providing 136 off-site parking spaces for up to 99 years approximately \$5.902 million (present valued at 5%).

IV. START AND END DATES OF SUBSIDY

The subsidy related to the Ground Lease payment will be from the first year of hotel operations until year fifty (50). At year fifty, the rent will be adjusted based on an appraisal and adjusted to then Fair Market Value. The subsidy for the parking spaces will be for up to 99 years.

V. PUBLIC PURPOSE

The City purchased the Julia Morgan designed YWCA and parking lot properties in 2012 for the purpose of rehabilitating and reusing the YWCA to halt any “demolition by neglect.” Given the current and long-term view of the City’s finances, the City does not have the financial wherewithal to restore the Julia Morgan Building. Without the subsidy, the Developer will not move forward with the project as the project’s financial returns are below the current hotel industry standards. By providing the subsidy, the Developer will perform the historic rehabilitate the Julia Morgan building and construct a hotel that will Increase the number of visitors to the City, which will spend money on dining, retail and entertainment activities in the City. Moreover, the hotel will create a new, active use in the Civic Center. Also, the hotel will generate significant public revenues to the City that can fund police, fire and other public services

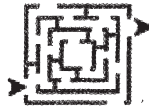
VI. PROJECTED TAX REVENUE TO CITY RESULTING FROM THE SUBSIDY

The following table projects the tax revenue to the City over a 20 year period:

	Net Present Value @ 5%	Gross Revenues (no discount)
Transient Occupancy Tax Revenues	\$25.99 M (calculated at 12.11 TOT tax rate %)	\$43.98 M
Sales Tax Revenue	\$1.30 M	\$2 20 M
Property Tax Revenue	\$2.46 M	\$4.07 M
Proposed Ground Rent	N/A	N/A
Total	\$29.75 M	\$50.26 M

VII. ESTIMATED NUMBER OF JOBS CREATED BY THE SUBSIDY

The Project is subject to the City of Pasadena’s First Source Local Hiring Ordinance and expected to generate a total of **352** jobs during a **two** year construction period and **144** permanent, full-time jobs, and **16** part-time jobs at Project build-out and stabilization.



KEYSER MARSTON ASSOCIATES
ADVISORS IN PUBLIC/PRIVATE REAL ESTATE DEVELOPMENT

MEMORANDUM

ADVISORS IN
REAL ESTATE
REDEVELOPMENT
AFFORDABLE HOUSING
ECONOMIC DEVELOPMENT

SAN FRANCISCO
A JERRY KEYSER
TIMOTHY C KELLY
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LOS ANGELES
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KEVIN E ENGSTROM
JULIE L ROMEY

SAN DIEGO
PAUL C MARRA

To: David Klug, Senior Project Manager
City of Pasadena

From: Kevin Engstrom

Date: March 23, 2017

Subject: Feasibility Review – Kimpton Hotel

Pursuant to your request, Keyser Marston Associates, Inc. (KMA) reviewed the development costs and operating projections of the proposed hotel to be located at the intersection of Marengo Avenue and Union Street in the City of Pasadena (City). The project is currently home to the Julia Morgan YWCA Building. The proposed project assumes the renovation of the YWCA Building and the construction of a 181 room Kimpton Hotel (Project). For this assignment, KMA undertook the following tasks:

- Reviewed the Hotel's development plans
- Reviewed the Hotel's development costs
- Reviewed the Hotel's operating projections
- Compared development costs and operating projections to industry standard ranges
- Estimated the Hotel's feasibility assuming typical developer returns

Based on this analysis, KMA evaluated the feasibility of the Project.

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ANALYSIS

The analysis summarized below evaluates the Project's feasibility based on the anticipated project costs and operating projections. The KMA analysis assumes the Hotel will be a first-class property operated by Kimpton Hotels. Any changes to the proposed operator could have a material impact on the findings discussed herein. For this analysis, KMA prepared a pro forma based on our review of the Developer's submittal and our experience with hotel development projects in Southern California.

Development Costs

The estimated development costs are shown in Table 1 and are summarized below.

- The project will utilize spaces in nearby structures currently operated by the City, as such no costs are assumed.
- The Hotel construction costs are estimated at \$288,800 per key. This estimate includes the cost of constructing the hotel rooms, renovating the YWCA building and site costs. Given the proposed quality level of this Project, this estimate is reasonable, when compared to other projects reviewed by KMA in the region. The Developer indicates this estimate is based on their experience with similar projects in Southern California. Based on information from the City and the Developer, these costs assume prevailing wages will be required for the construction of the project.
- The FF&E allowance for the Hotel is estimated at \$42,400 per key, which reflects a relatively high quality level compared to similar first-class properties KMA has evaluated in the region.
- The KMA analysis assumes a 4.5% hard cost contingency allowance. Typically, contingency allowances range from 3% to 5% of direct costs at project funding.
- The architecture & engineering costs are estimated at 9.0% of direct costs. Typically, these costs range from 6% to 9% of direct costs depending on the complexity of the development. Projects requiring a major renovation or rehabilitation are typically at the high end of this range.
- The City needs to review the estimated permits and fees (\$2.5 million) to ensure they are reasonable.

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- Pre-opening and working capital are estimated at \$21,300 per key, which is relatively high.
- The development management fee covers salary and other expense borne by the Developer during project development. KMA estimated this fee at 2% of direct costs (\$571,000). Typically, this fee ranges between 2% and 5% of direct costs depending on the complexity of the Project.
- KMA estimated a 5% contingency allowance for the Hotel's indirect costs, which is in addition to the 4.5% hard cost contingency.
- The Developer estimated the financing costs at \$3.5 million, which is relatively low given the proposed development costs.

Based on these assumptions, the total development costs are estimated at \$82 million, which equates to \$450,000 per key, reflecting a high-quality level for the Project.

Net Operating Income

The estimated net operating income (NOI) is shown in Table 2. The key assumptions are summarized below.

- The projected Average Daily Rate (ADR) for the hotel is \$269 with an 83% occupancy level at stabilization. These estimates are extremely healthy, as the average ADR in Pasadena was \$197 and the average occupancy was 84% in 2016 (CBRE Hotels).
- The other revenue sources are based on the Developer's submittal and KMA's experience with similar hotels in the region. The food and beverage sales at this property are very high, reflecting the operator's expertise.
- The Distributed and Undistributed expenses are based on KMA's experience with similar hotels in the region.
- KMA estimated the FF&E reserves at 4% of gross revenues, which is consistent with other hotels in the region.

KMA estimated the NOI for the Hotel at \$5.9 million, which is 23.8% of gross revenues. Similar full-service service hotels that KMA recently evaluated in Southern California have NOI's ranging from 22% to 30% of gross revenues. The hotels at the lower end of

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the range typically have higher food and beverage sales, which is the least profitable department in a hotel.

Estimated Project Surplus/(Feasibility Gap)

As shown in Table 3, KMA estimated the project return based on the projected construction costs and NOI. The return on cost for this project is extremely low at 7.17%. Typical return on costs for hotels in Southern California range from 9.0% to 11.0%. These returns reflect the underlying capitalization rates plus an allowance for developer profit. Currently, the average going-in cap rate for hotels in Los Angeles is 7.10%, thus indicating limited to no profit to the Developer unless cap rates decrease significantly or the hotel's operations exceed expectations.¹ Developers can make the decision to accept a lower return for a number of reasons, including a belief there is long-term upside in the market, market penetration desires and/or their cost of capital is lower than typical developers.

SUMMARY

The proposed Project supports a return on costs of 7.17%, which is a below market return. Some key issues requiring further consideration from the City include:

- The pro forma does not include any payment for land or parking costs, the inclusion of these items would diminish the feasibility of the Project to the point that the developer is unlikely to move forward with construction.
- The construction costs and FF&E allowance reflect a high-quality level for the Hotel. An agreement with the Developer should ensure the proposed quality level of the Hotel is maintained through development. Specifically, KMA would suggest including a minimum star rating and cost threshold in any agreement with the Developer. The cost threshold would be tied to the proposed hard costs and/or the FF&E allowance.
- The projected ADR and occupancy levels for the Project assume a very successful hotel that competes at the very high end of the Pasadena market.
- The renovation of a historic building assumes a significant amount of risk for the Developer.

¹ Source Situs RERC Real Estate Report – 4th Quarter 2016

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Based on the feasibility analysis, the Developer's returns are below market assuming no land costs and the parking is provided by the City. These findings would suggest the Developer is keenly interested in the Pasadena market and likely believes there is additional upside for a high-quality, well-positioned asset. To that end, a participation agreement, which generates revenue to the City if the Project exceeds projections, is warranted.

Attachment

TABLE 1

**ESTIMATED CONSTRUCTION COSTS
181 ROOM YWCA HOTEL
KIMPTON HOTELS
PASADENA, CALIFORNIA**

I. <u>Land Acquisition</u>	181 Rooms	\$0 /Room		\$0
II. <u>Direct Costs</u>				
Site Improvements	181 Rooms	\$0 /Room		\$0
Parking	41 Spaces	\$0 /Room		0
Building Shell	181 Rooms	\$288,801 /Room		52,273,000
FF&E	181 Rooms	\$42,376 /Room		7,670,000
Direct Construction Costs				<u>\$59,943,000</u>
Direct Contingency	4 5% Direct Costs			<u>2,674,000</u>
Total Direct Costs				\$62,617,000
III. <u>Indirect Costs</u>				
Architecture, Eng & Consulting	9 0% Direct Cost			\$5,636,000
Permits & Fees/Impact Fees	181 Rooms	\$13,812 /Room		2,500,000
Pre-Development	0 0% Direct Cost			0
Taxes, Ins, Legal & Acctg	2 0% Direct Cost			1,252,000
Pre Opening/Working Capital	181 Rooms	\$21,315 /Room		3,858,000
Marketing	181 Rooms	\$2,425 /Room		439,000
Development Management	2.0% Direct Costs			1,252,000
Contingency Allowance	5 0% Indirect Costs			<u>747,000</u>
Total Indirect Costs				\$15,684,000
IV. <u>Financing Costs</u>				
Construction Interest	\$2,393,000 Allowance			\$2,393,000
Loan Fees	\$1,097,000 Allowance			<u>1,097,000</u>
Total Financing Costs				\$3,490,000
V. <u>Total Construction Costs</u>				\$81,791,000
			Per Room	\$452,000

TABLE 2

ESTIMATED STABILIZED NET INCOME¹
181 ROOM YWCA HOTEL
KIMPTON HOTELS
PASADENA, CALIFORNIA

I. <u>Income</u>			
Rooms	181 Rooms	\$269 P O R	\$14,750,000
Food & Beverage	35 6% Gross Sales	\$160 P O R	8,773,000
Telephone	0 0% Gross Sales	\$0 P.O R	0
Parking	0 0% Gross Sales	\$0 P O R	0
Other Operated Departments	4 6% Gross Sales	\$21 P O R	1,129,000
Rentals & Other Income	0 0% Gross Sales	\$0 P O R	0
Gross Hotel Revenues			\$24,652,000
II. <u>Distributed Expenses</u>			
Rooms	24 0% of Dept Sales	\$65 P O R	3,540,000
Food & Beverage	73 0% of Dept Sales	\$117 P O R	6,404,000
Telephone	0 0% of Dept Sales	\$0 P O R	0
Parking	0 0% of Dept Sales	\$0 P O R	0
Other Operated Departments	43 0% of Dept Sales	\$9 P O R	485,000
Rentals & Other Income	0 0% of Dept Sales	\$0 P O R	0
(Less)Total Distributed Expenses			(\$10,429,000)
III. <u>Undistributed Expenses</u>			
General & Administration	9 5% Gross Revenues	\$43 P O R	\$2,342,000
Franchise Fees	0 0% Gross Revenues	\$0 P O R	0
Marketing	8 0% Gross Revenues	\$36 P O R	1,972,000
Property Operation & Maintenance	3 0% Gross Revenues	\$13 P O R	740,000
Utility Costs	2 0% Gross Revenues	\$9 P O R	493,000
Equipment Rental	0 0% Gross Revenues	\$0 P O R	0
(Less)Total Undistributed Expenses			(\$5,547,000)
IV. <u>Management Fees</u>			
	3 0% Gross Revenues	\$13 P O R	(\$740,000)
V. <u>Fixed Expenses</u>			
Taxes	3.4% Gross Revenues	\$15 P O R	\$838,000
Insurance	1 0% Gross Revenues	\$5 P O R	247,000
FF&E Reserves	4 0% Gross Revenues	\$18 P O R	986,000
(Less) Total Fixed Expenses			(\$2,071,000)
VI. <u>Net Operating Income (NOI)</u>			\$5,865,000
	23 8% Gross Revenues		

¹ Assumes stabilization in year 3 of operation and 83% occupancy

TABLE 3

ESTIMATED PROJECT SURPLUS / FEASIBILITY GAP
181 ROOM YWCA HOTEL
KIMPTON HOTELS
PASADENA, CALIFORNIA

-----Kimpton Return on Costs Before Land-----

I.	<u>Hotel NOI</u>	\$5,865,000
II.	<u>Total Development Costs</u>	\$81,791,000
III.	<u>Return on Costs Before Land</u>	7.17%