

# CITY OF LONG BEACH

DEPARTMENT OF ECONOMIC AND PROPERTY DEVELOPMENT  
333 West Ocean Boulevard 3<sup>RD</sup> Floor • Long Beach, CA 90802 • (562) 570-6099 • Fax (562) 570-6380

December 20, 2016

HONORABLE MAYOR AND CITY COUNCIL  
City of Long Beach  
California

## RECOMMENDATION:

Receive the supporting documentation into the record, conclude the public hearing regarding an economic subsidy in connection with a Transient Occupancy Tax Sharing Agreement with ESI Ventures, Inc., Lighthouse Investments, LLC, Firth Howard, LLC, David Clement, and Torey Carrick (Developer), pursuant to California Government Code Section 53083; and,

Authorize the City Manager, or designee, to execute any and all documents necessary to enter into a Transient Occupancy Tax Sharing Agreement with the Developer, or a to-be-formed entity owned or controlled by Developer, for the property at 110 East Ocean Boulevard. (District 2)

## DISCUSSION

Developer proposes to redevelop the property at 110 East Ocean Boulevard (Exhibit A) (Development Property) under a ground lease with the current owner of the Development Property. The Development Property is improved with an approximately 147,157 square foot office building built in 1929 and commonly known as the Ocean Center Building (Building). The Building was designated a historical landmark by the City Council. The Development Property is currently entitled for a 74-unit residential project.

### **The Project**

The Building is located at the southwest corner of Ocean Boulevard and Pine Avenue and is currently vacant. The Developer plans to convert the Building into a 139-room upscale boutique hotel with approximately 11,291 square feet of indoor restaurant/bar space including an additional 4,208 square feet of outdoor/patio space, and 4,906 square feet of ground floor retail space (Proposed Project). The Proposed Project will be catalytic in activating this prominent landmark in downtown Long Beach.

The sources of funds for the Proposed Project include 9 percent equity, 79 percent construction loans, and 12 percent historic tax credits.

The Proposed Project will generate 317 direct, indirect and induced construction jobs and 111 permanent jobs.

The Developer is in talks with several experienced boutique and lifestyle hotel operators. They confirmed they will not be seeking a "hard brand" (such as Marriott, Hilton, etc.) but an independent and boutique operator, which is a product type missing in the Long Beach hotel market. The Developer's vision for the Project will be an upscale hotel with unique and locally inspired design to create an original and curated experience for guests. The Developer will use the Building's unique historic character as a showcase to activate the public space and attract both local residents and visiting guests to the food and beverage, in particular the pool deck overlooking Long Beach. As Long Beach continues to grow as a destination for creative and innovative companies and people, the Developer envisions a hotel that serves those interests, including new convention business. Additionally, the operator would seek to be part of the Long Beach community and give this hotel a unique identity and brand that identifies with Long Beach and its creative class.

At a minimum, a Site Plan Review modification would be required to modify the current entitlement from a residential project to a hotel project. Based on the Proposed Project design, further environmental review could be necessary, though not likely. Staff anticipates the entitlement process for hotel use will take approximately six months. The Developer anticipates approximately 12 to 18 months to complete construction. With this schedule, occupancy could occur in 2018.

### **The Hotel Impact**

CBRE Hotels, a valuation and Advisory Services group, contracted by ESI Ventures, one of the general partners of the Developer, prepared a Market Impact Report (Report) that concluded that the Long Beach hotel submarket enjoys a strong level of economic activity that correlates directly to the demand for room nights. There is only one other hotel project planned at this time for the downtown area, the American Life hotel project (City-owned property) at 100 East Ocean Boulevard. The current hotel occupancy level of 78 percent demonstrates that there is an unsatisfied demand for hotel rooms. The projected opening of the hotel at 100 E. Ocean Blvd. is expected to result in occupancy levels decreasing to 75 percent in 2020, but is expected to return to its long-term stabilized level of 78 percent in 2021. The Report concludes that the opening of the Proposed Project in 2018 does not cause any negative impact to market occupancy.

The Report also concludes that there is an opportunity in downtown Long Beach for an independent boutique hotel that will capture its fair share of demand in the market by offering a high quality product and facilities. There is only one other independent boutique hotel in downtown, the 35-room Varden Hotel. There are two other boutique hotels, the Hotel Maya and the Hyatt Centric, which are affiliated with the Hilton and Hyatt hotels, respectively.

Historical growth in average daily room rates (ADR) increased from \$134 per night in 2011 to \$166 per night in 2015, reflecting a compound average growth rate of 2.3 percent. Occupancy levels over the same period increased from 71.5 percent in 2011 to 78 percent in 2015. Additionally, revenue per available room (RevPAR) has increased from \$96 per room in 2011 to \$130 per room in 2015.

The Report estimates occupancy levels from 2015 to 2023, assuming that the Proposed Project opens in 2018 and the additional proposed 427-room American Life Hotel project opens in 2019. Occupancy levels over the period fluctuate between a high of 79 percent in 2016 to a low of 75 percent in 2020. The Proposed Project opening does not cause any negative impact to market occupancy. The increased supply generated from the proposed American Life hotel project in 2019 reduces market occupancy to 75 percent; however, with no additional new supply, the market is estimated to return to the 78 percent occupancy in 2021 through the end of the projection period.

### **Transient Occupancy Tax (TOT) Sharing Agreement**

The City's real estate economic consultant, Keyser Marston Associates, Inc. (KMA), has conducted an analysis of the Proposed Project to review the financial framework provided in Developer's proforma and to determine if an economic gap exists.

#### **Financial Framework**

- The total development costs for the Proposed Project are estimated to be \$40.7 million. This includes hard and soft costs, ground lease reserve and security deposit of \$2.1 million, construction and renovation costs of \$153,000 per room, and 10 percent contingencies each for hard costs and indirect costs.
- The construction and renovation costs are in line with the industry average for a three-diamond boutique hotel.
- The CBRE Report assumed the market occupancy would be stabilized at 78 percent and the ADR would be \$182. KMA's analysis of CBRE's assumptions and Developer's submittal assumes that the Proposed Project supports an ADR of \$186, a 2 percent premium over competitive properties, due to the boutique brand and upscale amenities to be provided.
- KMA estimates the net operating income (NOI) for the Proposed Project at \$4.2 million, which is 31.3 percent of gross revenues. Similar boutique hotels in Southern California have NOIs ranging from 25 percent to 30 percent of gross revenues, indicating the Development Property is operating slightly more efficiently than the other properties.
- After the ground lease payment of \$1.1 million per year (initially), the NOI is \$3.1 million.

#### **Feasibility Gap**

KMA estimates the Proposed Project return based on the anticipated development costs and the Proposed Project's operating parameters. This analysis compares the level of investment supported by the Proposed Project's NOI to its total development costs. Typical hotel returns in Southern California range from 8.5 percent to 10.5 percent on costs. Given the location, operator, proposed quality and the fact that this is a renovation project, KMA assumed a 10.5 percent return on costs for the Proposed Project. Specifically, the high return on cost assumption reflects the complexity and risk associated with the renovation of a historic building.

- Assuming a 10.5 percent return on costs and \$5.4 million of Historic Tax Credits, the total warranted investment for the Proposed Project is \$34.6 million.
- Assuming the development costs are \$40.7 million and the total available investment for the Project is \$34.6 million, there is a feasibility gap of \$6.1 million.

As a result, the Developer is seeking to share the TOT generated by the Proposed Project. The Developer seeks 50 percent of the TOT actually received by the City (not including the 3 percent TOT generated under the Long Beach Tourism Business Improvement Area) for a period not to exceed 20 years. The percentage and duration of the TOT subsidy are the same as granted to the proposed American Life hotel project at 100 East Ocean Boulevard.

The total TOT to be received by the City during the first year of the Proposed Project's operation is estimated to be \$712,100. Over the 20-year term of the TOT subsidy, it is estimated the Developer and the City would each receive approximately \$12.4 million. KMA discounted the potential TOT subsidy at 8 percent and determined the present value of the subsidy is \$5.6 million, which is less than the feasibility gap of \$6.1 million. Although a feasibility gap will exist after the TOT subsidy based on the analysis, the Developer has agreed it will never pursue any additional subsidy from the City and has agreed to incorporate this condition in the TOT Sharing Agreement.

Absent the City's participation in covering the majority of the feasibility gap identified by KMA through TOT sharing, the Proposed Project would not proceed. Staff requests City Council's authority to enter into a TOT Sharing Agreement for up to 50 percent of the TOT generated by the Proposed Project and actually received by the City, for a period not to exceed 20 years. After the 20-year term expires, the City would receive 100 percent of the TOT generated by the Proposed Project, not including the portion collected under the Long Beach Tourism Business Improvement Area.

This matter was reviewed by Deputy City Attorney Richard F. Anthony on November 21, 2016 and by Revenue Management Officer Julissa Josè-Murray on December 6, 2016.

#### TIMING CONSIDERATIONS

Pursuant to California Government Code Section 53083, the Economic Development Subsidy Report was posted on the City's website on December 9, 2016. This report identifies the entity or entities receiving the subsidy, the schedule for the subsidy, the description of the subsidy, a statement of the public purpose for the entity, the projected tax revenue as a result of the subsidy, and the estimated number of jobs created by the subsidy. City Council consideration of the Proposed Project is requested by December 20, 2016, to ensure that the Proposed Development can occur in a timely manner.

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FISCAL IMPACT

If the City Council approves a TOT Sharing Agreement, upon hotel occupancy up to 50 percent of the TOT received by the City, not including the TOT associated with the Long Beach Tourism Business Improvement Area, will be rebated back to the Developer and at least 50 percent will be retained by the City. This rebate is anticipated to be approximately \$12.4 million during the term of the Agreement, which shall be not more than 20 years, with a similar amount being retained by the City.

The approval of this action will provide continued support to our local economy by creating or facilitating the creation of approximately 317 direct, indirect and induced construction jobs and 111 permanent jobs.

SUGGESTED ACTION:

Approve recommendation.

Respectfully submitted,



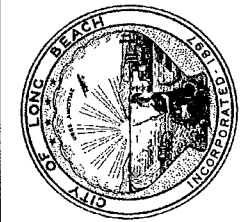
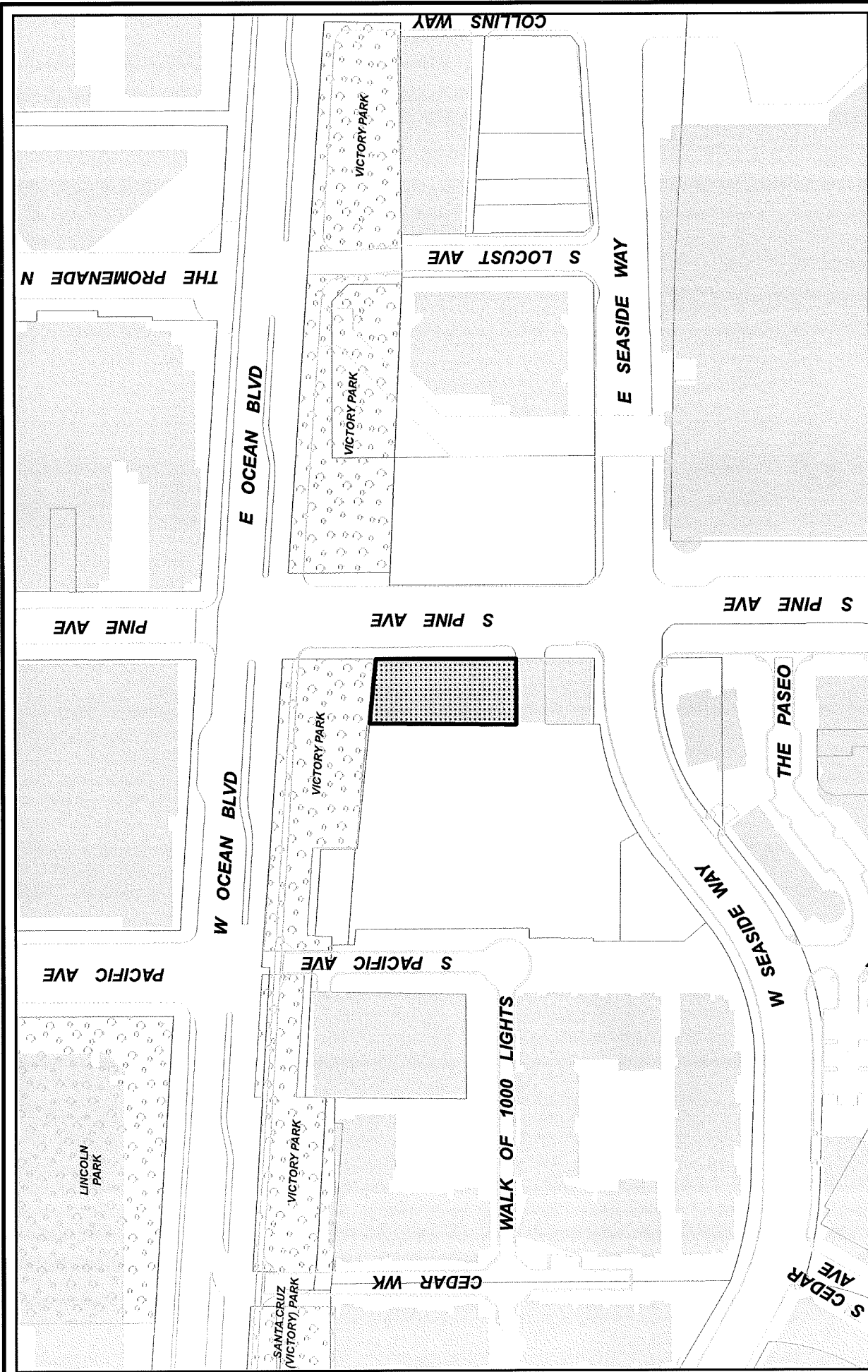
KATHRYN MCDERMOTT  
INTERIM DIRECTOR OF  
ECONOMIC & PROPERTY DEVELOPMENT

Attachments:

APPROVED:



PATRICK H. WEST  
CITY MANAGER



**Development Property**  
**Attachment**

110 W Ocean Blvd  
 AIN: 7278-007-035  
 Council District : 2

