



Legislation Text

File #: 22-0702, Version: 1

Recommendation to authorize City Manager, or designee, to execute any and all documents necessary to enter into a Hotel Management Agreement with Evolution Hospitality, LLC, of San Clemente, CA, for the reopening and operation of the Queen Mary hotel, attractions, parking, retail, food and beverage services, and ship related events for a period of five years, with the option to renew for two successive one-year periods, at the discretion of the City Manager. (District 1)

On June 8, 2021, the City Council authorized an emergency Caretaker Agreement with Evolution Hospitality, LLC (Evolution), to maintain the Queen Mary during a prolonged COVID-19 closure after the ship was returned to City of Long Beach (City) control when the former lessee went into bankruptcy. Since that time, Evolution has diligently maintained the ship and its immediate vicinity and worked closely with City staff to implement improvements on the Queen Mary.

The Department of Public Works (Public Works) has begun critical structural and safety projects at the ship and will continue to implement those projects as directed by the City Council. Additionally, the Special Events and Filming Office has facilitated filming activity on-board the ship to help generate additional revenue during the ship's closure.

Upon direction from the City Council, and in consultation with staff from the Harbor Department, City staff have worked with Evolution to negotiate a short-term Hotel Management Agreement to accommodate the re-opening of the Queen Mary. The scope of this agreement includes re-opening planning and operation of the ship hotel, attractions, parking, retail, food and beverage services, and ship related events.

In anticipation of a fall re-opening, the parties have negotiated the following major terms and conditions:

- **Term:** Effective Date of July 1, 2022, to accommodate pre-opening activities. Anticipated Commencement Date of October 1, 2022, for an initial five-year term through September 30, 2027. Two successive one-year renewal options are available at the discretion of the City Manager.
- **Property Management:** Evolution will be responsible for operation of the former Queen Mary leasehold area, excluding those areas previously leased to third-parties by the City and excluding the Harry Bridges Special Events Park. Evolution will operate and manage the Queen Mary Hotel, attractions, retail, food and beverage, parking, and Ship-based special events. Evolution will be responsible for the proper

and efficient operation, maintenance, and repair of the property. The City will remain responsible for capital improvements, and for programming of Special Events at Harry Bridges Park.

- **Expense Recovery:** City will reimburse Evolution for reimbursable expenses incurred during, and directly related to, the re-opening, management, and operation of the Queen Mary under this Agreement. These expenses may include, but are not limited to, legal and other costs incurred in obtaining and maintaining any liquor license, reasonable travel, telephone, telegram, facsimile, air express and other incidental expenses and any fees or expenditures required to operate the Hotel in the given jurisdiction.
- **Base Fee:** 2.5 percent of Total Operating Revenue for year one, and then 2 percent of Total Operating Revenue for the years following. Evolution reduced this from their standard 3 percent base fee.
- **Corporate Support Fees:** \$9,000/month; Evolution's corporate entity will provide centralized accounting and marketing support for on-ship operations. This fee will increase annually by 3 percent.
- **Incentive Fee:** 10 percent of Earnings Before Interest Depreciation and Amortization (EBIDA) in excess of \$7.5 million. Paid only after audited financial statements are received, reviewed and accepted by the City.
- **Performance Standard:** The City will have the right to terminate the Hotel Management Agreement upon at least 90 days' written notice without penalty, if for any two consecutive calendar years beginning with 2023, the Hotel fails to achieve both of the following 1) at least 90 percent of budgeted Gross Operating Profit for both such calendar years; and 2) at least 60 percent of the RevPAR (revenue per available room) of the Hotel's local competitive set for both such calendar years.
- **Termination Fee:** If the City terminates the Agreement in connection with the sale or lease of the asset, or defaults, then the City is required to pay a fee equal to the trailing monthly average of the total Base Fees earned by Evolution over the previous year, multiplied by the difference between (i) twenty-four months, minus (ii) the number of months in the Operating Term which have expired upon the effective date of such termination. Additionally, the City would incur costs associated with terminating hotel employees such as severance pay, unemployment compensation, earned and accrued vacation pay, bonus accruals, estimated tax payments and any other employee liability costs arising out of termination.
- **Re-opening Service Fee:** For the period prior to the planned October 1, 2022 re-opening, the City will pay to Evolution \$25,000 per month. Additionally, the City will reimburse Evolution for reasonable and documented reimbursable expenses during this period.

- **Pre-opening Budget:** Evolution will provide a re-opening budget setting forth the proposed costs and expenses anticipated to be incurred during the re-opening period. This is currently estimated at approximately \$1.6 million through October 1, 2022.
- **Pre-opening Improvements:** To safely re-open limited hotel, attraction and visitor serving services, approximately \$1 million in improvements are needed for (i) replacement of the ship's boilers, (ii) HVAC/refrigeration repairs, (iii) repairs to elevators, (iv) repair/installation of heat exchangers, (v) cleaning of the kitchens floors and ceilings, (vi) replacement of malfunctioning/broken guest room locks, (vii) installation of new kitchen hoods, (viii) repair/installation of restroom plumbing, and (ix) parking repairs and upgrades.
- **Operating Account:** All funds received by Evolution in the operation of the Queen Mary, including working capital furnished by the City, shall be deposited into an Operating Account in such federally insured financial institution as may be selected by Evolution and reasonably approved by the City. To the extent funds are available in the Operating Account, Evolution will pay all Operating Expenses. As part of its audit rights, the City will have the right to inspect the Operating Account at any time. Together with the annual financial report, Evolution will distribute to the City all sums in the Operating Account in excess of the working capital requirements.
- **Initial Working Capital:** To ensure the ability to pay for eligible operating expenses, and in accordance with industry norms, the City will provide \$1.5 million in working capital to be placed into the Operating Account upon execution of the agreement. For accounting purposes, this would be booked as prepaid expense, does not affect the net position on the City's fund, and does not represent any additional compensation or expense other than that already contemplated in the agreement. This minimum working capital level would be retained and anticipated to be supported by revenue generated upon re-opening of the Ship.
- **Furniture, Fixtures & Equipment (FF&E) Reserve:** An FF&E Reserve will be maintained for a reserve for replacements, substitutions and additions to furniture, fixtures and equipment. During each Fiscal Year four percent (4%) of Total Operating Revenues will be allocated and paid monthly to the FF&E Reserve. It will be held in a federally insured financial institution account separate from the Operating Account, and subject to the same auditing rights and accounting standards as the Operating Account. All funds in the FF&E Reserve, together with any interest earned thereon shall be used solely for purposes of replacing or refurbishing the FF&E in accordance with the applicable Capital Budget. Any funds remaining in the FF&E Reserve at the end of a Fiscal Year shall be carried forward to the next Fiscal Year. Upon expiration or termination of this Agreement, Evolution will remit all remaining amounts in the FF&E Reserve to the City.

- **Financial Reporting:** Evolution will deliver to the City in an electronic format within fifteen (15) days after the end of each month, the Monthly Reports. The Monthly Reports shall be prepared in accordance with the Uniform System and GAAP unless otherwise set forth in this Agreement. In addition, within seventy-five (75) days after (i) the end of each Fiscal Year, and (ii) the end of the Operating Term of this Agreement, Evolution shall deliver to the City an annual accounting, showing the results of operation of the Hotel during the Fiscal Year and a computation of Total Operating Revenues, Operating Expenses, and EBITDA, if any, and any other information necessary to make the computations required hereby or which may be requested by the City, all for such Fiscal Year.
- **Financial Records:** Evolution will keep full and accurate books of account and other records reflecting the results of the operation of the Hotel in accordance with the Uniform System and GAAP and will be available to the City and its representatives at all reasonable times for examination, audit, inspection and transcription.
- **Fiscal Year Budgets:** 30 days prior to October 1 of each Fiscal Year, Evolution will submit Budgets for the next Fiscal Year to the City. These Budgets will include the Operating Budget, the Capital Budget, and such other reports or projections as Evolution and City may agree on. Additionally, the capital budget should set forth in reasonable line-item detail proposed capital projects and expenditures including, but not limited to, FF&E expenditures.

The Budgets will be prepared in accordance with the Uniform System and GAAP to the extent applicable and will otherwise be prepared in accordance with Evolution's standard financial reporting and budgeting practices. The City will notify Evolution in writing of its approval or disapproval of the Budgets not later than thirty (30) days.

- **Capital Expenses:** The City of Long Beach will be responsible for the cost of larger capital improvements to the Ship and for restoration and preservation of historic items beyond maintenance of those items. Evolution will continue to engage the services of a Historic Resources Advisor, so Evolution can properly maintain and manage the assets and identify priority projects.
- **Labor Compliance:** Prior to the hotels closure in 2020, Evolution held labor agreements with the Seafarers International Union and International Brotherhood of Teamsters for all hourly associates, that totaled approximately 300 staff. Evolution will continue to honor these agreements upon the hotels re-opening. Evolution will make every effort to provide employment opportunities for those that were previously employed on the ship.
- **Insurance/Liability:** Insurance and liability terms of the proposed agreement have been reviewed by City Risk Manager.

With this proposed agreement in-place, Evolution will begin planning and work, in consultation with the Economic Development, Public Works, and Harbor Departments to prepare for a fall 2022 re-opening of the Queen Mary.

This matter was reviewed by Principal Deputy City Attorney Richard F. Anthony and Budget Operations and Development Officer Rhutu Amin Gharib on June 7, 2022.

EQUITY LENS

The City has incorporated the Equity Toolkit into this recommendation as requested by the City Council on April 21, 2020. Equity considerations were incorporated into the negotiation and development of this agreement. This recommendation is not anticipated to have any adverse equity impacts

City Council action is requested on June 21, 2022, to enter into a Hotel Management Agreement with Evolution Hospitality to provide for sufficient lead time to accommodate a proposed fall re-opening of the Queen Mary.

The recommended action will result in approximately \$2,870,500 in estimated pre-opening and re-opening costs in FY 22 in the Tidelands Area Fund Group. This estimate includes \$1.6 million pre-opening costs for staffing and other approved costs, \$1 million pre-opening improvements for priority visitor serving projects needed to safely re-open the ship, an 8.5 percent contingency of \$195,500 for additional re-opening needs, and \$75,000 for reopening service fees. This amount is not currently budgeted in the Tidelands Area Fund Group. The Economic Development Department will return to the City Council with a request for appropriation for this and other Queen Mary-related costs as part of the FY 22 Year-End Budget Performance Report. These expenses will be offset to the extent possible by revenue generated from the Queen Mary, Harry Bridges Special Events Park, and leases in the vicinity of the former Queen Mary leasehold. Any expenses not offset within the Tidelands Area Fund Group may need to be covered by the Tidelands Operating Fund Group.

Evolution anticipates the ship's operations can fully offset expenses for FY 23, with net revenue to the City approaching \$1,000,000 after all costs are settled. For FY 24 and beyond, the net revenue projections to the City may exceed \$7,000,000 annually. This does not include revenue generated at Harry Bridges Special Events Park, or from leases in the vicinity of the Queen Mary such as Carnival, Island Express Helicopters, or Catalina Express. The immediate magnitude of that impact is difficult to predict due to lingering COVID-19 related booking effects, and the new incentive fee structure proposed in the agreement.

This recommendation will result in significant staff resources from the Economic Development and Public Works Departments and is consistent with existing City Council priorities. There is no local job impact associated with this recommendation.

Approve recommendation.

JOHNNY M. VALLEJO
ACTING DIRECTOR OF ECONOMIC DEVELOPMENT

ERIC LOPEZ
DIRECTOR OF PUBLIC WORKS