



# REPORT TO THE REDEVELOPMENT AGENCY of the City of Sacramento

915 I Street, Sacramento, CA 95814-2604

Staff Report  
August 11, 2009

**Honorable Chair and  
Members of the Board**

**Title:** Status Report: Exclusive Right to Negotiate Agreements with USA Hospitality, Inc. for 800 K/L Site

**Location/Council District:** 800-816 K Street and 809-815 L Street/Council District 1

**Recommendation:** Provide Direction.

**Contact:** Denise Malvetti, Senior Project Manager, 808-7064 and Leslie Fritzsche, Downtown Development Manager, 808-5450

**Presenter:** Leslie Fritzsche, Downtown Development Manager

**Department:** Economic Development

**Division:** Downtown Development

**Organization No:** 18001021

## **Description/Analysis**

**Issue:** On October 7, 2008 the Agency Board authorized the Assistant City Manager to execute settlement agreement documents with the main property owners of the southside of the 700 and 800 blocks of K Street (M.H. Mohanna, Urban Innovation Partners, LLC, 8<sup>th</sup> and K Lofts, LLC, 726 K Street, LLC and 718 K Street, LLC). Two of the documents included in the settlement package were nine (9) month Exclusive Right to Negotiate Agreements (ERNs) with USA Hospitality, Inc. for a 400 room full service hotel on the 800 block of K Street and a mixed-use project at 8<sup>th</sup> and L Streets. In June 2009, the Agency Board granted a forty five (45) day extension to provide additional time to negotiate deal points. This is due to expire on August 23, 2009.

The developer has proposed a 409 room, four-star full service hotel at 8<sup>th</sup> and K streets and a 372 space parking garage at 8<sup>th</sup> and L Streets.

During the ten and a half months of negotiations the development team known as K Street Hotel Partners, LLC (see Attachment 1 for team composition) and Agency staff have not reached agreement on the business terms. The ERNs commit to a



purchase price of \$150 per square foot, approximately \$7.8M, for the Agency-owned parcels, but does not commit to any further City or Agency financial assistance.

Instead of the \$7.8M purchase price, the development team has requested that the Agency contribute the land for \$1.00. In addition to the land, the team has also requested a rebate of all of the Transient Occupancy Tax and net tax increment (net of required housing set-aside funds and pass-thru payments) generated from the project. The 100% Transient Occupancy Tax (TOT) rebate is in an amount equal to \$15.43 million over a period of eight (8) years and a 100% Tax Increment (TI) rebate in an amount equal to \$4.67M over ten (10) years. The development team has included in their pro-forma a land value of \$14 million for the land. If this figure is used for the value of the land proposed to be contributed by the Agency, the total request of the City and Agency is approximately \$34M (Attachment 1).

In lieu of payment for the land, K Street Hotel Partners has proposed contributing ten percent (10%) of net cash flow (after operating expenses, debt service/equity payment to Consus, their primary lender, and a preferred return to their investors) to the Agency. The City's/Agency's ten percent (10%) share is disproportionate to the amount that will be received by other project investors based on their respective amount of investment in the project. The City/Agency's proposed investment in the project is \$34 million of a \$137 million total project cost, or approximately 25%. The developer's pro-forma outlining the project costs and funding sources is included as Attachment 2 with the proposed distribution of net revenues from the project included as Attachment 3.

In addition, the team has outlined terms by which they would agree to a purchase of the garage by the City at the total cost of the garage less the \$1.63 million dollars in equity provided by the initial investors. At this time it is estimated that amount would equal approximately \$10,530,000. This sale would be contingent upon the following:

- Execution of a long-term parking agreement between the Agency and the Hotel;
- Development team retention of "air rights" above the garage to allow for the potential to construct residential units on top of the garage some time in the future;
- Payoff of the debt portion of the Consus Asset Management financing;
- Three years of operation of the hotel and garage.

Since the terms proposed by the development team are at such variance to the original ERNs, the costs to the City/Agency are high, and Agency staff has been unable to reach consensus with the development team on alternative business terms, staff is seeking input from Council on whether to continue discussions exclusively with this development team.

**Policy Considerations:** It has long been a priority of the Agency Board and staff to revitalize K Street and implement the JKL Corridor strategies outlined in the 2004 Charette. Staff continues to promote development throughout the Merged

Downtown Redevelopment Area and achieve the Implementation Plan goals of eliminating blight, stimulating economic growth, and leveraging private sector investment. Although the development of a hotel meets these goals, the level of requested City and Agency assistance is significant and the two parties have not reached an agreement on a financial structure.

The financial structure proposed by the developer relies heavily on the use of the transit occupancy tax funds generated by their project. This has not been done in the City before and a change to the existing ordinance would be required to make this possible. Currently the transit occupancy tax funds are used to support the Convention Center, the Convention and Visitors Bureau, the Sacramento Metropolitan Arts Commission, and General Fund operations.

**Environmental Considerations**

**California Environmental Quality Act (CEQA):** Not applicable.

**Sustainability Considerations:** Not applicable.

**Commission/Committee Action:** At their meeting of July 22, 2009 the Downtown Sacramento Partnership Board of Directors approved the concept of a hotel at 8<sup>th</sup> and K Streets.

**Rationale for Recommendation:** Not applicable.

**Financial Considerations:** There are no financial considerations affiliated with this action.

**M/WBE:** Minority/Women Business Enterprise requirements are not applicable as no federal funding is involved in this action.

Respectfully Submitted by:   
Leslie Fritzsche  
Downtown Development Manager on behalf of the  
Redevelopment Agency

Recommendation Approved:



Ray Kerridge  
City Manager

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**Attachment 1  
Background**

On October 7, 2008 as part of the legal settlement with the main properties owners of the 700 and 800 blocks of K Street ((M.H. Mohanna, Urban Innovation Partners, LLC, 8<sup>th</sup> and K Lofts, LLC, 726 K Street, LLC and 718 K Street, LLC) the Agency Board approved two, nine (9) month ERNs with USA Hospitality, Inc. for a 400 room full service hotel on the 800 block of K Street and a mixed-use project at 8<sup>th</sup> and L streets. The developer has proposed a 409 room hotel on the 8<sup>th</sup> and K site and a 372 space public parking garage on the 8<sup>th</sup> and L streets site. The estimated project cost for both the hotel and parking garage is \$136M.

The development team consists of the following:

USA Hospitality Inc. – a company whose principal, Bob Leach, has completed a number of local hotel projects including La Rivage, Rocklin Park Hotel, Radisson Inn at Lake Natoma, Hilton Garden Inn in Napa

Parkcrest Development – a local real estate development firm that has completed hotels as well as multi-and single-family residential projects

Consus Investment – a Korean investment company interested in investing \$91.67 million in a seven-year combined debt and equity position

8<sup>th</sup> and K Investors – a team of local investors consisting of John Lambeth, Mo Mohanna and Bill Tucker

The development team has secured a preliminary letter of interest from Marriott and has selected Sage Hospitality as hotel operators.

The development team has asked for the following contribution from the City and Agency:

Contribution of the Land	\$14,000,000 (value provided by Developer)
Transient Occupancy Tax Rebate	\$15,430,000 (\$12,800,000 NPV)
Tax Increment Rebate	\$4,670,000
<b>Total City/Agency Request</b>	<b>\$34,100,000</b>

**Attachment 2****PROJECT SOURCES AND USES****Uses**

Pre-Development Costs	\$2,700,000
Fees	\$3,119,870
Developer Fee	\$3,200,000
Franchise Fee	\$81,800
Finance Costs	\$6,858,530
Hard Construction Costs	\$82,882,000
Furniture Fixtures and Equipment	\$6,998,000
Pre-Opening Costs	\$1,052,000
Contingency	\$14,357,500
Operating Reserve	\$1,750,000
Land	\$14,000,000
	<b>\$137,000,000</b>

**Sources**

Consus Financing	\$91,670,000
Land (Agency Contribution)	\$14,000,000
TOT Rebate (City Contribution)	\$12,800,000*
Dougherty Funding LLC (Parking)	\$10,530,000
Investor Capital	\$8,000,000
	<b>\$137,000,000</b>

**Additional Funding**

Tax Increment Rebate (10 year rebate of tax increment net of all pass throughs)	\$4,655,463
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\* This figure is the net present value of the TOT over approximately an 8 year period. The actual dollars (not discounted to today's dollar) is \$15,430,000.

### Attachment 3 Hotel and Parking Garage Pro-formas And Investor Returns

	Year 1 2013		Year 2 2014		Year 3 2015		Year 4 2016		Year 5 2017	
	Amount	SPOR								
<b>Number of Rooms</b>	409		409		409		409		409	
Available Rooms (Annual)	149,285		149,285		149,285		149,285		149,285	
Occupied Rooms	92,437		101,660		111,100		113,653		115,589	
Occupancy	61.9%		68.1%		74.4%		75.9%		77.4%	
ADR	\$ 181.08		\$ 196.14		\$ 203.83		\$ 209.95		\$ 216.25	
RevPAR	\$ 112.12		\$ 133.57		\$ 151.70		\$ 160.37		\$ 167.44	
Growth			19.1%		13.6%		3.7%		3.7%	
<b>Revenues</b>										
Rooms	\$ 16,708,539	\$ 181.08	\$ 19,840,137	\$ 196.14	\$ 22,545,979	\$ 203.83	\$ 23,856,943	\$ 209.95	\$ 24,995,023	\$ 216.25
Food & Beverage	\$ 4,538,460	\$ 49.84	\$ 5,197,989	\$ 51.12	\$ 5,867,841	\$ 52.82	\$ 6,163,273	\$ 54.15	\$ 6,421,380	\$ 55.55
Telecommunications	\$ 317,960	\$ 0.34	\$ 34,538	\$ 0.34	\$ 37,257	\$ 0.09	\$ 37,540	\$ 0.09	\$ 37,547	\$ 0.09
Parking Garage	\$ 0	\$ 0.00	\$ 0	\$ 0.00	\$ 0	\$ 0.00	\$ 0	\$ 0.00	\$ 0	\$ 0.00
Spa	\$ 1,841,783	\$ 21.00	\$ 2,134,870	\$ 21.00	\$ 2,403,101	\$ 21.63	\$ 2,531,615	\$ 22.28	\$ 2,652,447	\$ 22.95
Other	\$ 1,693,061	\$ 16.32	\$ 1,858,795	\$ 18.28	\$ 2,155,110	\$ 19.40	\$ 2,338,472	\$ 20.58	\$ 2,450,085	\$ 21.20
Total Revenues	\$ 24,995,803	\$ 270.38	\$ 29,165,629	\$ 286.69	\$ 33,198,188	\$ 298.01	\$ 34,317,846	\$ 307.29	\$ 36,557,083	\$ 319.00
Growth			16.7%		13.9%		5.5%		4.7%	
<b>Department Expenses</b>										
Rooms	\$ 6,658,638	\$ 50.40	\$ 7,199,186	\$ 51.14	\$ 7,743,950	\$ 51.70	\$ 8,023,741	\$ 53.01	\$ 8,290,885	\$ 54.42
Food & Beverage	\$ 3,787,648	\$ 40.76	\$ 4,248,055	\$ 41.79	\$ 4,713,333	\$ 42.42	\$ 4,939,585	\$ 43.47	\$ 5,130,707	\$ 44.39
Telecommunications	\$ 317,960	\$ 0.34	\$ 34,538	\$ 0.34	\$ 37,257	\$ 0.09	\$ 37,540	\$ 0.09	\$ 37,547	\$ 0.09
Parking Garage	\$ 0	\$ 0.00	\$ 0	\$ 0.00	\$ 0	\$ 0.00	\$ 0	\$ 0.00	\$ 0	\$ 0.00
Spa	\$ 1,455,897	\$ 15.75	\$ 1,681,152	\$ 15.75	\$ 1,902,326	\$ 16.22	\$ 1,898,711	\$ 16.71	\$ 1,949,335	\$ 17.21
Other	\$ 321,469	\$ 9.87	\$ 377,351	\$ 8.63	\$ 460,575	\$ 8.83	\$ 564,651	\$ 9.28	\$ 604,989	\$ 9.56
Total Department Expenses	\$ 10,835,403	\$ 117.22	\$ 11,980,282	\$ 117.65	\$ 13,277,441	\$ 119.51	\$ 13,954,231	\$ 122.80	\$ 14,553,473	\$ 125.91
Gross Operating Income (Department Profit)	14,159,400	56.6%	17,205,347	58.0%	19,831,747	59.5%	20,863,615	60.0%	22,003,610	60.2%
<b>Overhead Expenses</b>										
Administrative & General	\$ 2,320,270	\$ 15.54	\$ 2,494,062	\$ 16.10	\$ 2,551,954	\$ 17.09	\$ 2,648,554	\$ 17.69	\$ 2,742,698	\$ 18.37
Management Fee	\$ 930,803	\$ 6.53	\$ 978,715	\$ 6.53	\$ 1,046,792	\$ 6.53	\$ 1,103,650	\$ 6.53	\$ 1,155,715	\$ 6.53
Franchise Fee	\$ 974,591	\$ 6.53	\$ 1,052,327	\$ 6.53	\$ 1,161,247	\$ 6.53	\$ 1,267,646	\$ 6.53	\$ 1,342,335	\$ 6.53
Marketing	\$ 1,698,796	\$ 11.38	\$ 1,803,748	\$ 12.08	\$ 1,900,012	\$ 12.73	\$ 1,957,646	\$ 13.14	\$ 2,035,135	\$ 13.61
Property Maintenance	\$ 1,039,194	\$ 6.98	\$ 1,070,370	\$ 7.17	\$ 1,102,481	\$ 7.39	\$ 1,135,556	\$ 7.59	\$ 1,169,622	\$ 7.83
Utilities	\$ 1,012,034	\$ 6.78	\$ 1,088,635	\$ 7.29	\$ 1,170,040	\$ 7.84	\$ 1,218,611	\$ 8.14	\$ 1,293,885	\$ 8.48
Total Overhead Expenses	\$ 7,538,678	\$ 51.17	\$ 8,487,857	\$ 56.86	\$ 9,532,366	\$ 63.85	\$ 9,928,861	\$ 66.33	\$ 10,311,380	\$ 68.07
GROSS OPERATING PROFIT	\$ 6,519,722	26.1%	\$ 8,717,490	29.3%	\$ 10,299,381	31.1%	\$ 11,034,814	31.6%	\$ 11,692,220	32.0%
<b>Fixed Expenses</b>										
Property Taxes	\$ 1,042,643	4.2%	\$ 1,073,923	3.7%	\$ 1,113,658	3.4%	\$ 1,154,883	3.3%	\$ 1,197,593	3.3%
Insurance	\$ 200,423	0.8%	\$ 206,436	0.7%	\$ 212,629	0.6%	\$ 219,008	0.6%	\$ 225,578	0.6%
Equipment Lease/Other	\$ 0	0.0%	\$ 0	0.0%	\$ 0	0.0%	\$ 0	0.0%	\$ 0	0.0%
Reserve for Replacement	\$ 527,325	2.1%	\$ 522,458	1.8%	\$ 519,562	1.6%	\$ 517,800	1.6%	\$ 514,953	1.6%
Total Fixed Charges	\$ 1,770,891	7.1%	\$ 1,802,817	6.3%	\$ 1,845,849	5.6%	\$ 1,891,691	5.5%	\$ 1,948,124	5.5%
NET OPERATING INCOME	\$ 4,748,831	19.0%	\$ 6,514,673	22.3%	\$ 7,577,432	22.9%	\$ 8,185,143	23.5%	\$ 8,728,098	23.9%

Source: Sage Pro Forma

Sacramento Hotel Project - 8th and K Street  
Hotel & Parking Operating Phase Cash Flow Distribution

Item	Assumption/ Reference	Operations									
		Year 1 2013	Year 2 2014	Year 3 2015	Year 4 2016	Year 5 2017	Year 6 2018	Year 7 2019	Year 8 2020	Year 9 2021	Year 10 2022
<b>Total Revenues Available for Distribution</b>											
Hotel Operations Cash Flow Ending Balance	Table 4	\$ 54,462,107	\$ 3,612,151	\$ 5,021,715	\$ 5,865,924	\$ 6,402,209	\$ 5,310,320	\$ 0,395,655	\$ 6,279,218	\$ 6,659,351	\$ 10,094,791
Parking Operations Cash Flow Ending Balance	Table 6	\$ 4,745,177	\$ 450,162	\$ 506,103	\$ 511,972	\$ 531,330	\$ 530,785	\$ 540,353	\$ 540,976	\$ 559,715	\$ 569,650
Total Hotel and Parking Revenues available for Distribution		\$ 59,207,284	\$ 4,062,313	\$ 5,527,818	\$ 6,377,896	\$ 6,933,541	\$ 5,841,105	\$ 6,027,018	\$ 7,026,192	\$ 7,309,066	\$ 10,664,441
Less Payments to Concess		\$ (23,409,622)	\$ (3,097,192)	\$ (4,470,300)	\$ (5,202,641)	\$ (5,781,915)	\$ (3,256,629)	\$ (1,440,653)	\$ -	\$ -	\$ -
Ending Balance Available for Distribution		\$ 35,797,662	\$ 965,151	\$ 1,057,518	\$ 1,094,955	\$ 1,141,626	\$ 2,584,476	\$ 5,486,365	\$ 6,826,192	\$ 7,398,090	\$ 10,664,441
<b>Distribution of Ending Balance</b>											
Equity Investors Preferred Return	Table 13	\$ 5,110,818	\$ 509,197	\$ 649,794	\$ 694,476	\$ 699,564	\$ 713,741	\$ 649,600	\$ 481,684	\$ 115,550	\$ -
Remaining Available for Distribution (Additional Payments)		\$ 30,686,844	\$ 455,954	\$ 407,724	\$ 400,479	\$ 442,062	\$ 1,870,735	\$ 4,837,765	\$ 6,594,209	\$ 7,282,540	\$ 10,664,441
<b>Distribution of Remaining Balance</b>											
City of Sacramento	10%	\$ 3,068,648	\$ -	\$ 28,638	\$ 41,648	\$ 44,206	\$ 187,273	\$ 483,776	\$ 659,421	\$ 729,351	\$ 865,425
Equity Investors	40%	\$ 4,274,594	\$ -	\$ 118,543	\$ 164,191	\$ 176,825	\$ 749,084	\$ 1,935,105	\$ 2,801,084	\$ 2,813,405	\$ 3,461,702
USA Hospitality	10%	\$ 3,068,648	\$ -	\$ 28,638	\$ 41,648	\$ 44,206	\$ 187,273	\$ 483,776	\$ 659,421	\$ 729,351	\$ 865,425
Park erect	40%	\$ 12,274,594	\$ -	\$ 118,543	\$ 164,191	\$ 176,825	\$ 749,084	\$ 1,935,105	\$ 2,801,084	\$ 2,813,405	\$ 3,461,702
Total		\$ 22,686,484	\$ -	\$ 296,367	\$ 395,116	\$ 442,062	\$ 1,870,735	\$ 4,837,762	\$ 6,594,210	\$ 7,282,512	\$ 8,664,254
Equity Investors IRR	9.1%	\$ 9,385,411	\$ 500,197	\$ 707,937	\$ 822,849	\$ 876,398	\$ 1,462,335	\$ 2,583,708	\$ 3,603,617	\$ 3,028,959	\$ 3,461,702

