Sacramento Housing & Redevelopment Agency

REPORT TO THE REDEVELOPMENT AGENCY of the City of Sacramento

915 I Street, Sacramento, CA 95814-2604

Staff Report
August 25, 2009

Honorable Chair and Members of the Board

Title: Status Report: 800 K/L Proposed Development

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: Denise Malvetti, Senior Project Manager and Leslie Fritzsche, Downtown Development Manager

Department: Economic Development

Division: Downtown Development

Organization No: 18001021

Description/Analysis

Issue: On October 7, 2008 the Agency Board (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, 8th 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 8th and L Streets.

In June 2009, the Board granted a 45 day extension to provide additional time to negotiate deal points. Staff scheduled an August 11, 2009 report to the Board to provide a status update. At the request of the development team known as K Street Hotel Partners, LLC (see Attachment 1 for team composition) this item was continued from the August 11, 2009 meeting to August 25, 2009 to allow them time to revise their financial proposal. The developer fully recognized that the ERN would expire on August 23, 2009 prior to the Board meeting.

On August 18, 2009 the development team submitted a revised proposal. As of the August 20, 2009 writing of this staff report, staff have not fully reviewed the details, implications and feasibility of the revisions with the developer but in principle they are positive developments. The general terms of the proposal are as follows:

The development proposal remains a 409 room, four-star full service hotel at 8th and K streets and a 372 space parking garage at 8th and L streets. The proposal for public financing continues to seek that the land be contributed for $1.00 instead of the $7.8M purchase price agreed to in the settlement ERNs. The development team has also requested 100 percent of net tax increment (net of required housing set-aside funds, pass-thru payments, and ERAF shifts) generated from the project. The Tax Increment (TI) rebate is projected to equal approximately $4.67M over 10 years.

The August 18, 2009 revised proposal has reduced the requested annual rebate of the Transient Occupancy Tax (TOT) from 100 percent to 50 percent of the TOT generated by the proposed hotel and has extended the term of the commitment from 10 years to 14 years. The present value of this contribution remains unchanged from the prior proposal. The 50 percent TOT rebate is in an amount equal to $12.8M in 2010 dollars with 8 percent interest (approximately $23M in actual dollars over approximately 14 years). Although this change will increase the carrying costs of this public contribution it recognizes the declining condition of the City's TOT fund in the current economic climate.

The revised proposal has increased the City and/or Agency's portion of available cash flow (after operating expenses, debt service/equity payments to Consus and Dougherty, the primary lenders) from 10 percent to 40 percent. In addition to receiving 40 percent of available cash flow, the City/Agency would receive 40 percent of proceeds at the time of sale (estimated to be in year 10). Based on the developer's estimates, the City/Agency could receive approximately $11M in cash flow during in the first 10 years of operation and an estimated $30M at sale. These assumptions and the project's ability to perform to this level will be fully analyzed by staff and consultants and discussed with the developer in the coming weeks. [1]

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.

The most fundamental challenge to development in today's economic environment is not the public commitments as outlined above, but rather the securing of private debt and equity. The proposed financial underpinning of this project is a $91 million debt and equity contribution from Consus of South Korea. Consus has substantial capacity and a track record of investment in large projects. Consus is exactly the type of investor needed to finance a project of this scale in today's market. However, to date the Developer has not received a formal commitment with

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1 To augment the substantial staff analysis, the City has retained two highly recognized industry consultants to assist in the review of the project. PKF Hospitality Research, an internationally recognized leader in this field was hired review the Developer's market assumptions. In addition the City has retained Keyser Marston to provide secondary review of the Developer's financial submittals.

complete terms and conditions from Consus. Staff wish to continue to work with the developer and Consus to secure that commitment after a rigorous underwriting review of the project cost and revenue projections and in consideration of the revised proposal.

Clearly it has been a long journey to bring us to where we are today on the 800 Block. The lawsuit settlement was the end of a saga and the ERN was the beginning of a new era of opportunity. That ERN has now been in force and tied up the property for 10 and a half months. While substantial progress has been made, a complete development proposal with financing commitments is not in place. Revitalization of the area has never been more urgent. Therefore staff recommends two concurrent processes. First is the preparation and release of a Request for Qualifications (RFQ) in 90 days. During the intervening 90 day period staff wish to continue working with the developer to finalize the terms of agreement with the City and secure the private financing commitments. Should that result in a financeable project the RFQ would not be released.

Staff is seeking Board input and direction on next steps for the 800 K/L site. Although the ERNs expired on August 23, 2009, Agency staff can continue to work with the development team while simultaneously preparing a Request for Qualifications to be released for the site within the next 90 days. If agreeable terms are reached before 90 days, staff will report back.

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.

The financial structure proposed for this project relies heavily on the use of the TOT revenues 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 TOT revenues are used to support the Convention Center, the Convention and Visitors Bureau, the Sacramento Metropolitan Arts Commission, and General Fund operations. Staff will prepare an analysis of the use, impacts and trends associated with TOT and will return to Council with a separate report.

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 8th 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: for
Leslie Fritzsche
Downtown Development Manager on behalf of the Redevelopment Agency

Approved by:
John Dangberg
Interim Director, Economic Development Department

Recommendation Approved:

Ray Kerridge
for 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, 8th 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 8th and L streets. The developer has proposed a 409 room hotel on the 8th and K site and a 372 space public parking garage on the 8th and L streets site. The estimated project cost for both the hotel and parking garage is $137M.

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 $91.67M in a seven-year combined debt and equity position

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	$12,800,000	50% of TOT $23,000,000 in actual dollars paid over 14 years
Tax Increment Rebate	$4,670,000	100% of net TI over 10 years
Total City/Agency Request	**$31,500,000**	

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
	$137,000,000

Sources

Consus Financing	$91,670,000
Land (Agency Contribution)	$14,000,000
TOT Rebate (City Contribution)	$12,800,000[1]
Dougherty Funding LLC (Parking)	$10,530,000
Parkcrest	$2,000,000
	$131,000,000[2]

Additional Funding

Tax Increment Rebate $4,670,000
(10 year rebate of tax increment net of all pass throughs)

[1] - This figure is the net present value of the TOT over approximately a 14 year period with 8 percent interest. The actual dollars (not discounted to today's dollar) is approximately $23,000,000.

[2] - The Developer has indicated that he will seek to fill the gap between sources and uses with additional funds from Consus or other Korean investment groups.

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

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Table 6
Sacramento Hotel Project – 8th and K Street
Hotel Pro Forma

	Year 1 2013			Year 2 2014			Year 3 2015			Year 4 2016			Year 5 2017		
Number of Rooms	409			409			409			409			409		
Available Rooms (Annual)	149,285			149,285			149,285			149,694			149,285		
Occupied Rooms	92,437			101,660			111,100			113,633			115,580		
Occupancy	61.9%			68.1%			74.4%			75.9%			77.43%		
ADR	$ 181.08			$ 196.14			$ 203.83			$ 208.95			$ 216.25		
RevPAR	$ 112.12			$ 133.57			$ 151.70			$ 159.37			$ 167.44		
Growth				19.1%			13.6%			5.1%			5.1%		
	Amount	Percent	$POR	Amount	Percent	$POR	Amount	Percent	$POR	Amount	Percent	$POR	Amount	Percent	$POR
Revenues															
Rooms	$ 16,738,539	67.0%	$ 181.08	$ 19,940,137	68.4%	$ 196.14	$ 22,645,879	68.4%	$ 203.83	$ 23,856,943	68.3%	$ 209.95	$ 24,995,623	68.4%	$ 216.25
Food & Beverage	$ 4,588,460	18.4%	$ 49.64	$ 5,197,289	17.8%	$ 51.12	$ 5,867,841	17.7%	$ 52.82	$ 6,153,273	17.6%	$ 54.15	$ 6,421,380	17.6%	$ 55.55
Telecommunications	$ 31,760	0.1%	$ 0.34	$ 34,538	0.1%	$ 0.34	$ 37,257	0.1%	$ 0.34	$ 37,543	0.1%	$ 0.33	$ 37,647	0.1%	$ 0.32
Parking Garage	$ 0	0.0%	$ 0.00	$ 0	0.0%	$ 0.00	$ 0	0.0%	$ 0.00	$ 0	0.0%	$ 0.00	$ 0	0.0%	$ 0.00
Spa	$ 1,941,183	7.8%	$ 21.00	$ 2,134,870	7.3%	$ 21.00	$ 2,403,101	7.3%	$ 21.63	$ 2,531,015	7.3%	$ 22.28	$ 2,652,447	7.3%	$ 22.95
Other	$ 1,693,661	6.8%	$ 18.32	$ 1,858,705	6.4%	$ 18.28	$ 2,155,110	6.5%	$ 19.40	$ 2,338,472	6.7%	$ 20.58	$ 2,450,085	6.7%	$ 21.20
Total Revenues	$ 24,993,603	100.0%	$ 270.39	$ 29,165,629	100.0%	$ 286.89	$ 33,109,188	100.0%	$ 298.01	$ 34,917,846	100.0%	$ 307.29	$ 36,557,083	100.0%	$ 1.00
Growth				16.7%			13.5%			5.5%			4.7%		
Department Expenses															
Rooms	$ 4,658,638	27.8%	$ 50.40	$ 5,199,186	26.1%	$ 51.14	$ 5,743,950	25.4%	$ 51.70	$ 6,023,741	25.2%	$ 53.01	$ 6,290,895	25.2%	$ 54.42
Food & Beverage	$ 3,767,648	82.1%	$ 40.76	$ 4,248,055	81.7%	$ 41.79	$ 4,713,333	80.3%	$ 42.42	$ 4,939,585	80.3%	$ 43.47	$ 5,130,707	79.9%	$ 44.38
Telecommunications	$ 31,760	100.0%	$ 0.34	$ 34,530	100.0%	$ 0.34	$ 37,257	100.0%	$ 0.34	$ 37,543	102.0%	$ 0.33	$ 37,547	100.0%	$ 0.32
Parking Garage	$ 0	0.0%	$ 0.00	$ 0	0.0%	$ 0.00	$ 0	0.0%	$ 0.00	$ 0	0.0%	$ 0.00	$ 0	0.0%	$ 0.00
Spa	$ 1,455,897	75.0%	$ 15.75	$ 1,601,152	75.0%	$ 15.75	$ 1,802,326	75.0%	$ 16.22	$ 1,898,711	75.0%	$ 16.71	$ 1,989,335	75.0%	$ 17.21
Other	$ 921,400	54.4%	$ 9.97	$ 877,351	47.2%	$ 8.63	$ 980,575	45.5%	$ 8.83	$ 1,054,651	45.1%	$ 9.28	$ 1,104,989	45.1%	$ 9.56
Total Department Expenses	$ 10,835,403	43.4%	$ 117.22	$ 11,960,282	41.0%	$ 117.65	$ 13,277,441	40.1%	$ 119.51	$ 13,854,231	40.0%	$ 122.80	$ 14,553,473	39.8%	$ 125.91
Gross Operating Income (Department Profit)	14,158,400	56.6%		17,205,347	59.0%		19,831,747	59.9%		20,963,616	60.0%		22,003,610	60.2%	
Overhead Expenses			$PAR			$PAR			$PAR			$PAR			$PAR
Administrative & General	$ 2,320,270	9.3%	$ 15.54	$ 2,404,062	8.2%	$ 16.10	$ 2,551,854	7.7%	$ 17.09	$ 2,648,554	7.6%	$ 17.69	$ 2,742,698	7.5%	$ 18.37
Management Fee	$ 593,603	2.4%	$ 3.98	$ 768,715	2.6%	$ 5.15	$ 1,046,732	3.2%	$ 7.01	$ 1,103,850	3.2%	$ 7.37	$ 1,155,715	3.2%	$ 7.74
Franchise Fee	$ 974,581	3.9%	$ 6.53	$ 1,352,327	4.6%	$ 9.06	$ 1,761,247	5.3%	$ 11.80	$ 1,854,584	5.3%	$ 12.39	$ 1,942,335	5.3%	$ 13.01
Marketing	$ 1,696,796	6.8%	$ 11.36	$ 1,803,748	6.2%	$ 12.08	$ 1,900,012	5.7%	$ 12.73	$ 1,967,648	5.6%	$ 13.14	$ 2,035,135	5.6%	$ 13.63
Property Maintenance	$ 1,039,194	4.2%	$ 6.96	$ 1,070,370	3.7%	$ 7.17	$ 1,102,481	3.3%	$ 7.39	$ 1,135,556	3.3%	$ 7.58	$ 1,169,822	3.2%	$ 7.83
Utilities	$ 1,012,034	4.0%	$ 6.78	$ 1,088,635	3.7%	$ 7.29	$ 1,170,040	3.5%	$ 7.84	$ 1,218,611	3.5%	$ 8.14	$ 1,265,665	3.5%	$ 8.48
Total Overhead Expenses	$ 7,638,678	30.6%	$ 51.17	$ 8,487,857	29.1%	$ 56.86	$ 9,532,366	28.8%	$ 63.85	$ 9,928,801	28.4%	$ 66.33	$ 10,311,390	28.2%	$ 69.07
GROSS OPERATING PROFIT	$ 6,519,722	26.1%		$ 8,717,490	29.9%		$ 10,299,381	31.1%		$ 11,034,814	31.6%		$ 11,692,220	32.0%	
Fixed Expenses															
Property Taxes	$ 1,042,643	4.2%		$ 1,073,923	3.7%		$ 1,113,658	3.4%		$ 1,154,863	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	$ 527,825	2.1%		$ 922,458	3.2%		$ 1,395,642	4.2%		$ 1,471,800	4.2%		$ 1,540,953	4.2%	
Total Fixed Charges	$ 1,770,891	7.1%		$ 2,202,817	7.6%		$ 2,721,929	8.2%		$ 2,845,671	8.1%		$ 2,964,124	8.1%	
NET OPERATING INCOME	$ 4,748,831	19.0%		$ 6,514,673	22.3%		$ 7,577,452	22.9%		$ 8,189,143	23.5%		$ 8,728,096	23.9%	

Source: Sage Pro Forma

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Table 15
Sacramento Hotel Project -- 8th and K Street
Hotel & Parking Operating Phase Cash Flow Distribution

Item	Assumption/ Reference	TOTAL	Pre-Development and Construction Year 1 2009	Year 2 2010	Year 3 2011	Year 4 2012	Operations Year 1 2013	Year 2 2014	Year 3 2015 Conexus Takeout Loan	Year 4 2016	Year 5 2017	Year 6 2018	Year 7 2019	Year 8 2020	Year 9 2021	Year 10 2022
Total Revenues Available for Distribution																
Hotel Operations Cash Flow Ending Balance	Table 6	$54,170,606					$12,407,240	$1,851,466	$4,558,052	$2,111,469	$2,660,376	$3,767,242	$4,907,212	$6,085,679	$7,290,460	$8,535,810
Parking Operations Cash Flow Ending Balance	Table 10	$1,775,177					$25,214	$100,192	$176,103	$181,972	$191,332	$200,785	$210,333	$215,576	$229,716	$239,553
Plus Revenues from Sale of Hotel [1]																$65,000,000
Total Hotel and Parking Revenues Available for Distribution		$120,945,783					$12,432,454	$1,951,658	$4,734,155	$2,293,441	$2,851,708	$3,968,027	$5,117,545	$6,301,255	$7,520,176	$73,775,363
Less Payments to Conexus		($18,816,757)					($12,407,240)	($1,851,466)	($4,558,052)	$0	$0	$0	$0	$0	$0	$0
Ending Balance Available for Distribution		$102,129,026					$25,214	$100,192	$176,103	$2,293,441	$2,851,708	$3,968,027	$5,117,545	$6,301,255	$7,520,176	$73,775,363
Distribution of Ending Balance																
Equity Investors Preferred Return	Table 14	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0
Remaining Available for Distribution (Additional Payments)		$102,129,026	$0	$0	$0	$0	$25,214	$100,192	$176,103	$2,293,441	$2,851,708	$3,968,027	$5,117,545	$6,301,255	$7,520,176	$73,775,363
Distribution of Remaining Balance																
City of Sacramento	40%	$40,851,610	$0	$0	$0	$0	$10,086	$40,077	$70,441	$917,376	$1,140,683	$1,587,211	$2,047,018	$2,520,502	$3,008,071	$29,510,145
Parkcrest	30%	$22,638,708	($3,000,000)	($3,330,000)	($240,000)	($1,430,000)	$7,564	$30,058	$52,831	$688,032	$855,512	$1,190,408	$1,535,264	$1,890,376	$2,256,053	$22,132,609
USA Hospitality	30%	$30,638,708	$0	$0	$0	$0	$7,564	$30,058	$52,831	$688,032	$855,512	$1,190,408	$1,535,264	$1,890,376	$2,256,053	$22,132,609
Total	100%	$94,129,026	($3,000,000)	($3,330,000)	($240,000)	($1,430,000)	$25,214	$100,192	$176,103	$2,293,441	$2,851,708	$3,968,027	$5,117,545	$6,301,255	$7,520,176	$73,775,363
Equity Investors IRR																
Parkcrest	12.8%		($3,000,000)	($3,330,000)	($240,000)	($1,430,000)	$7,564	$30,058	$52,831	$688,032	$855,512	$1,190,408	$1,535,264	$1,890,376	$2,256,053	$22,132,609
USA Hospitality	N/A		$0	$0	$0	$0	$7,564	$30,058	$52,831	$688,032	$855,512	$1,190,408	$1,535,264	$1,890,376	$2,256,053	$22,132,609
Combined	20.3%	$53,277,415	($3,000,000)	($3,330,000)	($240,000)	($1,430,000)	$15,128	$60,115	$105,662	$1,376,065	$1,711,025	$2,380,816	$3,070,527	$3,780,753	$4,512,106	$44,265,218

[1] Sale of hotel assumptions:

Rooms	409
Sale price per room	$380,000
Subtotal Sale Price	$155,420,000
Less 5% Costs of Sale	($7,771,000)
Less Takeout Loan Payoff (Rounded)	($76,900,000)
Less Repayment of TOT Note Receivable (Rounded)	($5,400,000)
Net Revenue	$65,000,000