REPORT OF THE
CHIEF LEGISLATIVE ANALYST

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TO: Honorable Members of the Economic Development Committee

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ECONOMIC DEVELOPMENT INCENTIVE POLICY FOR HOTEL DEVELOPMENT

SUMMARY
At its meeting of June 24, 2014, the Economic Development committee requested additional review of concepts within the proposed Hotel Incentive Policy. This report provides review of questions concerning alternative incentive amounts, waiver of Transfer of Floor Area Rights fees, and non-fiscal incentives.

Consideration of the issues raised by Committee has resulted in further refinements to the proposed Hotel Incentive Policy. This report now recommends a Hotel Incentive Policy that would be consistent with the Block Grant Infrastructure Fund (BGIF) Policy. The BGIF Policy, approved in 1998, includes guidelines to provide financial support to a range of economic development projects. This policy includes requirements that determine whether a project has a financial gap, the amount of assistance that can be provided (no more than 50% of net new site specific revenue), and the benefits to the City that warrant assistance. Financial assistance for the five hotel projects previously approved by Council were analyzed within this policy framework.

The Hotel Incentive Policy would be implemented by the Economic and Workforce Development Department (EWDD), with assistance from the CLA, City Administrative Officer (CAO), and City Attorney.

The Hotel Incentive Policy would provide financing support for eligible hotels with a financing gap as determined by a financial and economic analysis as follows:

- Up to 50% of net new site specific tax revenues for new hotels with 300 or more rooms maintained at a minimum 3-star quality;
- Up to 50% of net new site specific tax revenues for adaptive reuse hotel projects with 150 or more rooms maintained at a minimum 3-star quality; and
- Up to 50% of net new site specific tax revenues for renovations of existing hotels with 150 or more rooms maintained at a minimum 3-star quality.

Eligibility will be determined based on compliance with the terms of the Hotel Incentive Policy, the BGIF Policy, appropriate land use and zoning authority, and entitlement approval.

This report also recommends that various City departments report on actions that could address land use compatibility and entitlement constraints on hotel development.

RECOMMENDATIONS

That the City Council:

1. Approve a Hotel Incentive Policy, consistent with the Block Grant Infrastructure Fund (BGIF) Policy, whereby applicants may be eligible for up to 50% of net new site specific tax revenue to assist in the construction of new hotels with 300 or more rooms with a minimum quality/service level equivalent to a 3-star rating; the renovation of existing hotels with 150 or more rooms with a minimum quality/service level equivalent to a 3-star rating; or adaptive reuse hotel projects with 150 or more rooms with a minimum quality/service level equivalent to a 3-star rating;

2. Instruct the Economic and Workforce Development Department (EWDD), with support from the Chief Legislative Analyst (CLA), City Administrative Officer (CAO), and City Attorney, to implement the Hotel Incentive Policy;

3. Instruct the EWDD to prepare and release a Request for Qualifications (RFQ) to establish a list of economic and financial analysts qualified to evaluate the development costs and economic impacts of hotel development for use in the Hotel Incentive Policy and similar economic development projects, as required by the BGIF Policy;

4. Instruct the EWDD, CLA, CAO, Office of Finance and request the City Attorney and Controller to prepare standard documents for use in policy implementation, including monitoring;

5. Instruct the Planning Department, EWDD, and CLA to report to Council concerning any entitlement provisions that constrain hotel development;

6. Instruct the Planning Department to conduct a study of small hotels to identify their appropriate locations throughout the City, compatibility with local land uses and zoning, and options to transition these properties, if appropriate, to other uses;

7. Instruct the Planning Department to report on the status of the Central City Community Plan update with regard to the development of hotels, with consideration of new construction, renovation, and adaptive reuse opportunities; and

8. Instruct the EWDD, with the Office of Finance, City Controller, and CAO, to report annually on the status of projects assisted under the Hotel Incentive Policy, including compliance with California Government Code Section 53083 Compliance reporting, the hotel incentive agreements, and the BGIF Policy.

BACKGROUND

The purpose of a Citywide incentive policy is to increase the number of hotel rooms available in the City and create certainty in the development process for hotels. Over the last 25 years, the City has experienced a .7% increase in hotel room development, compared to the national average of 1.4%. A Citywide policy would also respond to the increase in tourism projected by the Los Angeles Tourism and Convention Board (LATCB) which seeks to increase tourist visits from 42.2 million in 2013 to more than 50 million annual visitors by 2020. LATCB recently reported that 6,400 new hotel rooms were built in New York City in 2014, while only 1,100 new hotel rooms were added in Los Angeles County.

On August 27, 2013, the Economic Development Committee considered a report concerning the establishment of an incentive policy to encourage the development of hotels. The proposed incentive policy would provide limited assistance for the development of qualified hotel projects throughout the City, as well as enhanced incentives for qualified hotel projects in specified geographic areas as noted below.

Further, enhanced incentive areas were proposed within the policy to achieve specific goals relative to the Los Angeles Convention Center (LACC), Downtown Los Angeles, adaptive reuse projects in Downtown, Los Angeles Airport, Hollywood, North Hollywood, and City sections near the Burbank Airport. The LACC, for example, requires specific hotel products to meet the needs of convention clients. The policy was designed to provide enhanced incentives that address the business needs of this City-owned facility.

At its meeting of June 24, 2014, the Committee considered additional recommendations from the CLA and instructed that research be completed on several issues, as follows:

- Adjust the Downtown Incentive Zone so that the southern boundary is Adams Blvd., not the Santa Monica Freeway (I-10)

- Evaluate options to provide more than 50% of net new site specific tax revenue to support a project, such as providing 100% of transient occupancy tax (TOT) plus 20% of remaining net new site specific tax revenues for hotels with 450 or more rooms and 100% of TOT plus 35% of remaining net new site specific tax revenues for hotels with 600 or more rooms;

- Evaluate waiver of the TFAR Transfer Fee; and

- Evaluate options to improve development certainty through the entitlement and permit process

This report provides responses to the questions posed at that meeting, as well as a revised set of recommendations concerning the establishment of a Hotel Incentive Policy.

Additional Policy Review

Consideration of the questions posed by members of the Committee drew attention to critical elements of the policy that required adjustment. As noted above, the Committee requested additional detail on four concerns. Additional issues have been identified during preparation of this report and are presented here for consideration.

Zone Incentives

The Hotel Incentive Policy initially proposed in August 2013 included several zones in areas across the City where hotel developments that meet particular needs would receive increased incentives. Zones were identified for Downtown Los Angeles, Los Angeles Convention Center (LACC) adjacent, Hollywood, and North Hollywood. Incentive amounts were determined for each of these areas, with the maximum amount provided in the LACC zone.

Questions posed by the Committee resulted in a reconsideration of this approach. The designation of specific hotel incentives zones within the proposed policy might reduce the opportunity to develop hotels in other parts of the City. Data presented to the Committee showed a significant lack of hotel development in the City, with Los Angeles producing rates on average of only .7% per year for the last 25 years, compared to the national average of 1.4%. Limiting hotel incentive support to just 25% or 40% of net new site specific revenues, as initially proposed, could impede the development of hotels in areas of the City where they may be most appropriate and needed.

The Committee's request that the boundaries of the Downtown Incentive Zone be adjusted reflects the unintended result of setting zones. Development in the City is dynamic. A boundary established today may not be relevant tomorrow. The result of establishing zones creates a program that may be too restrictive and could unintentionally delay development of new hotels. Periodic adjustments to the zones would likely be necessary to ensure that the incentive policy remains effective, which could delay development. Further, other areas of the City might emerge as appropriate hotel zones with a need for greater financial assistance.

To address these concerns, the policy proposed in this report recommends that a single incentive be available to all areas of the City, for new construction, adaptive reuse, and renovations of existing properties. It does not recommend the creation of specific zones. This approach would simplify the policy and ensure that every qualifying hotel project is given full consideration and opportunity on the same terms. This approach provides greater flexibility to meet the demands of hotel developments that may be proposed.

Alternative Incentive Amounts
The Committee requested that analysis be conducted on a proposal to provide the following additional incentives to hotels in the vicinity of the Los Angeles Convention Center:

- Hotels with 200 to 449 rooms: 50% of all site specific revenues or 100% of TOT;

- Hotels with 450 to 599 rooms: 100% of TOT plus 20% of the remaining site specific revenues for up to 35 years for first three years of the policy; and

- Hotels with 600 or more rooms: 100% of TOT plus 35% of the remaining site specific revenues for up to 35 years, plus a waiver of the TFAR Transfer Fee, for the first three years of the policy.

Each of these elements would provide a project with more than 50% of net new site specific tax revenues. This would be a deviation from the BGIF Policy, which is discussed in detail below. Altering the criteria of the BGIF Policy is not recommended. The criteria established for that policy ensure that the City's General Fund is protected and new revenues are generated to provide City services, such as police and fire, once the project is completed. Further, the BGIF Policy provides flexibility to provide additional support if appropriate, providing flexibility to meet the needs of specific projects. To date, no project has been awarded additional funding support greater than 50%, even though the BGIF Policy allows such consideration. Notwithstanding this recommendation, establishing additional incentives as noted above is a policy matter for the City Council and Mayor.

TFAR Fee Waiver
Transfer of Floor Area Rights (TFAR) is a means to provide additional floor area development rights to projects that would otherwise be limited in their total size by existing zoning. The City's TFAR policy currently transfers floor area from the LACC to approved projects in exchange for a transfer fee and a public benefit fee. The Wilshire Grand Hotel, for example, will become the tallest building west of the Mississippi due to the transfer of floor area from the LACC.

Committee requested review of a waiver of the TFAR transfer fee for hotels with 600 rooms or more as an additional incentive to the development of hotels with a significant number of rooms to serve the LACC. As noted in previous reports, competitive convention centers in California all have several hotels with 1,000 or more rooms adjacent or attached to their exhibit halls. Incentives to encourage the development of such hotels adjacent to the LACC would improve the LACC's ability to compete with other convention centers.

Waiver of the transfer fee would require an amendment to the TFAR ordinance. Provisions are not currently provided in the ordinance for waiver of either the transfer fee or the public benefit fee. Any such waiver should also be evaluated within the requirements of the Development Fee Subsidy Policy in the Administrative Code adopted by Council and be consistent with the City's Financial Policies. Additional research is required by the City Attorney to determine whether any TFAR fee waiver would be allowable. If the Council chooses, it should request that the City

Attorney report on the structure for such a fee waiver and instruct the CLA and CAO to review and evaluate the structure for such a waiver.

It should be noted that implementation of the TFAR program is currently under review. Revisions to the program may be in order due to the elimination of redevelopment in California. The TFAR program was, in part, implemented by the former CRA/LA. Implementation is now being transferred to the Department of City Planning (DCP). Amendments related to fee waivers should be included as part of this pending review of the policy and the implementing ordinance.

Entitlement and Permit Processing

The Committee also requested a review of entitlement or permitting actions that could create savings for a project. To address this issue, interviews were conducted with members of the local development community. Two key issues emerged in these conversations. The City should provide:

- a predictable and reliable entitlement process to allow developers to better manage costs associated with planning and building, and
- a problem-solving City staff to ensure timely solution of review and issues.

General consensus among those interviewed was that hotels are not significantly different from other types of developments with regard to the entitlement and permit review process. Hotels typically encounter the same issues that any residential and commercial project encounters, though the development characteristics for hotels may provide certain thresholds that could be adjusted. For example, hotels with 250 rooms or more need a Major Project conditional use permit unless they are processed with a site plan review.

As with any project, the relative ease in gaining approval for a hotel relates to the degree to which hotel uses are "baked" into zoning and land use policies. The extent of special approvals for zoning variances and other entitlement approvals affects the time, effort, and cost of the project.

A common theme was that consistency in the rules for development would help create certainty throughout the development process. If those rules are known, a developer can determine the costs of a project, can develop greater certainty in underwriting the project, and better manage implementation of the project.

The Department of City Planning (DCP) is currently reviewing the Central City Community Plan, as well as considering a significant revision to the City's Zoning Code (known as re:code LA). Additional review of those sections of the Central City land use plan and the Zoning Code related to hotels would be appropriate at this time.

The Department of Building and Safety has recently implemented a case management program that is intended to address the permitting component of this issue. Application of these concepts to hotel development within existing land use and zoning regulations could improve the ability to develop hotels, but will take additional time as community plans are prepared and adopted.

Small Roadside Motels and Hotels

As noted in the June 2014 CLA report concerning hotel incentives, some motels attract business that is not directed toward standard convention or tourist interests. Historically, small motels were constructed along major roads entering the City, such as Colorado Boulevard (Route 66) and San Fernando Road. These small roadside motels met the needs of long distance car travelers looking for an overnight stop.

These motels do not typically have the larger number of rooms found in the projects that would participate in this incentive policy and do not have the parcel size to allow for a significant increase in size. Further, many are now located among land uses that may not be ideally compatible, such as the mix of motels and industrial uses along San Fernando Road.

Solutions to the issues associated with these small motels range from increased enforcement to resolve illegal activities such as prostitution and review in the Community Plan process to ensure that land uses are compatible with the local vision for that community. This report recommends that the Planning Department conduct a study of small hotels in the City to determine their location, evaluate their compatibility with local land uses, and recommend ways to transition some of these properties toward other, more appropriate uses.

BGIF Policy

The BGIF Policy was developed in the mid-1990s and approved by Council in 1998 to provide assistance to projects located in Community Development Block Grant (CDBG) areas. Funding provided through the program was intended to close the finance gap in these projects, using financing resources available through federal grant programs, such as Section 108 loans. Amendments to the BGIF Policy in 2001 allowed a wider range or projects, across the City, to participate in the program.

The BGIF Policy sets the maximum site-specific assistance available to a project at no more than 50% of net new site specific tax revenue estimated to be generated by the project. In other words, the project receives no more than half of the site-specific revenue generated after development and the City's General Fund receives at least 50% of the site specific revenue generated after development. The BGIF Fund was established to provide a source of funds to repay Section 108 loans. The 50% funding level ensures that adequate funds were available to service those loans regardless of future economic conditions.

Additionally, the 50% funding level ensures that the City's General Fund receives funds to support City services. New projects have the potential to increase demands on City services, such as police and fire, and this approach provides new funds to support these services. The BGIF Policy allows the Council and Mayor to waive this requirement, though no waiver has been approved to date.

Analysis is required to show that, but for assistance through the BGIF Policy, the project would not be feasible, would be limited in scope, would not be constructed in the target location, and the probability of success would be substantially decreased. Such projects must also demonstrate that they have maximized private funding sources and have exhausted all other finance resources. Finally, the developer may not receive an undue financial return from the project.

Projects receiving assistance through the BGIF Policy must demonstrate a substantial City Public Benefit to the City, such as the creation of jobs, providing goods and services to under-served areas, reinforcing City economic development strategies, and creating a multiplier-effect on further economic development.

On-going monitoring is a requirement of the BGIF Policy. The Office of Finance and the CAO are required to ensure that anticipated revenues are generated by the project and report on an annual basis concerning the status of the project and the incentives provided.

The BGIF Policy has provided the basis for many commercial/retail projects assisted by the City, including the Lawry's California Center, Midtown Crossing, Pacoima Plaza, Chesterfield Square, Westfield Topanga, and five Downtown hotel developments.

RECOMMENDED HOTEL INCENTIVE POLICY

A key concern raised in both the 2009 Motion and in Committee member questions was that hotel incentives to date have been conducted in an ad hoc manner. Review of hotel incentive agreements approved by Council to date, prompted by questions raised by the Committee, shows that all have been developed and approved within the context of the BGIF Policy. Although projects appeared to be considered and approved on an ad hoc basis, they conformed to the City's existing economic development policy.

The Hotel Incentive Policy recommended in this report would clearly establish that the City's financial assistance for hotels is consistent with the BGIF Policy. Rather than create a new policy, the Hotel Incentive Policy will be more defined and explained within established City economic development policies.

The Hotel Incentive Policy we now recommend includes the following components:

- Up to 50% of net new site specific tax revenues available for new hotels with 300 or more rooms maintained at a minimum 3-star quality;

- Up to 50% of net new site specific tax revenues available for adaptive reuse hotel projects with 150 or more rooms maintained at a minimum 3-star quality; and

- Up to 50% of net new site specific tax revenues available for renovations of existing hotels with 150 or more rooms maintained at a minimum 3-star quality.

The room number thresholds and hotel quality criteria for new hotel construction would ensure that the City's incentives and financial support are directed at projects large enough to address the on-going need for hotel rooms in the City. Hotels with 300 or more rooms likely include construction methods and amenities that result in higher construction and operating costs, potentially resulting in financing gaps that require funding assistance.

Adaptive reuse hotels typically have higher costs due to the construction requirements that result from a significant change in building use. Additionally, adaptive reuse in areas such as Downtown involves older buildings that require significant structural and systems upgrades to meet modern safety requirements. The 150 room threshold provides an opportunity to assist smaller projects where significant expansion would not be possible or desirable, while preserving historic properties.

The room and quality threshold for renovations of existing hotels established in this policy would apply to those hotels operating under the City's hotel minimum wage law.

As with past practice, net new site specific tax revenues are determined as those taxes that accrue to the City's General Fund generated by the development, less those taxes and fees that accrue to the City's General Fund prior to project development. The net new site specific tax revenue analysis will be conducted by an independent consultant that specializes in the financial structures for hotel development and operations, under contract to the City. Developers applying to receive incentives would provide funds to cover all costs associated with the required analyses.

The net new site specific tax revenue analysis would consider revenues generated by all elements of a project. If a project is multi-phased, the analysis will focus on the single phase in which the hotel will be constructed. Site specific tax revenues typically included in such analysis are property tax, sales tax, transient occupancy tax, and parking tax. Other relevant taxes may be included depending on the type of project.

One adjustment in this policy compared to past hotel incentives is that the City's amount of financial support in this policy will be based solely on the 50% net new site specific tax revenue factor. Previous hotel subventions were based on the lower of either 50% net new site specific tax revenue or 100% of Transient Occupancy Tax (TOT). This dual factor was required due to the use of Community Taxing Districts (CTD) as the means to provide the subvention. Since the City is now relies on the conditional approval of the Hotel Incentive Agreement and creation of a Special Fund to provide financial support, the 100% of TOT factor is no longer necessary.

Application Process

The application process would largely follow the steps currently in place for the consideration of revenue participation requests, with some streamlining that results from approval of a formal policy. The following process would ensure that the Council reviews and approves consideration of any application to provide financial support before project analysis begins and again approves the final terms for financial support following review by an independent, third party and negotiations between the City and the Developer.

The EWDD would be responsible for receiving and processing applications. All subsequent review and negotiations related to those applications would be led by the the EWDD, with participation by the CLA, CAO, and City Attorney. EWDD would provide reports to the Council and Mayor regarding each relevant phase of the application approval process, including approval of any Memorandum of Understanding (MOU) and incentive agreement as further discussed below. EWDD would also provide all monitoring reports, with assistance from the Office of Finance, CAO, and City Controller as appropriate.

First, Hotel Developers interested in receiving a revenue participation would submit an application, including a full description of the project and other elements of the Developer's proposal, for City consideration, including an executed MOU that outlines the terms and responsibilities of the revenue participation agreement. This application and MOU would be reviewed to determine which incentive the project would be eligible to receive and whether the application and MOU are complete.

Upon determination that all is in order, the application package would be submitted to Council for review and approval of authority to accept funding to conduct the necessary fiscal and economic studies.

Once approved by Council, the City and the developer would initiate the necessary studies to determine fiscal viability of the project, whether the development has a gap in financing, and what kind of economic impact would be created by the project. Such analysis would determine whether the project would qualify for revenue participation assistance and how much would be available. The analysis would also determine whether the project meets the City Public Benefit requirement of the BGIF Policy.

If the incentive is available, the City and developer would then prepare a Hotel Incentive Agreement for consideration by Council. The Hotel Incentive Agreement would describe the scope of the City's financial support for the project and require that the developer provide Community Benefits appropriate to protect the local community and match the City's participation. The Hotel Incentive Agreement would be submitted to Council for final consideration and approval.

Implementation of this Policy

One of the significant time factors involved with the analysis of applications for revenue participation is the hiring of independent fiscal and economic advisors to review the construction costs and estimated site specific revenues of proposed projects. To facilitate this process, it is recommended that the EWDD establish a list of consultants qualified to conduct such reviews. A Request for Qualifications (RFQ) should be released in an effort to identify and establish a list of firms qualified to complete financial and economic studies related to hotels specifically. This is a specialized area of economic research. Such a list would allow the City to more quickly complete the required fiscal and economic analyses necessary to support this incentive policy. It is recommended that this list of qualified consultants be available for any type of economic development proposal that requires analysis of fiscal viability and net economic impact on City revenues. This is consistent with the BGIF Policy, which requires that a review be performed by a third party.

Another way to streamline the application process is to develop standard MOU and revenue participation agreements. The operative applications, documents, and contracts would be available for developers to review prior to application submission. This would facilitate understanding of the terms, available incentives, and policy requirements as a further means to streamline the incentive policy.

FISCAL IMPACT

There is no impact to the General Fund associated with this action. Implementation of such an incentive policy is anticipated to generate future net new sales tax, business tax, utility tax, and other tax revenues. The fiscal impact of each project participating in the incentive policy would be reported as part of the approval process.

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