

REPORT OF THE CHIEF LEGISLATIVE ANALYST

DATE: January 13, 2012

TO: Honorable Members of the Trade, Commerce,
and Tourism Committee

FROM: Gerry F. Miller *[Signature]*
Chief Legislative Analyst

Assignment No: 12-01-0009

SUBJECT: Olympic North Hotels Assistance

SUMMARY

Motion (Perry-Reyes, CF#11-0966) instructed the Chief Legislative Analyst (CLA) to evaluate and recommend appropriate forms of economic development support for the proposed Olympic North Hotels project. This development would create two hotels with a combined total of 392 rooms in the Los Angeles Sports and Entertainment District (LASED) in Downtown Los Angeles. The Developer, Williams/Dame & Associates, Inc./901 West Olympic Boulevard Limited Partnership, has entered into an agreement with Marriott Hotels to build a single structure that will contain both a Residence Inn and a Courtyard at the site, with support parking and amenities. Project development is consistent with all requirements laid out in the LASED and is fully entitled, allowing for construction to begin as early as April 2012.

As with other significant hotel developments that have received City development assistance, the Developer has requested assistance to complete the financing package for this project. A draft Memorandum of Understanding has been prepared to allow for the negotiation of terms and conditions necessary to implement such assistance. Further, the Developer would be required to provide up to \$150,000 for consultants who will verify the economic impacts and financial needs of the hotel. Such assistance would conform with established City policies on economic development and would be consistent with other hotel and mixed-use projects recently approved by the City.

RECOMMENDATIONS

That the City Council:

1. AUTHORIZE the Chief Legislative Analyst (CLA) to execute a Memorandum of Understanding (MOU) substantially in conformance with the attached document relative to negotiation of the terms and conditions necessary to implement assistance for the development of the Olympic North Hotels project;
2. INSTRUCT the CLA, with assistance of the CAO and City Attorney, to negotiate the definitive agreements related to the Olympic North Hotels project and submit them to City Council for approval;

3. AUTHORIZE the CLA to accept up to \$150,000 for consultant services from the Developer; request/authorize/instruct the Controller to deposit/appropriate/expend all funds received as a result of this action in Fund 100, Department 28, Contractual Services Account 3040; and authorize the CLA to make any technical corrections, revisions, or clarifications to the above instructions in order to effectuate the intent of this action; and
4. AUTHORIZE the CLA to issue a Request for Qualifications and select consultants as needed to conduct the analyses necessary to evaluate the economic impacts of this project.

BACKGROUND

The Los Angeles Economic Development Corporation (LAEDC) has reported that the tourism and hospitality industry is the largest business sector in Los Angeles County, supporting nearly half a million jobs. Hotels provide lodging to visitors who shop and eat in the City, attend events at City cultural attractions, and access local transportation hubs, such as the harbor and airport. All of these activities generate important revenues for the City's General Fund, including transient occupancy tax, sales tax, business tax, and utility tax funds. For that reason, the City has from time-to-time provided economic assistance for the development and renovation of local hotels.

Further, analysis recently conducted by CSL International on behalf of the City concerning the Farmers Field project reported that lack of hotel rooms within a half mile of the Los Angeles Convention Center (LACC) is a significant competitive disadvantage to increasing large convention business at the LACC. A competitive market would provide 7,000 to 7,500 hotel rooms in this zone, but there are currently only 1,685 rooms available within walking distance of the LACC. Therefore, an additional 5,300 to 5,800 rooms are needed in the area to make the LACC a nationally competitive facility.

On October 18, 2011, the City Council approved a Motion (Perry-Reyes) instructing the CLA to evaluate the proposed Olympic North Hotels project and recommend appropriate forms of economic development to support the project. This project is located within the LASED and is fully entitled within the provisions of that specific plan.

The Olympic North Hotels project would result in the construction of two hotels in one building with a total of 392 rooms. Both hotels are Marriott products, including a Courtyard which will have 174 rooms and a Residence Inn which will have 218 rooms. Both hotels are 3-star rated products, providing a good quality hotel at a lower price-point than the other hotels in the district.

The lower price point for both hotels compared to other hotels in the district is significant in that it expands the range of rooms available in the area at different affordability levels. Further, the Developer reports that one of the hotels, the Residence Inn, provides a room product that is not currently available in Downtown Los Angeles. This hotel is designed to serve visitors who plan on an extended stay. For example, convention planners typically arrive before and after the active

days of a convention to set-up and remain after to break-down the event. Extended stay hotels provide amenities to serve this demand, including kitchenettes in each room. Families are also more likely to stay in this type of hotel. Thus, this development will provide a type of hotel room that will be unique in Downtown.

The Developer reports that the project is expected to create 800 on-site construction jobs and 338 on-site permanent jobs once the hotels are operational. The Developer's economic analysis indicates a total annual economic benefit of \$5 million annually, with an increase in direct revenues to the City of \$1.7 million annually.

Available Assistance

At this time, the City has limited options for providing economic development assistance. The model currently available for hotel developments involves the creation of a community taxing district and the provision of transient occupancy tax revenues to support financing of the development. The amount of such assistance, however, is limited to no more than 50% of the total net new revenues generated by the project. This is the model used for recent hotel projects, such as the Convention Center Headquarters Hotel and the Wilshire Grand Hotel.

At this time, the structure for this model is well-understood and the analytical requirements to determine the amount of assistance required are known. The steps required to move forward include adoption of a non-binding MOU that describes how the City and the Developer would determine whether and how much assistance would be provided and the terms of any definitive agreements necessary to implement any assistance. It is recommended that this model be implemented at this time for this project.

Memorandum of Understanding

If the City is to enter into negotiations to provide development assistance for the Olympic North Hotels, the draft MOU attached to this report provides terms on which final, definitive agreements would be based. The terms of this MOU are consistent with past City economic development projects, including the recently approved Wilshire Grand Hotel and Centre project.

The draft MOU provides the following terms:

- All pro-formas and other applicable data and documents necessary to evaluate the financing of the project will be provided for analysis;
- Funds will be provided by the Developer to pay for a full independent analysis of the construction costs and financing of the project to determine the funding gap and the actual assistance needed by the project and the expected net new revenues generated by the project;
- An assistance cap will be established which will not exceed 50% of the net new revenues accruing to the City;

- Payment of all project-related City revenues currently generated at the site will be guaranteed by the Developer;
- Following completion of construction, the City will have access to all records necessary to determine actual construction costs and financing needs and to adjust the assistance provided. The assistance may not exceed the assistance cap, but may be reduced based on the actual construction costs and gap;
- The hotels will be operated at Three-Star Lodging Establishment grade or higher, as defined and determined by the Mobile Travel Guide;
- Actions will be taken to ensure that the City is designated as “point of sale” for all eligible construction contracts, including purchases by subcontractors; and
- A community benefits package will be developed and approved by Council.

These terms will ensure that the City continues to receive an amount of City tax revenue equal to that currently generated by the property through construction and the entire subsidy period. Further, the subsidy amount will be calculated on net new revenue, which is an amount equal to all revenues generated by the new project, less an amount equal to revenues generated by the existing project and revenues generated by the new project that are currently being captured in other areas of the City.

In addition, these terms provide that the City will be able to conduct independent analysis of the proposed project to ensure an understanding of financing and construction costs of the project and that the City’s subsidy for the project is limited to funds needed to ensure completion of the new hotels. All studies associated with this effort will be funded by the Developer, with the City overseeing the contractor’s efforts.

FISCAL IMPACT

There is no impact to the General Fund associated with this action.

John Wickham
Analyst

Attachment A: Memorandum of Understanding

**Memorandum of Understanding (“MOU) Between the City of Los Angeles (“City”) and
901 West Olympic Boulevard Limited Partnership (“Developer”)**

The above listed parties agree to this MOU to provide guidelines for the negotiations between the parties for redevelopment of the northwest corner of Olympic Boulevard and Francisco Street. All terms and issues set forth in this MOU are subject to further discussion.

BACKGROUND

Developer is proposing to redevelop the northwest corner of Olympic Boulevard and Francisco Street, which is currently vacant, with a new project consisting of two hotels (the “Hotel”) totaling 392 rooms, 174 of which are branded as Courtyard Marriott’s limited service brand hotel providing a high quality offering at 3-star rates. The other 218 are branded as Residence Inn rooms, Marriot’s extended stay offering, also at 3-star rates. The project will also consist of approximately 5,100 square feet of ground floor retail space, an approximately 11,474 square feet of project-serving conference and meeting rooms, spa, fitness center, and ancillary hotel office areas (collectively, with the Hotel, the “Project”).

The Project is desirable to the City because it would expand the lodging options currently available to visitors to the City. With investment from the City, the Developer is able to commence construction by Spring 2012. The City’s willingness to contribute to the financial feasibility of the Hotel is based on the projected development and operation of the proposed Hotel as a new source for hotel rooms and supporting amenity areas to support tourism in Los Angeles and to support the Los Angeles Convention Center, which has been recognized through the American Recovery and Reinvestment Act process as an Economic Recovery target area and is also designated as a Targeted Employment Area, and the public benefits resulting therefrom. The Project will provide much needed “workforce” lodging to complement the offerings at the Convention Center and will provide families with an added lodging option when they travel to downtown Los Angeles.

DEPOSIT FOR FINANCIAL ADVISORS

The Developer shall deposit with the City an amount to be negotiated to hire financial advisors with expertise in hotel operations and development, commercial/retail project development, and outside legal counsel as necessary thereto (collectively, the “Professionals”). Notwithstanding that the Developer will pay for such services, the City shall be the client of the Professionals for the purposes of reporting and duty of loyalty. The amount deposited with the City shall cover all charges already incurred by the Professionals prior to the execution of the MOU as well as the amount necessary for any future work. The Developer acknowledges that the City shall have no obligation to continue with the financial analysis and negotiations of the Agreements should the funding provided by the Developer be insufficient to cover the work of the City’s outside consultants; however, City will provide written notice to Developer at the point which 75% of the deposit amount has been spent by City.

FUTURE HOTEL FUNDING NEGOTIATIONS

The Developer is interested in entering into definitive written agreements (“Agreements”) with the City in relation to development of the Project. The terms to be further discussed and negotiated are as follows:

1. Determination of Funding Gap. City will hire outside consultants to determine whether or not there exists a funding gap for building the Hotel.
 - a. The Developer shall provide to the City the pro-formas for all elements of the Project, including all Hotel, retail, and commercial portions in sufficient detail for the City’s consultants to conduct an independent analysis of the Project pro-formas.
 - b. In order to calculate the funding gap for the Hotel, which amount shall be used to determine the Subvention Amount, the City and the Developer shall agree on a rate of return for the Developer at a level reasonably sufficient for the Developer to proceed with the Project.
 - c. Based on the agreed-upon pro-forma assumptions and the rate of return as described above, the City’s consultants shall calculate the net present value (NPV) gap in Hotel funding necessary for the Developer to achieve the agreed-upon rate of return for the Hotel (“Funding Gap”).
2. Transient Occupancy Tax (“TOT”) Subvention. The parties propose that, should a Funding Gap be identified, the City will consider setting up a Community Taxing District (“CTD”), or other mechanism to assist in Project financing which would provide Developer with an amount equivalent to the NPV of up to 100% of the TOT generated by the Hotel (the “Subvention Amount”), as calculated below in part 2.a. The payment period of the Subvention Amount provided to Developer would commence with the issuance of a certificate of occupancy for the Hotel and expire upon the earlier of the termination date as provided in the agreements (for example, events of default) or when the Subvention Amount has been received (Subvention Term). The parties propose that the Subvention Amount provided to the Developer be calculated as follows:
 - a. The Subvention Amount will not exceed 50% of the amount of total net new General Fund revenues expected to be generated in connection with the Project, inclusive of the hotel and retail uses during the Subvention Term. The “Annual Base Period Amount” is defined as revenues currently generated by this site. Net new revenues shall be defined as General Fund tax revenues to the City as a result of the project less the Annual Base Period Amount and, in the event of a specific relocating business, revenues already collected by the City in other areas as determined by an independent consultant. General Fund revenues shall include the City’s share of construction related tax revenues, property taxes, sales taxes, utility users taxes, gross receipts taxes, parking revenues taxes, Transient Occupancy Taxes, and any other revenues reasonably expected to be received by the City’s General Fund from the Project.

- b. Upon completion of construction for the Hotel, the City, through its independent consultant, would conduct a review of the Hotel construction costs and Hotel financing to confirm the Funding Gap. Upon completion of this review the TOT Subvention Amount may be adjusted, but may not be higher than the amount calculated pursuant to 2(a). For purposes of this Section, the discount rate used to calculate the Funding Gap would be the Developer's actual blended cost of capital.
3. Developer Guarantee. The parties propose that the Developer provide to the City a guarantee of current annual revenues to the City's General Fund equal to the amount generated by the existing property as follows ("Guarantee"):
- a. **Guarantee Term.** The Guarantee Term would commence upon Developer securing a building permit for the Hotel and would expire at a date to be mutually agreed upon by City and Developer in the Agreements. On an annual basis, the City would calculate TOT revenues accruing to the Developer from Hotel operations. Should the Funding Gap as calculated in Section 2(b) be achieved prior to the end of the Subvention Term, the Subvention Amount and Guarantee would cease and all future TOT would accrue to the City.
 - b. **Guarantee Amount.** The parties propose that Developer provide fixed annual payments, as described more fully in Section 3(c), equal to the total General Fund revenues generated by the existing property and paid to the City for the period to be determined, without escalation (the "Annual Base Period Amount" which is the same as the "Guarantee Amount").
 - c. **Guarantee Payments.** Developer proposes that it provide annual payments to satisfy the Annual Base Period Amount through a combination of the following (collectively, the "Payments"):
 - i. All Project Related City Revenues as indicated in Section 2(a) above.
 - ii. To the extent the sum total of Payment i above does not satisfy the Annual Base Period Amount in a given year, the amount of TOT generated by the Hotel necessary to equal the outstanding Annual Base Period Amount would be retained by the City and not be refunded to the Hotel.
 - iii. To the extent the sum total of Payments i and ii above do not satisfy the Annual Base Period Amount in a given year, Developer shall make cash payments to the General Fund to satisfy any remaining shortfall of the Annual Base Period Amount.
4. Transfer of Hotel and Property. The parties propose that during the Subvention Term, the Developer shall not sell, assign, convey or transfer the Hotel without the prior written consent of the City, which consent shall not be unreasonably withheld; provided however, without consent of the City the Developer may permit transfers of direct or indirect financial interests in the Hotel.

5. Hotel Operator. During the Subvention Term, any change in the Hotel operator shall require the prior written approval of the City, which consent shall not be unreasonably withheld. The City will agree to a pre-approved list of acceptable Hotel operators and standards, which shall be attached as an exhibit to the Agreements.
6. Hotel Standards. The parties propose that the Hotel shall have a minimum of 390 lodging rooms. During the Subvention Term, the Hotel shall be operated, furnished, serviced, maintained and refurbished to the standard of quality, commonly known as a Three-Star Lodging Establishment, as defined and as determined by the Mobil Travel Guide, or at an equivalent level by an alternative nationally recognized hotel rating service.
7. Construction Sales Tax. The parties propose that the Developer will cause the City to be designated as the “point of sale” for all construction related purchases (including purchases made by any subcontractors of the Developer’s general contractor) for the Project. It would be the sole responsibility of the Developer to ensure that all contractors on qualified construction contracts obtain the necessary permits from the State to self-report sales tax, and credit would only be given for Construction Sales Tax that the City actually receives.
8. Community Benefits Package. The parties propose that the complete development of the Hotel is a Community Benefit in the provision of a new Three-Star Lodging Establishment and supporting facilities which would address the deficiency of workforce and family oriented hotel facilities in the downtown area of Los Angeles, which has been recognized through the American Recovery and Reinvestment Act process as an Economic Recovery target area and is also designated as a Targeted Employment Area. Further, a Community Benefits Package will be adopted by the Developer and implemented in association with development of the Project as a condition of receipt of the Subvention Amount. The Community Benefits Package would include elements above and beyond existing City contracting requirements, and shall be subject to City Council approval. Elements for consideration would include, but not be limited to, living wage for hotel workers and opportunities for local hiring and job training programs. The Community Benefits Package shall also provide that, similar to the Airport Hospitality Enhancement Zone under Section 104.110, et seq, of the Municipal Code, living wage provisions for hotel workers could be replaced by a collective bargaining agreement.
9. Preconstruction Activities. The parties propose that the Developer shall proceed with applications for permits for, and seeking financing for, the initial Site work necessary for the Project’s construction, including demolition of the existing structures.

IMPLEMENTING THIS MOU

This MOU authorizes City staff, with the assistance and consultation of the City Attorney, to negotiate Agreements consistent with the terms and conditions of this MOU with the Developer and to report to the City Council or any committee selected by the City Council on the progress of such negotiations. The Developer understands that any and all final Agreements are subject to the requirements of the Los Angeles City Charter and the City Council. The parties further

understand that this MOU is merely an expression of the City's intent to negotiate the terms and issues outlined herein and further understand that this MOU is not binding on any of the parties.

IN WITNESS WHEREOF, the parties executed this Memorandum of Understanding on the dates indicated.

THE CITY OF LOS ANGELES:

By: _____
Chief Legislative Analyst

Date: _____

By: _____
City Clerk

Date: _____

DEVELOPER:

901 WEST OLYMPIC BOULEVARD LIMITED PARTNERSHIP

By: WDA Olympic Development, LLC,
Its: General Partner

By: WD Olympic Holdings, LLC,
Its: Manager

By: Williams/Dame & Associates, Inc.,
Its: Manager

By: _____
Name: _____
Its: _____