Office of the City Manager

ACTION CALENDAR
June 12, 2018

To: Honorable Mayor and Members of the City Council

From: Dee Williams-Ridley, City Manager

Submitted by: Jordan Klein, Economic Development Manager

Subject: Authorizing the City Manager to Defer Impact Fees for 2129 Shattuck Avenue

RECOMMENDATION

Adopt a Resolution authorizing the City Manager to modify the existing incentive package for the hotel project at 2129 Shattuck Avenue by deferring Public Works / Transportation impact fees.

FISCAL IMPACTS OF RECOMMENDATION

This Resolution would defer the collection of Public Works / Transportation impact fees totaling up to $4,250,383 for up to ten years. By enabling a commercial project that will generate new General Fund revenue that is estimated to exceed $4 million per year, the net impact of this Resolution would be positive for the City's General Fund.

A deferral would immediately impact two major projects in the Downtown and require a funding plan to replace the deferred fees. Of the $4.25 million of anticipated fees, approximately $1.625 million is programmed for expenditure in Fiscal Year (FY) 2019 on the Shattuck Avenue Reconfiguration project, and $450,000 is programmed in FY 2019 for the Center Street Plaza Design project. These fee revenues were programmed with anticipated receipt of 50% of the total amount development fees at the time of permit issuance, which is estimated for FY 2019. To avoid impacts to these Public Works projects, if the deferral is approved, staff recommends that the FY 2018 Property Transfer Tax Revenue in excess of the $12.5 million baseline be used to replace the $2.075 million in deferred fees that were budgeted for the Shattuck Avenue Reconfiguration project and Center Street Plaza Design project. Staff projects that the FY 2018 Property Transfer Tax in excess of the $12.5 million will be sufficient to cover the deferrals. The $2.075 million will be included in the First Amendment to the Annual Appropriation Ordinance that will be presented to Council in November 2018.

CURRENT SITUATION AND ITS EFFECTS

On May 26, 2016, the Zoning Adjustments Board granted a Use Permit for the construction of a 16-story hotel and commercial development at 2129 Shattuck Avenue. On July 19, 2016, City Council authorized the City Manager to execute a contract with the project sponsor that grants a rebate of future transient occupancy tax revenue generated by the project, in an amount not to exceed the total value of permit and

impact fees charged to the project with adjustments for inflation. (See Attachment 2, Financial Assistance for Hotel Feasibility; Contract with Center Street Partners, LLC, July 7, 2016.)

In February 2018, Pyramid Hotel Group, the project developer, requested that the City provide additional assistance to improve the project's financial feasibility and ensure that it would proceed. Pyramid Hotel Group requested that the City defer or waive all outstanding permitting and impact fees, totaling approximately $9.64 million, in order to prevent the cancelation of the project.

As of May 14, 2018, the City of Berkeley has collected permit processing fees from the project sponsors totaling approximately $2.17 million. (See Attachment 1A, Fee Schedule, 2129 Shattuck Avenue.) The outstanding permitting and impact fees total $9.52 million. This includes Land Use division fees ($10,000, or approximately 0.1% of outstanding fees), affordable housing and childcare mitigation fees ($1.56 million, or 16.4%), Building and Safety division fees ($2.77 million, or 29.2%), Fire Department fees ($85,260, or 0.9%), Public Works fees ($842,358, or 8.9%), and project-specific Public Works impact fees ($4.25 million, or 44.7%). This calculation excludes traffic impact mitigation projects; the developer remains responsible for implementation of those projects prior to issuance of the final certificate of occupancy.

The City Manager has the authority to modify the payment schedule for the affordable housing mitigation fee and childcare mitigation fee, as per Resolution No. 66,617-N.S. and Resolution No. 66,618-N.S. The City Manager has notified the project sponsor of her intention to modify the payment schedule for those fees, which total $1.56 million. Staff recommends that City Council authorize the City Manager to also defer the payment schedule for project-specific Public Works fees. This will reduce the total initial cost of the project, boosting its financial feasibility and enabling Pyramid Hotel Group to move ahead with construction of the project in 2018.

BACKGROUND

Project Background and 2016 Incentive Agreement

The site at 2129 Shattuck Avenue at Center Street, which had until recently been occupied by a Bank of America branch, has long been considered a potential site for a hotel and commercial development. The Downtown Area Plan, adopted in 2012 following a comprehensive community planning process, explicitly identifies a new hotel as a desired use for which the City should grant higher height allowances and consideration of incentives.[1]

In April 2015, the project applicants (property owner Center Street Partners, LLC and project developer Pyramid Hotel Group) submitted an application to build a 16-story commercial project at the site. In addition to 329 hotel suites, the project includes

[1] See Downtown Area Plan, pages LU-6 to LU-10 and ED-6, available at http://www.ci.berkeley.ca.us/dap/

conference center facilities, several full- and quick-service restaurants, and parking. On May 26, 2016, ZAB voted unanimously to support the project and grant the use permit.

In May 2016, soon after the use permit was granted, the project sponsor requested financial assistance to improve the project's financial feasibility. At that time, the hotel projected to generate a total return on cost of 6.7%; hotel projects of this type in our region typically require a projected return on cost of at least 8% in order to attract financing. The City engaged two outside firms, HTL Hospitality Advisors and Strategic Economics, to conduct independent reviews of the pro forma information provided by the project sponsor, including projected development costs, operating costs and revenues. Each consultant confirmed that the sponsor's cost assumptions were reasonable, and the revenue assumptions were optimistic; i.e., the consultants found that the sponsor's estimates for average room rates and occupancy rates were higher than local averages, meaning that their operating income and annual return on costs may ultimately be lower than projected. The project location has long been considered an excellent site for a hotel (within one block of the UC campus and the Downtown Berkeley BART station), thus there is justification for the sponsor's optimistic revenue projections. Nevertheless, as noted in the report prepared by Strategic Economics, the low projected rate of return threatens the feasibility of the development project (see Attachment 3, Strategic Economics Peer Review of 2129 Shattuck Community Benefits Proposal). The findings of each consultant are consistent with the sponsor's assertion that the project requires assistance to achieve financial feasibility.

Staff recommended, and Council adopted, a financial assistance package for the project that was linked to new transient occupancy tax (TOT) revenue generated by the project. The City agreed to rebate 50% of the new TOT revenue generated by the hotel project until the cumulative total of the rebate equals the total value of permits and fees paid by the project. The maximum cumulative value of the rebate will not exceed $13,125,267. This figure is based on staff's estimate (at the time) of the value of permit and impact fees to be charged to the hotel project ($11.2 million) with adjustments for inflation.

February 2018 Request from Pyramid Hotel Group
In February 2018, Pyramid Hotel Group notified the City Manager that the project was at risk of cancelation due to increased costs. The increase in the total project cost is primarily due to increased construction costs; originally projected at $107.4 million in July 2016, by April 2018 that estimate had increased to $125 million. (See Attachment 4, Pyramid Hotel Group, Updated Request and Cost and Capital Stack Comparison, April 2018.) The increased project cost results in a significant decrease in the projected return on cost to 5.8%, well below the range of what is considered financially feasible for a project of this type. One of Pyramid Hotel Group's equity partners declined to continue with the project, resulting in a gap in the project's financing plan.

While evaluating Pyramid Hotel Group's request, staff conducted research to confirm the updated cost projections and revenue projections. Staff found that estimates of the

two-year increase of construction costs from December 2015 to December 2017 range from 6% to 26%.[2] Pyramid Hotel Group's reported cost increase (16.4%) falls squarely within that range. In addition, Pyramid Hotel Group is required by the project's community benefits agreement to obtain a project labor agreement. While staff was unable to identify a dedicated index for firms employing unionized labor, costs for those firms are reportedly increasing at a higher rate. The City of Berkeley's own capital projects staff and consultants, in gathering construction bids for Measure T1 projects, report that construction rates for firms that employ unionized labor have been increasing by roughly 1% per month over the past year.

While Pyramid Hotel Group's cost projections have increased, their revenue projections remain unchanged. An analysis of hotel revenue data sources confirms the credibility of this projection. While the average daily rate for hotel rooms in Berkeley increased slightly in 2017, that was offset by a slight decrease in average occupancy rate, resulting in no change in the average revenue per available room.[3] This is borne out in the City's own TOT revenue figures, which showed no change from FY2016 to FY2017.

A deferral of impact fees owed by the project will reduce the total initial project cost and the developer's equity gap. By year 12 of the project, this results in a 1% greater return on equity for Pyramid Hotel Group; by year 20, the increase grows to 2%. (See Attachment 5, Pyramid Hotel Group, 20-Year Operating Projections.) The result is a more financially feasible project, offsetting project risks and allowing the developer to move ahead with the project. Deferral of these fees by up to 10 years would allow for the project to generate new TOT revenues such that the permit fees could be rebated immediately upon payment, as per the existing incentive agreement.

Economic Impact Analysis
The Office of Economic Development estimates that the project will generate approximately $50.2 million in new General Fund and special tax and assessment revenue over ten years subsequent to its completion. The net present value of that projected revenue, discounted at 4%, is estimated at $42.4 million. (See Attachment 6, OED Economic Impact Analysis.) A portion of that new revenue – up to $13,125,267 – will be offset by the TOT rebate agreement. Thus the net new revenue is projected to exceed $37 million in the project's initial ten years, and over $5 million per year (in 2018 dollars) beyond that period. Once fully occupied, the project will employ an estimated 110 people and create indirect employment in Berkeley for an estimated 103 people, for a total of 213 new jobs.

Public Works Capital Program Impacts
In the event the Pyramid Hotel project did not proceed and no fees were collected,

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[2] Sources include: Engineering News-Record (https://www.enr.com/economics/faq); Rider Levett Bucknall (http://assets.rlb.com/production/2017/10/24002747/2017-Q3-QCR-updated.pdf); Turner & Townsend (http://www.turnerandtownsend.com/en/insights/international-construction-market-survey-2017/)
[3] Source: STR Global

Public Works drafted an alternative funding strategy within its programs to reallocate funding to the Shattuck Avenue Reconfiguration project to keep it on schedule. The Shattuck project has $2,777,000 in OBAG grant funding that must be spent in a timely fashion. The Center Street Plaza project at this time does not have local funding beyond development fees, so received development fees from other projects would have to be accumulated over time to continue the project. The same programs would be impacted if fees are deferred and no General Fund support is made to replace the deferred funding. The following table shows the impacts to Public Works programs and projects to backfill the first portion of development funds due. The estimated impact is $2,075,000 for FY 2019.

Shattuck Avenue Reconfiguration

Program/Project Impacted	Backfill Funding	Dollars
FY 2019 Street Paving & Rehabilitation	369 - SB1 New State Transportation Tax	$1,000,000
Streets Maintenance - Roadway Thermoplastic Marking (13TM01). On-Call Markings contract and staff time	391 - Measure B, LS&R 406 - Measure BB, LS&R	$75,000 $50,000
Bike & Ped Programming (Amounts TBD but impacts to Bike to Work Day, Planning Intern, BEST plan update, Complete Streets Implementation tools)	392 - Measure B, B&P	$50,000
RR Crossing Safety (Quiet Zone) Grant Local Match Fund Balance (Potential grant local matches)	406 - Measure BB, LS&R 406 - Measure BB, LS&R	$65,000 $85,000
Hearst project closeout (would support Complete Streets elements in other projects)	Various	$300,000
	Total	**$1,625,000**

Center Street Plaza (Design)

Program/Project Impacted	Backfill Funding	Dollars
Reduction in scope of Center Street Plaza design project to only preliminary/conceptual (includes consultant design contract and staff costs)	*(NO BACKFILL SOURCE)*	$450,000
	Total	**$450,000**

ENVIRONMENTAL SUSTAINABILITY

Currently, due to a lack of sufficient supply of hotel rooms in Downtown Berkeley to meet demand, visitors to Downtown Berkeley (including visitors to UC Berkeley campus) are often forced to seek accommodations outside of the immediate area. Staff

speculates that this project, by increasing the supply of hotel rooms in our highly walkable, transit-accessible downtown, could potentially reduce the amount of greenhouse gases generated by trips from visiting hotel guests.

RATIONALE FOR RECOMMENDATION

The proposed hotel and conference center for 2129 Shattuck Avenue is a highly desirable addition to Downtown Berkeley that will provide a boost to Berkeley's local economy and result in a significant increase in General Fund revenue for the City. There are many examples of precedents of municipalities providing incentives and concessions to hotel projects, to offset the risks associated with high development costs and ensure the generation of future revenues. Additionally, the high desirability of a hotel project and the consideration of incentives for such a project are stated policies of the Downtown Area Plan adopted by Council.

ALTERNATIVE ACTIONS CONSIDERED

Staff considered denying Pyramid Hotel Group's request and providing no relief. Given the uncertain result of this course of action, and the opportunity to boost General Fund revenues by helping to enable the project, staff decided against this.

Staff considered a number of options to provide the full assistance that Pyramid Hotel Group requested (additionally including outstanding Land Use fees, Building and Safety fees, Fire Department fees, and other Public Works fees). In this case, the City would be required to use General Funds to cover staff costs related to plan check and inspections, and other project related costs. Staff also considered other financing methods, such as a revenue bond or a loan from a related enterprise fund. Staff ultimately decided against each of these courses of action due to the City's overall budget constraints, financial risk associated with this course of action, and other factors.

Staff considered requesting authorization for a deferral of the project-specific Public Works fees for a shorter period of time (e.g., for five years rather than ten years). This form of assistance may be insufficient for the sponsors to proceed with the project.

CONTACT PERSON

Jordan Klein, Economic Development Manager, (510) 981-7534

Attachments:
1: Resolution
    Exhibit A: Fee Schedule, 2129 Shattuck Avenue
2: Financial Assistance for Hotel Feasibility, July 7, 2016
3: Strategic Economics Peer Review of 2129 Shattuck Community Benefits Proposal
4: Pyramid Hotel Group, Cost and Capital Stack Comparison, April 2018
5: Pyramid Hotel Group, 20-Year Operating Projections
6: OED Economic Impact Analysis

RESOLUTION NO. ##,###-N.S.

AUTHORIZING THE CITY MANAGER TO DEFER PUBLIC WORKS TRANSPORTATION IMPACT FEES FOR 2129 SHATTUCK AVENUE

WHEREAS, Center Street Partners, LLC has received a Use Permit to construct a 16-story hotel and commercial project at 2129 Shattuck Avenue; and

WHEREAS, the project will provide significant economic development benefits to the City of Berkeley in terms of both job creation and new tax revenue, including new property tax revenue, transient occupancy tax revenue, sales tax revenue, and other new revenue; and

WHEREAS, the Downtown Area Plan, adopted in 2012, identifies a hotel and conference center as a highly desired use that warrants consideration of incentives; and

WHEREAS, Pyramid Hotel Group, the project developer, has stated that due to increased construction costs and other related costs has threatened the viability of the project and may result in project cancelation; and

WHEREAS, the City of Berkeley, by deferring Public Works / Transportation impact fees, can improve the overall financial feasibility of the project and allow it to proceed.

WHEREAS, the first $2.075 million of the FY 2018 Property Transfer Tax in excess of the $12.5 million baseline will be allocated to temporarily replace the deferred fees.

NOW THEREFORE, BE IT RESOLVED by the Council of the City of Berkeley that the City Manager is authorized to modify the payment schedule for Public Works Transportation impact fees by up to ten years.

Exhibits
A: Fee Schedule, 2129 Shattuck Avenue

Estimated Fees for 2129 Shattuck Ave. by Department
As of May 14, 2018

Planning and Development Department

Land Use Division

Item Number	Fee/Requirement	Permit or Record Number	Total Amount	Paid	Unpaid	% of Unpaid Total
1	Preliminary Design Review (DRC)	DRCP2015-0010	$18,950.00	$18,950.00	$0.00	0.0%
2	Final Design Review (DRC)	DRCF2017-0008	$3,734.00	$3,734.00	$0.00	0.0%
3	Use Permit & EIR (ZAB)	ZP2015-0071	$316,840.00	$306,840.00	$10,000.00	0.1%
		Sub Totals	$339,524.00	$329,524.00	$10,000.00	0.1%

Mitigation Fees

1	Childcare fees (Childcare Impact Fee - Commercial)		$391,000.00	$0.00	$391,000.00	4.1%
2	Housing fees (Housing Impact Fee - Commercial)		$1,172,000.00	$0.00	$1,172,000.00	12.3%
		Sub Totals	$1,563,000.00	$0.00	$1,563,000.00	16.4%

Building and Safety Division

Item Number	Fee/Requirement	Permit or Record Number	Total Amount	Paid	Unpaid	% of Unpaid Total
1	Building Permit Fees	B2016-05813: Phase I	$90,754.00	$90,754.00	$0.00	0.0%
2		B2017-02450: Phase II $66,141,646.00	$3,450,643.51	$1,396,601.09	$2,054,042.42	21.6%
2A	Building Permit Fees Foundation	B2018-01249; $ 3,300,000.00	$102,765.60	$102,765.60	$0.00	0.0%
2B	Building Permit Fees Super-Structure	B2018-01860; $ 18,437,000.00	$573,829.56	$0.00	$573,829.56	6.0%
2C	Demolition Permit	B2018-01258	$9,696.08	$0.00	$9,696.08	0.1%
3	Mechanical Permit Fees	B2016-05813: Phase I	$22.00	$22.00	$0.00	0.0%
4		B2017-02450: Phase II	$45,231.55	$0.00	$45,231.55	0.5%
5	Electrical Permit Fees	B2016-05813: Phase I	$22.00	$22.00	$0.00	0.0%
6		B2017-02450: Phase II	$45,772.05	$0.00	$45,772.05	0.5%
7	Plumbing Permit Fees	B2016-05813: Phase I	$576.50	$22.00	$554.50	0.0%
8		B2017-02450: Phase II	$45,576.50	$0.00	$45,576.50	0.5%
9	Permit Fees for revisions and extensions	B2016-05813: Phase I	$0.00	$0.00	$0.00	0.0%
10		B2017-02450: Phase II	$0.00	$0.00	$0.00	0.0%
11	Address Assignment		$200.00	$0.00	$200.00	0.0%
		Sub-Totals	$4,365,089.35	$1,590,186.69	$2,774,902.66	29.2%

Fire Department

Item Number	Fee/Requirement	Permit or Record Number	Total Amount	Paid	Unpaid	% of Unpaid Total
1	Fire Service Water Underground	Deferred Permit	$1,960.00	$0.00	$1,960.00	0.0%
2	Fire Pump / Storage Tank System	Deferred Permit	$9,408.00	$0.00	$9,408.00	0.1%
3	Standpipe	Deferred Permit	$3,136.00	$0.00	$3,136.00	0.0%
4	Fire Sprinkler	Deferred Permit	$22,932.00	$0.00	$22,932.00	0.2%
5	Fire Alarm / Voice Evacuation	Deferred Permit	$12,544.00	$0.00	$12,544.00	0.1%
6	Emergency Responser Radio System	Deferred Permit	$3,136.00	$0.00	$3,136.00	0.0%
7	Smoke Control	Deferred Permit	$28,224.00	$0.00	$28,224.00	0.3%
8	Cooking Hood & Duct Extinguishing	Deferred Permit	$3,920.00	$0.00	$3,920.00	0.0%
		Sub-Total	$85,260.00	$0.00	$85,260.00	0.9%

Public Works Department

Item Number	Fee/Requirement	Permit or Record Number	Total Amount	Paid	Unpaid	% of Unpaid Total
1	Traffic Engineering fee	B2016-05813: Phase I	$11,640.00	$11,640.00	$0.00	0.0%
2		B2017-02450: Phase II	$565,951.55	$565,951.55	$0.00	0.0%
3	Utility Fee -Public Works -Sewer Connection Fee	B2016-05813: Phase I	$6,429.20	$0.00	$6,429.20	0.1%
4		B2017-02450: Phase II	$532,016.30	$0.00	$532,016.30	5.6%
5	Public Works Engineering Fee: Construction Staging, Sidewalk and Parking arrangement during construction	Engineering Permit (# TBD)	$303,912.10	$0.00	$303,912.10	3.2%
		Sub Totals	$1,419,949.15	$577,591.55	$842,357.60	8.9%

Public Works / Transportation Impact Fees

Item Number	Fee/Requirement	Permit or Record Number	Total Amount	Paid	Unpaid	% of Unpaid Total
1	SOSIP Impact Fee (Streets and Open Space Impact Fee)		$437,707.00	$0.00	$437,707.00	4.6%
2	Open Space In Lieu Fee		$957,676.00	$0.00	$957,676.00	10.1%
3	Parking In Lieu Fee		$2,265,000.00	$0.00	$2,265,000.00	23.8%
4	Center St. Plaza In Lieu Fee		$400,000.00	$0.00	$400,000.00	4.2%
5	Shattuck Reconfiguration In Lieu Fee		$190,000.00	$0.00	$190,000.00	2.0%
		Sub-Totals	$4,250,383.00	$0.00	$4,250,383.00	44.7%
		TOTAL:	**$11,683,681.50**	**$2,167,778.24**	**$9,515,903.26**	**100%**

Office of the City Manager

ACTION CALENDAR
July 19, 2016

To: Honorable Mayor and Members of the City Council

From: Dee Williams-Ridley, City Manager

Submitted by: Michael Caplan, Economic Development Manager

Subject: Financial Assistance for Hotel Feasibility; Contract with Center Street Partners, LLC

RECOMMENDATION

Adopt a Resolution authorizing the City Manager to execute a multi-year contract with Center Street Partners, LLC for an amount not to exceed the total value of permit and impact fees charged to the project with adjustments for inflation, estimated by staff to be up to $13.1 million.

FISCAL IMPACTS OF RECOMMENDATION

This Resolution would commit approximately $1.5 million per year in General Fund revenue for up to 8 years (with adjustments for inflation) and enable a commercial project that will generate an estimated $4.2 million in new General Fund revenue per year. Thus, the net impact of this Resolution would be positive for the City's General Fund. OED estimates that facilitating the hotel project per the terms of the Resolution would generate approximately $2.7 million of net new General Fund revenue per year for up to 8 years and significantly higher net revenue beyond that period. The hotel project would also generate significant other tax and impact fee revenues that would flow into various special funds and to Berkeley Unified School District; OED estimates those revenues at approximately $2.3 million in the first year following completion of the project, and approximately $300,000 per year beyond the first year. This contract has been entered into the City's contract management database and assigned CMS No. H3WSR.

CURRENT SITUATION AND ITS EFFECTS

On May 26, 2016, the Zoning Adjustments Board (ZAB) granted a Use Permit to Center Street Partners, LLC (the "project sponsor") for the construction of a 16-story hotel and commercial development at 2129 Shattuck Avenue. Subsequently, in a letter to the City Manager dated May 31, 2016 (Attachment 2), the project applicant requested financial assistance from the City to ensure the financial feasibility of the hotel project.

According to the project sponsor's projections of development costs, operating costs and revenues, which have been reviewed and confirmed by independent consultants, the project currently projects to operate with a rate of return of approximately 6.7%.

Hotel projects of this type are expected to operate with a rate of return of approximately 8 to 10%. The project sponsor's own projections fall short of that range, and thus the project may not be able to attract financing for construction.

The project sponsor requests that the City provide financial assistance equivalent to the full amount of all permit and impact fees charged to the project, with adjustments for inflation. The project sponsor suggests structuring that assistance as a grant of a portion of the transient occupancy tax revenue generated by the project. By providing financial assistance, the City can boost the project's revenues and increase its projected rate of return for the first several years of operation, and thus enable the project sponsor to attract financing.

BACKGROUND

The site at 2129 Shattuck Avenue at Center Street, currently occupied by a Bank of America branch, has long been considered a potential site for a hotel and commercial development. The Downtown Area Plan, adopted in 2012 following a comprehensive community planning process, explicitly identifies a new hotel as a desired use for which the City should grant higher height allowances and consideration of incentives.[1]

In April 2015, the project applicants (property owner Center Street Partners, LLC and project developer Pyramid Hotel Group) submitted an application to build a 16-story commercial project at the site (see Attachment 3, Staff Report for 5/26/16 ZAB Hearing). In addition to 334 hotel suites, the project includes conference center facilities, several full- and quick-service restaurants, and parking. On May 26, 2016, ZAB voted unanimously to support the project and grant the use permit.

The Office of Economic Development (OED) analyzed the net economic impact of the proposed project (see Attachment 4) and concluded that the project will provide very significant economic development benefits to the City of Berkeley in terms of both job creation and new tax revenue. The project estimates that it will directly employ 110 people, and OED estimates that it will create an additional 103 indirect jobs, for a total of 213 new jobs. New General Fund revenues include increases to property tax revenue, transient occupancy tax revenue, sales tax revenue, and business license tax revenue. OED estimates the present valuation of total net new revenues to be $23.8 million projected for a 5-year period, or $42.5 million projected for a 10-year period.

During the entitlement process the City engaged two outside firms, HTL Hospitality Advisors and Strategic Economics, to conduct independent reviews of the pro forma information provided by the project sponsor, including projected development costs, operating costs and revenues. Each consultant confirmed that the sponsor's cost assumptions were reasonable, and the revenue assumptions were optimistic; i.e., the consultants found that the sponsor's estimates for average room rates and occupancy

[1] See Downtown Area Plan, pages LU-6 to LU-10 and ED-6, available at http://www.ci.berkeley.ca.us/dap/

rates were higher than local averages, meaning that their operating income and annual return on costs may ultimately be lower than projected. Staff notes that the project site has long been considered an excellent site for a hotel, and thus there is justification for the sponsor's optimistic revenue projections. Nevertheless, as noted in the report prepared by Strategic Economics, the low projected rate of return threatens the feasibility of the development project (see Attachment 5, Strategic Economics Peer Review of 2129 Shattuck Community Benefits Proposal). The findings of each consultant are consistent with the sponsor's assertion that the project requires assistance to achieve financial feasibility and attract financing for construction.

Staff recommends that Council provide financial assistance to facilitate the hotel development project by adopting the attached Resolution. Key features of this Resolution include:

- **Financial assistance will be linked to new TOT revenues generated by the project.** The annual value of the assistance will not exceed 50% of the new TOT revenues generated by the hotel project until the cumulative total of the rebate equals the total value of permits and fees. If the project generates a larger amount of TOT than anticipated, the subsidy would be paid out more quickly.
- **The maximum cumulative value of the rebate will not exceed $13,125,267.** This figure is based on staff's estimate of the value of permit and impact fees to be charged to the hotel project, which total an estimated $11.2 million (see Attachment 6). Staff projects that financial assistance will be provided through annual payments of approximately $1.5 million per year over 8 years; after adjusting for inflation (projected at 3% per year), the total value in nominal dollars increases to approximately $13.1 million (see Attachment 6). This amount may be adjusted downward to reflect the actual value of permits and fees paid by the project sponsor.
- **The project is required to meet conditions related to community benefits and ongoing financial benefit to the City.** The contractual agreement will be contingent on the project satisfying certain conditions. The project must continue to provide community benefits as defined through the entitlement process (including union labor for project construction and operations, and public accessibility of restaurants and bars). The project also must continue to provide economic benefits to the City via payments of TOT and business license taxes.

ENVIRONMENTAL SUSTAINABILITY

Currently, due to a lack of sufficient supply of hotel rooms in Downtown Berkeley to meet demand, visitors to Downtown Berkeley (including visitors to UC Berkeley campus) are often forced to seek accommodations outside of the immediate area. Staff speculates that this project, by increasing the supply of hotel rooms in our highly walkable, transit-accessible downtown, could potentially reduce the amount of greenhouse gases generated by trips from visiting hotel guests.

RATIONALE FOR RECOMMENDATION

The proposed hotel and conference center for 2129 Shattuck Avenue is a highly desirable addition to Downtown Berkeley that will provide a boost to Berkeley's local economy and result in a significant increase in General Fund revenue for the City. There are many examples of precedents of municipalities providing incentives to hotel projects, to offset the risks associated with high development costs and ensure the generation of future revenues. Additionally, the high desirability of a hotel project and the consideration of incentives for such a project are stated policies of the Downtown Area Plan adopted by Council.

ALTERNATIVE ACTIONS CONSIDERED

Staff considered offering no financial assistance to the project. Given the opportunity to boost General Fund revenues, this potential course of action was dismissed.

Staff considered structuring the assistance in an up-front rebate of permit costs and impact fees. In this case, the City would be required to designate General Funds to cover staff costs related to plan check and inspections, transportation impact mitigations, and other project related costs. Staff determined that structuring the assistance as a rebate of future revenues, with an allowance for inflation, would provide the same benefit to the project sponsor with less of an impact on City resources.

Staff considered structuring the assistance as a deferral of permit costs and impact fees. Staff determined that, in addition to the need to designate General Funds to cover costs in the interim period, this form of assistance would not be sufficient to enable the hotel project to attract financing.

Staff considered structuring a TOT rebate over time with conditions requiring the project to annually demonstrate the ongoing need for assistance, ensuring that the annual amount of rebate would not exceed the additional revenue necessary for the project to achieve a 7.6% rate of return, the minimum rate necessary (as stated by the applicant) for project feasibility. The applicant was very concerned that linking the subsidy to project performance would be make it much more difficult to attract needed financing, asserted that establishing annual rates of return would be extremely difficult to ascertain and that this approach risked making the project infeasible.

CONTACT PERSON

Michael Caplan, Economic Development Manager, (510) 981-2490

Attachments:
1: Resolution
2: May 31, 2016 Correspondence from Center Street Partners, LLC to the City Manager
3: Staff Report for 5/26/16 ZAB Hearing
4: OED Economic Impact Analysis of 2129 Shattuck Ave

5: Strategic Economics Peer Review of 2129 Shattuck Community Benefits Proposal
6: Staff Calculations of Financial Assistance Valuation

RESOLUTION NO. ##,###-N.S.

CONTRACT: CENTER STREET PARTNERS, LLC

WHEREAS, Center Street Partners, LLC has received a Use Permit to construct a 16-story hotel and commercial project at 2129 Shattuck Avenue; and

WHEREAS, the project will provide significant economic development benefits to the City of Berkeley in terms of both job creation and new tax revenue, including new property tax revenue, transient occupancy tax revenue, sales tax revenue, and other new revenue; and

WHEREAS, the Downtown Area Plan, adopted in 2012, identifies a hotel and conference center as a highly desired use that warrants consideration of incentives; and

WHEREAS, Center Street Partners, LLC has stated that their current rate of return, projected at 6.7% of project costs, is insufficient to attract financing for construction of the hotel project; and

WHEREAS, Center Street Partners, LLC has requested financial assistance equivalent to the total value of permit and impact fees charged by the City to the project, in order to increase their rate of return, economic feasibility of the project, and ability to attract financing; and

WHEREAS, the City of Berkeley has engaged third party consultants who have confirmed that the pro forma assumptions stated by Center Street Partners, LLC are fair and reasonable, and that based on the project's projected cost basis, operating costs, and operating revenues, as well as the prevailing rate of return expected of hotel projects by commercial real estate investors, the project would likely be economically infeasible; and

WHEREAS, the City of Berkeley is able to provide assistance in the form of a rebate of future transient occupancy tax revenues generated by the project, thereby increasing the economic feasibility of the project, facilitating the development of the hotel and commercial project, and increasing the likelihood of future General Fund revenues, without assuming any risk; and

WHEREAS, this contract has been entered into the City's contract management database and assigned CMS No. H3WSR.

NOW THEREFORE, BE IT RESOLVED by the Council of the City of Berkeley that the City Manager is authorized to execute a multi-year contract with Center Street Partners, LLC not to exceed $13,125,267 or the total value of permit and impact fees charged to the development project at 2129 Shattuck Avenue with adjustments for inflation, granting financial assistance in the form of a subsidy in an amount of up to 50% of new transient occupancy tax revenue generated by the project, on the conditions that the project meets

its requirements to provide significant community benefits and generates positive fiscal impacts for the City of Berkeley.

STRATEGICECONOMICS

MEMORANDUM

Date: May 24, 2016

To: Greg Powell
City of Berkeley Planning and Development Department

From: Sujata Srivastava

Subject: Peer Review of 2129 Shattuck Community Benefits Proposal

INTRODUCTION

The City of Berkeley retained Strategic Economics to conduct a peer review of the applicant's community benefits proposal for the 2129 Shattuck hotel. According to the City of Berkeley's Municipal Code (Section 23E.68.090.E), any development projects in Downtown Berkeley that exceed 75 feet in height must provide "significant community benefits." The potential options for providing significant community benefits include: affordable housing beyond the existing requirements; project labor agreement (PLA); flat fee contributions to a City fund; and other amenities and benefits.

The applicant's community proposal includes a project labor agreement for construction and a labor agreement with the local hotel workers' union. However, the applicant's proposal does not include additional fee contributions, stating that the payment of fees would render the project infeasible according to their pro forma analysis. This memorandum report provides a review of key assumptions in the applicant's community benefits proposal, focusing on two aspects: 2) the estimated value of the construction PLA, and 2) the project's pro forma assumptions. Strategic Economics did not evaluate the underlying assumptions of the hotel workers' labor agreement, or the estimate of lost revenues from providing fewer hotel rooms in order to accommodate a larger conference facility.

CONSTRUCTION PROJECT LABOR AGREEMENT

The community benefits proposal for the hotel project includes a project labor agreement (PLA) for construction. Total construction costs are estimated at approximately $112 million, including the cost of building the hotel plus tenant improvements. The value of the construction PLA is estimated at five percent of total construction costs, or $5.6 million, consistent with City Council guidance on this issue. This is a conservative estimate of the value of a union labor agreement for construction, which the Alameda County Building Trades Council estimates at between 10 and 12 percent.

PRO FORMA REVIEW

In order to determine if the project could feasibly contribute additional community benefits in the form of fee contributions, Strategic Economics reviewed several key assumptions in the financial pro forma submitted by the applicant: the revenue assumptions, the operating cost assumptions, and the development cost assumptions. Finally, Strategic Economics reviewed data on the expected rates of return for hotel development to determine whether the proposed project is financially feasible, and if it could contribute additional fees.

REVENUE ASSUMPTIONS

The applicant's key revenue input is the revenue per available room (RevPAR), which is measured by multiplying the average daily rate (ADR) by the occupancy rate. The applicant's pro forma assumes an ADR of $271 per room and an occupancy rate of 77 percent in the third year of operations, for a RevPAR of about $210 (Figure 1).

While the applicant's occupancy rate assumption is close to what is reported by Smith Travel Research (STR) for the Berkeley market area (within five miles of Downtown Berkeley), the assumptions regarding ADR are significantly higher than the reported ADR for luxury, upscale, and midscale hotels (Figure 1).[1] However, there are a number of properties within the market area that are older and in need of renovation, and a new property is likely to command much higher rates. The applicant's estimated ADR of $271 for the proposed hotel represents an increase of over 47 percent above the ADR achieved in existing luxury, upscale, and midscale hotels within five miles of Downtown Berkeley. Due to confidentiality, Strategic Economics does not have any information regarding the hotel's marketing or branding strategy. However, the applicant's optimistic estimate of ADR seems to align with an expectation that hotel rates will experience growth, that the proposed hotel will be aimed at a more upscale market, and/or that the property will be unique compared to what is currently offered in the market area, and therefore can demand significantly higher rates.

Figure 1: Key Revenue Assumptions

Assumptions	Market Average	Applicant
Average Daily Rate	$183	$271
Occupancy Rate	80%	77%
RevPAR	$147.32	$209.80

Source: Center Street Partners, 2016; Smith Travel Research, 2015; Strategic Economics, 2016

OPERATING COST ASSUMPTIONS

The applicant's pro forma estimates that operating costs, including occupancy-related and undistributed costs, would make up about 43 percent of total revenues, resulting in a "house profit" of 57 percent of total revenues. This estimate of house profit is higher than typical for U.S. hotels. As reported by STR, in 2014

[1] The data for all luxury, upscale, and midscale hotels within a five-mile radius is presented here because the applicant did not provide detail about the type of property being proposed, the "flag," or the marketing/branding strategy.

the average house profit percentage was about 37 percent of total revenues.[2] Strategic Economics does not have detailed information about how the assumptions for operating costs were derived, but the applicant has cited their experience operating other hotel properties in the Berkeley market and other locations.

The project's net operating income is calculated by subtracting operating and fixed costs from total revenues. The annual net operating income (before debt service) calculated by the applicant is $11.3 million. If lower assumptions regarding ADR and house profit were applied, the resulting annual net operating income would be considerably lower.

DEVELOPMENT COST ASSUMPTIONS

The main categories of development costs include land costs, construction costs, and indirect costs. Strategic Economics reviewed the construction cost inputs for the proposed hotel. According to the applicant, the construction cost for the building is $384 per square foot. Construction costs can vary a great deal from project to project, depending on the specifics of the building program, design, site characteristics, and other factors. The applicant's per-square-foot construction cost estimate is higher than typical for high-density hotels in the Bay Area, which are usually estimated at between $300 and $350 per square foot.[3] However, it is reasonable to assume that the construction costs for this proposed project would be higher than average, given the complexity of infill development on a small downtown parcel, recent increases in construction labor costs, and the cost premium associated with the labor agreement for construction.

RETURN ON COST

The financial feasibility of the project is measured by the applicant using the "return on cost" or ROC metric. Return on cost is calculated by dividing a project's expected net annual operating income at year of stabilization by total development costs (including construction costs, soft costs, and land costs but excluding financing costs). Using ROC as a metric for feasibility allows for a comparison of rates of return among similar projects, without skewing the results based on the specific financing arrangements (such as the particular combination of debt and equity) that can be highly variable from project to project.

To establish a reasonable threshold for a developer's rate of return on new hotel development projects in Berkeley, Strategic Economics reviewed recent data on hotel capitalization rates. A project's capitalization (or "cap") rate is the ratio of net operating income divided by the acquisition value. The ROC for the proposed hotel development project can be compared to the overall capitalization rate for hotel properties in the current market, which represent an investor's expectation of return.[4] As shown in Figure 3, the overall capitalization rate (cap rate) for recently sold hotel projects ranged from 7.0 percent to 11.0 percent, depending on the lodging segment and location. Investors expect for hotel cap rates to rise in the near term as the growth in occupancy rates and ADRs starts to level off. Based on this review, it can be concluded that a proposed hotel in Berkeley would need to achieve a return on cost of at least 7.0 percent to be

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[2] Smith Travel Research, HOST Almanac, 2015. House profit is defined as the net revenues before deducting for fixed charges and management fees.

[3] RS Means, 2015.

[4] A project's capitalization (or "cap") rate is the ratio of net operating income divided by property value. Real estate brokerage firms typically calculate the market capitalization rate as the average capitalization rate for projects sold in a given period.

considered financially viable. The minimum rate of return would be even higher for certain types of properties, such as limited service and select service hotels.

POTENTIAL FOR FEE CONTRIBUTIONS

The proposed hotel, with a return on cost of 6.7 percent, would not be considered financially feasible in today's market. It should be noted that the applicant's calculation of return assumes higher than average revenues and lower than average operating costs, resulting in an optimistic estimate of net operating income. There are several factors that could allow the proposed hotel to perform better than other hotels in the market area, including the prime location in the heart of Downtown Berkeley, the higher quality of the product compared to existing properties in the area, the high demand for hotels in Berkeley, and the lack of new room additions since 1994.

While the hotel market is currently very strong, if more conservative estimates of revenue and costs are applied, the project's return on cost would be lower, resulting in a project that is less financially viable than what is proposed by the applicant. The hotel project is still infeasible even if lower construction costs are assumed ($325 per square foot instead of $384 per square foot).

Nonetheless, Strategic Economics concludes that it is not reasonable to expect that the proposed development could contribute additional fees to a community benefits fund.

Figure 2. Hotel Cap Rates by Property Type, 2014-2015

Source	Location	Limited Service/ Midscale/ Economy	Luxury/ Upscale	Full-Service	Select Service/ Extended Stay
CBRE Cap Rate Survey	U.S.	8.77%-9.42%	6.76%-7.39%	7.28%-7.84%	7.69%-8.24%
CBRE Cap Rate Survey	Oakland MSA	9.00%-11.00%	7.00%-8.00%	6.50%-8.50%	7.50%-10.00%
PWC Real Estate Investor Survey	U.S.	8.78%	6.98%	7.60%	8.45%
HVS Consulting	U.S.	9.00%	6.70% for full service and luxury		7.80%

Source: CBRE Cap Rate Survey, 2nd Half 2015, PWC Real Estate Investor Survey, 3Q2015; HVS Consulting, Jan 2015.

PROPOSED RESIDENCE INN, BERKELEY CA

Modification Proposal April 10, 2018

We are requesting the Hotel Incentive Agreement be modified to show recovery for Pyramid of only the permit and fee costs paid to date of $2.5 million, with the remaining $8.7 million of such fees deferred until after hotel opening. In exchange for this, we propose the City receive 75% of the TOT collections, rather than 50% per the current agreement. As shown in the schedule on the following page, this would result in:

- **The City receiving 100% of TOT in apporximately 4 years versus than 8 years per the current agreement**
- **The City would also save over $1.6 million in inflation/interest expense**

In support of this request, we offer the following supporting material:

- Narrative discussion of the changes in the financing structure (see below)
- Cash Flow comparison for TOT costs with proposed permit changes (page 2)
- Comparison of Development Costs and Capital Stack (page 3)

At the time the City approved the Hotel Incentive Agreement ("HIA") in July 2016 which provided for reimbursement of certain permit and impact fees from future Transient Occupancy Tax ("TOT") receipts, total project costs were estimated at $169.5 million. Today, the total project costs are estimated at $194 million.

After the HIA was executed, Pyramid reviewed proposals from various lenders and equity partners, Pyramid selected Acron USA Development ("Acron") to be its joint venture ("JV") equity partner, and Barings Real Estate Advisors, an affiliate of Massachusetts Mutual Life Insurance Co. ("Barings") to be the construction lender.

Due to rapidly rising Bay Area construction costs, and further refinement of project scheduling, including a decision to relocate Bank of America ("B of A") to an offsite location during construction, the total cost of the project had risen to $185 million by 12/31/17.

Pyramid and Barings were ready to close the construction loan and execute the purchase of the property from B of A in December 2017. Two weeks before closing, Acron informed Pyramid they would be unable to provide their equity funding, and the JV agreement was terminated.

This left a gap of nearly $60 million of equity in order for the project to move forward. Pyramid informed the other project participants, including the General Contractor - Suffolk Construction ("Suffolk") and Barings of this development. At that time, the project was placed on hold until it was determined funds could be raised.

By March, 2018, Pyramid was able to secure commitments for a majority of the remaining funds. Some from Barings, who agreed to provide a layer of "mezzanine financing" at a much higher interest rate. However, despite "value engineering" and other analysis undertaken to reduce costs, construction and other costs increased again, partially due to Suffolk having to obtain new bids from subcontractors who could no longer hold the prices quoted several months earlier. In addition, interest rates have dramatically risen over the past several months which increased the cost of the construction loans

As of today (April 10, 2018), the total cost is estimated at $194 million, which includes the full amount of City of Berkeley permit and fees. This has resulted in an equity gap of over $8 million.

CASH FLOW COMPARISON

ORIGINAL CALCULATION FROM HOTEL INCENTIVE AGREEMENT

Assumptions:

Amount of "Permit and Impact Fees"	$11,214,000	(assumed to be paid in 2017/18)
Annual Inflation Rate	3.0%	
Unrecovered Balance as of 1/1/2019	11,722,396	(1.5 years inflation)
Commencement Date	1/1/2019	

Payment Period Start Date	Inflation Factor	Estimated Room Revenue	Total TOT @ 12%	Max. Annual Payment [1]	Opening Balance	Less: TOT Rebate Payments	Sub Total	Plus Inflation	Unrecovered Balance
1/1/2019	3.0%	23,142,205	2,777,065	1,388,532	11,722,396	(1,388,532)	10,333,864	310,016	10,643,880
1/1/2020	3.0%	23,836,471	2,860,376	1,430,188	10,643,880	(1,430,188)	9,213,691	276,411	9,490,102
1/1/2021	3.0%	24,551,565	2,946,188	1,473,094	9,490,102	(1,473,094)	8,017,008	240,510	8,257,518
1/1/2022	3.0%	25,288,112	3,034,573	1,517,287	8,257,518	(1,517,287)	6,740,232	202,207	6,942,439
1/1/2023	3.0%	26,046,755	3,125,611	1,562,805	6,942,439	(1,562,805)	5,379,633	161,389	5,541,022
1/1/2024	3.0%	26,828,158	3,219,379	1,609,689	5,541,022	(1,609,689)	3,931,333	117,940	4,049,273
1/1/2025	3.0%	27,633,003	3,315,960	1,657,980	4,049,273	(1,657,980)	2,391,293	71,739	2,463,032
1/1/2026	3.0%	28,461,993	3,415,439	1,707,720	2,463,032	(1,707,720)	755,312	22,659	777,971
1/1/2027	3.0%	29,315,852	3,517,902	1,758,951	777,971	(777,971)	-	-	-

(1) Calculated at 50% of the TOT per original agreement

CALCULATION BASED ON PROPOSAL OF APRIL 10, 2018

Assumptions:

Amount of "Permit and Impact Fees"	$2,534,305	Equal to total costs paid through March 31, 2018
Annual Inflation Rate	3.0%	
Unrecovered Balance as of 1/1/2020	2,668,849	(1.75 years until estimated hotel opening date of January 1, 2020)
Commencement Date	1/1/2020	

Payment Period Start Date	Inflation Factor	Estimated Room Revenue	Total TOT @ 12%	Max. Annual Payment [1]	Opening Balance	Less: TOT Rebate Payments	Sub Total	Plus Inflation	Unrecovered Balance
1/1/2020	3.0%	23,836,471	2,860,376	715,094	2,668,849	(715,094)	1,953,755	58,613	2,012,367
1/1/2021	3.0%	24,551,565	2,946,188	736,547	2,012,367	(736,547)	1,275,821	38,275	1,314,095
1/1/2022	3.0%	25,288,112	3,034,573	758,643	1,314,095	(758,643)	555,452	16,664	572,115
1/1/2023	3.0%	26,046,755	3,125,611	781,403	572,115	(572,115)	-	-	-
1/1/2024	3.0%	26,828,158	3,219,379	804,845	-	-	-	-	-
1/1/2025	3.0%	27,633,003	3,315,960	828,990	-	-	-	-	-
1/1/2026	3.0%	28,461,993	3,415,439	853,860	-	-	-	-	-
1/1/2027	3.0%	29,315,852	3,517,902	879,476	-	-	-	-	-
1/1/2028	3.0%	30,195,328	3,623,439	905,860	-	-	-	-	-

(1) Based on 25% of the TOT based on proportional amount of fees to be recovered

RECAP/COMPARISON	Original	Current	Difference
Permits & Fees collected by City prior to opening	$ 11,214,000	$ 2,534,305	$ 8,679,695
Amount of TOT payments rebated	13,125,267	2,782,400	10,342,867
Effective Inflation/Interest Cost	1,911,267	248,095	1,663,172

ATTORNEY-CLIENT PRIVILEGED COMMUNICATION

PROPOSED RESIDENCE INN, BERKELEY CA

COST AND CAPITAL STACK COMPARISON

Total $ in thousands

	Costs as of July 2016 City Council Presentation	Costs as of December 2017	Costs as of April 2018
Sources			
Construction Financing- Senior Loan	$ 115,000	$ 126,000	$ 129,500
Construction Financing- Mezzanine Loan	-		15,000
Equity- JV Partner	49,050	53,100	-
Equity- Pyramid and affiliates	5,450	5,900	41,500
GAP- UNFUNDED EQUITY	-	-	8,000
Total Sources	169,500	185,000	194,000
Uses			
Land	$ 15,400	$ 16,000	16,000
Construction- base building	107,400	117,400	125,000
Construction- tenant improvements (2)	5,300	3,600	3,600
Furnishings & Equipment	9,800	10,900	10,900
Design, Legal and other professional	5,000	9,500	10,000
Project Management	6,500	5,800	5,600
City Permits & Fees	11,200	11,500	11,500
Pre Opening and Working Capital	1,100	1,300	1,300
Financing Fees and Interest during construction	7,800	9,000	10,100
Total	169,500	185,000	194,000

SUBSTANTIAL INCREASE IN CONSTRUCTION COSTS REQUIRE ADDITIONAL RELIEF

BERKELEY HOTEL PROJECT- OPERATING PROJECTIONS

- As requested, we have prepared 20 year projections showing the key metrics including debt service and return on equity

- We reference the "operating pro forma" that was submitted to the City as part of our approval process in May - July 2016
  This document is shown as "Exhibit A" (see following page)

- As noted, Exhibit A represented the stabilized year (third year of operations), which corresponds to
  "Year 3" on the 20 year projections (Exhibit B)

- On Exhibit B, we have shown how the recovery of fees works on both the original (2016) TOT agreement and under
  the current proposal

BERKELEY HOTEL PROJECT **OPERATING PRO FORMA** **EXHIBIT A**

Total $ in thousands

Based on stabilized year operations- calendar 2020 if hotel opens as scheduled in late 2018

ORIGINALLY PREPARED 5-10-16

			Comments
% OF OCCUPANCY	77%		Will ramp up to this level over first two to three years
AVERAGE RATE	$271		Opening rate in 2018 is estimated at $245
REVENUE	$	%	
ROOMS	25,500	93%	
PARKING	1,300	5%	
OTHER DEPARTMENTS	500	2%	Includes telephone, guest laundry, miscellaneous income
TOTAL REVENUE	27,300	100%	
OPERATING COSTS			*Percentages are of department revenues*
ROOMS	5,100	20%	Primarily housekeeping labor and supplies, front desk operations
PARKING	600	46%	
OTHER DEPARTMENTS	100	20%	
TOTAL OPERATING COST	5,800	21%	
TOTAL OPERATING DEPT. INCOME	21,500	79%	
UNDISTRIBUTED OPER. EXP			*Percentages are of total revenues*
GENERAL & ADMINISTRATION	1,600	6%	Includes credit card commissions, general management
SALES & MARKETING	1,500	5%	Includes national marketing and frequent guest programs from the brand
REPAIRS & MAINTENANCE	700	3%	
UTILITIES	700	3%	
FRANCHISE EXPENSE	1,500	5%	Royalty fees payable to brand (calculated based on 6% of room sales) *
TOTAL UNDISTRIBUTED EXPENSES	6,000	22%	
GROSS OPERATING PROFIT	15,500	57%	
FIXED CHARGES AND OTHER			*Percentages are of total revenues*
MANAGEMENT FEE	800	3%	
RE TAXES	1,900	7%	No abatements are assumed
INSURANCE	300	1%	Property and casualty insurance including earthquake
RENT AND OTHER	100	0%	
CAPITAL RESERVE	1,100	4%	Reserve for future replacement of furnishings & equipment *
TOTAL FIXED CHARGES	4,200	15%	
INCOME BEFORE DEBT SERVICE	11,300	41%	Annual return on costs before debt service is 6.7%

* Royalty fees and capital reserves are actually ramped up over first three years; these represent the stabilized rates

BERKELEY HOTEL PROJECT: 20 YEAR OPERATING PROJECTIONS

EXHIBIT B

Total $ in thousands

	Year 1	Year 2	Year 3	Year 4	Year 5	Year 6	Year 7	Year 8	Year 9	Year 10	Year 11
% OF OCCUPANCY	73%	75%	77%	77%	77%	77%	77%	77%	77%	77%	77%
AVERAGE RATE	$245	$258	$271	$282	$290	$299	$308	$317	$327	$337	$347
TOTAL REVENUE	23,127	24,961	27,300	27,914	28,752	29,614	30,503	31,418	32,361	33,331	34,331
GROSS OPERATING PROFIT	12,879	13,929	15,500	15,755	16,228	16,715	17,216	17,733	18,265	18,812	19,377
INCOME BEFORE DEBT SERVICE	9,423	10,082	11,300	11,451	11,814	12,188	12,574	12,972	13,382	13,805	14,241
RETURNS UNDER CURRENT TOT REBATE AGREEMENT											
TOT REBATE CALCULATION											
STARTING BALANCE	11,500	10,556	9,479	8,233	6,917	5,514	4,020	2,432	745	-	-
PLUS INFLATION FACTOR (3%)	345	317	284	247	207	165	121	73	22	-	-
50% OF TOT COLLECTED @ 12% X ROOMS	(1,289)	(1,394)	(1,530)	(1,564)	(1,611)	(1,659)	(1,709)	(1,760)	(768)	-	-
REMAINING BALANCE	10,556	9,479	8,233	6,917	5,514	4,020	2,432	745	-	-	-
AVAILABLE FOR DEBT SERVICE (1)	10,712	11,476	12,830	13,015	13,425	13,847	14,283	14,732	14,149	13,805	14,241
DEBT SERVICE (2)	(13,005)	(11,172)	(11,172)	(11,172)	(11,172)	(11,172)	(11,172)	(11,172)	(11,172)	(11,172)	(11,172)
NET CASH FLOW (LOSS)	(2,293)	304	1,658	1,843	2,252	2,675	3,110	3,560	2,977	2,633	3,069
EQUITY (3) 49,500											
ANNUAL RETURN ON EQUITY	(4.6%)	0.6%	3.3%	3.7%	4.6%	5.4%	6.3%	7.2%	6.0%	5.3%	6.2%
RETURNS UNDER PROPOSED TOT REBATE AGREEMENT											
STARTING BALANCE (4)	5,700	4,582	3,326	1,895	389	-	-	-	-	-	-
PLUS INFLATION FACTOR (3%)	171	137	100	57	12	-	-	-	-	-	-
50% OF TOT COLLECTED @ 12% X ROOMS	(1,289)	(1,394)	(1,530)	(1,564)	(400)	-	-	-	-	-	-
REMAINING BALANCE	4,582	3,326	1,895	389	-	-	-	-	-	-	-
AVAILABLE FOR DEBT SERVICE (1)	10,712	11,476	12,830	13,015	12,214	12,188	12,574	12,972	13,382	13,805	14,241
DEBT SERVICE (2)	(13,005)	(11,172)	(11,172)	(11,172)	(11,172)	(11,172)	(11,172)	(11,172)	(11,172)	(11,172)	(11,172)
NET CASH FLOW (LOSS)	(2,293)	304	1,658	1,843	1,042	1,016	1,402	1,800	2,210	2,633	3,069
EQUITY (5) 43,700											
ANNUAL RETURN ON EQUITY	(5.2%)	0.7%	3.8%	4.2%	2.4%	2.3%	3.2%	4.1%	5.1%	6.0%	7.0%

NOTES

(1) Equals income before debt service plus 50% of TOT collected

(2) Construction Loan 144,500 @ L+620 (9.0%) for first year, then converts to permanent loan at same amount but at 6.0% with 25 year amortization schedule

(3) Equity based on total project cost of 194,000 (which includes 11,500 of up front permit costs), less 144,500 debt financing

(4) Starts with amount that would be paid up front after deferral of 5,800 (1,600 childcare & housing impact fees + 4,200 public works impact and in lieu fees)

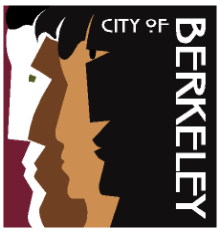
(5) Equity requirements are reduced dollar for dollar for the amount of fees deferred (49,500 - 5,800 = 43,700)

BERKELEY HOTEL PROJECT: 20 YEAR OPERATING PROJECTIONS

EXHIBIT B

Total $ in thousands

	Year 12	Year 14	Year 15	Year 16	Year 17	Year 18	Year 19	Year 20
% OF OCCUPANCY	77%	77%	77%	77%	77%	77%	77%	77%
AVERAGE RATE	$357	$379	$390	$402	$414	$426	$439	$452
TOTAL REVENUE	35,361	37,515	38,640	39,799	40,993	42,223	43,490	44,795
GROSS OPERATING PROFIT	19,958	21,174	21,809	22,463	23,137	23,831	24,546	25,282
INCOME BEFORE DEBT SERVICE	14,690	15,631	16,124	16,632	17,155	17,695	18,252	18,825
RETURNS UNDER CURRENT TOT REBATE AGREEMENT								
TOT REBATE CALCULATION								
STARTING BALANCE	-	-	-	-	-	-	-	-
PLUS INFLATION FACTOR (3%)	-	-	-	-	-	-	-	-
50% OF TOT COLLECTED @ 12% X ROOMS	-	-	-	-	-	-	-	-
REMAINING BALANCE	-	-	-	-	-	-	-	-
AVAILABLE FOR DEBT SERVICE [1]	14,690	15,631	16,124	16,632	17,155	17,695	18,252	18,825
DEBT SERVICE [2]	(11,172)	(11,172)	(11,172)	(11,172)	(11,172)	(11,172)	(11,172)	(11,172)
NET CASH FLOW (LOSS)	3,518	4,459	4,952	5,460	5,983	6,523	7,079	7,653
EQUITY [3] 49,500								
ANNUAL RETURN ON EQUITY	7.1%	9.0%	10.0%	11.0%	12.1%	13.2%	14.3%	15.5%
RETURNS UNDER PROPOSED TOT REBATE AGREEMENT								
STARTING BALANCE [4]	-	-	-	-	-	-	-	-
PLUS INFLATION FACTOR (3%)	-	-	-	-	-	-	-	-
50% OF TOT COLLECTED @ 12% X ROOMS	-	-	-	-	-	-	-	-
REMAINING BALANCE	-	-	-	-	-	-	-	-
AVAILABLE FOR DEBT SERVICE [1]	14,690	15,631	16,124	16,632	17,155	17,695	18,252	18,825
DEBT SERVICE [2]	(11,172)	(11,172)	(11,172)	(11,172)	(11,172)	(11,172)	(11,172)	(11,172)
NET CASH FLOW (LOSS)	3,518	4,459	4,952	5,460	5,983	6,523	7,079	7,653
EQUITY [5] 43,700								
ANNUAL RETURN ON EQUITY	8.1%	10.2%	11.3%	12.5%	13.7%	14.9%	16.2%	17.5%



Office of Economic Development

5/29/2018

SUBJECT: Economic Impact Analysis of the Proposed Project at 2129 Shattuck Ave.

This memo outlines the projected economic impacts of the planned hotel development project at 2129 Shattuck Avenue in Downtown Berkeley. Economic Development staff based this analysis on the description of the approved project, as well as assumptions and projections regarding its development and operations that were vetted by HTL Hospitality Advisors, a consultancy specializing in hotel development and operations. Staff also integrated local tax and fee rates, economic multipliers applying to the hotel industry, and contextual factors regarding the project's size, location and product type and amenity attributes. Staff also used overnight visitor data generated from a November, 2015 study prepared by Dean Runyan Associates for Visit Berkeley (the Berkeley Convention and Visitor's Bureau). Staff concluded that this project will provide significant economic development benefits to the City of Berkeley in terms of both job creation and new tax revenue. This analysis was originally conducted in May 2016, for review by the Zoning Adjustments Board. The analysis was revised in May 2018 to update the project specifications and constants related to local taxes and fees.

I. Project Description and Assumptions

The hotel development project at 2129 Shattuck Avenue in Downtown will provide 329 all suite rooms to the Berkeley market, becoming the second largest hotel property in the City (the Doubletree is the largest with 375 rooms). The project will increase the total number of hotel/motel rooms in Berkeley by 23 percent, from the current 1445 to 1774. In the Downtown it will more than double the number of hotel/motel rooms from 226 (Hotel Shattuck Plaza has 199 and Downtown Berkeley Inn Motel has 27) to 555.

Hotel projects are uniquely beneficial to the communities in which they are located. They are a significant source of good-paying jobs (in this case union jobs) that are available to people who don't have advanced educations. In addition, they generate a very high amount of tax and assessment revenue to the City. Beyond the usual property tax, retail sales tax and business license tax, hotels generate Transient Occupancy Tax (TOT), which in Berkeley amounts to 12% of room rates. An additional assessment of 1% of room rates is paid by visitors towards Berkeley's Tourism Improvement District which promotes the local hospitality industry. So the job and income generating potential of a large hotel project puts it in a different class from other types of projects.

The Office of Economic Development used its economic assessment tool (summary included as an attachment below) to project annual tax and fee revenue impacts over a five year period based on a number of assumptions:

Building Assumptions:

- 329 hotel rooms (all suites)
- 9,900 square feet of leasable meeting room/conference facilities including outdoor terrace
- 81 parking spaces
- 6,075 square feet of Bank of America branch
- 7,941 other retail space
- Future assessed valuation is estimated at $161 million
- The estimated construction time is 20 months

Other Assumptions:

- Property Tax projections were based on Pyramid's estimated project valuation and were inflated by 2% per year over 5 year and 10 year periods as allowed under Prop 13.
- Business license taxes, Transient Occupancy Taxes, and sales tax revenues were included as part of the revenue projections, were based primarily on the developer/owner's projections, and were conservatively inflated at 2% per year for both 5- and 10-year periods.
- Other taxes and assessments were kept the same over the 5- and 10-year projection because of uncertainty regarding future inflation adjustments which are linked to factors such as the CPI.
- The potential impact of local sourcing of building materials was not included. If some portion of materials were to be sourced locally this would increase the potential economic impact of the project.
- Staff included the multiplier impacts of spending by new permanent employees working in the building in the model. But staff did not calculate the multiplier impact of workers during the construction period as this is hard to gauge.
- Staff did not include potential impacts of employment by the building management or contracted services related to building operation. The economic benefits of any such hiring and contracting would be in addition to those specified.
- Staff assumed that there would be no significant changes in employment or tax revenues stemming from Bank of America's replacement space.

II. Conclusions

OED estimates that the project will generate approximately $50.2 million in new General Fund and special tax and assessment revenue over ten years subsequent to its completion. This includes approximately $4.34 million in General Fund revenues in

the project's first year. This also includes approximately $2.31 million in special taxes, assessments and mitigation payments for affordable housing and childcare. Many of these revenues represent new, ongoing funding streams for the City of Berkeley. OED estimates the present valuation of total new revenues to be $23.8 million projected for a 5-year period, or $42.4 million projected for a 10-year period.

Property Tax Revenue: *Based on an estimated project valuation of approximately $161 million, OED estimates that this project will generate $594,190 in additional annual tax revenues.*

County property taxes amount to one percent of the project's assessed valuation. The City of Berkeley receives 32.58% of that one percent which flows to the City's General Fund. The City also receives an additional 4.92% of one percent of assessed valuation which goes towards voter approved debt service. The estimated valuation of the new project at approximately $161 million will constitute a significant reassessment of the current assessed valuation of $2,549,446. Current property tax revenue from property plus voter approved debt service total $9,560. This project will increase that tax revenue figure by $594,190 for a new total of $603,750. The City will also receive a one-time Transfer Tax payment of $240,000.

Transient Occupancy Tax Revenue: *This project is likely to generate approximately $3.01 million annually in Transient Occupancy tax.*

As stated above, TOT in Berkeley is 12% of room rates. This projection of $3.01 million in annual TOT revenues is based on projections of achievable room rates and hotel occupancy rates provided by the developers and vetted by HTL Hospitality Services. It is important to note that TOT flows directly to the City's General Fund so is a particularly valuable revenue source for the City.

Sales Tax Revenue: *OED estimates that this project will generate approximately $207,311 in annual Sales Tax Revenue.*

This figure is based on $55,500 in estimated direct sales tax generated by the restaurant and café space and $151,811 from secondary sales tax generated from hotel employees and guests. To generate the direct sales tax figure, OED staff determined the average sales/square foot of the City's top restaurants and cafes and applied that figure to the planned new retail square footage. Staff based the secondary sales tax capture figure on visitor spending data from the Dean Runyan Associates report. In addition to the $207,311 figure, OED estimates that approximately $10,000 in sales tax revenues will be generated from spending by construction workers during the 20-month construction period.

Business License Taxes: *OED estimates that this project will generate approximately $278,000 in annual Business License Tax Revenue.*

This figure is based on projected revenues for the hotel, on-site restaurants, and property rental fees collected by the developer/owner for the 7,941 square feet of retail space.

Other Tax and Assessment Revenue: *OED estimates that this project will generate annual special taxes and assessments totaling approximately $309,860.*

These include annual payments of $127,862 in special Berkeley Unified School District assessments, and annual payments of $181,998 for various City special assessments (e.g., street lighting, landscaping, libraries, emergency services, and storm water management). Most of these taxes and assessment are based on building square footage, except for the storm water assessment that is based on the parcel size.

SOSIP, Affordable Housing and Childcare Mitigation Fees: *This project is expected to generate one-time payments of approximately $437,707 for the Streets and Open Space Improvement Plan, $1,172,000 in Affordable Housing Mitigation Fees and $391,000 in Childcare Mitigation Fees.*

The City requires new development projects within the Downtown Area to contribute payments for implementation of the Streets and Open Space Improvement Plan (SOSIP). The City also requires that development of new commercial property pay one-time mitigation fees to offset project impacts on Berkeley's affordable housing and childcare demand. These fees do not flow into the City's General Fund but rather to special accounts used to implement the specified mitigations.

Additional One-Time Fees: *For purposes of this analysis, OED is not including fees related to plan check, utilities, EIR traffic mitigations or in-lieu fee for street improvements, on-site open space, and parking, all of which are based on cost recovery.*

Permanent Job Created: *Once fully occupied, this project will provide jobs to an estimated 110 people and create indirect employment in Berkeley and the region of an additional people – a total of 213 new jobs.*

To generate an estimate of indirect employment, OED used industry specific economic multipliers that were developed by the Economic Policy Institute in Washington, DC. The 'multiplier effect' is based on the idea that new workers spending their income in the local economy helps generate even more new job creation. The factor for hotels is .94 indirect jobs for every 1 direct job. This suggests that this project could potentially generate an additional 103 indirect jobs. As the new workers housed at 2129 Shattuck are likely to spend locally, some portion of these 103 indirectly created jobs will likely be located in Berkeley.

Impact on Center Street and the Downtown Berkeley Economy: *The proposed hotel project will have a significant economic stimulus effect in the Downtown, particularly the block of Center Street between Shattuck Avenue and the U.C. Berkeley*

Campus. It will more than double the number of hotel/motel rooms in the area and provide a higher quality all-suite format. This will attract more visitors and help establish the area as an overnight visitor destination. The number of new visitors will provide a significant positive impact on nearby restaurants, retailers and cultural venues.

Because of its limited inventory and lack of new supply, Berkeley has been exporting hotel demand to surrounding East Bay jurisdictions for many years. Hotel/motel operators report that demand for Berkeley hotel rooms has dramatically pushed local room and occupancy rates since 2010.

The Dean Runyan Associates report found that the rate of people coming to Berkeley for overnight stays is increasing on a year over year basis since 2010. In Berkeley that annual rate of increase was 2.9 percent, greater than the 2.2 percent growth for the larger 5 county metro area. That likely accounts for some of the increase in demand for hotel rooms in Berkeley. In addition, Downtown Berkeley has been going through a significant revitalization process which has spurred the establishment of many new restaurants and cultural venues. The increase in regional hotel demand combined with a more attractive Downtown district suggests that a transit-oriented hotel with a new all-suite product type would be in a good position to attract new customers to the area.

Other benefits to the Downtown economy stem from provision of 9,900 square feet of leasable meeting room space and 7,941 square feet of new restaurant and café space. The former will assist in attracting conferences and meetings to the Downtown that can't currently be accommodated. The latter will help animate the north side of Center Street between Shattuck Avenue and Oxford Street, and improve the area's attractiveness and walkability.

Overnight visitors spend money at local shops, restaurants and arts venues; in fact, they are a significantly stronger source of buying power than ordinary residents. Based on data from the Dean Runyan Associates report, OED estimates average spending in Berkeley by visitors staying at this hotel will be approximately $130 per person per day, not including spending on the room itself. So a 329-room hotel in this location will likely be of substantial benefit to neighboring businesses and the Downtown commercial district as whole.

Environmental Impact

As a transit oriented property, the proposed hotel will provide visitors with the possibility of not requiring a car during their visit. Direct BART access options from San Francisco International and Oakland International airports enhance the likelihood that such car-free visits can be both captured and promoted.

Office of Economic Development

Economic Impact Report: Center Street Hotel / Pyramid Hotel Group

PROJECT DESCRIPTION: 329-room hotel, 8,000 SF Restaurant

TAX & ASSESSMENT IMPACTS	1 Year
GENERAL FUND (GF)	
Property Tax and Debt Service	$594,190
Property Transfer Tax	$240,000
Business License Tax	$277,939
Transient Occupancy Tax	$3,006,976
Sales Tax	$55,500
Sales Tax from Employees and Residents	$151,811
Sales Tax from Construction Employees	$10,291
TOTAL GENERAL FUND REVENUES	**$4,336,706**
SPECIAL TAXES & ASSESSMENTS	
Affordable Housing Mitigation Fees	$1,172,000
Child Care Mitigation Fees	$391,000
SOSIP Fees	$437,707
Other City of Berkeley Assessments	$181,998
School District Taxes	$127,862
TOTAL SPECIAL TAXES & ASSESSMENTS REVENUES	**$2,310,567**
10-YEAR TOTAL PROJECTED REVENUES	**$50,166,078**
5-YEAR PROJECTION DISCOUNTED @ 3%	**$23,823,179**
10-YEAR PROJECTION DISCOUNTED @ 4%	**$42,439,359**

PERMANENT EMPLOYMENT IMPACT	
Direct Employment	110
Indirect Employment	103
TOTAL PERMANENT EMPLOYMENT	**213**

This analysis is only an estimate intended for internal use by City of Berkeley staff and elected officials.

Notes

* Excludes fees related to plan check, utilities, EIR traffic mitigations, and in lieu fees for street improvements, on-site open space, and parking
* Excludes calculations related to bank branch, which is assumed as no net impact