

TAX SHARING REPORT

PREPARED IN ACCORDANCE WITH SECTION 3.25.040 OF THE CATHEDRAL CITY MUNICIPAL CODE FOR ANALYSIS OF THE REQUEST FOR APPROVAL OF A TRANSIENT OCCUPANCY TAX SHARING AGREEMENT WITH MIRAGE BOB HOPE VARNER, LLC, FOR BEST WESTERN PLUS OR EQUIVALENT HOTEL BRAND AND THE CITY OF CATHEDRAL CITY

A Transient Occupancy Tax Sharing Report, as defined in Cathedral City Municipal Code (“CCMC”) Chapter 3.25, provides the fiscal analysis necessary to determine the current or projected revenue generated by an Applicant for a Transient Occupancy Tax (TOT) Sharing Agreement. This information is used to establish a “TOT Base” or historic benchmark for the TOT collected by the City from the subject hotel. After the TOT Base has been determined, projections of additional TOT revenue directly attributable to the development, expansion, or renovation of the hotel will be generated. The incremental difference between the TOT Base and the projected additional revenues represents a new source of income for the City, of which a portion could be shared with the business owner without a negative fiscal impact on City revenues.

If it can be demonstrated that the proposed improvements will result in community-wide benefit, often defined as additional revenues that can be used to provide municipal services, the City Council may choose to approve a TOT Sharing Agreement in order to incentivize the hotel owner/investor to complete the development, upgrades and/or improvements. This report identifies the financial data necessary to allow the City Council to reach a conclusion about the value and validity of an application for a TOT Sharing Agreement.

In accordance with CCMC Section 3.25.040(b), the following factors, together with any additional studies or reports requested by the City Council, shall be analyzed:

1. For Existing Hotels, the existing level of TOT generated by the facility, and the projected TOT to be generated after a planned expansion or renovation project; and
2. For New Hotels, the projected TOT to be generated by the new facility; and
3. For New and Existing Hotels, the amount of expected TOT increment to be generated by the renovation or construction; and
4. For New and Existing Hotels, the quality of the facility and services provided by the Hotel; and
5. For New and Existing Hotels, the total projected cost to construct the new Hotel or expand (renovate) the Existing Hotel; and
6. The necessity for public assistance.

Proposal

The Cathedral City TOT Sharing Program identifies specific criteria for participation by the Owner/Developer of a new Hotel. In accordance with CCMC Chapter 3.25.030, each participant must:

1. Be the Owner/Developer of an new Hotel that will be developed
2. Complete and submit an application for participation in the TOT Sharing Program
3. Be approved following a public hearing conducted by the City Council
4. Enter into a TOT Sharing Agreement in the form approved by the City Council
5. Execute and record against the Hotel property the Operating Covenants provided in CCMC Section 3.25.050
6. Execute an Indemnification Agreement in the form approved by the City

In this instance, Mirage Bob Hope Varner, LLC, (Applicant) is seeking assistance to develop a 4-story, 90-room, upper-midscale limited service hotel in the proposed Crossings at Bob Hope Center to be located

at the southeast corner of Bob Hope Drive and Varner Road (TPM 36619, Parcel 8). The City contracted with Keyser Marston Associates (KMA), an independent professional financial consultant, to evaluate financial data obtained from the Applicant and derived from industry standards, to project the expected gap, if any, between the Applicant's financial investment to complete the Project and projected future earnings to determine the necessity for participation in an economic incentive program. The Applicant was solely responsible for the cost of KMA's analysis. The analysis indicates development of the new Hotel will generate additional TOT revenue to the City and participation in a TOT Sharing Agreement will bring the economic return to be generated by the Project more in line with generally targeted returns for hotels similar to that being proposed.

Per City Ordinance No. 729, any proposed TOT sharing shall not exceed seventy-five (75) percent and ten (10) years unless City Council determines that additional assistance is warranted to achieve the City's goals. Based on the application submitted, discussions with the Applicant, and Council direction, the recommended Sales Tax Sharing Program is a reimbursement of fifty (50) percent of all incremental TOT revenue generated by the Hotel up to a total of \$1,438,800 over a maximum period of ten (10) years following completion of the improvements and acceptance by the City. Operating Covenants will require the Applicant to devote the property to the intended use for a period of ten (10) years after completion of the improvements.

Existing TOT Generation and Determination of TOT Base

All TOT revenues are general fund revenues of the City. Prior to its existence, TOT revenue was not generated by the Project. Therefore, the TOT base for the new hotel would be \$0.

Expected TOT Revenue

Projected revenue is based on room rate (approximately \$100 per night) and expected occupancy rates specific to a upper-midscale limited service hotel with freeway frontage and direct freeway access. KMA employed these factors to analyze projected TOT revenue to be generated over the next 10 years and has estimated that total to be \$2,877,300.

Quality of Facility & Services Provided

The Applicant is currently processing a land use application with the City for a conditional use permit to entitle the Hotel project. The Hotel is part of a larger commercial center entitled "The Crossings at Bob Hope" located at the southeast corner of Bob Hope Drive and Varner Road with direct freeway access via Bob Hope Drive. In addition to the Hotel, the Center will include several national commercial retailers, including Starbucks, McDonald's, Taco Bell, Subway, and Arco AMPM. The entire development is scheduled for Planning Commission consideration in May 2016.

The Hotel is proposed as a 4-story, 90-room, upper-midscale limited service hotel with a port cochere, outdoor pool, off-lobby lounge and eating area with breakfast offerings and daily snacks; a 10 to 20-person small conference space; and two large suites. The architecture is reflective of current-day hotel designs for similar-style projects. Average room rates will be \$100 per night. The financial analysis indicates that the proposed hotel development will result in TOT revenue totaling nearly \$3 million dollars over 10 years. It is anticipated that guests of the Hotel will support the neighboring food and convenience store establishments being developed within the Center.

Projected Construction and Costs

In preparing the site for development, the Applicant projects overall costs to be approximately \$13 million, including current and projected costs associated with the Project's proportionate share of the North City Extended Specific Plan preparation, annexation application, flood control measures, and other off-site improvement costs. The time and cost associated with providing the necessary

infrastructure to the unimproved Project area and complying with recent changes to the CVWD water flow map significantly exceeds early estimates by the Applicant.

Necessity of Public Assistance

In addition to constructing a new, 90-room hotel and bringing a Best Western Plus franchise to the City, the Applicant intends to partner with Manilal Patel, President of M.M.P. Properties, Inc., as the lead operator of the Hotel. Mr. Patel owns and manages several hotels ranging from 50 to 100 rooms and that include franchises such as Wyndham, IHG, Choice, and Best Western. Mr. Patel is building a Fairfield Inn by Marriott in Palm Desert, California and has recently opened a new Best Western Plus in Lancaster, California. Best Western has strong brand recognition with a national reservation system. The average room rate for the Cathedral City property is projected to be \$100 per night.

The new Hotel will serve to enhance the travel experience for visitors to the City and increase TOT revenue that might not otherwise be produced. Promoting and enhancing the economy of the City translates into new sources of revenue for the City's general fund, which supports public services the City provides to its residents and visitors. Having a new limited service hotel will provide freeway travelers and others another option for overnight stays within the City.

Within the past four years, the Applicant has invested a significant amount of time and resources in securing the property and prospective commercial retailers; obtaining approval of a new specific plan and adding the Project area to the City's corporate boundaries; preparing site design and development plans; and securing City and CVWD approvals. Development of the Hotel will further the Developer's ability to continue to participate in the public/private partnership for implementation of the required flood control facilities. Additionally, guests of the Hotel are anticipated to support the future adjacent retail. That retail and the Hotel itself will provide a return on the overall development investment. According to the Applicant, the Hotel will employ 15 permanent employees following the construction phase, which will also generate employment opportunities.

Developers of new, limited service hotels, according to KMA, currently seek economic returns (leveraged return on equity invested) in the mid-teens. The Applicant is projecting approximately \$13 million in site preparation and construction costs to complete the project. In assessing the Applicant's project proposal, anticipated development budget, and achievable net operating income, KMA concluded that the targeted return on investment could not be achieved without participation in the City's economic incentive program.

Table 1, Column A (Attachment 3) shows the Applicant's share of anticipated project cash flow, including the initial investment in the construction year (Year 0 - pre-operation), annual revenues (net of hotel operating expenses and loan payment), and hotel sales proceeds at Year 10. To calculate the leveraged return to the Applicant during the ten-year analysis period, hypothetical sales proceeds from the property in Year 10 are combined with the annual cash flow both before and after the proposed tax sharing. A City share of 50 percent of project-generated TOT for the first 10 years of operation brings the original expected 11.2 percent leveraged return to 13.8 percent, which is more in line with KMAs determination of expected developer returns for a hotel project of this type. The City's economic incentive program is performance driven; therefore, payments would cease upon totaling \$1,438,800 or at the end of the ten-year period, whichever occurs first. A total net increase of \$2,877,300 in TOT revenues from the Project to the City, prior to the proposed tax sharing, is projected through Year 10.

Project entitlements are anticipated to be received in May 2016. Pending City and CVWD approval of the final engineering and drainage design plans, construction of the flood control project will proceed and is estimated to take approximately eight months to complete. During this time, the Applicant will pursue building permit approvals from the City. The hotel construction, estimated to take twelve

months, would follow. Receipt of entitlements and consent to participate in the City's economic incentive program will provide the Applicant with the support necessary to pursue the hotel franchise, which in turn will further the Applicant's pursuit of the remaining project approvals and implementation of the required flood control facilities, which will also lead to development of the other commercial retailers in the Center.

In accordance with CCMC 3.25, the proposed public assistance through participation in the Tax Sharing Program, at a rate of 50 percent over the base year for a period of 10 years, is necessary to provide a Project more in line with a reasonably supportable development cost in relation to return on that investment.

Recommendation

Based on the contents of this Transient Occupancy Tax Sharing Report, the potential for public benefit and the request by the Applicant, staff recommends approval of the application for a TOT Sharing Agreement that reimburses fifty (50) percent of the annual TOT actually received by the City; that the total TOT reimbursement not exceed \$1,438,800 in total; that the length of the agreement not exceed ten (10) years pending completion of the development and acceptance by the City as stated in the TOT Sharing Agreement; and that the Operating Covenants require the Applicant to devote the property to the intended use for a period of ten (10) years after completion of the development.

Attachment

Table 1

TABLE 1

ESTIMATE OF CITY ASSISTANCE AND DEVELOPER CASH FLOW
 BEST WESTERN PLUS
 CATHEDRAL CITY

Year	A	B		C = B x 50%	D = A + C
	Developer Cash Flow	Projected Annual TOT to City @ 12.0%	City Assistance to Developer @ 50.0%	Grand Total Developer Cash Flow	
Construction - Developer Investment	(\$4,222,000)	\$0	\$0	(\$4,222,000)	
1	\$116,000	\$215,300	\$107,700	\$223,700	
2	\$305,000	\$242,900	\$121,500	\$426,500	
3	\$185,000	\$272,000	\$136,000	\$321,000	
4	\$276,000	\$280,200	\$140,100	\$416,100	
5	\$303,000	\$288,600	\$144,300	\$447,300	
6	\$332,000	\$297,300	\$148,700	\$480,700	
7	\$361,000	\$306,200	\$153,100	\$514,100	
8	\$392,000	\$315,400	\$157,700	\$549,700	
9	\$423,000	\$324,800	\$162,400	\$585,400	
10 - Hotel Sale	\$7,817,000	\$334,600	\$167,300	\$7,984,300	
Total	\$6,288,000	\$2,877,300	\$1,438,800		
Developer Leveraged IRR	11.2%	→	→	13.8%	