

STAFF REPORT

DATE: November 1, 2016
TO: City Council
FROM: Mike Webb, Assistant City Manager
Diane Parro, Chief Innovation Officer
SUBJECT: Hotel Background Information

Recommendation

This item is informational and is intended to assist in the consideration of the two hotel proposals that are on the same agenda under separate reports.

Fiscal Impact

Hotels generate significant revenue to the City of Davis through Transient Occupancy Taxes and Property Taxes generated on-site, as well as sales tax generated through purchases made by hotel guests. The 2015-16 budget assumes the City will collect \$1,270,000 in TOT from our eleven hotels.

The Finance and Budget Commission (FBC) reviewed the two pending hotel applications and concluded that each would likely result in a net fiscal benefit to the City of Davis. The Commission considered the analysis prepared by Commissioner Dan Carson in their deliberations, which is attached to this report for reference. Specifically, the Commission concluded that the estimated net fiscal benefit of either of these hotels is likely to be in the hundreds of thousands of dollars* annually with a one-time fiscal benefit of \$1.8-1.9 million in development and impact fees and construction tax revenue. Financial benefits to Davis Joint Unified School District, the local tourism district and the County of Yolo would be significant.

The rationale for the fiscal benefits is largely the same for each hotel based on the distinct similarity of the projects. If both hotel projects are approved, the fiscal benefits cannot be simply combined because, depending on the timing of the opening of each hotel, demand may be split until new customer demand is created and absorption is achieved. Eventually, the City can expect each hotel to produce the fiscal impact as estimated if market assumptions are realized.

**The Finance and Budget Commission did not provide a specific figure for either hotel because estimates of tax revenues are sensitive to assumptions about the occupancy and room rates.*

Council Goal(s)

This effort supports the following Goal/Objective/Task:

Goal: Drive Innovation and Economic Vitality

Objective: Develop Davis as a visitor destination

Background and Analysis

The Department of Community Development and Sustainability has received entitlement applications for construction of two extended stay hotels. One proposed hotel, Residence Inn, is on Second Street at Mace Boulevard and the other, Hyatt House, is on Cowell Boulevard.

To provide an analysis of the potential new supply of hotels rooms, a report *New Hotel Impact & Analysis* prepared under City contract by HVS, was presented to the City Council on March 15, 2016 ([HVS Report](#)). The key findings of the report suggest that the addition of a hotel conference center and one extended-stay hotel in the near-term would be beneficial to the City, other hotels, and the overall market and that the addition of a second extend-stay hotel would not benefit the market for four to five years after the initial extend-stay hotel opened.

This report is intended to provide updated information on hotels and the lodging market in Davis which have occurred since March, which may provide useful background in Council's review of the two pending hotel applications.

Topics included in this report are:

1. Changes in Davis hotel supply since March 2016
2. Demand generators
3. Transient Occupancy Tax
4. Potential locations in Davis zoned and available for hotel development

Davis Hotel Supply – not increasing as quickly as anticipated

- Embassy Suites Hotel & Conference Center
Although the construction and operation of this facility was considered as an assumption for the HVS study, no application for building permits has been submitted at this time.

City Council approved entitlements for the hotel conference facility at 1111 Richards Boulevard in summer 2015. The approved project involves replacement of the existing University Park Inn and Suites and Caffé Italia restaurant with a six-story 132-room Embassy Suites hotel and 13,772 square feet of conference space. Litigation was filed against the project, which is still pending. Although the litigation would not prevent issuance of building permits for the project as approved, an application has not been submitted. The timing on the project is unknown and nothing is likely to happen prior to the resolution of the litigation.

- Candlewood Suites
This spring, staff received an inquiry from the owner of an existing hotel considering expansion with additional extended-stay rooms and a second brand. No application was submitted, and staff does not believe the concept is being pursued at this time.

Demand Generators – unmet need for supply exists and will increase over time

- There are people attending UC Davis events but not staying in Davis hotels.

An informal poll of event planners at UC Davis on hotel needs was recently conducted by campus. We received the following information.

- Hotel Loyalty Programs – guests want to use loyalty programs and are not provided with all the choices in Davis. There are presently no Hyatt or Hilton hotels in the City of Davis, for example. Both brands have strong customer loyalty and associated programs.
- Amenities and services – guests want better appointed facilities (no details provided).
- Depending on the time of year, supply cannot accommodate all guests.
- 50% of event planners that responded (unknown number of respondents), replied that more hotel rooms are needed.
- 50% of respondents think there is enough demand for two new hotels (this is not explained any further).

Room type – The HVS study addresses the segment of the market that prefers an extend-stay room format and determines that demand for this segment is estimated to be 3,797 rooms in 2016 and the forecast calls for modest increases. All of the demand is currently unmet in our city.

- Golden 1 Arena
This new regional facility opened on September 20, 2016 and is 15 miles from downtown Davis which makes it well within our market. The venue opened with sold-out headliner concerts for Paul McCartney and Maroon 5, and the Sacramento Kings season opened there on October 18. 2016 has been a record high year for hotels in Sacramento with occupancy at 75.2% on average before the opening of the arena and while new hotels are in process in Sacramento, the unmet need could easily benefit Davis hotels.
- Sports Complex
On July 19, 2016 City Council approved moving forward with support for a community-based organization to pursue the development of a new sports complex. While in the earliest stages, this was a milestone and there is an expectation that some new/and or improved facilities will significantly increase the amount of tournament play which will have direct positive impact on demand for hotel rooms within the next few years.
- Expansion of UC Davis student body, faculty and staff populations
The UC Davis 2020 Initiative launched in 2011 called for increased enrollment of 5,000 students by the 2020 academic year and this increase to the student body is underway with a student body of 32,120 in the last academic year. In addition, the Long Range Development Plan (LRDP) for UC Davis, still in draft form, is planned for submittal to the Regents for approval in 2017. The LRDP calls for an increase of 6,870 students and 2,405 faculty/staff by the year 2027. While 2027 is the proposed completion deadline, projects will certainly be phased in with the potential for addition of students and employees to begin within a few years. This represents a substantial increase to the already large number of people that visit Davis to explore UC Davis as a possible university or employment option.

- Mace Ranch Innovation Center (MRIC)
This project was active in March 2016 and is not active at this time. While the project was projecting growth in the need for hotel space, it also included a hotel within the project, so the net impact on these current hotel proposals is not significant.
- Nishi Gateway Project
The Nishi Gateway Project ballot measure did not pass in June 2016 but was projected to have positive impact on the need for growth in the supply of hotel rooms. Because this was smaller than MRIC and included only a relatively small amount of square footage devoted to commercial/R&D, the demand for hotel rooms would not have been significant.

Transient Occupancy Taxes (TOT)

- Davis voters approved Measure B in June 2016 which increased the TOT from 10%-12%. The increase will go into effect on December 1, 2016. This was estimated to generate an additional \$240,000 per year in tax revenue which goes in to the City's general fund. The increase in TOT means that each hotel room now contributes more in tax revenue and this makes additional hotel rooms of increased benefit, particularly with a net positive room absorption over time and higher rate rooms
- Hotel stays of longer than 30 days are not subject to TOT collection. Staff has included conditions of approval in the Conditional Use Permits of the two proposals to limit hotels stays to no longer than 30 days to avoid the provision that allows for the collection of TOT to be discontinued after a stay of 30 days.

Potential Locations in Davis Zoned and Available for Hotel Development

The attached map highlights the eight locations in the City where hotels are permitted or conditionally permitted by current zoning. No vacant sites exist in the City that staff believes would accommodate a hotel, therefore any potential hotel development on these site(s) would require redevelopment of the property. Furthermore, no project proposals or interest in potential projects has been expressed to the City in hotels on any of these sites.

Options for City Council Action on Hotel Proposals

As the City Council undertakes review of the two hotel proposals, there is a range of potential actions that the City Council may consider. As both proposals include City legislative actions (General Plan and Zoning Amendments), the City has full discretion to consider the proposals without regard to the typical time limitations under the Permit Streamlining Act. However, if approved, a project will have an 18-month timeline for Conditional Use Permit, Final Planned Development and Design Review entitlements. Substantial construction must occur before the deadline, but an extension of up to an additional 18 months can be granted by the City and is not uncommon for larger projects.

It is important to take into account the uncertainties of development when considering the following options. It is common for projects to experience significant delays to completion due to complications securing financing, potential litigation, construction document preparation and processing, finalizing land acquisition, and construction.

The timing of the hotel projects may be the key determining factor in their successful entry in to the Davis market and the ability for the market to achieve absorption without substantial negative impacts to current hotels. Such project applications are not made lightly by the proponents and not without substantial investment in land acquisition/option costs, plan development, and entitlement processing. Such investments are also not made without confidence on the applicant's part that there is sufficient market demand to absorb the project.

The range of options for City Council action includes the following:

1. Approve application(s) with findings and conditions as set forth in the staff report(s), including any modifications that the Council may deem appropriate.
2. Deny application(s) with findings for denial (these findings would need to be crafted at the dais or a request made of staff to return to Council at a future meeting with draft denial findings). Davis Municipal Code states that if a proposal for rezoning or conditional use permit is denied a substantially similar proposal may not be proposed for a minimum of one year.
3. Request that an applicant(s) explore project changes as may be suggested by the Council, thereby continuing the hearing and returning at a later date for consideration. The City Council may establish timeframe parameters (minimum and maximum) for consideration of changes prior to the matter returning to the Council for action. Depending upon the scope of the changes staff would determine whether new public hearing notices would be required and whether Planning Commission review of the changes would be necessary. Unless the matter is continued to a date certain, new public hearings notices would be required.
4. Continue the application hearing(s) to a future date pending further information (examples include: Embassy Suites litigation/project status, additional data or market analysis, etc...).

Attachments

1. *Hyatt House Hotel Potential Fiscal Impact* by Dan Carson for the Finance and Budget Commission on August 14, 2016.
2. *Marriott Residence Inn Potential Fiscal Impact* by Dan Carson for the Finance and Budget Commission on September 1, 2016.
3. Map of City of Davis Zoning for Hotels

Date: August 14, 2016
From: Dan Carson
To: City of Davis Finance and Budget Commission
Subject: Hyatt House Hotel Potential Fiscal Impact

Quick Summary of Findings

- The Hyatt House project would financially benefit the city and local agencies. For example, it would likely result in a net fiscal benefit to the City of Davis of almost \$700,000 annually and one-time fiscal benefits exceeding \$1.8 million. Yolo County, the Davis Joint Unified School District, and a local tourism district would also benefit financially from the project.
- The estimate of hotel tax revenues from the project is sensitive to assumptions about the occupancy and room rates generated from the new hotel. The actual outcome could be higher or lower than estimated, perhaps by a couple hundred thousand dollars, on an ongoing basis.
- The Hyatt House project is unlikely to financially undermine other existing or approved hotels.
- The new hotel is almost certain to expand the city's overall hotel tax revenue base. City hotel tax revenues increased in recent years even in the wake of past hotel expansions by UC Davis outside of the city limits.
- Both the Hyatt House and a competing extended-stay hotel proposal may be able to move ahead in the Davis market, particularly if litigation over the Embassy Suites is resolved, allowing its conference center to move forward, and the growth planned for the UC Davis campus continues. However, this is a concern only if city policymakers determine that both projects meet written criteria adopted by the City Council, including the negotiation of development agreements with project applicants that could potentially provide additional benefits to the city from the project.
- If both extended-stay projects are found to warrant approval, city policymakers may wish to allow the private marketplace to determine, via its investment and financing decisions, whether both projects can proceed at the same time. In this event, the city should examine whether city ordinances and the development agreements provide the applicants sufficient flexibility to adjust the timing of their projects to ensure their success.

Background. Michelle Weiss, Alzeda Knickerbocker, and I recently convened as a subcommittee to explore various options to improve the city's revenue picture. One of the several options we discussed was pending development proposals to expand the number of hotels in the city and their potential net fiscal impact on city finances.

Since that meeting, I learned that one of those hotel proposals, a proposed Hyatt House in South Davis, was scheduled for its first hearing before the city Planning Commission on Aug. 24. I was also advised by city staff that a formal fiscal analysis of the proposal was not being prepared for Planning Commission and City Council consideration. (Staff does believe it is fiscally beneficial to the city.) Because this is a critical economic development and fiscal issue, I have prepared such an analysis of the Hyatt House.

In my prior 17-year career as a fiscal and policy analyst before I retired, I prepared many fiscal analyses. My volunteer analysis work on this matter, in my role as vice chair of the City of Davis Finance and Budget Commission, included the following steps:

- Reviewing documents describing the project, including materials received directly from the applicant and others posted on the city web site.
- Submitting detailed questions about the scope and finances of the project to the applicant and city staff.
- Analyzing available data on the local hotel marketplace, including various reports prepared by private consultants with expertise in the hotel industry. Some reports were prepared for hotel project applicants while another was prepared for the city.
- Analyzing relevant city budget and revenue data.

Hyatt House Project Would Financially Benefit the City and Local Agencies. Based on the available data, I find that the Hyatt House project is likely to result within a few years of its opening in a net ongoing fiscal benefit to the city of almost **\$700,000** annually. The main driver of these new revenues is the city's now-12% hotel tax (officially called the transient occupancy tax or TOT), although sales and property tax revenues would also contribute to an improved bottom line for the city. My analysis finds that the offsetting cost for the city to provide public services to the hotel site would be relatively minor in comparison to the anticipated new revenues the project would bring.

My analysis indicates that the project would likely result in a one-time fiscal benefit to the city of more than **\$1.8 million**. The project would likely generate development impact fees and construction tax revenues of this magnitude. Unknown additional one-time benefits to city government could result from forthcoming negotiations with the city over a development agreement for the hotel project.

In addition, my analysis indicates that the project would likely generate **\$105,000** in assessments for a local district created to promote tourism; **\$54,000** in additional property tax revenues for Yolo County; and **\$72,000** in additional property tax revenues and assessments for the Davis Joint Unified School District.

A table summarizing my findings and my analytical assumptions is below.

Mid-Range Estimates of Fiscal Impact of the Hyatt House Project		
<i>Ongoing City Revenues</i>		<i>Comments</i>
Property taxes	\$43,000	Assume construction cost of \$15 M (secured roll) plus \$2.75 M for furniture, fixtures, and equipment taxed (unsecured roll). Because property in Tax Rate Area 001-025 is in a former redevelopment area, the City of Davis is allocated 24% of "residual" property tax revenues generated in excess of the sums needed to retire redevelopment program debts.
Transient occupancy taxes (TOT)	629,000	Assumes average Davis hotel market occupancy rates and room rates estimated by HVS Consulting assuming no new hotel development (Scenario 1, page 67)
Sales taxes	38,000	Based on full 2% Bradley Burns plus Measure O sales tax rates and room revenues of \$3.8 M. Ongoing revenues after December 2020 expiration of Measure O will depend on future City Council and voter actions.
Subtotal	\$710,000	
<i>Ongoing City Costs</i>		
Additional marginal costs for police, fire, public administration, public works	18,000	Per-person served population = 95 (40 staff plus 150 guests based on average of 1.25 guests per room) / 2 to reflect that this population has lesser impact on city service costs than full-time residents. Using same cost assumptions FBC adopted for Nishi (\$436,000 total costs for 2,269 persons served or \$192.15 per person served), Hyatt House would generate public costs of \$192.15 x 95 persons served.
Net Ongoing Fiscal Impact on City of Davis	\$692,000	
<i>One-Time Fiscal Benefits for City</i>		
Construction tax	\$252,000	Fees are now set at \$3.34 per SF for commercial construction under automatic inflation adjustments. Building size is 75,490 SF. Under the Municipal Code, revenues are placed in a special fund but can be used "for any public purpose" authorized by the City Council.
Development impact fees	1,527,000	Under the Municipal Code, fee proceeds shall be used to pay for public improvements to implement the city General Plan -- giving the city broad discretion over their use. Based on fee schedule for South Davis after Mello-Roos credits for CFD 1990-4. Includes fees for roadways, storm sewer, parks, open space, public safety, and general facilities = \$20,223 per 1,000 SF with project of 75,490 SF. Does not include water or sewer hookup fees or other mitigation or permit fees not available for general city purposes.
Sales tax revenues from project construction	\$55,000	Applicant estimates \$2.75 M in taxable sales from construction. Assumes 2% sale tax rate for city.
Community enhancement funds	Unknown	Subject to negotiation in pending development agreement
Total one-time fiscal benefits	\$1,834,000	
<i>Ongoing Revenues to Other Local Agencies</i>		
Visitor Attraction Business Improvement District	\$105,000	2% assessment on room revenues for special district created by city ordinance in 2000. Proceeds used by Yolo County Visitors Bureau to promote Davis tourism.
Yolo County	\$54,000	Includes County General Fund, County ACO Fund, and County Library, which receive a combined 30.3% of property tax allocations in Tax Rate Area 001-025.
Davis Joint Unified School District (DJUSD)	\$72,000	DJUSD would be allocated 38.4% of "residual" property tax revenues from estimated increase in assessed values (\$68,000). In addition, DJUSD would receive an additional \$3,500 in special assessments. Another 28.7% or \$51,000 used to support the state's Proposition 98 obligation for local public schools, in effect freeing up funding for other state programs.
SF=square foot		

These estimates are expressed in current dollars, but are intended to represent the fiscal impacts of the project once fully operational within a few years of opening. In general, with the exception of sales tax receipts, the nominal dollar amounts of revenues generated would grow over time. For example, construction tax rates are automatically adjusted each year for inflation. The approach used in this report is intended to give policymakers a better idea of what the fiscal benefits of the project are worth today.

These estimates represents a mid-range projection of both the ongoing and one-time net fiscal impacts on the city. In other words, these estimates represent my best effort to deliberately gauge the true fiscal impact of the project, and were not deliberately adjusted to be either conservative or optimistic.

TOT Estimate Sensitive to Occupancy and Rate Assumptions. One highly sensitive set of assumptions are the occupancy and room rates generated from the new hotel, because these directly affect the calculation of TOT revenues. The actual revenues generated from the project thus could be higher or lower than the estimate made here.

I am advised by the applicants that the overall Davis hotel market is currently achieving 71% occupancy and an Average Daily Rate of \$123 per room. If this average result occurred at the newly constructed Hyatt House, city TOT revenues would be about \$460,000 annually, by my estimate.

However, the brand name, location, and amenities of the new hotel would give it an advantage within the Davis hotel marketplace over other hotel properties. For example, the existing Hyatt Place hotel on the UC Davis campus, which is generally comparable in size and proximity to downtown Davis to the proposed new Hyatt House hotel, is reportedly operating at 86% occupancy with a much higher Average Daily Rate of \$162 per room. If this result occurred at a newly constructed Hyatt House, I estimate that city TOT revenues from that project could reach \$730,000 annually.

PKF Consulting, the hotel industry experts retained by the Hyatt House project applicant, projected last year that the new hotel would eventually achieve 78% occupancy and an Average Daily Rate of \$186 per room because of its high-quality construction, location near I-80, and brand affiliation. If that were the result, I estimate that city TOT revenues would be about \$767,000 annually.

A separate study prepared for the City of Davis by another hotel consulting firm, HVS Consulting and Valuation, analyzed the PKF report and found its conclusions about occupancy and room rates “slightly aggressive but not entirely unreasonable.” HVS noted that PKF assumed the timely development of the Embassy Suites hotel (still the subject of litigation), the Panattoni office complex in South Davis (no longer an active development proposal), and the Nishi Gateway project (which in June was defeated in a citywide vote on Measure A). On the other hand, HVS estimated that in the absence of any new hotel development, improving economic trends would lead to an Average Daily Rate of \$154 per room and a 77.6% occupancy rate in the overall market by 2021. If the Hyatt House achieved these estimated occupancy and room rates, I estimate that it would generate \$629,000 in annual TOT revenues.

Consistent with my overall approach of providing a mid-range analysis, I assumed for the purposes of this analysis that \$629,000 in additional TOT revenues would be achieved by the Hyatt House project, consistent with the HVS estimate of average occupancy and room rates. My assumption effectively takes into account (a) the uncertain timing and approval of other pending hotel projects, (b) the uncertain timing for resolution of

litigation relating to the Embassy Suites hotel and convention center (discussed further below), (c) the maturity of the current eight-year economic recovery and the risk of another recession will eventually occur, and (d) the setback for the nearby Nishi Gateway innovation center project, which could have generated additional hotel room demand.

However, the occupancy and room rates assumed in my calculations of TOT revenues from the Hyatt House are still substantially higher than those existing in the Davis marketplace today. This is justified, in my view, because of (e) the strong likelihood of continued growth in the student population, staff, and research activities at UC Davis in the coming years, which will lead to additional hotel demand, and (f) strong underlying growth in the national, regional and local hotel industry (discussed further below), as shown by the commercial success of Hyatt Place on the UC Davis campus.

Hyatt Project Unlikely to Financially Undermine Other Existing or Approved Hotels.

One question that the City Council has discussed over the past year is the potential impact of additional hotel project projects, such as the Hyatt House, on the city's existing stock of hotel properties. Another area of inquiry has been the potential impact of Hyatt House on an additional project, a new 132-room Embassy Suites hotel and conference center, that would take the place of the existing 45-room University Park Inn & Suites on Richards Boulevard. That project has been approved by the City Council but is currently the subject of a legal challenge in the courts over environmental impact review issues.

My analysis indicates that, while the development of Hyatt House obviously could affect room rates and occupancy rates of other city hotels or the planned new Embassy Suites, the completion of the new hotel project is highly unlikely to fundamentally undermine the ability of these competitors to operate successfully in the Davis market.

Here are some of the key reasons for my conclusions:

- Most of the new hotel rooms that would be added at Hyatt House are extended-stay rooms with kitchens and other amenities, a new type of hotel space not now available at competing hotels. This would substantially mitigate the competition with existing hotel properties and attract visitors who are now staying outside the Davis market.
- Following setbacks in the wake of the severe 2008 recession, the hotel industry is booming in the Davis market, the region, and nationally. Occupancy rates and hotel room rates are rising strongly. A strong tourism economy could help ease the transition of Hyatt House into the Davis marketplace.
- The planned continued expansion of UC Davis is another important factor driving hotel growth in the local market and could smooth the entry of a new hotel into the market.
- Depending upon how quickly the Embassy Suites litigation is resolved, it is possible that additional Hyatt House rooms could be added to the Davis market

during the period that the existing University Park Inn & Suites rooms have been taken off the Davis market to make way for the new, larger hotel on the site.

- If the Embassy Suites case is resolved soon and is able to proceed in a timely manner, the development of the conference center will drive significant additional hotel business that would well exceed the new beds that Hyatt House would bring to the market. The Hyatt House applicants' hotel industry expert concluded that the 18,000 square feet of new conference space at Embassy Suites could draw 500 to 1,000 attendees. A hotel with that amount of meeting space would typically feature 350 to 400 guestrooms, the consultant said, rather than the 132 planned for Embassy Suites. That means other hotels, including Hyatt House, could accommodate those new guests without undermining other existing hotels, including Embassy Suites itself.

New Hotel Likely to Expand City Hotel Tax Revenue Base. City policy-makers have also explored what impact the proposed Hyatt House hotel expansion might have on city TOT revenues. My analysis indicates that the addition of the new hotel would almost certainly result in a significant net increase in city TOT revenues, even after taking into account the risk of a modest temporary reduction in the receipt of hotel taxes from competing hotels.

I analyzed how City of Davis hotel tax revenues were affected by the opening of a 75-room Hyatt Place hotel on the UC Davis campus in March 2010. Because that hotel is outside the city limits, that new hotel generated no hotel tax revenue for the City of Davis but potentially could have affected the TOT revenues the city received from the competing hotels within the city limits.

However, the data shows that the new hotel did not harm city finances. Whatever impacts may have been experienced by particular hotels, as the table below shows, City of Davis TOT revenues in the aggregate grew 5% in the first full fiscal year after the Hyatt Place opened and continued to grow thereafter. No existing hotels within the city limits closed their doors as a result of the entry of this new competitor. The same result was evident when Hyatt Place expanded by 52 rooms in March 2014. City of Davis TOT revenues grew 5.5% in the following fiscal year. This can also be seen in the table below.

The evidence suggests that the additional TOT revenue generated by the Hyatt House is highly likely to outweigh any potential loss of city TOT revenue from any reduction in business for its competitors. The entry of a higher-end hotel into the market might even induce some competitors to bolster their rates, further increasing city TOT revenues.

How Did UC Davis' Hotel Affect City of Davis Hotel Tax Revenues?				
	Occupied rooms in Davis hotel market (a)		City of Davis TOT revenue	Notes
2007	128,272	2007-08	\$1,120,983	
2008	122,117	2008-09	\$1,031,031	
2009	115,129	2009-10	\$912,456	March 2010 Hyatt Place opens with 75 rooms
2010	126,794	2010-11	\$958,434	5% increase in city TOT revenues
2011	147,872	2011-12	\$1,050,157	
2012	150,767	2012-13	\$1,436,067	
2013	159,025	2013-14	\$1,250,725	March 2014 Hyatt Place expands by 52 rooms
2014	176,473	2014-15	\$1,319,909	5.5% increase in city TOT revenues
(a) Source: STR Inc. (as quoted by PKF, p. 16, "Proposed HYATT House -- Davis, CA"). Includes Hyatt Place				
(b) Source: Comprehensive Annual Financial Reports				

Could Davis Sustain Two Extended-Stay Projects? Still another extended-stay hotel project, Marriott Residence Inn, is being proposed near Mace Boulevard north of Interstate 80. A consultant retained by the city has questioned whether the Davis market is sufficient at this time to simultaneously support the development of both that project and the Hyatt House project, and raised the question of whether one of the two extended-stay hotel projects should be delayed for a few years.

This potential for an overcrowded extended-stay market becomes a concern, of course, only if either or both projects are found to meet environmental and other written criteria adopted by the City Council last spring for consideration of new hotels. This analysis defers to city staff, the Planning Commission, and the City Council regarding whether either or both of the two proposed projects meet these criteria, which include the negotiation of development agreements with project applicants that could potentially provide additional benefits to the city.

However, if both projects are found to meet the city's criteria, the available evidence suggests that it is possible that both projects could succeed in the Davis market, especially if litigation is resolved so as to allow the Embassy Suites conference center to proceed and create significant new hotel room demand for the local market. The continued growth planned at UC Davis could also expand the hotel market to the point where two new hotels could be sustained.

If city policymakers decide both projects meet city land-use and other criteria and are worthy of approval, they may wish to let the private marketplace, via its investment and financing decisions, determine whether one or both projects are warranted in the Davis market. Private lenders and investors are much better suited than city policymakers to evaluate the financial strengths and capabilities of competing project applicants.

My analysis finds little downside for the city in taking this approach, given the potential economic benefits to the city from these projects. The risk of a reduction in city TOT revenues is low and TOT revenues are a relatively small share of the city's overall General Fund revenue base.

However, if the city takes this approach, it may wish to consider whether current city ordinances and the development agreements it negotiates with the two applicants allow them sufficient flexibility over their phasing of the development of their projects, should they choose to coordinate their efforts.

Conditional use permits, such as the one sought for the Hyatt Hotel project, ordinarily have a life of 18 months, but can be extended by city staff for an additional 18 months. City policymakers may wish to consider whether this time window is sufficient if two extended-stay hotel projects are allowed to move ahead now. The city may wish to consider whether specific provisions should be included in any hotel development agreements, or whether changes should be adopted in city ordinances governing such projects, to allow additional flexibility in the delivery of such projects after they have been approved.

Date: September 1, 2016
From: Dan Carson
To: City of Davis Finance and Budget Commission
Subject: Marriott Residence Inn Potential Fiscal Impact

Quick Summary of Findings

- The Marriott Residence Inn project would financially benefit the city and local agencies. For example, it would likely result in a net fiscal benefit to the City of Davis of more than **\$600,000** annually and one-time fiscal benefits of almost **\$1.9 million**. Yolo County, the Davis Joint Unified School District, and a local tourism district would also benefit financially from the project.
- The estimate of hotel tax revenues from the project is sensitive to assumptions about the occupancy and room rates generated from the new hotel. The actual outcome could be higher or lower than estimated, perhaps by a couple hundred thousand dollars, on an ongoing basis.
- The Marriott Residence Inn project is unlikely to financially undermine other existing or approved hotels, in part because it is a new type of product in the Davis hotel marketplace (extended-stay) that is likely to be priced much higher than many existing hotels.
- The new hotel is almost certain to expand the city's overall hotel tax revenue base. City hotel tax revenues increased in recent years even in the wake of past hotel expansions by UC Davis outside of the city limits.
- Both the Marriott Residence Inn and a competing extended-stay hotel proposal may be able to move ahead in the Davis market, particularly if litigation over the Embassy Suites is resolved, allowing its conference center to move forward, and the growth planned for the UC Davis campus continues. However, this is a concern only if city policymakers determine that both projects are an appropriate land use and that both meet written criteria adopted by the City Council for such projects, such as the negotiation of development agreements that could potentially provide additional benefits to the city from the projects.
- If both extended-stay projects are found to warrant approval, city policymakers may wish to allow the private marketplace to determine, via its investment and financing decisions, whether both projects can proceed at the same time. In this event, the city should examine whether city ordinances and the development agreements provide the applicants sufficient flexibility to adjust the timing of their projects to ensure their success.

Background. I recently provided all of you with an analysis of the Hyatt House extended-stay hotel proposal. The Planning Commission conducted a public hearing on that proposal on August 24, but continued the hearing until September 14. Meanwhile, city staff is also scheduling a Planning Commission hearing on a separate extended-stay Marriott hotel project for September. Both projects are expected to reach the City Council for consideration in October.

Giving this timing, we have an opportunity on the Finance and Budget Commission to advise policymakers regarding the potential fiscal impacts of both of these projects. The potential for helping to address the city's long-term fiscal liabilities with economic development via such hotel projects has been one of the items that Alzada Knickerbocker, Michelle Weiss, and I have discussed in our Revenues Subcommittee. Accordingly, I decided to undertake a similar analysis of the Marriott project to further inform our discussion.

My volunteer analysis work on this matter included the following steps:

- Reviewing documents describing the project, including materials received directly from the applicant and others posted on the city web site.
- Submitting detailed questions about the scope and finances of the projects to the applicants and city staff.
- Analyzing available data on the local hotel marketplace, including various reports prepared by private consultants with expertise in the hotel industry. Some reports were prepared for hotel project applicants while another was prepared for the city.
- Analyzing relevant city budget and revenue data.

Marriott Project Would Financially Benefit the City and Local Agencies. Based on the available data, I find that the Marriott project is likely to result within a few years of its opening in a net ongoing fiscal benefit to the city of more than **\$600,000** annually. The main driver of these new revenues is the city's now-12% hotel tax (officially called the transient occupancy tax or TOT), although property tax revenues would also contribute to an improved bottom line for the city. My analysis finds that the offsetting cost for the city to provide public services to the hotel site would be relatively minor in comparison to the anticipated new revenues the project would bring.

My analysis indicates that the project would likely result in a one-time fiscal benefit to the city of almost **\$1.9 million**. The project would likely generate development impact fees and construction tax revenues of this magnitude.

In addition, my analysis indicates that the project would likely generate **\$105,000** in assessments for a local district created to promote tourism; **\$19,000** in additional property tax revenues for Yolo County; and **\$72,000** in additional property tax revenues and assessments for the Davis Joint Unified School District.

A table summarizing my findings and my analytical assumptions is below.

Mid-Range Estimates of Fiscal Impact of the Marriott Residence Inn		
		Comments
<i>Ongoing City Revenues</i>		
Property taxes	\$29,000	Assume construction cost of \$13.8 M (secured roll) plus \$1.8 M for furniture, fixtures, and equipment (FFE) (unsecured roll), plus increase in assessed value for purchase of site. According to Yolo County Finance Department, in Tax Rate Area 001-030, the City of Davis is allocated 16.9% of property tax revenues generated under Prop. 13.
Transient occupancy taxes (TOT)	629,000	Assumes average Davis hotel market occupancy rates and room rates estimated by HVS Consulting assuming no new hotel development (Scenario 1, page 67)
Subtotal	\$658,000	
<i>Ongoing City Costs</i>		
Additional marginal costs for police, fire, public administration, public works	42,000	Per-person served population = 216 (30 staff plus 186 guests based on average of 2.0 guests per room) and 77.6% occupancy rate / 2 to reflect that this population has lesser impact on city service costs than full-time residents. Using same cost assumptions FBC adopted for Nishi (\$436,000 total costs for 2,269 persons served or \$192.15 per person served), Hyatt House would generate public costs of \$192.15 x 216 persons served.
Net Ongoing Fiscal Impact on City of Davis	\$616,000	
<i>One-Time Fiscal Benefits for City</i>		
Construction tax	\$264,000	Fees are now set at \$3.34 per SF for commercial construction under automatic inflation adjustments. Building size is 78,953 SF. Under the Municipal Code, revenues are placed in a special fund but can be used "for any public purpose" authorized by the City Council.
Development impact fees	1,554,000	Under the Municipal Code, fee proceeds shall be used to pay for public improvements to implement the city General Plan -- giving the city broad discretion over their use. Based on fee schedule for Mace Ranch after Mello-Roos credits for CFD 1990-2. Includes fees for roadways, storm sewer, parks, open space, public safety, and general facilities = \$19,685 per 1,000 SF with project of 78,953 SF. Does not include water or sewer hookup fees or other mitigation or permit fees not available for general city purposes.
Sales tax revenues from project construction	\$36,000	Applicant estimates \$1.8 M in FFE. Assumes 2% sale tax rate for city.
Community enhancement funds	Unknown	Subject to negotiation
Total one-time fiscal benefits	\$1,854,000	
<i>Ongoing Revenues to Other Local Agencies</i>		
Visitor Attraction Business Improvement District	\$105,000	2% assessment on room revenues for special district created by city ordinance in 2000. Proceeds used by Yolo County Visitors Bureau to promote Davis tourism.
Yolo County	\$19,000	Includes County General Fund, County ACO Fund, and County Library, which receive a combined 10.9% of property tax allocations in Tax Rate Area 001-030.
Davis Joint Unified School District (DJUSD)	\$72,000	DJUSD would receive 40.1% of property tax allocations in Tax Rate Area 001-030. In addition, DJUSD would receive an additional \$3,400 in special assessments. Another 21.8% or \$37,000 used to support the state's Proposition 98 obligation for local public schools, in effect freeing up funding for other state programs.
SF=square foot; M = million		

These estimates are expressed in current dollars, but are intended to represent the fiscal impacts of the project once fully operational within a few years of opening. In general, with the exception of sales tax receipts, the nominal dollar amounts of revenues generated would grow over time. For example, construction tax rates are automatically adjusted each year for inflation. The approach used in this report is intended to give policymakers a better idea of what the fiscal benefits of the project are worth today.

These estimates represent a mid-range projection of both the ongoing and one-time net fiscal impacts on the city. In other words, these estimates represent my best effort to deliberately gauge the true fiscal impact of the project, and were not deliberately adjusted to be either conservative or optimistic.

TOT Estimate Sensitive to Occupancy and Rate Assumptions. One highly sensitive set of assumptions are the occupancy and room rates generated from the new hotel, because these directly affect the calculation of TOT revenues. The actual revenues generated from the project thus could be higher or lower than the estimate made here.

I am advised that the overall Davis hotel market is currently achieving 71% occupancy and an Average Daily Rate of \$123 per room. If this average result occurred at the newly constructed 120-room Marriott, city TOT revenues would be about \$460,000 annually, by my estimate.

However, the brand name, location, and amenities of the new hotel would give it an advantage within the Davis hotel marketplace over other hotel properties. For example, the existing Hyatt Place hotel on the UC Davis campus, which is generally comparable in size to the proposed new Marriott hotel, is reportedly operating at 86% occupancy with a much higher Average Daily Rate of \$162 per room. If this result occurred at a newly constructed Marriott, I estimate that city TOT revenues from that project could reach \$730,000 annually.

PKF Consulting, hotel industry experts retained by the Hyatt House applicant, projected last year that the Hyatt House would eventually achieve 78% occupancy and an Average Daily Rate of \$186 per room because of its high-quality construction, location near I-80, and brand affiliation. PKF was separately retained by the Marriott applicants to analyze the potential impact of their project on the overall Davis hotel marketplace. The published report does not specify the rates that the new Marriott hotel would likely achieve once it achieved full operation. However, Marriott representatives advised me that the Marriott project could likewise achieve the 78% occupancy and an Average Daily Rate of \$186 per room projected by PKF for Hyatt House. If that were the result, I estimate that city TOT revenues would be about \$767,000 annually from the Marriott Residence Inn.

Two separate studies of the Davis hotel marketplace were prepared earlier this year under contract with the city of Davis by another firm with hotel industry expertise, HVS Consulting and Valuation. HVS noted that the PKF analyses, which are dated April and June 2015, assumed the timely development of the Embassy Suites hotel (still the subject of litigation), the Panattoni office complex in South Davis (not currently an active development proposal), and the Nishi Gateway project (which in June was defeated in a citywide vote on Measure A). On the other hand, HVS projected that in the absence of any new hotel development, improving economic trends would nonetheless lead to an Average Daily Rate of \$154 per room and a 77.6% occupancy rate in the overall market by 2021. If the Marriott achieved these estimated average occupancy and room rates for the Davis market, I estimate that it would generate \$629,000 in annual TOT revenues.

Consistent with my overall approach of providing a mid-range analysis, I assumed for the purposes of this analysis that \$629,000 in additional TOT revenues would be achieved by the Marriott project, consistent with the HVS estimate of average occupancy and room rates. My assumption effectively takes into account (a) the uncertain timing and approval of other pending hotel projects, (b) the uncertain timing for resolution of litigation relating to the Embassy Suites hotel and convention center (discussed further below), (c) the maturity of the current eight-year economic recovery and the risk of another recession will eventually occur, (d) the setback for the nearby Nishi Gateway innovation center project, which could have generated additional hotel room demand, and (e) the possibility

that a small portion of long-term and other guests would be exempt under state law and city ordinance from paying TOT.

However, the occupancy and room rates assumed in my calculations of TOT revenues for the Marriott are still substantially higher than those existing in the Davis marketplace today. This is justified, in my view, because of (f) the strong likelihood of continued growth in the student population, staff, and research activities at UC Davis in the coming years, which will lead to additional hotel demand, and (g) strong underlying growth in the national, regional, and local hotel industry (discussed further below), as shown by the commercial success of Hyatt Place on the UC Davis campus.

Marriott Unlikely to Financially Undermine Other Existing or Approved Hotels. One question that the City Council has discussed over the past year is the potential impact of additional hotel project projects, such as the Marriott, on the city's existing stock of hotel properties. Another area of inquiry has been the potential impact on an additional project, a new 132-room Embassy Suites hotel and conference center, that would take the place of the existing 45-room University Park Inn & Suites on Richards Boulevard. That project has been approved by the City Council but is currently the subject of a legal challenge in the courts over environmental impact review issues.

My analysis indicates that, while the development of Marriott obviously could affect room rates and occupancy rates of other city hotels or the planned new Embassy Suites, the addition of the Marriott is highly unlikely to fundamentally undermine the ability of these competitors to operate successfully in the Davis market.

Here are some of the key reasons for my conclusions:

- The new hotel rooms that would be added at Marriott are extended-stay rooms with kitchens and other amenities, a new type of hotel space not now available at other competing existing or approved hotels. The new rooms also are likely to be available for as much as double the rates now being asked by surrounding properties, such as Day's Inn in South Davis. This would substantially mitigate the competition with existing hotel properties and attract new visitors who are now staying outside the Davis market.
- Following setbacks in the wake of the severe 2008 recession, the hotel industry is booming in the Davis market, the region, and nationally. Occupancy rates and hotel room rates are rising strongly. A strong tourism economy could help ease the transition of Marriott into the Davis marketplace.
- The planned continued expansion of UC Davis is another important factor driving hotel growth in the local market and could smooth the entry of a new hotel into the market.

- Depending upon how quickly the Embassy Suites litigation is resolved, it is possible that additional Marriott rooms could be added to the Davis market during the period that the existing University Park Inn & Suites rooms have been taken off the Davis market to make way for the new, larger hotel on the site.
- If the Embassy Suites case is resolved soon and is able to proceed in a timely manner, the development of the conference center will drive significant additional hotel business that would well exceed the new beds that Marriott would bring to the market. The Hyatt House applicants' hotel industry expert concluded that the 18,000 square feet of new conference space at Embassy Suites could draw 500 to 1,000 attendees. A hotel with that amount of meeting space would typically feature 350 to 400 guestrooms, the consultant said, rather than the 132 planned for Embassy Suites. That means other hotels, including Marriott, could accommodate those new guests without undermining other existing hotels, including Embassy Suites itself.

New Hotel Likely to Expand City Hotel Tax Revenue Base. City policy-makers have also explored what impact the proposed new hotels might have on city TOT revenues. As I indicated to you in my prior memo about the Hyatt House proposal, my analysis indicates that the addition of the Marriott Residence Inn would almost certainly result in a significant net increase in city TOT revenues, even after taking into account the risk of a modest temporary reduction in the receipt of hotel taxes from competing hotels.

I analyzed how City of Davis hotel tax revenues were affected by the opening of a 75-room Hyatt Place hotel on the UC Davis campus in March 2010. Because that hotel is outside the city limits, that new hotel generated no hotel tax revenue for the City of Davis but potentially could have affected the TOT revenues the city received from the competing hotels within the city limits.

However, the data shows that the new hotel did not harm city finances. Whatever impacts may have been experienced by particular hotels, as the table below shows, City of Davis TOT revenues in the aggregate grew 5% in the first full fiscal year after the Hyatt Place opened and continued to grow thereafter. No existing hotels within the city limits closed their doors as a result of the entry of this new competitor. The same result was evident when Hyatt Place expanded by 52 rooms in March 2014. City of Davis TOT revenues grew 5.5% in the following fiscal year. This can also be seen in the table below.

The evidence suggests that the additional TOT revenue generated by the Marriot is highly likely to outweigh any potential loss of city TOT revenue from any reduction in business for its competitors. The entry of a higher-end hotel into the market might even induce some competitors to bolster their rates, further increasing city TOT revenues.

Last Major Hotel Expansions and City Hotel Tax Revenues				
	Occupied rooms in Davis hotel market (a)		City of Davis TOT revenue	Notes
2007	128,272	2007-08	\$1,120,983	
2008	122,117	2008-09	\$1,031,031	
2009	115,129	2009-10	\$912,456	March 2010 Hyatt Place opens with 75 rooms
2010	126,794	2010-11	\$958,434	5% increase in city TOT revenues
2011	147,872	2011-12	\$1,050,157	
2012	150,767	2012-13	\$1,436,067	
2013	159,025	2013-14	\$1,250,725	March 2014 Hyatt Place expands by 52 rooms
2014	176,473	2014-15	\$1,319,909	5.5% increase in city TOT revenues
(a) Source: STR Inc. (as quoted by PKF, p. 16, "Proposed HYATT House -- Davis, CA"). Includes Hyatt Place				
(b) Source: Comprehensive Annual Financial Reports				

Could Davis Sustain Two Extended-Stay Projects? As I noted in my earlier memo, a consultant retained by the city has questioned whether the Davis market is sufficient at this time to simultaneously support the development of both the Marriott and the Hyatt House projects, and raised the question of whether one of the two extended-stay hotel projects should be delayed for four or five years.

This potential for an overcrowded extended-stay market becomes a concern, of course, only if either or both projects are found to meet environmental and other written criteria adopted by the City Council last spring for consideration of new hotels. This analysis defers to city staff, the Planning Commission, and the City Council regarding whether either or both of the two proposed projects meet these criteria. A draft of the council resolution containing those criteria for both the Hyatt House and Marriott projects, is attached. (Notably, the criteria reference the negotiation of development agreements with project applicants that could potentially provide additional revenue to the city.)

If both projects are found to meet the city's land-use rules and the written criteria, the available evidence suggests that it is possible that both projects could succeed in the Davis market, especially if litigation is resolved so as to allow the Embassy Suites conference center to proceed and create significant new hotel room demand for the local market. The continued growth planned at UC Davis could also expand the hotel market to the point where two new hotels could be sustained.

If city policymakers decide both projects meet city land-use and other criteria and are worthy of approval, they may wish to let the private marketplace, via its investment and financing decisions, determine whether one or both projects are warranted in the Davis market. Private lenders and investors are much better suited than city policymakers to evaluate the financial strengths and capabilities of competing project applicants.

My analysis finds little downside for the city in taking this approach, given the potential economic benefits to the city from these projects. The risk of a reduction in city TOT revenues is low and TOT revenues are a relatively small share of the city's overall General Fund revenue base.

However, if the city takes this approach, it may wish to consider whether current city ordinances and the development agreements it negotiates with the two applicants allow them sufficient flexibility over their phasing of the development of their projects, should they choose to coordinate their efforts.

Conditional use permits, such as the one sought for the Marriott project, ordinarily have a life of 18 months, but can be extended by city staff for an additional 18 months. City policymakers may wish to consider whether this time window is sufficient if two extended-stay hotel projects are allowed to move ahead now. The city may wish to consider whether specific provisions should be included in any hotel development agreements, or whether changes should be adopted in city ordinances governing such projects, to allow additional flexibility in the delivery of such projects after they have been approved.

Attachment

RESOLUTION NO. _____, SERIES 2016

**RESOLUTION OF THE ESTABLISHING CRITERIA FOR EVALUATION OF
HOTEL PROPOSALS**

WHEREAS, the City has received applications for land-use entitlements for hotels in east and south Davis; and

WHEREAS, the City Council goals for FY 2014-16 include the tasks to facilitate development of a hotel conference center and to conduct comprehensive analysis of hotel market in Davis and multiple proposals.

WHEREAS, the City Council has reviewed an analysis of the capacity of the Davis hotel market to absorb additional hotel rooms, particularly extended stay rooms.

NOW, THEREFORE, BE IT RESOLVED that the Davis City Council:

1. Approves the following criteria for evaluation of hotel proposals:

Site

- A Proximity to demand generators, including international businesses, sports facilities, and UC Davis.
- B Pedestrian and bicycle access and accommodations, including loaner bicycles
- C Visibility and accessibility from Interstate 80.
- D Site location, product characteristics and amenities, and desirability for extended stay travelers (restaurants, groceries, neighborhood services, etc.)

Project

- E Sustainability, including commitment to CalGreen Tier 1. LEED Gold or higher is encouraged. Desirable components could be on-site generation of renewable energy, water conservation practices, LED lighting, and similar measures.
- F High-profile brand not provided elsewhere in the City of Davis
- G Transportation demand management commitments, including a shuttle service to airport and conference facilities
- H Anticipated revenue to the City of Davis (including TOT, property tax, sales tax, and Development Agreement commitments)
- I Commitment to high-quality architectural treatments that reflect the community and neighborhood context
- J Integration of project amenities such as public art.

Developer

- K Demonstrated team experience and capability for both the development and operation of a first-rate hotel facility

- L. Demonstrated financial capacity for project delivery, if approved;
- 2. Affirms that these criteria will supplement the customary planning entitlement review considerations of plan consistency, zoning standards, CEQA review, and urban form.

PASSED AND ADOPTED on this 19th day of April, 2016, by the following vote:

AYES:

NOES:

ABSENT:

Daniel M. Wolk
Mayor

ATTEST:

Zoe Mirabile, CMC
City Clerk

Hotel Zoning



Areas where hotel uses are permitted
 or conditionally permitted by zoning*.

*None of the areas on this map identified for hotel uses contain vacant sites that staff believes would accommodate a hotel.