KEYSER MARSTON ASSOCIATES
ADVISORS IN PUBLIC/PRIVATE REAL ESTATE DEVELOPMENT

DRAFT
MEMORANDUM

Attorney, Client and Work Product Privilege
(Evid. Code, Sec 950 et.seq.; Code Civ .Proc. Sec. 2018

To: Dylan Johnson, City Attorney for Carpinteria
Brownstein, Hyatt, Farber & Schreck

From: Kevin Engstrom
James Rabe

Date: June 21, 2016

Subject: Draft Carpinteria Hotel Financial Analysis

Pursuant to your request, Keyser Marston Associates, Inc. (KMA) evaluated the developer returns and City revenue potentially generated by a 30-room hotel development on the Linden Avenue and Fifth Street property (Site) in the City of Carpinteria. The analysis summarized herein relies on the data collected for the Carpinteria Hotel Market summary submitted to the City, and KMA's experience with similar projects in the region. To test the potential financial viability of a project on the Site, KMA prepared a pro forma analysis to provide order-of-magnitude estimates of developer returns. Based on the market performance of a hotel, KMA estimated the potential revenues to the City.

PROTOTYPE PROJECT

To prepare this analysis, KMA evaluated the feasibility of a 30-room, high quality (three diamond/three diamond plus) boutique hotel project on the Site (Project). The analysis assumes the Project would be comparable in quality to the following properties: Hotel Indigo Santa Barbara; The Wayfarer; Coast Hotel West Beach Inn; and The Upham Hotel. The Project would include a restaurant component providing dining options for both guests and the general public. In addition, the analysis assumes the provision of 80 – 100 replacement parking spaces on a nearby site.

It is important to note that the pro forma analysis is conceptual in nature, and should only be used to gain an understanding of the relative viability of the development being tested, and an order of magnitude estimate of potential City revenues. It will be necessary to re-evaluate the results of the analysis if and when a formal development proposal is submitted for the Site. These development proposals may assume a greater number of hotel rooms, fewer hotel rooms or a higher service/quality level.

FINANCIAL ANALYSIS

The pro forma analysis is shown in Appendices 1 and 2, with the key findings summarized in Table 1. KMA prepared two alternative development scenarios: Scenario One assumes the Project's performance is consistent with the comparable hotels (Appendix 1). Scenario Two assumes the Project can generate an average daily rate (ADR), that is 10% higher than the other properties (Appendix 2). For both scenarios, the estimated construction costs are the same.

Estimated Construction Costs (Appendices 1 and 2 – Table 1)

The KMA construction cost analysis is based on the following assumptions:

1. Direct Construction Costs:

   a. The off-site improvement costs are estimated at $300,000 for the provision of replacement parking. These costs would not include any land costs.

   b. The hotel on-site costs are estimated at $10,000 per key. These costs would include parking, landscaping and hardscaping.

   c. The direct building costs for the hotel are estimated at $150,000 per key, or $4.5 million.

   d. KMA provided a $30,000 per room allowance for furniture, fixtures and equipment (FF&E) costs. This reflects a high quality level.

2. Indirect Costs:

   a. The indirect cost estimates used in this analysis are based on industry standards.

b. Based on estimates provided by City staff, the public permits and fees costs are estimated at $11,000 per key.

3. The financing costs are based on the following assumptions:

   a. The construction period is set at 18 months, and the interest rate is set at 7.0%.

   b. The loan to value ratio is set at 65%, and the loan origination fees are set at two points.

The total construction costs are estimated at $8.0 million, which equates to $267,000 per room.

Stabilized Net Operating Income (Appendices 1 and 2 – Table 2)

Based on the potential market conditions and typical operating parameters for small-scale boutique hotels, KMA estimated the Project's net operating income (NOI). The results of this analysis are show in Appendices 1 and 2 – Table 2 and summarized below:

1. Hotel Operating Income:

   a. For Scenario 1 - the average daily rate (ADR) for the hotel is estimated at $228, and the average occupancy level is set at 76%. The ADR is consistent with the four comparable properties in and the projected occupancy level reflects the pioneering nature of the Project. For Scenario 2, the ADR is estimated to be 10% higher - $251 and the average occupancy level is also set at 76%.

   b. The food and beverage department revenues are estimated at 25% of gross revenues, which assumes a vibrant dining establishment that attracts guests, locals and area visitors to the establishment.

   c. The revenue from "other" operating departments could include vending machines, telephone and rentals.

2. Operating Expenses

   a. The undistributed expenses are estimated at 21% of gross revenues. These expenses include: administration, marketing, maintenance and utilities.

   b. Management fees are estimated at 3% of gross revenues.

c. The fixed expenses are estimated at 5% of gross revenues, and include insurance and reserves.

d. Property taxes are estimated at 1.1% of Project costs.

As shown in Appendices 1 and 2 – Table 2, the stabilized net operating income is estimated to range from $805,000 in Scenario One to $892,000 in Scenario Two.

Estimated Developer Return (Appendices 1 and 2 – Table 3)

The City has the option to seek a ground lease or sale of the property. Typically, developers prefer to have ownership of the land; however, they will enter into ground leases for properties in select locations. In particular, hotel developers are willing to enter into ground leases for properties with coastal locations in Southern California, as these have traditionally supported lower capitalization rates (higher imputed values) than inland properties. Reasons for this include: better funding opportunities, greater resistance to recession and higher ADRs. Typically, the rents will range between 3% to 8% of revenues; however, many hotel developers anticipate having the land contributed at no cost when entering into a public-private partnership. Reasons for this can include: city design requirements, uncertain market conditions limited funding options and other factors that will reduce hotel feasibility. Based on these factors, KMA estimated the City's ground rent under three scenarios.

- Zero Ground Rent
- Ground Rent equal to 3.0% of gross revenue
- Ground Rent equal to 8.0% of gross revenue

The table below summarizes the stabilized, annual ground lease revenue to the City:

Potential Annual City Ground Rent

Ground Rent	Scenario One	Scenario Two
0% of Revenue	$0	$0
3% of Revenue	$81,300	$89,500
8% of Revenue	$216,900	$238,700

Over 20 years, the Scenario One ground rent would range from $2.2 million at 3.0% to $5.8 million at 80%. For the same period, the ground rent in Scenario Two range from $2.4 million at 3.0% to $6.3 million at 8.0%.[1]

The project return to a developer is based on the anticipated development costs and hotel operating parameters. For public-private partnerships, KMA estimates returns based on the stabilized NOI generated by the project (less ground rent) compared to its total construction costs ((NOI-Ground Rent) ÷ Costs). This measure of return is known as a return on cost analysis (ROC). Essentially, the ROC analysis is a static measure that incorporates both the cap rate and a reasonable developer profit. The ROC is not the same as an Internal Rate of Return (IRR) analysis, which measures the project return over time. Typically, a hotel developer's profit in an ROC analysis is measured as a premium of 150 to 250 basis points (1.5% to 2.5%) over the cap rate. For hotel projects in Southern California, the typical stabilized ROC for hotels ranges from 9.0% to 11.0% depending on the location, quality and risk associated with the project. The table below summarizes the ROC for the Project under the alternative ground rent and revenue scenarios.

Potential Developer Return

Ground Rent	**Scenario One**	**Scenario Two**
0% of Revenue	10.0%	11.1%
3% of Revenue	9.0%	10.0%
8% of Revenue	7.3%	8.1%

The returns shown herein indicate the Project should be financially feasible; however, the potential ground rent revenue to the City is less certain. Recent hotel projects reviewed by KMA in Newport Beach, Costa Mesa and Pasadena have seen ground rents of 3% to 4% of gross revenues, which may provide an acceptable return of 9% to 10% for a developer of this Project. Ultimately, these revenues will be influenced by many factors, including project costs which could be significantly higher, revenues which are uncertain, operating efficiencies, and the level of risk a developer is willing to assume to construct a hotel on the Site.

CITY REVENUE SUMMARY

The on-site public revenues generated by the Project are shown in Table 1. The revenue assumptions are based on the pro forma analyses. The Project would generate

[1] Assumes an annual 2.5% increase in ADR after stabilization in Year 3.

revenue to the City in the form of transient occupancy tax (TOT), sales tax and property taxes, as described below.

1. Sales Tax Revenue – The sales tax estimate assumes the City receives 1% of the total taxable retail sales. For a hotel, the sales tax revenue is generated by the food and beverage department, with some ancillary revenues generated by other departments. This analysis only assumes the hotel's food and beverage revenues.

2. Property Tax Revenue – The property tax estimate assumes only the general 1.0% rate applied to the Project's assessed value. The bonded indebtedness rate above 1.0% is not considered. The analysis assumes the City General Fund receives approximately 10.1% of the property tax, with the balance going to other taxing agencies and designated funds.

3. TOT Revenues - The analysis assumes the City TOT rate is 12% of room revenues. Based on the Project's ADR and occupancy, KMA estimated the potential TOT generated for the City.

The stabilized, annual on-site revenues generated by the Project are estimated below.

Potential Annual City Revenues

Revenue Source	Scenario One	Scenario Two
Sales Tax	$6,800	$7,500
Property Tax	8,100	8,100
Transient Occupancy Tax	227,600	250,700
Total	**$242,500**	**$266,300**

Over a period of 20 years, the public revenues would total $6.4 million for Scenario One and $7.1 million for Scenario Two. In addition to these revenues, hotel guests will also spend money in the City, which will increase the City's sales tax base. In summary, the total stabilized, annual City revenues plus ground rent are shown below.

Potential Annual City Revenue Plus Ground Rent

Ground Rent	Scenario One	Scenario Two
0% of Revenue	$242,500	$266,300
3% of Revenue	$323,800	$355,800
8% of Revenue	$459,400	$505,000

The City revenue plus ground rent over a 20-year period is summarized in the table below.

Potential City Revenue Plus Ground Rent over 20 Years

Ground Rent	Scenario One	Scenario Two
0% of Revenue	$6,428,600	$7,051,100
3% of Revenue	$8,589,100	$9,427,200
8% of Revenue	$12,189,400	$13,388,000

The KMA analysis indicates the Project may be financially feasible. However, there are a significant number of cost, revenue, political and risk variables that could affect these findings. The potential magnitude of these issues could ultimately lead hotel developers to determine the Project is not feasible. Ultimately, the market and financial feasibility of a hotel on this Site will be determined through a solicitation of proposals and negotiations with a developer.

SUMMARY TABLE

HOTEL COMPARISON
CARPINTERIA HOTEL ANALYSIS
CARPINTERIA, CALIFORNIA

		Scenario One	Scenario Two
II.	**Development Costs**		
	Land Costs	$0	$0
	Direct Costs	6,000,000	6,000,000
	Indirect Costs	1,386,000	1,386,000
	Financing/Closing Costs	636,000	636,000
	Total Development Costs	**$8,022,000**	**$8,022,000**
	Per Unit	$267,400	$267,400
III.	**Room Revenue Summary**		
	ADR	$228.00	$251.00
	Occupancy Rate	76.0%	76.0%
	RevPAR	$173.00	$191.00
IV.	**Net Operating Income**		
	Income	$2,711,000	$2,984,000
	Distributed Expenses	(1,032,000)	(1,136,000)
	Undistributed Expenses	(569,000)	(628,000)
	Management Fees	(81,000)	(90,000)
	Fixed Expenses	(224,000)	(238,000)
	Project NOI	**$805,000**	**$892,000**
V.	**Potential Ground Rent**		
	No Ground Rent	$0	$0
	Low Scenario	($81,300)	($89,500)
	High Scenario	($216,900)	($238,700)
	Estimated Developer Return on Costs		
	No Ground Rent	**10.0%**	**11.1%**
	Low Scenario	**9.0%**	**10.0%**
	High Scenario	**7.3%**	**8.1%**
VII.	**Annual Public Revenues**		
	Sales Tax	$6,800	$7,500
	Property Tax	8,100	8,100
	TOT	227,600	250,700
	Total	**$242,500**	**$266,300**
	Annual City Revenues w/ Ground Rent		
	No Ground Rent	**$242,500**	**$266,300**
	Low Scenario	**$323,800**	**$355,800**
	High Scenario	**$459,400**	**$505,000**

APPENDIX 1
SCENARIO ONE - LOW REVENUE

APPENDIX 1 - TABLE 1

ESTIMATED CONSTRUCTION COSTS
SCENARIO ONE - LOW REVENUE: 30 ROOM FULL-SERVICE HOTEL
CARPINTERIA HOTEL ANALYSIS
CARPINTERIA, CALIFORNIA

I.	**Land Acquisition**	30	Rooms	$0	/Room		$0
II.	**Direct Costs**						
	Off-Site Improvements	$300,000	Allowance			$300,000	
	On-Site Improvements	30	Rooms	$10,000	/Room	300,000	
	Hotel Shell	30	Rooms	$150,000	/Room	4,500,000	
	Hotel FF&E	30	Rooms	$30,000	/Room	900,000	
	Total Direct Costs						$6,000,000
III.	**Indirect Costs**						
	Architecture & Engineering	8.0%	Direct Cost			$480,000	
	Permits & Fees/Impact Fees	30	/Room	$11,000	/Room	330,000	
	Pre-Opening/Working Capital	30	/Room	$5,000	/Room	150,000	
	Taxes, Ins, Legal & Acctg	2.0%	Direct Costs			120,000	
	Development Management	4.0%	Direct Costs			240,000	
	Contingency Allowance	5.0%	Indirect Costs			66,000	
	Total Indirect Costs						$1,386,000
IV.	**Financing Costs**						
	Building Interest[1]	$8,022,000	Building Costs	7.00%	Interest	$505,000	
	Financing Fees[2]	2.00	Points			131,000	
	Total Financing Costs						$636,000
V.	**Total Construction Costs**						$8,022,000
						Per Room	$267,000

[1] Assumes 18 month building period and 60% average outstanding balance.
[2] Assumes loan to value ratio of 65%.

APPENDIX 1 - TABLE 2

ESTIMATED STABILIZED NET INCOME[1]
SCENARIO ONE - LOW REVENUE: 30 ROOM FULL-SERVICE HOTEL
CARPINTERIA HOTEL ANALYSIS
CARPINTERIA, CALIFORNIA

I.	**Income**						
	Rooms	30	Rooms	$228.00	/Room	$1,897,000	
	Food & Beverage	25.0%	Gross Sales	$22,600	/Room	678,000	
	Other	5.0%	Gross Sales	$4,530	/Room	136,000	
	Gross Hotel Revenues						$2,711,000
II.	**Distributed Expenses**						
	Rooms	24.0%	of Dept. Sales	$15,170	/Room	$455,000	
	Food & Beverage	75.0%	of Dept. Sales	$16,970	/Room	509,000	
	Other	50.0%	of Dept. Sales	$2,270	/Room	68,000	
	(Less)Total Distributed Expenses						($1,032,000)
III.	**Undistributed Expenses**						
	General & Administration	8.0%	Gross Revenues	$7,230	/Room	$217,000	
	Franchise Fees	0.0%	Gross Revenues	$0	/Room	0	
	Marketing	7.0%	Gross Revenues	$6,330	/Room	190,000	
	Utilities	3.0%	Gross Revenues	$2,700	/Room	81,000	
	Maintenance & Property Ops.	3.0%	Gross Revenues	$2,700	/Room	81,000	
	(Less)Total Undistributed Expenses						($569,000)
IV.	**Management Fees**	3.0%	Gross Revenues	$2,700	/Room		($81,000)
V.	**Fixed Expenses**						
	Taxes	1.1%	Value	$2,970	/Room	$89,000	
	Insurance	1.0%	Gross Revenues	$900	/Room	27,000	
	FF&E Reserves	4.0%	Gross Revenues	$3,600	/Room	108,000	
	(Less) Total Fixed Expenses						($224,000)
VI.	**Net Operating Income (NOI)**	29.7%	Gross Revenues				$805,000

[1] Assumes stabilization in year 4 of operation and 76% occupancy.

APPENDIX 1 - TABLE 3

PROJECT RETURN
SCENARIO ONE - LOW REVENUE: 30 ROOM FULL-SERVICE HOTEL
CARPINTERIA HOTEL ANALYSIS
CARPINTERIA, CALIFORNIA

I. Ground Rent Scenarios

No Ground Rent	0%	Gross Revenues	$0	Ground Rent
Low Scenario	3%	Gross Revenues	$81,300	Ground Rent
High Scenario	8%	Gross Revenues	$216,900	Ground Rent

II. Project NOI Less Ground Rent

No Ground Rent	$805,000	NOI
Low Scenario	$723,700	NOI
High Scenario	$588,100	NOI

III. Estimated Developer Return

No Ground Rent	10.0%	Project R.O.C
Low Scenario	9.0%	Project R.O.C
High Scenario	7.3%	Project R.O.C

APPENDIX 2 - TABLE 1
SCENARIO TWO - HIGH REVENUE

APPENDIX 2 - TABLE 1

ESTIMATED CONSTRUCTION COSTS
SCENARIO TWO - HIGH REVENUE: 30 ROOM FULL-SERVICE HOTEL
CARPINTERIA HOTEL ANALYSIS
CARPINTERIA, CALIFORNIA

I.	**Land Acquisition**	30	Rooms	$0	/Room		$0
II.	**Direct Costs**						
	Off-Site Improvements	$300,000	Allowance			$300,000	
	On-Site Improvements	30	Rooms	$10,000	/Room	300,000	
	Hotel Shell	30	Rooms	$150,000	/Room	4,500,000	
	Hotel FF&E	30	Rooms	$30,000	/Room	900,000	
	Total Direct Costs						$6,000,000
III.	**Indirect Costs**						
	Architecture & Engineering	8.0%	Direct Cost			$480,000	
	Permits & Fees/Impact Fees	30	/Room	$11,000	/Room	330,000	
	Pre-Opening/Working Capital	30	/Room	$5,000	/Room	150,000	
	Taxes, Ins, Legal & Acctg	2.0%	Direct Costs			120,000	
	Development Management	4.0%	Direct Costs			240,000	
	Contingency Allowance	5.0%	Indirect Costs			66,000	
	Total Indirect Costs						$1,386,000
IV.	**Financing Costs**						
	Building Interest[1]	$8,022,000	Building Costs	7.00%	Interest	$505,000	
	Financing Fees[2]	2.00	Points			131,000	
	Total Financing Costs						$636,000
V.	**Total Construction Costs**						$8,022,000
						Per Room	$267,000

[1] Assumes 18 month building period and 60% average outstanding balance.
[2] Assumes loan to value ratio of 65%.

Prepared by: Keyser Marston Associates, Inc.
Filename: \\fullad1\Employee\kengstrom\My Documents\Carpinteria\Hotel Project\Carpinteria Hotel Pro Formas;Scenario 2;6/16/2016;kee

APPENDIX 2 - TABLE 2

ESTIMATED STABILIZED NET INCOME[1]
SCENARIO TWO - HIGH REVENUE: 30 ROOM FULL-SERVICE HOTEL
CARPINTERIA HOTEL ANALYSIS
CARPINTERIA, CALIFORNIA

I.	**Income**						
	Rooms	30	Rooms	$251.00	/Room	$2,089,000	
	Food & Beverage	25.0%	Gross Sales	$24,870	/Room	746,000	
	Other	5.0%	Gross Sales	$4,970	/Room	149,000	
	Gross Hotel Revenues						$2,984,000
II.	**Distributed Expenses**						
	Rooms	24.0%	of Dept. Sales	$16,700	/Room	$501,000	
	Food & Beverage	75.0%	of Dept. Sales	$18,670	/Room	560,000	
	Other	50.0%	of Dept. Sales	$2,500	/Room	75,000	
	(Less)Total Distributed Expenses						($1,136,000)
III.	**Undistributed Expenses**						
	General & Administration	8.0%	Gross Revenues	$7,970	/Room	$239,000	
	Franchise Fees	0.0%	Gross Revenues	$0	/Room	0	
	Marketing	7.0%	Gross Revenues	$6,970	/Room	209,000	
	Utilities	3.0%	Gross Revenues	$3,000	/Room	90,000	
	Maintenance & Property Ops.	3.0%	Gross Revenues	$3,000	/Room	90,000	
	(Less)Total Undistributed Expenses						($628,000)
IV.	**Management Fees**	3.0%	Gross Revenues	$3,000	/Room		($90,000)
V.	**Fixed Expenses**						
	Taxes	1.1%	Value	$2,970	/Room	$89,000	
	Insurance	1.0%	Gross Revenues	$1,000	/Room	30,000	
	FF&E Reserves	4.0%	Gross Revenues	$3,970	/Room	119,000	
	(Less) Total Fixed Expenses						($238,000)
VI.	**Net Operating Income (NOI)**	29.9%	Gross Revenues				$892,000

[1] Assumes stabilization in year 4 of operation and 76% occupancy.

Prepared by: Keyser Marston Associates, Inc.
Filename: \\fullad1\Employee\kengstrom\My Documents\Carpinteria\Hotel Project\Carpinteria Hotel Pro Formas;Scenario 2;6/16/2016;kee

APPENDIX 2 - TABLE 3

PROJECT RETURN
SCENARIO TWO - HIGH REVENUE: 30 ROOM FULL-SERVICE HOTEL
CARPINTERIA HOTEL ANALYSIS
CARPINTERIA, CALIFORNIA

I. Ground Rent Scenarios

No Ground Rent	0%	Gross Revenues	$0	Ground Rent
Low Scenario	3%	Gross Revenues	$89,500	Ground Rent
High Scenario	8%	Gross Revenues	$238,700	Ground Rent

II. Project NOI Less Ground Rent

No Ground Rent	$892,000	NOI
Low Scenario	$802,500	NOI
High Scenario	$653,300	NOI

III. Estimated Developer Return on Costs

No Ground Rent	11.1%	Project R.O.C
Low Scenario	10.0%	Project R.O.C
High Scenario	8.1%	Project R.O.C