ESCONDIDO
City of Choice

CITY COUNCIL

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Agenda Item No.: 26
Date: June 9, 2010

TO: Honorable Mayor and Members of the City Council and Community Development Commission

FROM: Charles Grimm, Assistant City Manager

SUBJECT: Approval of Amended Disposition and Development Agreement for Downtown Hotel and Conference Center Project and Extension of Time for Preliminary and Master Development Plan (Case File No. 2005-21-PD/SPA, ER 2005-13 and ADM 09-0113)

RECOMMENDATION:

It is requested that Council and the Commission take the following actions:

a) Adopt CDC Resolution 2010-07, and authorizes the Chair and City Clerk to execute an Amended Disposition and Development Agreement between the Escondido Community Development Commission and Escondido Development, LLC and replaces an earlier Agreement and which specifies the roles, responsibilities and financial obligations of the parties in the development and ongoing operation of the project.

b) Acting as the City Council, adopt Resolution 2010-111, approving the Amended Disposition and Development Agreement and rescinding City Resolution 2006-216(R), which authorized the execution of the original Disposition and Development Agreement.

c) Adopt Resolution No. 2010-108 to approve a time extension of the Preliminary and Master Development Plan for the 196-room hotel and related facilities for three years.

FISCAL ANALYSIS:

This project is expected to cost a total of $56,318,369 of which the Commission will contribute cash in the amount of $16,485,489 consisting of covenant acquisition consideration, payment for a share portion of construction of a two-level subterranean parking structure and various site preparation requirements, as well as off-site improvements.

The City's anticipated revenue from the project calculated in net present values has been estimated at $27,351,000. This revenue stream consists of Transient Occupancy Tax, property and sales tax receipts, and ground lease payments.

A complete financial analysis is found in the report from Keyser Marston & Associates, which is attached to this staff report.

GENERAL PLAN ANALYSIS:

A Downtown Hotel and Conference Center Project is consistent with the General Plan goal of an economically viable downtown area.

PREVIOUS ACTION:

- In June 2004 the Council directed negotiations take place with the Phelps/CW Clark development team for the Hotel and Conference Center project.

- In February 2005 the Council directed staff to continue negotiations with an expanded project that included a mixed use project on Public Parking Lot One; the project included residential condominiums, public parking and retail spaces.

- In May 2006 the City and the Developer agreed to eliminate the mixed use project from the expanded project and to construct only the hotel including the subterranean parking and refurbishment of the Conference Center building, with no project development to take place on Public Parking Lot One. While the City Council stated a continuing interest in the concept of additional residential development in the immediate downtown area, Council directed that the future uses of Lot One be considered as part of the Downtown Specific Plan and its environmental review.

- In August 2006, the City adopted Resolution 2006-217 amending the Downtown Specific Plan's Civic Center District and also adopted a Planned Development for a project which consisted of a nine-story hotel with seven above-ground floors, 196 rooms, a restaurant, health club, and administrative offices, and installation of signals and/or stop signs at three nearby intersections. The request involved the adoption of project-specific development standards for a maximum building height of 75 feet and 209 parking spaces to be built in the hotel's two underground parking levels based on studies conducted by Walker & Associates and resulting in a reduction of 75 surface parking spaces that currently exist between City Hall and the California Center for the Arts. The City also adopted Resolution 2006-216, authorizing the Mayor and City Clerk to execute a Disposition and Development Agreement between the City of Escondido and Escondido Development, LLC that specified the roles, responsibilities and financial obligations of the parties in the development and ongoing operation of the project.

BACKGROUND:

Market Demand

The City commissioned a Hotel Market Demand study in April 2003 by PKF Consulting. The study demonstrated a potential for success for a full-service hotel constructed and operated in conjunction with the existing CCAE Conference Center. During the extended time of negotiations with the development team, the 2003 study was reviewed and updated in January 2006, after CW Clark and Sage Hospitality provided revised assumptions regarding Average Daily Rate, occupancy and expenses relating to the hotel operations. The hotel operating projections reflected in the Keyser Marston Associates financial analysis represented the expected financial outcomes of these studies. No update to the studies has been conducted since January 2006.

Development Team

After the completion of the initial Market Study, the City conducted a Request for Qualifications (RFQ) process, followed by a Request for Proposal (RFP) process among qualified firms. The City Council set a goal of creating a public-private partnership with a quality team that was willing to invest substantial private funds into the project. The team of CW Clark, Inc., Phelps Program Management, Joseph Wong Design Associates, Sage Hospitality Group and Hensel Phelps Construction were selected for the project. Starting in 2003, extensive negotiations have taken place with the City's negotiating team under the direction of the City Council. City staff has been supported by a team of involving consulting expertise in the areas of hotel development issues, financial implications and assessments and legal support for creating the original Disposition and Development Agreement and the presently proposed Amended Disposition and Development Agreement.

Since the original approval in August 2006, the project has remained generally the same, but there have been significant changes among the Developer's team. Sage Hospitality has been replaced by Dow Hospitality, and Hensel Phelps has been replaced by Bob Bahen and Bahen Enterprises. The actual Developer of the project remains Escondido Developers, LLC, but this is now a limited liability corporation consisting of Craig Clark and Bahen Enterprises. Bahen will replace Phelps as Guarantor.

Hensel Phelps was formerly both a developer and the general contractor for the project. As noted above, Hensel Phelps is no longer involved and Jaynes Construction has been selected as the general contractor for the project. A guaranteed maximum price contract has been executed between the Developer and Jaynes Construction dated January 28, 2010 in the amount of $46,948,781.00. In addition, a faithful performance bond in the amount of $43,396,630.00 and a labor and materials bond in the amount of $43,396,630.00 have been issued by Western Surety, Inc., with the City, the Community Development Commission, and J & H Capital named as beneficiaries.

In the original Disposition and Development Agreement, a specific project lender was not identified. The present deal includes a construction loan which has been obtained by the Developer from J & H Capital, a private financial entity based in Texas. The construction loan is effective August 1, 2010 and is in the amount of $55,081,250.00. Jaynes will also be providing a loan of $6.1 million to the Developer.

The Project

The project consists of a 196 room Marriott Hotel situated on city-owned property located between the City Hall and the California Center for the Arts Escondido (CCAE) and refurbishment of the existing Conference Center building. The hotel will be operated in conjunction with and physically connected to the current CCAE Conference Center building. Two levels of underground parking will be constructed under the hotel providing 209 parking spaces and the hotel will have use of the 11 surface parking spaces located adjacent to the Conference Center on its south side. This combined parking inventory represents 220 spaces for the Hotel and Conference Center project. The architectural theme of the hotel is consistent with, and complementary to the other buildings in the Civic Center complex.

Project Changes

During the initial negotiation period, the developer team, aware of the City Council's publicly-stated goal of bringing additional residential development to the downtown area, proposed a mixed-use project of high-quality condominiums for a location across West Valley Parkway from the hotel on Public Lot One. The City's role would have been to add public parking to the project along with limited commercial spaces to create additional downtown activity along the Maple Avenue corridor connecting Grand Avenue to the CCAE. This change in the project scope added financial benefit to both the City (sale of air space above the public parking) and the Developer (the value of residential development to complement the hotel investment).

In response to a high level of community concern with the mixed-use portion of the project, and the concern that the height of the proposed building might negatively impact downtown, the City and the Developer agreed to remove the mixed-use portion of the project from the Hotel and Conference Center. The proposed Hotel and Conference Center project being considered by the City Council at this time does not include consideration of any mixed-use development in the downtown area. Moreover, there are no agreements in place or proposed, with either the developer team or any other entity, for further development on the Public Lot One property.

Although no new public parking will be constructed as part of this project, the Staff and the Downtown Business Association are continuing to work on long term parking solutions for the downtown area. These efforts will be built on the information gathered in the Walker Parking

Consultants study as well as consideration of alternatives for a parking system that can be implemented with full DBA and City cooperation and coordination.

Disposition and Development Agreement

The Amended and Restated Disposition and Development Agreement replaces the Escondido Community Development Commission for the City as the governmental entity assisting with the project. The hotel project itself is consistent with the broad goals set forth in the 1984 Redevelopment Plan. The primary avenues of Commission and City participation in the hotel project include 1.) Making the land available pursuant to a 55 year lease agreement; 2.) permitting the use of the conference center for hotel-related purposes as part of the same lease agreement; 3.) providing a $10.718 million contribution comprised of $6.1 million towards the construction of the parking garage and $4.617 million in exchange for covenants on the part of the Developer to construct and commence operating a hotel project; and 4.) constructing certain public improvements required by the project.

Upon approval of the Amended Disposition and Development Agreement (Amended DDA), the City will deposit only the first portion of its funds ($6.1 million) with Bank of the West, where they will be held subject to the terms of the Amended DDA until such time as certain conditions are fulfilled. The City's $6.1 million will be released to the construction account upon completion of the parking garage shell. The remaining $4.5 million City contribution will be provided only as the final funds to complete the project.

The Developer will use loan proceeds from Jaynes Construction, Developer Equity, and a $55 million loan from J&H Capital Investments, LLC (a private lender) to pay for the cost of the parking garage, renovation of the Conference Center, and construction of the hotel. The loan from Jaynes Construction is anticipated to be approximately $6.1 million. The Developer Equity consists primarily of $3 million in cash held by Bahen Enterprises in Bank of America, and equity contributed by Craig Clark.

Developer Equity (except those funds already expended) and the loan from Jaynes Construction will be placed in a Developer construction account at Chicago Title. Thereafter, the $55 million loan from J & H Capital and the $6.1 million loan from Jaynes Construction will fund, and physical construction of the project will commence. The City funds, when paid to the Developer, will repay the Jaynes Construction loan and offset Developer contributions and loans.

The Disposition and Development Agreement presented as part of this CDC and City Council action defines the specific responsibilities for both the CW Clark Team and the City in this project. Specifically, the parties are responsible as follows:

The Developer will:

- Obtain all entitlements and approvals for the Hotel and Conference Center, paying all permit fees required by the City
- Design, construct and operate a 196-room full service Hotel and Conference Center
- Refurbish the current Conference Center and upgrade to Marriott standards, and assume full responsibility for all operating and maintenance costs during the term of the lease
- Secure a twenty-year franchise agreement with Marriott International, operating the hotel to Marriott standards and quality
- Make ground lease payments to the City for the fifty-five year term of the lease as a percentage of gross revenue of Hotel and Conference Center operations
- Contribute equity and private financing to complete construction of the project
- Enter into an operating agreement between the City, the CCAE and the Hotel

The Commission will:

- Lease the Conference Center and the land under the hotel site for 55 years to the Developer
- Contribute $10,718,000 in equity towards the project in exchange for the construction and operation covenants from the Developer
- Pay for offsite costs including traffic signal improvements at West Valley Parkway/Maple Street and West Second Avenue/Maple Street and connection of the City Hall building to a new chiller system ($1,260,000)

<u>Risk and Cost Overruns</u>

In the original Disposition and Development Agreement approved by the City on August 23, 2006 the completion of the project, regardless of cost, was guaranteed by Hensel Phelps Corporation, which had sufficient capital and liquidity to stand behind such a guaranty. Under the present structure, the risk of cost overruns has been addressed by a combination of factors.

The Developer now proposes to cover risk of cost overruns and completion by an executed construction contract in the amount of $46,948,781.00, as well as a Performance Bond and a Labor and Material Bond issued by Western Surety securing the performance of the construction contract. The City and Agency are both listed as beneficiaries of these security instruments. In addition, Bahen Enterprises has provided $3,000,000 in a Bank of America account, and that amount will be transferred to the construction account following execution of this Amended Disposition and Development Agreement, and thereafter be held to cover cost overruns and contingencies.

During the negotiation process, the City requested that the Jaynes Construction Contract and Payment Bond and Performance Bond include a $2.0M construction contingency plus $7.46 million of costs reclassified from Design Consultants ($2.51M), FF&E ($4.5 M) and FF&E Contingency ($450,000). The General Contingency is increased to $1.8M so all Contingencies total 6.6% of the Project Cost excluding the Interest/Operating Reserve.

Financial Implications

Attached to the staff report prepared in conjunction with the original project approval in August 2006 were two reports from Keyser Marston Associates representing their assessment of the economics of the proposed project. In summary form, the information below represents Annual City revenues from this project:

Transient Occupancy Tax: (Projected at year 4) (Collected immediately on hotel opening)	$ 821,000
Sales tax: (Contributed by hotel guests; includes spending in Escondido)	$ 294,000
Property taxes: (Includes Redevelopment Tax Increment)	$ 250,000
Housing Set-Aside:	$ 76,000
Total Annual City Revenues	**$1,441,000**

Base Rent (Ground Lease) payments begin after 10 years of operations and are based on a percentage of gross revenues from all operations of the Hotel and Conference Center.

Net present value of all project revenues (calculated through the 55-year lease term):

Base Rent Payments:	$ 7,731,000

Taxes (Hotel and Property):	$19,620,000
Total Present Value of City Revenue (2006): Discount rate 8%	**$27,351,000**

The transition of the Conference Center from operation by the CCAE to the lease to the Hotel operation is critically important to the City. As part of the lease, the Developer will assume full responsibility for the operations, maintenance and capital maintenance of the Conference Center building. This building is currently owned by the City and operated by the CCAE; periodic repairs and maintenance are the responsibility of the City as it contributes to the CCAE. Additionally, the City pays the utility costs of this building. All of these costs will be the responsibility of the hotel Developer during the entire term of the lease.

Keyser Marston has also prepared a report dated May 2010 pursuant to Section 33433 of the California Community Redevelopment Law. The purpose of this report is to inform the Commission and the public about the proposed lease between the Commission and Escondido Development, LLC. That report is part of the staff packet on this matter.

Sequence of Commission Participation

As noted elsewhere, Commission participation in the hotel project involves providing the land, providing the conference center facilities, as well as the $10.7 million contribution in exchange for the Developer's covenant to construct and operate the hotel and renovate the conference center. The Developer has requested, and the draft documents reflect, that renovations to the conference center will not occur until the later stages of hotel construction.

California Center for the Arts Escondido

The CCAE Board conducts operations at the Center for the Arts. Their responsibility under three management agreements with the City includes operations of the theaters, Museum and the Conference Center. The City, as the owner of the CCAE buildings, has determined to separate the Conference Center building from the balance of the CCAE campus. The CCAE Board will continue its responsibility to operate the remaining CCAE venues. The original Management Agreement between the City and the CCAE Board expired in September 2010; however, the City Council authorized three replacement agreements on December 16, 2009 by Resolution 2009-179. These divide the CCAE into 3 separate segments with different terms and operating parameters. The conference center agreement is now separate, which makes transition with the hotel project easier. The three new management agreements were executed on May 27, 2010.

The City Council will evaluate the financial impact of the CCAE's reduced operational venues to understand levels of financial support that might need to be adjusted due to the Hotel project. Keyser Marston Associates has been retained by the City to evaluate the impact of this project on CCAE operations and revenues. The findings of the study are in final review and will serve as a basis for future City financial support of the CCAE.

Additionally, an operating agreement will be created between the CCAE, the Hotel Operator and the City to ensure that the interrelationship of the Hotel and the CCAE can be most beneficial to all parties.

EXTENSION OF TIME FOR THE PRELIMINARY AND MASTER DEVELOPMENT PLAN

The Preliminary and Master Development Plan for the 196-room hotel and related facilities was approved by the City Council on August 23, 2006. Unless a time extension is granted, planned development approvals expire according to the same schedule and procedure as a tentative map (three years) if the development entitlements have not been exercised. An application for a time extension and the associated fees were submitted on August 20, 2009, prior to the PD expiration date. The associated Precise Development Plan application was submitted on October 27, 2009. Action on the time extension and Precise Development Plan were deferred pending the completion of the ongoing DDA negotiations. Staff has reviewed the request for the time extension and determined that no changes to the conditions of approval are warranted. Refinements to the conditions will be evaluated as part of the future Precise Plan review to determine conformance with the approved Master Development Plan, the recently adopted Maple Street Pedestrian Corridor Master Plan and the recently adopted code amendments pertaining to storm water requirements and water conservation.

SUMMARY

The Downtown Hotel Project is critical to the ongoing economic development of the City and the downtown area. The project has undergone extensive negotiations and review, and it is an outstanding example of public-private partnering for the benefit of the City and the Developer Team.

Respectfully submitted,

Charles Grimm
Assistant City Manager

ESCONDIDO REDEVELOPMENT PROJECT AREA

ESCONDIDO, CALIFORNIA

SUMMARY REPORT PERTAINING TO THE PROPOSED AMENDED AND RESTATED DISPOSITION AND DEVELOPMENT AGREEMENT OF CERTAIN SITE WITHIN THE REDEVELOPMENT PROJECT AREA

California Community Redevelopment Law
Section 33433

PURSUANT TO PROPOSED AMENDED AND RESTATED DISPOSITION AND DEVELOPMENT AGREEMENT
BETWEEN
ESCONDIDO COMMUNITY DEVELOPMENT COMMISSION
AND
ESCONDIDO DEVELOPMENT, LLC

Community Development Commission
of the
City of Escondido, California

June 2010

KEYSER MARSTON ASSOCIATES

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I. INTRODUCTION

A. Purpose of Report

This Summary Report was prepared in accordance with Section 33433 of the California Community Redevelopment Law in order to inform the Community Development Commission of the City of Escondido (Commission) and the public about the proposed lease between the Commission and Escondido Development, LLC (Developer) under review as of May 5, 2010. This Report describes and specifies:

1. The costs to be incurred by the Commission under the Amended and Restated Disposition and Development Agreement (DDA);

2. Estimated value of the interest to be conveyed at the highest and best use permitted under the Redevelopment Plan;

3. The estimated value of the interest to be conveyed at the proposed use and with the conditions, covenants, and development costs required by the lease of the Site;

4. The compensation to be paid to the Commission pursuant to the proposed transaction;

5. An explanation of the difference, if any, between the compensation to be paid to the Commission under the proposed transaction, and the fair market value at the highest and best use consistent with the Redevelopment Plan; and

6. An explanation of why the lease of the Site will assist with the elimination of blight.

B. Summary of Findings

KMA's principal conclusions are summarized as follows:

- The estimated costs of the DDA to the Commission totals $10,718,000.

- The estimated fair market value of the Site at its highest and best use is $7,410,000.

- The estimated re-use value of the interest to be conveyed is *negative* $24,499,000.

- The estimated value of the net compensation to be received by the Commission is *negative* $2,628,000.

C. Description of Area and Proposed Project

<u>City Overview</u>

The City of Escondido (City) is located at the confluence of Interstate 15 and Highway 78. It is approximately 18 miles inland, 30 miles northeast of downtown San Diego, and has a population of about 135,000. The City is a highly desirable place to live, offering a number of amenities including a range of housing options, parks and lakes, golf courses, art galleries, antique stores, restaurants, and wineries.

In the early 2000s, a number of developers began noticing the potential of downtown Escondido for both commercial and residential development. This trend continued until 2007/2008, when the national housing market downturn and credit crisis plunged the nation into recession. However, prior to the collapse several commercial projects and condominium developments were proposed in or near downtown. As the nation and Southern California start to see evidence of economic recovery, some of the previous development proposals in the City will likely become active again.

<u>Proposed Development</u>

The proposed 196-room, full-service Marriott brand hotel (Project) will be developed on a 2.36-acre site (Site) on the north side of West Valley Parkway adjacent to the California Center for the Arts Escondido (CCAE). The Site comprises the existing 25,000-SF conference center facility situated on approximately one-half of the Site and a surface parking lot comprising the remaining half of the Site.

The CCAE opened in 1994, and is situated on a total 12-acre site extending north of the subject Site and adjacent to the Escondido Civic Center and Downtown Escondido. The CCAE consists of a 1,535-seat concert hall, a 408-seat theater, museum, and the conference center.

Table 1 describes the proposed Project. The Project is planned to contain approximately 118,000 SF of gross building area (GBA) inclusive of meeting space and a restaurant in a seven-story Type I structure. In addition, the hotel will contain 220 parking spaces, of which 209 will be provided in a two-level subterranean garage, with an additional 11 surface spaces. As part of the Project, the Developer will refurbish the CCAE conference center and incorporate it as part of the hotel operations.

D. Proposed Transaction Terms

This section summarizes the salient business terms of the proposed DDA between the Commission and Developer.

- The Commission will lease the Site and existing conference center to the Developer for a period of 55 years. For the first 10-year period from the date the hotel commences operation, no rent will be payable. Beginning in Year 11 the Base Rent will be one percent (1%) of hotel gross revenues and will increase one percent (1%) each year thereafter, and ending in Year 15 at a maximum of 5% for the balance of the lease term. The following table summarizes the rent schedule:

Operating Year	Base Rent (% of Gross Revenue)
0 - 10	0%
11	1%
12	2%
13	3%
14	4%
15 - 55	5%

  As shown in Table 2, KMA has prepared a 55-year operating cash flow for the Project and estimates that the Commission will receive total base rent of $6,900,000 in present value terms (based on an 8.0% discount rate).

- The Commission will receive Additional Rent for any year where actual gross revenue exceeds the pro forma gross revenues by more than one million dollars. The Additional Rent will be equal to 5.0% of the gross revenue in excess of the pro forma revenue. As noted in Table 2, KMA estimates the Commission will receive total additional rent of $1,189,000 in present value terms (base on an 8.0% discount rate).

- The Commission will contribute a maximum $10,718,000 toward the construction of the subterranean parking.

- After the Developer has received repayment in full of the construction loan and developer equity investment, the Commission will receive 65% of project cash flow and net proceeds from any capital event until the earlier of the following: (1) the Commission has received its original contribution ($10,718,000) plus 4% compounded interest, or (2) the 26th anniversary of the commencement of operation of the hotel.

  KMA conservatively estimates zero revenue to the Commission from this participation provision, inasmuch as any sale or other capital event would be undertaken solely at Developer's discretion.

- The Developer will deliver to the Commission a performance guaranty duly executed by the Guarantors together with the financial information from the Guarantors to allow the Commission to determine whether the Guarantors are capable of performing under the Guaranty, if necessary.

- The Developer agrees to continuously use and operate the hotel for a period of 55 years from the date of the leasehold conveyance.

- The Developer and any subcontractors will comply with all governmental requirements applicable to public works, including the payment of prevailing wages.

II. COSTS OF THE DDA TO THE COMMISSION

The estimated costs of the DDA to the Commission total $10,718,000, as shown below:

Transaction-Related Costs [1]	**Amount**
Site Acquisition	$0
Conference Facility Development	$0
Commission Contribution to Subterranean Parking	$10,718,000
Commission Third Party and Other Costs	$0
Total Commission Costs	**$10,718,000**

(1) Per Commission.

III. ESTIMATED VALUE OF THE INTEREST TO BE CONVEYED AT THE HIGHEST AND BEST USE PERMITTED UNDER THE REDEVELOPMENT PLAN

This section presents an analysis of the fair market value of the Site at its highest and best use.

Typically, the analysis of fair market value at highest and best use does not consider the specific Commission/Developer transaction or development concept, but rather the most profitable use that is consistent with the Redevelopment Plan, or other governing land use regulations. The purpose of the analysis is to estimate the maximum compensation that the Commission could achieve if it were to offer the subject property or development on the open market.

The highest and best use of the Site is that use that generates the highest property value. By definition, the highest and best use is the use that is physically possible, financially feasible, and legally permitted. The City's Downtown Specific Plan (revised March 10, 2010) governs the land uses for the Site. According to the Specific Plan, the Site is in the Park View District which allows for multiple uses including residential above ground floor uses, general retail, eating and drinking establishments, general office use, and specialty services. Lodging uses are allowed with a conditional use permit.

The 2.36-acre Site is comprised of a surface parking lot and the CCAE conference center. Each component contains approximately one-half of the entire Site. Therefore, KMA conducted the following surveys of comparable sales: (1) commercial and residential land sales for the parking lot portion, and (2) commercial building sales for the conference center portion. For each survey, KMA searched the communities of Escondido, Oceanside (east of I-5), Poway, Rancho Bernardo, San Marcos, and Vista.

The survey of comparable commercial and residential land sales, for the purpose of valuing the parking lot portion of the Site, consisted of 1.0 to 10.0 acres from January 2008. The results of this survey are presented in Table 3. As shown, sales ranged from about $14 to $41 per SF of land. The median price was $24 per SF of land and the average was $26 per SF of land. In KMA's view, the value of the Site would fall above the median and average sales prices due to its location in Downtown Escondido and proximity to the CCAE and Grape Day Park. On this basis, then, KMA estimates the value of the parking lot portion of the Site to be $35 per SF land.

The survey of comparable commercial building sales, for the purpose of valuing the conference center portion of the Site, consisted of buildings of 10,000 SF to 50,000 SF sold from January 2008 to the present. The results of this survey are presented in Table 4. As shown, sales ranged from $88 to $390 per SF building area. The median price was $185 per SF building and the average was $208 per SF building. KMA believes that the value of the conference center portion of the Site would fall toward the middle range of the comparables, or say $225 per SF of building area.

The following table summarizes the KMA conclusion of the fair market value of the Site at its highest and best use.

Subject Site	**Totals**
Parking Lot Area (approximately 51,000 SF x $35/SF)	$1,785,000
Conference Center (25,000 SF x $225/SF)	$5,625,000
Total Fair Market Value at Highest and Best Use	**$7,410,000**

On this basis, then, KMA finds that the fair market value of the Site at its highest and best use is $7,410,000.

IV. ESTIMATED VALUE OF THE INTEREST TO BE CONVEYED AT THE USE AND WITH THE CONDITIONS, COVENANTS, AND DEVELOPMENT COSTS REQUIRED BY THE LEASE OF THE SITE

This section explains the principal conditions and covenants which the Tenant of the Site must meet in order to comply with the City of Escondido Redevelopment Plan. The DDA contains specific covenants and conditions designed to ensure that the conveyance of the Site will be carried out in a manner to achieve the Commission's objectives, standards, and criteria under the Redevelopment Plan. Such covenants and conditions include the Site being restricted to a 55-year operating covenant and prevailing wages.

KMA estimated the residual value of the Site based on the terms of the DDA absent any Commission contributions for subterranean parking or off-site infrastructure improvements. Tables 5 to 8 present KMA's residual value analysis for the proposed Project.

Development Costs

In calculating the direct costs of the development, KMA evaluated the pro forma submitted by the Developer in comparison with our experience with similar projects. KMA found the cost estimates to be high on a per-SF basis when compared with current industry standards for a development of this type. As shown in Table 5, total costs for the Project, excluding land acquisition, are estimated to be $69,799,000, or $589 per SF gross building area (GBA). These include the following:

- Total parking garage costs, such as site preparation, subterranean parking, surface parking, indirect costs, and financing costs, are estimated to be $10,718,000, or about $49,000 per space. These costs are inclusive of the requirement to pay prevailing wages.

- Direct construction costs, such as site preparation, parking, shell construction, tenant improvements, FF&E, and contingency, are estimated to be $38,712,000, or $327 per SF GBA. These costs are inclusive of the requirement to pay prevailing wages.

- Indirect costs, such as architecture and engineering, permits and fees, legal and accounting, taxes and insurance, developer fee, marketing and pre-opening expenses, and contingency, are projected to be $9,141,000, or 23.6% of direct costs.

- Financing costs, consisting of loan fees, interest during construction, and operating deficit reserves, are estimated to be $11,228,000, or 29.0% of direct costs.

Net Operating Income

Table 6 presents the KMA estimate of Net Operating Income (NOI) for the Project. KMA reviewed the revenue projections provided by the Developer, as well as the March 2008 market study prepared by PKF Consulting. The Developer projects an average daily rate (ADR) of $159 in operating Year 1 and $174 in operating year 4 (stabilized). There is considerable risk in achieving these projections due to the ongoing national recession, recent decline in hotel industry performance, and the untested nature of the Escondido hotel market.

KMA has assumed the Developer's NOI projection of $4,147,000 at stabilization (operating year 4). This NOI projection reflects the following assumptions:

- An ADR for the hotel of $174 per night at a 75.0% occupancy rate.
- Parking revenue at $130 per space per month.
- Other revenue, such as food and beverage, telephone revenue, and rental revenue, equal to 70.0% of room revenue.
- Departmental, overhead, and fixed expenses totaling approximately 75.2% of gross revenue.

Residual Land Value

The residual land value supported by the Project can be estimated as the difference between the total development costs, exclusive of land acquisition, and the maximum debt and equity investment that can be attracted to the Project based on current industry standards.

Tables 7 and 8 present the KMA estimate of the Developer's Unleveraged Internal Rate of Return (IRR). KMA estimates that the Project requires a minimum unleveraged IRR of 10.0%, reflective of the level of risk associated with the location, quality, and mix of components proposed for the Project. Based on this target IRR, KMA calculates that the maximum private investment supported by the Project is $45,300,000.

In sum, the comparison of total development costs (Table 5) and maximum supportable investment (Table 7) yields a residual land value of *negative* $24,499,000, as follows:

Residual Land Value	**Totals**
Supportable Private Investment	$45,300,000
(Less) Total Development Costs	($69,799,000)
Residual Land Value	($24,499,000)

On this basis, then, KMA concludes that the fair re-use value of the Site is *negative* $24,499,000.

V. THE COMPENSATION WHICH TENANT WILL BE REQUIRED TO PAY

The present value of the net compensation to be received by the Commission for the Site under the terms of the lease over the 55-year term is *negative* $2,628,000, determined as follows:

Source	**Totals**
Base Rent (Table 2)	$6,900,000
Additional Rent (Table 2)	$1,189,000
Total Estimated Compensation (rounded)	$8,090,000
(Less) Commission Contribution (Section I.D)	($10,718,000)
Net Estimated Compensation to Commission	($2,628,000)

VI. EXPLANATION OF THE DIFFERENCE, IF ANY, BETWEEN THE COMPENSATION TO BE PAID TO THE COMMISSION BY THE PROPOSED TRANSACTION AND THE FAIR MARKET VALUE OF THE INTEREST TO BE CONVEYED AT THE HIGHEST AND BEST USE CONSISTENT WITH THE REDEVELOPMENT PLAN

The Commission will receive total compensation of *negative* $2,628,000. The fair market value at highest and best use of the interest to be conveyed is $7,410,000. The compensation to the Commission is significantly lower than the fair market value at highest and best use due to the following factors:

- The agreement by the Developer to continuously use and operate the hotel for a period of 55 years from the date on which the hotel commences operations under the name of the Franchisor in accordance with the Franchise Agreement and Operator Agreement

- The obligation by the Developer and its contractors to comply with governmental requirements applicable to public works, including the payment of prevailing wages.

- The obligation to commence construction within 30 days after conveyance, notwithstanding current market and financing conditions for hotel use.

VII. EXPLANATION OF WHY THE LEASE OF THE SITE WILL ASSIST WITH THE ELIMINATION OF BLIGHT

The Escondido Redevelopment Plan contains the goals and objectives and the projects and expenditures proposed to eliminate blight within the Project Area. These blighting factors include:

- Areas suffering from economic dislocation and disuse.
- Areas which are stagnant or improperly utilized, and which the planning, redesign, or redevelopment could not be accomplished by private enterprises acting alone, without public participation.
- The subdividing and sale of lots of irregular form and shape, and inadequate size for proper usefulness and development.

Implementation of the proposed DDA can be expected to assist in the alleviation of blighting conditions through the following:

- Creating a more dynamic environment that contributes to a lively community character and rich quality of life.
- Improving the image of Downtown Escondido as a business, visitor, and community center for commercial and recreation uses.
- Encouraging commercial development to provide more and diversified local employment for underemployed and unemployed residents.

VIII. LIMITING CONDITIONS

The estimates of re-use and fair market value at the highest and best use contained in this memorandum assume compliance with the following assumptions:

1. There are no known soil or subsoil problems, including toxic or hazardous conditions on the Site that need to be remediated in order to develop the Site.

2. The ultimate development will not vary significantly from that assumed in this Re-use Analysis.

3. The title of the property is good and marketable; no title search has been made, nor have we attempted to determine the ownership of the property. The value estimates are given without regard to any questions of title, boundaries, encumbrances, liens or encroachments. It is assumed that all assessments, if any are paid.

4. The Site will be in conformance with the applicable zoning and building ordinances.

5. Information provided by such local sources as governmental agencies, financial institutions, realtors, buyers, sellers, and others was considered in light of its source, and checked by secondary means.

6. If an unforeseen change occurs in the economy, the conclusions herein may no longer be valid.

7. The Development will adhere to the schedule of performance described in the Lease.

8. Both parties are well informed and well advised and each is acting prudently in what he/she considers his/her own best interest.

attachments

TABLE 1

PROJECT DESCRIPTION
DOWNTOWN HOTEL AND CONFERENCE CENTER
ESCONDIDO COMMUNITY DEVELOPMENT COMMISSION

I. Site Area	2.36 Acres	
II. Gross Building Area		
Hotel Rooms	93,588 SF	79.0%
Meeting Rooms	1,300 SF	1.1%
Restaurant	2,700 SF	2.3%
Lobby/Lounge	5,000 SF	4.2%
Other Common Area/First Floor Circulation/Back of House	15,900 SF	13.4%
Subtotal Gross Building Area (GBA)	118,488 SF	100.0%
Conference Center (Gross SF)	25,000 SF	
III. Number of Rooms		
Number of Guest Rooms	196 Rooms	
Average Room Size - Net SF	477 SF	
Number of Meeting Rooms	2 Rooms	
Number of Floors	7 Floors	
IV. Parking		
Parking Area		
Total Parking Area	78,370 SF	
Parking		
Subterranean Parking	209 Spaces	
Surface Parking at Hotel	11 Spaces	
Total Parking Spaces	220 Spaces	
Average SF per Space	356 SF per Space	
Parking Ratio	1.1 Spaces per Room	

Prepared by: Keyser Marston Associates, Inc.
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TABLE 2

PROJECTION OF ANNUAL LEASE REVENUE TO CDC
DOWNTOWN HOTEL AND CONFERENCE CENTER
ESCONDIDO COMMUNITY DEVELOPMENT COMMISSION

Lease Year (1)	Operating Year	Base Ground Lease Payment	Additional Rent Above Pro Forma	Total
1	-1	$0	$0	$0
2	0	$0	$0	$0
3	1	$0	$0	$0
4	2	$0	$0	$0
5	3	$0	$0	$0
6	4	$0	$0	$0
7	5	$0	$0	$0
8	6	$0	$0	$0
9	7	$0	$0	$0
10	8	$0	$0	$0
11	9	$0	$0	$0
12	10	$0	$0	$0
13	11	$206,000	$159,000	$365,000
14	12	$424,000	$164,000	$588,000
15	13	$655,000	$169,000	$824,000
16	14	$900,000	$174,000	$1,074,000
17	15	$1,159,000	$180,000	$1,339,000
18	16	$1,194,000	$185,000	$1,379,000
19	17	$1,229,000	$190,000	$1,419,000
20	18	$1,266,000	$196,000	$1,462,000
21	19	$1,304,000	$202,000	$1,506,000
22	20	$1,343,000	$208,000	$1,551,000
23	21	$1,384,000	$214,000	$1,598,000
24	22	$1,425,000	$221,000	$1,646,000
25	23	$1,468,000	$227,000	$1,695,000
26	24	$1,512,000	$234,000	$1,746,000
27	25	$1,557,000	$241,000	$1,798,000
28	26	$1,604,000	$248,000	$1,852,000
29	27	$1,652,000	$256,000	$1,908,000
30	28	$1,702,000	$264,000	$1,966,000
31	29	$1,753,000	$272,000	$2,025,000
32	30	$1,805,000	$280,000	$2,085,000
33	31	$1,860,000	$288,000	$2,148,000
34	32	$1,915,000	$297,000	$2,212,000
35	33	$1,973,000	$306,000	$2,279,000
36	34	$2,032,000	$315,000	$2,347,000
37	35	$2,093,000	$324,000	$2,417,000
38	36	$2,156,000	$334,000	$2,490,000
39	37	$2,220,000	$345,000	$2,565,000
40	38	$2,287,000	$354,000	$2,641,000
41	39	$2,356,000	$365,000	$2,721,000
42	40	$2,426,000	$376,000	$2,802,000
43	41	$2,499,000	$387,000	$2,886,000
44	42	$2,574,000	$399,000	$2,973,000
45	43	$2,651,000	$411,000	$3,062,000
46	44	$2,731,000	$423,000	$3,154,000
47	45	$2,813,000	$436,000	$3,249,000

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TABLE 2

PROJECTION OF ANNUAL LEASE REVENUE TO CDC
DOWNTOWN HOTEL AND CONFERENCE CENTER
ESCONDIDO COMMUNITY DEVELOPMENT COMMISSION

Lease Year (1)	Operating Year	Base Ground Lease Payment	Additional Rent Above Pro Forma	Total
48	46	$2,897,000	$449,000	$3,346,000
49	47	$2,984,000	$462,000	$3,446,000
50	48	$3,074,000	$476,000	$3,550,000
51	49	$3,166,000	$490,000	$3,656,000
52	50	$3,261,000	$505,000	$3,766,000
53	51	$3,359,000	$520,000	$3,879,000
54	52	$3,459,000	$536,000	$3,995,000
55	53	$3,563,000	$552,000	$4,115,000
Present Value		**$6,900,000**	**$1,189,000**	**$8,090,000**
Discount Rate	**8.0%**			

(1) 55-year ground lease, i.e., two years of construction and 53 years of operations.

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TABLE 3

COMMERCIAL AND RESIDENTIAL LAND SALES COMPARABLES (1)
DOWNTOWN HOTEL AND CONFERENCE CENTER
ESCONDIDO COMMUNITY DEVELOPMENT COMMISSION

Sale Date	Address	City	Sale Price	Acres	$/SF Land	Property Description
12/23/2009	1260 W. Valley Parkway	Escondido	$2,094,545	1.18	$40.75	Retail/Restaurant
12/23/2008	1755 Citracado	Escondido	$5,500,000	3.19	$39.58	Medical
5/15/2008	South Melrose Drive	Vista	$4,540,000	3.44	$30.30	Hotel
1/10/2008	139-141 Canyon Drive	Oceanside	$1,450,000	1.14	$29.20	Retail
3/10/2008	13010 Poway Road	Poway	$1,200,000	1.12	$24.60	Commercial
9/17/2008	439 W. Washington Avenue	Escondido	$1,137,500	1.09	$23.96	Condominium
8/7/2008	Old Grove Road @ College Boulevard	Oceanside	$6,634,000	6.49	$23.47	Office
9/17/2008	300 Zukor Gin	Escondido	$4,437,500	4.46	$22.84	Condominium
12/30/2009	W. San Marcos Boulevard @ Via Vera Cruz	San Marcos	$3,500,000	3.89	$20.66	N/A
3/19/2008	Emerald Drive @ Highway 78	Vista	$800,000	1.12	$16.40	Retail
12/17/2009	Del Lago Boulevard @ Via Rancho Parkway	Escondido	$2,700,000	4.37	$14.18	Hold for investment
		Minimum	$800,000	1.09	$14.18	
		Maximum	$6,634,000	6.49	$40.75	
		Median	$2,700,000	3.19	$23.96	
		Average	$3,090,322	2.86	$25.99	

(1) Selected sales transactions for commercial and residential land between 1.0 and 10.0 acres in Escondido, Oceanside (East of I-5), Poway, Rancho Bernardo, San Marcos, and Vista from January 2008 to present.

Source: CoStar Comps
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