

# Memo

**To:** Sean Sullivan, Economic Development Manager  
**From:** Jason Aarsvold, Ehlers  
**Date:** 1-2-2020  
**Subject:** Cobblestone Hotel – Request for Assistance

The City of Ramsey received a request for assistance to construct a 60 room Cobblestone Hotel and Suites project within the COR area on City-owned land. The developer is requesting the City write-down the cost of the land to \$1 to make the project financially feasible.

You requested that Ehlers review the developer’s proposal to determine whether the request is reasonable and within industry standards. Ehlers conducted a thorough review of the developer’s budget and operating pro forma to ensure all development costs, anticipated revenues, and expenditures were represented appropriately. The table below depicts the sources and uses of funds for the project as proposed by the developer.

<b>SOURCES</b>			
	<b>Amount</b>	<b>Pct.</b>	<b>Per Room</b>
First Mortgage	5,000,000	62.7%	83,333
Developer Equity	2,970,001	37.3%	49,500
<b>TOTAL SOURCES</b>	<b>7,970,001</b>	<b>100%</b>	<b>132,833</b>

<b>USES</b>			
	<b>Amount</b>	<b>Pct.</b>	<b>Per Room</b>
Acquisition Costs	1	0.0%	0
Construction Costs	5,800,000	72.8%	96,667
Furniture, Fixtures, & Equipment	1,385,000	17.4%	23,083
Professional Services	265,000	3.3%	4,417
Financing Costs	170,000	2.1%	2,833
Developer Fee	250,000	3.1%	4,167
Cash Accounts/Escrows	100,000	1.3%	1,667
<b>TOTAL USES</b>	<b>7,970,001</b>	<b>100%</b>	<b>132,833</b>

## Analysis

Generally, this project meets the expectations of a limited service, or upper midscale, hotel project regarding the financing structure, projected revenues, developer fee, and on-going operational costs. Following are our findings from the analysis completed for the project:

- The Developer proposes to finance the entire hotel project with a combination of equity and debt. The proposed financing includes just over 37% equity and 62.7% debt in the form a first mortgage. For a project of this nature, we would expect to see an equity

contribution of at least 25%. The developer indicates the first mortgage would include a 20-year term with 5.5% interest. While these terms are within industry standards and are used for the analysis, we were not given an actual lending commitment to review.

- The total development cost (TDC) for this project is \$7.97 million or \$132,833 per room, assuming no payment for the land. Based on our experience with similar projects, we would expect total development costs to range between \$125,000 and \$150,000 per room with a payment for land. The development costs are within an acceptable range, but we did not receive a detailed breakdown for review. **Using a look-back provision for development costs in the purchase/development agreement is advised.**
- The development fee of \$250,000 is 3.1% of total development costs. For a project of this nature, we would expect to see a developer fee of no more than 5%. The proposed fee is acceptable.
- The developer proposes an Average Daily Rate (ADR) of \$112 in year one with a 60% percent occupancy assumption. This increases to an ADR of \$121 by year three with a 68% occupancy assumption. We typically see ADR assumptions of between \$110 and \$125 in year 1 depending on the local market. The projected ADR is on the lower-end of the acceptable range. Occupancy should be at or above 68% upon stabilization, and this project is exceeding that benchmark. Given the lower projected ADR, however, a look-back provision is recommended.
- The total operating costs are projected at just over \$20,800 per room. The proposed operating costs are within industry standards.
- The projected rates of return for this project, with the full land write-down, are below industry standards. Upon stabilization, the projected cash on cost return (net operating income / TDC) is 7%. Hotel developer/owners would like to see a cash on cost of up to 9%. The projected cash on cash return (annual cash flow / equity) is 4.8%. Hotel developer/owners would like to see a cash on cash return of up to 10%.

## Recommendations

In summary, the lower than average projected return on investment means the project does demonstrate a need for assistance. Providing the requested land write-down will help facilitate development of the hotel without unduly enriching the developer.

In addition, we estimate the project will generate approximately \$45,000 annually in tax increment within the COR TIF district. These funds will be available as a result of this project to repay the City for land costs and other investment in the COR area.

To provide added assurance that the assistance is warranted, including a look-back provision in the purchase/development agreement is recommended. This provision will help ensure the actual TDC is as much as projected and that the returns on investment do not exceed industry standard.