Downtown Phoenix Inc.

DTPHX.ORG

July 20, 2017

Downtown Phoenix Partnership Board of Directors

RE: Sheraton Grand Phoenix Hotel

Dear Board Members:

The City of Phoenix is evaluating a proposal to sell the Sheraton Grand Hotel. As an important DTPHX stakeholder, I want to give you some background on this important transaction.

In 1989, the Phoenix City Council created an additional tax revenue to kick-start redevelopment efforts in conjunction with a decision by the Phoenix Suns to relocate downtown. The Council increased the tax by one percent on hotel stays and two percent on short-term car rentals. The revenue was invested in downtown and the City funded 50 percent of then America West Arena.

The tax revenue was also invested in construction of the Translational Genomics Research Institute (TGen), development of the Phoenix Biomedical Campus and security for a portion of the debt on the city-owned Sheraton Grand Hotel.

When the Sheraton was planned, a commitment was made that no municipal General Fund taxes that support police, fire, parks, and community centers, among other city services, were used to develop and support the operations of the hotel.

The Sheraton was developed by the City in conjunction with the construction of the new convention center and at a time when Downtown Phoenix was severely lacking in hotel rooms. No significant hotel development had occurred in more than 20 years and the convention business was reliant exclusively on the Hyatt Regency and Wyndham (now the Renaissance). The Sheraton helped downtown break through and we now we have eleven hotels in downtown with more on the horizon.

A key factor associated with our burgeoning downtown hospitality market is the General Fund revenue from hotels flowing into city coffers has nearly tripled since 2008. The tax that facilitated the development of the Sheraton which is paid principally by out-of-town guests has created a substantial revenue stream supporting services that improve the quality of life in all parts of Phoenix.

Even though the Sheraton now has positive cash flow, there is going to be a sizeable gap between its sale price and the amount the City owes to its lenders (see attached). According to the City, that gap will be covered by hotel cash accounts and revenue from the 1989 tax adjustment. The money flowing into the General Fund from the Sheraton and other downtown hotels will not be impacted and can be expected to grow.

The Sheraton opened in the teeth of the Great Recession and will continue to be an investment that has risks. Given normal economic cycles, the proposed exit strategy eliminates this risk going forward and merits strong consideration by the City Council. This is especially true since the Sheraton is at the age where it needs a facelift requiring a capital infusion that would be difficult for the City to provide.

You will see a variety of stories and commentary about the Sheraton Grand Hotel in the next couple of months so I hope this provides some context.

If you have any questions, please do not hesitate to give me a call.

Sincerely,

David Krietor, President & CEO

July 13, 2017
Attachment

SHERATON GRAND PHOENIX HOTEL INFORMATION:

The April 17, 2017 Council packet contained a memo that provided an update on the hotel including its history, economic impact, financial performance and sale effort. In summary, that information noted the city's total financial investment to date was $47M and that economic activity at the Convention Center and downtown continues to grow. A link to that packet can be found here:
https://www.phoenix.gov/cityclerksite/City%20Council%20Meeting%20Files/4-17-17_GenInfoPacket.pdf

It is important to provide a clear analysis of the cost to sell the hotel as proposed in the Letter of Intent the city signed on July 10. The city's current outstanding debt on the hotel is $306M. There could also be up to $5M in transaction costs related to the sale. The proposed offer from TLG is $255M. The hotel has $16M in profits and other cash accounts that will become available to the city at the time of the sale. Below is a chart outlining these numbers:

2008 Original Development Bonds	$350M
--	--
2015 Refinance	-$44M
2017 Debt on Hotel	$306M
Estimated Transaction Costs	+$5M
Total	$311M
--	--
TLG Offered Sale Price	-$255M
Total	$56M
--	--
Profit/Cash Accounts Returned to City	-$16M
Total Gap Remaining	$40M

In summary, the city's previous investment of $47M, plus the $40M gap related to the sale of the hotel means the city's total financial investment in the hotel, if the deal is approved, is estimated at $87M.

Previously TLG Phoenix offered the city $300M for the hotel. This deal did not close because TLG had not yet completed a full analysis of property taxes. That's why their new offer was adjusted accordingly.

The hotel requires a significant renovation to remain competitive in this market. Selling the facility allows the city to avoid these extra expenses. The hotel has a $13M capital reserve account that the buyer will use to partially fund a $30M to $40M renovation. This account is required by contract per the hotel operator and has been funded solely by hotel revenues.

It is important to provide a clear assessment of the value and the benefits of the hotel to the community:

- The hotel has generated approximately $50M in direct sales tax revenue (state, county, city) from its original construction through today. The new owner will continue to pay millions of dollars in sales taxes annually.

- City revenues from hotel taxes downtown have nearly tripled due to the expansion of the convention center, the opening of the Sheraton and the other newly developed hotels:
  - 2008 (before Sheraton): $40M in sales resulting in $2M in city tax revenue annually
  - 2016: $111M resulting in $5.8M in city tax revenue annually

- New revenue will be generated with the sale of the hotel as the new owner will be required to pay lease excise tax to local school districts, community colleges, Maricopa County and the city's General Fund. The city has never been required to pay this tax. Estimates of the new revenue to these entities include:
  - About $1.8M year one
  - About $45M over 20 years

- According to the 2017 State Auditor General Report, (https://www.azauditor.gov/sites/default/files/PhoenixConventionCenter-EconomicAndFiscalImpactAnalysisJune7_2017.pdf) since the hotel opened and through 2016, the Phoenix Convention Center has hosted:
  - 483 citywide conventions
  - 1.7M guests
  - 4.9M room nights
  - Resulting in $1.6B in direct spending

- The hotel has been the lodging headquarters for about half of the events at the Phoenix Convention Center listed above.

- Some high profile convention center events with hotel guests include:
  - NFL Super Bowl – 2015
  - NCAA College Football Playoffs – 2016
  - NCAA Final Four – 2017
  - A more complete list is attached

- Since the city invested in the hotel/convention center infrastructure, private business has invested hundreds of millions of dollars in expanding the downtown hospitality footprint:
  - Westin (242 rooms)
  - Kimpton Palomar (242 rooms)
  - Hilton Garden Inn (170 rooms)

- FoundRE (100 rooms)
- Courtyard and Residence Inn (300 rooms)
- Hampton Inn (210 rooms)

City of Phoenix

Phoenix Convention Center
Top Citywide Conventions/Major Events 2009-2017

Month/Year	Event	Attendance	Room Nights
05/2009	National Rifle Association Annual Meetings & Exhibits	64,324	8,330
03/2017	2017 NCAA Final Four Fan Fest	50,803	37,989
05/2011	2011 MLB All-Star Fan Fest	46,700	8,897
11/2009	US Greenbuild Annual Conference & Expo	27,300	12,539
08/2011	Assemblies of God - 54th General Council	21,000	14,541
01/2015	Super Bowl XLIX - HQ/Media/Staff	20,000	22,993
01/2016	2016 College Football Playoff National Championship	16,250	17,625
08/2009	The 110th Veterans of Foreign Wars & Ladies Auxiliary Annual National Convention	13,000	10,583
05/2015	Institute for Electrical & Electronics Engineers (IEEE) Microwave Symposium	12,000	8,413
06/2017	2017 Southern Baptist Convention Annual Meeting	12,000	16,600
06/2011	Southern Baptist Convention Annual Meeting	11,000	10,869
06/2014	USA Volleyball Championship	10,500	8,928
04/2014	Aviation Week 2014 MRO Americas Conference & Exhibition	10,000	9,666
01/2011	Penton Media - The Special Event	9,000	3,513
01/2014	Imaging USA - 2014 Annual Convention & Expo	8,100	4,329
02/2014	Keller Williams National Convention	8,000	13,473
04/2010	Juice Plus+ 2010 Leadership Conference	8,000	3,142
01/2009	Mary Kay Leadership Conference	7,800	8,243
01/2009	Imaging USA - 2009 Annual Convention & Expo	7,700	4,631
01/2015	2015 SCCM Critical Care Congress	7,500	9,711
04/2016	AudiologyNOW!	7,100	13,872
07/2011	Order of Elks 2011 Annual Grand Lodge Convention	6,800	18,343
03/2014	Society of Toxicology 53rd Annual Meeting & Expo	6,527	14,403
03/2016	2016 Materials Research Society Spring Meeting & Exhibit	6,500	8,989
04/2017	2017 Materials Research Society Spring Meeting & Exhibit	6,500	9,558
03/2013	National Indian Gaming Association	6,000	6,970

ATTACHMENT A

City of Phoenix

To: Ed Zuercher
City Manager

Date: April 13, 2017

From: Paul Blue
Deputy City Manager

ITEM: 1

Subject: UPDATE ON SHERATON GRAND PHOENIX

This report provides information on the history and current status of the City-owned Sheraton Grand Hotel and the more than $1 Billion in economic impact that the City's investment in the hotel made possible with the expansion of the Phoenix Convention Center.

Background

In the early 2000's, the State of Arizona and City of Phoenix partnered on a $600 million expansion to the Phoenix Convention Center. As part of the feasibility analysis for the expansion, the need for additional hotel rooms was identified as essential to serve the increased convention activity that the expansion would attract. Without additional hotel rooms, the expansion of the Convention Center would not be financially feasible. Despite numerous City requests and efforts, the private sector was unwilling to make a hotel investment at that time.

Like several communities nationally with convention centers that also had a shortage of nearby hotel rooms, the City pursued its own development of a headquarters convention hotel, the Sheraton Grand Phoenix (Hotel). With a total development cost of $350 million, the 1,000-room Hotel opened in fall 2008. As part of the development, the City also purchased the $3.6 million development site and funded a $10.3 million operating reserve using non-General Fund capital reserves.

The Hotel financial plan, developed as part of the original bond issuance, assumed that all operating costs, senior debt payments and capital reserve accounts were funded solely by revenues generated from the Hotel. The subordinate debt service was separately backed by the Sports Facilities Fund, a special revenue fund generated by taxes on hotels and rental cars. If Hotel revenue was not sufficient to pay subordinate debt service, Sports Facilities Fund resources would be used to pay the difference.

Economic Impact

The events associated with the Super Bowl, College Football Playoffs, and the Final Four across the last three years are estimated as a group to have created over $1 billion in economic impact region-wide. These events would not have been possible in downtown Phoenix without an expanded Convention Center and the Hotel.

Additionally, since 2009, nearly 1.5 million delegates have attended events at the Phoenix Convention Center, generating more than $1.5 billion in direct spending, per a 2016 report prepared by the State of Arizona Auditor General's consulting team. This outcome would also not be achievable without the expanded Convention Center and the Hotel.

Financial Performance

- From 2008 through 2011, the Hotel paid all operating expenses and met all debt service payments solely from Hotel funds.

- From 2012 through 2014 combined, the City made $29.1 million in payments from the Sports Facilities Fund because there was not enough revenue from the Hotel to meet subordinate debt payments after paying all other operating and debt expenses.

- In 2015, the City refinanced the original $350 million debt through J.P. Morgan Chase with a new loan of $306 million. Prior to this refinancing, the City made additional debt service payments from the Sports Facilities Fund of $4.3 million and utilized existing reserve accounts inside the Hotel corporation to further pay down debt. The new loan immediately reduced annual debt service payments by more than 50%.

- Since 2015, occupancy at the Hotel has grown. Staff took actions to reduce expenses and the new loan lowered debt service payments. These factors created a positive cashflow for 2015-2017 (2017 projected) that resulted in an accumulated net profit of $14.4 million. Per City Council direction, all Hotel net profits are being reserved to pay down debt and/or support a future sale.

- Based on rooms already booked, the Hotel projects 2018 to deliver the best financial performance in the Hotel's history.

- In summary, the total City cash investment into the Hotel has been $47.3 million over the last 12 years comprised of:

    - Original Land Acquisition 3.6 M
    - Original Operating Reserve 10.3 M
    - 2012-15 Subordinate Debt Payments 33.4 M

Sale Effort

In December 2015, staff recommended and City Council authorized marketing of the Hotel for sale. Staff received an offer from TLG Phoenix, LLC (TLG), in January 2016, and the City Council authorized the pursuit of exclusive negotiations with TLG in February 2016. The transaction was intended to close by June 2016.

TLG and the City were not able to come to terms. As a result, the exclusivity of negotiations was terminated in Summer 2016. Since that time, the City has pursued discussions with a variety of different parties, including TLG, about sale of the hotel.

The Asset Manager for the Hotel, CHM Warnick, has been instrumental in helping the City identify and approach a number of potential purchasers. Additionally, a number of interested parties have approached the City directly.

Conclusion

City staff will continue to update the City Council on the ongoing sales efforts. Fortunately, the 2015 refinance and subsequent profits have reduced the financial pressure on the Hotel. Further investment from the Sport Facilities Fund has not been necessary. In fact, the Hotel is generating a reserve from net profits. Economic activity at the Convention Center and in downtown continues to grow, spurred in part by the original investment in the Hotel. City staff continues to entertain all legitimate offers, seek qualified buyers, and is focused on selling the Hotel as quickly as possible at terms favorable to the City.