



Staff Reports

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To: Honorable Mayor and Members of City Council

From: Dr. Peter Pirnejad - Assistant City Manager - Development Services

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TITLE:

2018 Lodging Market Study and Related Economic Impact Analyses

RECOMMENDED ACTION:

Receive report and provide direction to staff regarding potential updates to the City's lodging policies to be brought back to a future City Council meeting.

DISCUSSION:

In late 2017, the City of Napa retained Cushman & Wakefield (Cushman) and BAE Urban Economics (BAE) to update the 2007 lodging market study and related economic analyses, respectively. The new study examines changes from the previous study, but primarily provides information on current market trends and projections of demand, supply and economic-oriented effects.

Similar to the 2007 study, Cushman prepared an inventory of existing and proposed facilities; developed definitions of lodging product types; analyzed demand generators; forecasted occupancy, average rates and potential capacity by lodging type; reviewed available meeting and banquet facilities; and identified potential issues and constraints to growth in the hospitality sector. Also, the study includes Cushman's suggested recommendations. BAE was retained to prepare the related projections of economic and fiscal effects as well as to assess labor availability.

This staff report provides a general overview of the study findings. The forecasts reflected in the market study are projected for the next ten years, based on the known pipeline of new rooms (as of December 2017) for years one through six, and the sustainable occupancy for years seven through ten. These projections have been used by BAE in the preparation of estimates regarding economic impacts, fiscal impacts, and labor accessibility.

General Market Trends

- As of January 2018, global lodging industry leaders generally do not express concern about a downturn affecting the current market cycle. Nationally, revenue growth is expected to range between 3 - 5% overall.
- Shifts in demographics of hotel users from baby boomers to millennials, and changing lifestyle trends, are shaping the perception and design of hotel products. There is a renewed emphasis on public space, a desire for communal social spaces, and hotel guests are seeking unique and local experiences with operators offering more options for activity programming

(e.g., classes, tours, tastings.)

- Wine production and tourism will continue to lead the Napa Valley economy forward. Napa Valley is a regional, domestic, and global destination but primarily attracts visitors from California. In this context, the Napa Valley economy benefits from its regional proximity to the broader Bay Area, and Sacramento, which provide a strong base of hospitality demand. Additionally, the increase in total air passengers to Bay Area airports bodes well for the Napa Valley hotel market.
- Most leisure demand in Napa Valley is generated by visitors taking advantage of the numerous wine- and food-oriented facilities, recreational opportunities, and other tourist attractions. Subsequent to the 2007 study, the lodging market has shown strong growth in all performance measures, supported by the appeal of the region's wine, food, and beverage attractions.
- In Napa Valley, there are four major lodging destinations: City of Napa, Calistoga, St. Helena and Yountville. Since the 2007 study, each location has become a more distinctive destination including lodging and complementary retail, food and beverage, and entertainment uses including tasting rooms. The continued investment in downtown Napa is enhancing the City as its own destination.
- Since 2007, the local lodging market has been resilient and robust, and continues to attract new development despite natural event challenges. National investors are now more present in the marketplace. The most notable growth in inventory in the City has been in the full-service market segment.
- Unlike the market conditions at the time of the 2007 study which were showing weakness in the pre-recession economy, hotel performance has improved since 2010. The current market study shows that the number of peak occupancy nights has expanded from three months in 2010 to seven months by 2016, annual occupancy and average daily rates are at very high levels, and lodging performance has set records since 2010.
- Over the past ten years, the number of available rooms valley-wide increased by 28% (from 3,432 in 2007 to 4,349 in 2017), and by 37% in the city (from 1,832 in 2007 to 2,515 in 2017). In two years, between 2008 and 2009, the city of Napa saw 321 rooms come online. In the past seven years, since 2010, new room supply in the City of Napa has been modest (17% increase) with only 362 rooms activated despite a large number of entitled lodging sites.
- The hotel market valley-wide and in the City of Napa has continued to thrive even as new hotels have opened. Demand for rooms has been strong for all product segments and is expected to grow over the long-term barring any unforeseen events.

Room Supply

- The Cushman analysis indicates that Napa Valley is capable of absorbing the additional proposed lodging in the existing pipeline (2,321 rooms - 91% inside the city, 9% outside the city) as market conditions allow. While not all of these rooms may be built, the analysis projects that the demand for hotel rooms will exceed the proposed supply in the long-term (155,817 room nights, or 427 rooms, by 2027).
- While the study identifies capacity for absorption of the current lodging pipeline based on the projection methodology used, this finding does not in any way imply that potential projects should be, or are, approved as a result.
- The study estimates that the anticipated additional rooms reflected in the current pipeline for the overall market could be absorbed by 2027, with a slight drop in occupancy projected around 2022-2023 as new projects are completed and new rooms come online; market-wide sustainable occupancy is forecasted at 72%. Room rates are expected to remain healthy throughout this time period and have been projected reflecting inflationary growth levels.
- For purposes of forecasting supply and demand, the inventory of anticipated projects that the consultant included in the analysis reflect those that are likely to be probable. However, the consultant points out that there is always a level of uncertainty associated with new hotel development and some of the projects may not materialize as anticipated which would result in a reduction of supply in comparison to the future projections.

Lodging Demand

- The Napa Valley lodging market continues to be seasonal. Demand is strongest on the weekend and during the summer months where occupancy can exceed 80%. With the exception of 2014 which was impacted by the earthquake, and the fall of 2017 due to the wildfires, demand has increased nearly every month for the past seven years.
- Since the 2007 study, Napa Valley's seasonal demand pattern has been expanding. The highest hotel occupancies continue to occur during the summer months from July through October. However, occupancy levels in the shoulder period (November, March, and April) and the low period (December through February) have been regularly increasing each year since 2010.
- Consistent with the 2007 study, and similar to most markets, the valley-wide lodging market continues to be comprised of three guest-type demand classifications: 1) commercial (business) travelers, 2) leisure travelers, and 3) meeting/group travelers. With the dominance of online reservation portals, it has become more challenging to accurately determine the purpose of travel. However, it is the consultant's opinion that the strong performance of the B&Bs/small inn product type is directly related to greater online presence and ease of making reservations for these properties. Additionally, this type of lodging may provide hotel guests with a more local and unique experience.
- For the demand analysis, based on historical data and field surveys, the consultant combined the commercial and leisure travelers into one market segment reflecting 87% of accommodated demand. The meeting/group travelers market segment is much smaller, reflecting only 13% of accommodated demand.

- The study also addresses latent demand which accounts for travelers who could not be accommodated by the existing competitive supply for various reasons. Latent demand analysis covers induced demand which is additional demand created by a new demand generator such as a specialized lodging property, and displaced demand reflecting travelers unable to secure accommodations in the market due to facilities being at full capacity.
- The consultant forecasts that demand by lodging type will remain generally constant throughout the projection period, subject to the overall economic health of the nation and the region's tourism industry. Demand, particularly for leisure travelers to Napa Valley, is expected to continue to remain strong.

Occupancy and Average Daily Rates

- Following the Great Recession, the combined occupancy level for all hotel types in the Napa Valley market has steadily increased from a low of 61% in 2010 to 71% by 2017. Sustainable occupancy valley-wide is projected at 72% through 2027. For the city of Napa pipeline, annualized sustainable occupancy is forecasted to range by property type: B&Bs/small inns - 64% (historical at 64%); limited-service hotels - 75% (historical at 76%); and full-service properties - 72% (historical at 71%).
- Similar to occupancy rates, the average daily rate for all Napa Valley hotel types increased from \$226 in 2010 to \$323 by 2017. For the estimated additional lodging capacity in the City of Napa, the anticipated average daily room rate is projected to increase over the forecast period from 2018 to 2027, and range by property type: B&Bs/small inns - \$296 (2018) | \$394 (2027); limited-service hotels - \$200 (2018) | \$266 (2027); and full-service properties - \$262 (2018) | \$352 (2027).
- The consultant did not include a local-only forecast for the luxury/resort hotel product category, determining that there is not a product type in the City of Napa categorized as luxury with rates that compete with the up-valley resorts, which can exceed \$2,000 on peak nights. Cushman indicated that in general, luxury properties in Napa Valley are small with high service levels. The consultant did include such proposed properties, including the City of Napa, for the total valley-wide calculations.

Meeting Space

- The consultant identified three categories of meeting space by venue valley-wide: 1) wineries, 2) hotels, and 3) exposition centers/other. Currently, there is a total of 324,729 square feet of space within Napa Valley, of which the majority of space is located in the City of Napa - approximately 228,000 square feet or 70% of the total. This is primarily due to the City being home to the largest venues which include The CIA at Copia and the Napa Valley Expo.
- Currently the ratio of total venue space to guestrooms in Napa Valley is approximately 64 square feet per room, and 93 square feet per room in the City of Napa. For hotels only, the ratio is 39 square feet per room valley-wide, and 36 square feet per room in the City. In either case, these ratios are either in line with, or higher than, industry benchmarks, depending upon the property type.

- Since the 2007 study, meeting space in Napa Valley has and is continuing to expand with the opening of full-service hotels in the City of Napa and the conversion of Copia into The CIA at Copia. The consultant concludes that hotel occupancy of recent years indicate that the market is supported by the existing facilities. Additionally, trends over the past 20 years have shown that the appeal of meeting space is more important to larger hotels and during softer economic periods.

Economic and Fiscal Effects

Using the findings of the Cushman study, BAE Urban Economics projected the spinoff economic effects and estimated tax revenue anticipated from the additional proposed lodging. Additionally, BAE used data from the *2016 Visitor Profile Final Report of Findings* completed by Destination Analysts, Inc. for Visit Napa Valley.

Economic Effects. The economic effects were forecasted using a regional input-output software model - IMPLAN and include projections for direct and indirect spending and job creation as well as induced spending. The analysis is based on a single point in time at the assumed buildout in 2023 as reflected in the Cushman study. The BAE estimates include full and reduced buildout scenarios. The more conservative estimates reflect a reduction of full buildout to approximately 60 - 70%, assuming that full buildout of the current lodging pipeline does not come to fruition.

- Under the full buildout scenario of 2,112 rooms proposed within the City of Napa, BAE estimates the creation of approximately 6,000 direct and indirect jobs (e.g., lodging, retail, restaurants, etc.) and the generation of nearly \$760 million in annual ongoing economic output across all sectors of the Napa Valley economy. BAE estimates that construction would support about 1,200 jobs and generate nearly \$185 million in output.
- For the 70% reduced buildout scenario of 1,498 rooms, BAE estimates the creation of approximately 4,300 new jobs and the generation of nearly \$530 million in annual ongoing economic output across all sectors of the Napa Valley economy. BAE estimates that construction would support about 850 jobs and generate about \$130 million in output.
- For the 60% reduced buildout scenario of 1,291 rooms, BAE estimates the creation of approximately 3,700 new jobs and the generation of nearly \$450 million in annual ongoing economic output across all sectors of the Napa Valley economy. BAE estimates that construction would support about 730 jobs and generate approximately \$110 million in output.

Fiscal Revenue Effects. The fiscal revenue effects were calculated using the findings from the Cushman study. The analysis is based on a single point in time at the assumed buildout in 2023. The BAE estimates include both full and reduced buildout scenarios. The more conservative estimates assume a reduction of full buildout to approximately 60 - 70%, assuming that full buildout of the current lodging pipeline does not come to fruition.

- Assuming full buildout, BAE projects the generation of approximately \$30 million annually in revenue to the City of Napa including 87% from transient occupancy taxes, 7% from property tax and property tax in lieu of vehicle license fees, 5% from sales taxes, and 1% from business license fees. Additionally, BAE projects that full buildout could generate up to \$2 million in sales and use taxes from construction.

- At the 70% reduced buildout scenario, BAE projects the generation of approximately \$21 million annually in revenue to the City of Napa, and \$1.4 million in one-time construction use taxes.
- At the 60% reduced buildout scenario, BAE projects the generation of approximately \$18 million annually in revenue to the City of Napa, and \$1.2 million in one-time construction use taxes.

Future Constraints

Both Cushman and BAE identify future constraints associated with the expansion of the lodging/hospitality market that could affect the projects reflected in the current pipeline. Cushman touches upon the regional challenges of traffic congestion, housing costs, and the availability of/access to labor. Cushman reflected that these issues are expected to continue to be challenging for lodging operators but did not appear to have deterred development of new hotels, the interest of hotel developers, and the successful operation of existing lodging.

BAE further analyzed hotel industry labor availability and housing affordability related to this market segment, assuming full and reduced buildout scenarios.

- Assuming full buildout by 2023, BAE projects the labor demand to be approximately 1,000 additional hotel workers, and a related housing need of 540 units. At the 70% reduced buildout scenario, the labor demand is estimated at nearly 700 workers and 378 housing units. For the 60% reduced buildout scenario, the worker demand is estimated at approximately 600 employees and 324 units.
- BAE concludes that City of Napa hotels will need to draw a portion of the new workers from new members of the labor force and workers moving from outside of the area given the low unemployment rate in Napa's 30-minute and 60-minute commute sheds which is 5.5% and 5.1%, respectively. For the 30-minute commute shed there is not a large enough pool of potential workers. For the 60-minute commute shed, while the pool of candidates may be adequate, the long commute times may be a factor in deterring interest for such positions.
- A 30-minute drive time includes communities from St. Helena to Vallejo. A 60-minute drive time encompasses cities located in Alameda, Contra Costa, Marin, Napa, Solano, Sonoma, and Yolo Counties. BAE acknowledges that drive times can vary substantially based on traffic conditions resulting in commutes taking longer than 30 or 60 minutes.
- While some hotel employees working in the City of Napa will live in Napa, BAE concludes that many will live elsewhere due to housing cost or availability, personal preference, proximity to family or a spouse's place of employment, or other factors.
- As of 2017, for workers employed in hotels within Napa County, BAE indicated the weighted average annual income to be approximately \$42,800. Taking into account job categories typical of the hotel industry, BAE has estimated employment across multiple income-levels for the proposed hotels in the City, which in turn, will necessitate access to housing that is affordable at multiple levels (low-income, moderate income and above moderate income.)

- BAE reported that hotel operators in Napa have expressed concern that the region's high housing costs may limit their ability to find workers in the future. The City of Napa has residential development in the pipeline, implementation of which will be essential to hotel operators' ability to attract and retain hotel workers for new jobs over time.
- Housing affordability across the Bay region is challenging and is not unique to the City of Napa or Napa Valley. The City's residential pipeline, which is anticipated to result in a considerable number of new housing units at a range of affordability levels, concurrent with the development of new hotels, will be critical to addressing the housing challenges.

Consultant Recommendations

Cushman and BAE have made the following recommendations to assist the City in the facilitation of a sustainable lodging/hospitality market.

1. For long-term growth and sustainability, consider a wide variety of lodging products that target the evolving visitor trends, and look beyond the conventional categories articulated in the study to expand the base of lodging demand by offering a number of unique guest experiences. Examples of new concepts include: experiential-based lodging, dedicated wellness centers, lodging facilities with communal public space, upscale, and other facility types. It is important to have a variety of lodging options to attract guests, particularly during softer periods.
2. Brands are an important factor to consider. Globally affiliated lodging facilities are able to ramp up quickly. Additionally, brand affiliations have the ability to expand demand for particular hotels and grow the market. Whenever possible, the design of new hotels to be built should reflect the wine country destination of Napa.
3. Feasibility is an inherent monitor on hotel development and a factor to be considered. Some product types may not be feasible to build based on the cost of land and construction, or may be feasible only as part of mixed-use projects. For example, luxury hotels are the most complicated and expensive hotels to build. Due to the large investment, such facility types require high average daily rates and occupancies to be feasible.
4. Lodging projects can take many years to come to fruition due to many factors such as finding suitable sites, obtaining entitlements, financing, and rising construction costs. Consider incorporating additional flexibility into the entitlement and development process for new hotels, taking into account the cyclical nature of the lodging development industry, to avoid delayed construction by improving the match between market timing and optimal lodging facility programming.
5. Not all new hotels need to be built downtown. Some lodging facilities may be more feasibly developed on sites outside of the core; therefore, consider a variety of lodging product types and locations.
6. With the advent of ridesharing services, to ease the need for parking at hotels, undertake further study of the impact of the increased use of rideshares and public transportation options

for locally transporting hotel guests to area attractions.

7. As a hedge for softer market cycles, additional proposed full-service and resort hotels under consideration should include an appropriate complement of meeting space. New hotel projects should provide a minimum of 15 - 50 square feet of contiguous meeting space per guest room depending upon the type of hotel and location to support group meeting demand. Limited-service hotels with meeting room space and close proximity to support services would be considered desirable.
8. Access to locally-based housing that is affordable for multiple income levels is a critical component to be considered. Implementing the City's existing residential pipeline is fundamentally important. Partnerships between major employers, local government, and affordable housing developers could be key to continuing to address the availability of workforce housing.

Next Steps

The consultants' recommendations warrant a review of the City's existing hotel policy which was revised in 2008 following the completion of the 2007 HVS Lodging Market Study. Subject to direction from the City Council, staff will proceed with undertaking a review of the existing lodging policy as reflected in Resolution R2008 76 (see Attachment 3), and bring updated and new policy recommendations to the City Council for consideration at a future Council meeting.

FINANCIAL IMPACTS:

This agenda item is informational and does not result in a financial impact without future Council action.

CEQA:

The Assistant City Manager has determined that the Recommended Action described in this Agenda Report is not subject to CEQA, pursuant to CEQA Guidelines Section 15060(c).

DOCUMENTS ATTACHED:

ATCH 1 - Lodging Market Study Product Categories

ATCH 2 - Cushman & Wakefield Napa Valley Lodging Market Study, 2018 and BAE Urban Economics Economic Impact Analyses Memos

ATCH 3 - Council Resolution R2008 76

NOTIFICATION:

The Agenda was posted at least 72 hours in advance of the Council meeting.