



CITY COUNCIL AGENDA REPORT

MEETING DATE: Tuesday, March 25, 2025
TO: CITY COUNCIL
WRITTEN BY: SR. ADMINISTRATIVE ANALYST ZAVALA
RECOMMENDED BY: CITY MANAGER VIDES
APPROVED BY: TAMARA VIDES, CITY MANAGER
SUBJECT: DEVELOPMENT OF A HOTEL INCENTIVE POLICY

RECOMMENDATION:

Staff recommend that the City Council provide direction to the City Manager regarding the development of a draft Hotel Incentive Policy for Council consideration. This policy aims to attract high-quality hotel developments that will contribute to the City's economic growth, generate substantial Transient Occupancy Tax (TOT) revenues, and enhance the local business environment.

BACKGROUND:

Transient Occupancy Tax (TOT) is a vital revenue source for cities, collected from guests staying at hotels, motels, and other lodging establishments. In Watsonville, the TOT rate is 12%, meaning that for every night a visitor stays in a local hotel, the hotel pays a portion of their lodging cost to the City. This revenue plays a crucial role in funding essential municipal services, infrastructure improvements, and community programs. Eight hotels operate within city limits, and the City expects to generate approximately \$1.6 million in TOT revenue from them this fiscal year.

Attracting new quality hotels can be a significant driver of economic development due to their ability to generate hundreds of thousands of dollars in annual TOT revenues and stimulate millions of dollars in visitor spending at local businesses. However, the current national economic and financial market conditions present challenges for developers in securing affordable financing commitments.

Many cities across the State have adopted hotel incentive policies to encourage the development of high-quality hotels in targeted locations. These policies aim to enhance the economic vitality of the City while ensuring that hotel developments incorporate ancillary facilities that provide additional community benefits.

A standard framework in such policies requires developers to present a comprehensive development plan, including:

- A franchise brand that meets minimum size and quality standards,
- A financial feasibility analysis outlining construction cost budgets, operating income projections, and expected return on investment,
- Identification of a financial gap that requires support to make the project feasible.

To bridge the financial gap and support hotel development, the City could consider incentives such as TOT revenue-sharing agreements, support infrastructure improvements, or provide parking variances. These agreements typically include a threshold level after which the City will rebate a percentage of the TOT generated each year for a defined term, with the goal of ensuring public and private sector benefits.

DISCUSSION:

High-quality hotels drive tourism, increase local business revenues, and expand the City's tax base. Given the competitive landscape for attracting hotel developers, implementing an incentive policy would strengthen the City's ability to secure quality hotel investments that might otherwise be located in neighboring jurisdictions or simply not develop at all.

The policy guidelines that the City could evaluate include hotel projects' economic impact, financial feasibility, and alignment with community goals. The financial assistance provided through TOT sharing agreements or infrastructure support will help offset high development costs while ensuring that the City benefits from long-term economic gains. Furthermore, these incentives will encourage the inclusion of community-enhancing facilities such as conference spaces, dining establishments, and recreational amenities that would not be financially viable without City support.

The following are examples of hotel incentive policies established by other cities.

Morgan Hill:

- The City's contribution covers up to 50% of costs for off-site improvements like roadways, sidewalks, and utilities.
- The contribution is repaid via a rebate from future TOT revenues, capped at 10 years or once 50% of the costs are reimbursed.
- If the subsidy cap isn't reached in 10 years, the program may extend for another 5 years at the City Manager's discretion.

Dublin:

- Offers TOT rebates of up to 70% for 4-star hotels and 50% for 3-star hotels.
- Rebates can last up to 20 years for 4-star hotels and 15 years for 3-star hotels.

- Renovated hotels can receive a TOT increment rebate for up to 10 years.

Santa Ana:

- Targets high-end hotel developments (4-star or higher) with economic incentives.
- Uses 50% of the Hotel Visitors' Tax (HVT) incremental revenue to address funding gaps.
- Incentives are negotiated based on project feasibility and economic impact.

POLICY AND INCENTIVE ITEMS THAT COULD BE CONSIDERED

To support and encourage high-quality hotel development in Watsonville, the Council may consider various incentive tools that can aid in hotel development while ensuring the City continues to benefit from increased Transient Occupancy Tax (TOT) revenues.

The following policy options outline potential approaches for Council consideration:

1. **TOT Revenue-Sharing Agreements:** The City Council may explore structured TOT rebate programs to help address funding gaps while maintaining financial benefits for the City. A possible framework could include:
 - a. A 60% TOT rebate after meeting a threshold for a defined period to incentivize the development of high-quality 4-star hotels.
 - b. A 40% TOT rebate after meeting a threshold for 3-star hotels, ensuring a balanced approach to hotel development.
 - c. The City Council may authorize the City Manager to negotiate agreements on a case-by-case basis, ensuring incentives align with economic benefits.
2. **Hotel Renovation:** To support the modernization of aging hotel facilities, the City could develop a program offering TOT rebates to encourage hotel renovations that could lead to higher occupancy and TOT collected.
3. **Public Improvement Support:** The City may support hotel developments by facilitating necessary public infrastructure improvements, such as upgraded roads, sidewalks, and utility enhancements, through development and reimbursement agreements with potential developers. This support could come in the form of TOT rebates and grant opportunities, helping to create a more attractive investment environment and encouraging further development in the area.
4. **Grant Support:** The City can assist hotel developers in securing external funding by helping with grant applications or by being applicants or co-applicants for grants. This could include identifying and applying for state, federal, or private funding opportunities that align with the City's goals for economic development, tourism, or sustainability. By partnering with developers, the City can increase the likelihood of securing additional resources to support hotel projects.

5. **Leveraging Existing Revolving Loan Fund:** The City's Revolving Loan Fund can be used to support hotel renovation projects. This fund provides an opportunity to offer financial assistance to existing hotels in need of upgrades, ensuring that projects can move forward even if they face financing challenges.

The Hotel Incentive Policy will align with best practices from other municipalities while tailoring the approach to meet the City's unique economic and development objectives.

CALIFORNIA ENVIRONMENTAL QUALITY ACT (CEQA) DETERMINATION:

N/A

STRATEGIC PLAN:

Economic Development

Infrastructure & Environment

Fiscal Health

FINANCIAL IMPACT:

The preparation of a draft Hotel Incentive Policy will have no immediate financial impact on the City's budget. However, if adopted, the policy could result in future TOT-sharing agreements or other financial incentives that may temporarily reduce initial TOT revenues while supporting long-term economic growth. The policy will be structured to ensure a net positive fiscal impact by attracting new hotel developments that generate sustained TOT revenues, increase local business activity, and enhance the overall economic vitality of the City.

ALTERNATIVE ACTION:

The City Council may choose not to explore a Hotel Incentive Policy at this time.

ATTACHMENTS AND/OR REFERENCES (IF ANY):

None.