Executive Summary of the Status of DHI Process in July-August of 2011

Executive Reporting of the Downtown Hotel Solutions and Mixed Use Options

Working Committee on Downtown Hotel Solutions and Mixed Use Options

---

August 10, 2011

This is a revision of a similar executive summary of Alexandria policies compiled three years ago on August 5, 2008.

The privately-owned Hotel Bentley and the publicly-owned Alexander Fulton Hotel properties, along with the publicly-owned Alexandria Riverfront Center, each present unique obstacles and challenges to redevelopment and reinvestment in the Alexandria downtown area. All are key ingredients to the success of a reinvigorated Third Street and downtown corridor. Alexandria is moving on a deliberate course to return the publicly-owned Alexander Fulton to the private sector. Public officials and private investors must work together to resolve these issues, with an eye toward long term and sustainable solutions. An updated SWOT analysis issued with this Executive Summary lists some important considerations about the future of the current (or similar) process(es) and open a window on the issues facing Government, the Community, and Business participants. Robust public debate is needed to aid policymaking in the downtown revitalization efforts of Alexandria.

The following comments provide a summary of points more particularly discussed in an accompanying Status Report on the Downtown Hotels Initiative ("DHI") regarding the unique and common challenges of downtown revitalization, market trends in the hotel and convention world, and public-private partnering. Unless otherwise stated, these challenges refer to those in the Alexandria market.

"Snapshot" Conclusions

The Mayor's Office of Economic Development wishes to highlight Alexandria's needs and to distinguish those needs from wants or best cases. Alexandria's Administration cannot know each interested private party's or stakeholder's needs, and thus these must be shared. The Administration provides the following snapshot of the Executive Summary:

Executive Summary, July-August 2011
Working Committee on Downtown Hotel Solutions and Mixed Use Options

- City officials in the interim have favored a global version (during the period it posed no additional risk), but need additional activity to justify why Alexandria is not compelled to recommend Fulton-only arrangements (now that title issues will be cleared up by settlement with Capital One).

- While the Alexander Fulton's legal problems pend(ed), its offer in a dispositive manner was impaired. The DHI's global nature, while the Fulton was operated on another's "dime," posed no increased risk to the City outside of continued declines in operations and other transactions costs. But, with the City having no funds to prop up hotel operations, that was an academic point and one over which Alexandria had no control. Stakeholders must be careful not to present a false dichotomy: if the Alexander Fulton had been sold earlier instead of pursuing the DHI, Alexandria would be further along with claimed policies of disentanglement.

- Alexandria must disentangle itself from the current Alexander Fulton relationship. While not everyone agrees with that premise, *e.g.*, some stakeholders, like preservationists, believe Alexandria should stay engaged for the global deal until something happens because this is that important. They can cite support for this type of "political courage." They will argue the populace does not have all the facts or institutional history. Unfortunately (or fortunately, depending on your bent), Alexandria does not have to weigh in on that policy dichotomy. The reason is it presents a false dichotomy similar to the previous one. This is because Alexandria cannot afford to budget operating dollars for hotel operations while we await (the courage part of) "something happening." There are no public funds to resolve a commercial enterprise's fiscal problems, making the argument an academic point.

- Alexandria could neither have auctioned the Alexander Fulton last year or the year before while the Alexander Fulton's ownership was disputed, in court, and under a stay order, nor could Alexandria accept continuing a manager-operator relationship obligating the City for future commercial operating costs—a true statement even if the operator was the best in the business. Why? There was and remains no budgeted money for such expenditures of operating a commercial business on the public dime.

- That analysis was the underlying assumption of the DHI to offer a runway toward activity, with generous timeframes, and time away from management agreements obligating the City for future commercial operating costs.

- Alexandria could (and will) not: (i) run afoul of US Bankruptcy Court; and (ii) allow anyone or any entity to buy the Alexander Fulton or allow it to be auctioned before title and constitutional issues were resolved. (The false dichotomy that Alexandria had this choice to arrive at a different result in the last two years is inaccurate. Alexandria could neither enter into an unconditional lease nor sell the hotel. Alexandria could not allow Capital One to acquire assets it never owned, even though Alexandria winning the legal proceedings required Alexandria to recognize and discharge obligations associated with its property.

- When the current non-risk agreement with Noble runs out on October 31, 2011, Alexandria must have a new runway with the Alexander Fulton for an acceptable exit or a global deal in place.

- Most would rather the latter, but the Administration is compelled to work the former simultaneously on a basis of first come, first served in the absence of something extraordinary. The timeframe is even more important because funds are limited and closure of the going concern at the Alexander Fulton results in tremendous loss to Alexandria.

- Finally, it must be remembered a smaller DHI warrants a smaller allocation of public commitment. From new public infrastructure to "primarily-favored" use of supportive public infrastructure, modifications are necessary in the discussion. For example, the scaled global version's interaction with the Alexandria Riverfront Center has changed.

Executive Summary of Policy Development
July-August 2011

A more formal, detailed Executive Summary of the policies underlying the Status Report follows:

Alexandria is bound to follow certain considerations with regard to pledging public monies, resources, property, or aid to individuals or private industry.

- Alexandria funds, credit, property, or things of value will not be loaned, pledged, or donated to or for any person, association, or corporation, public or private, except for programs of social welfare for the aid and support of the needy for a public purpose, unless there is a written cooperative endeavor outlining all obligations based on a valid statute, ordinance, charter or contract, for a public purpose, and for a public benefit proportionate to its cost (*i.e.*, the amount expended by the City is met with a comparable return

Executive Summary, July-August 2011
Working Committee on Downtown Hotel Solutions and Mixed Use Options

or real and substantial obligation to create a future return).

- Alexandria shall also only make such commitments after full disclosure and public participation.

Alexandria has concluded its overarching obligation is to secure a return of the former Holiday Inn and now Alexander Fulton Hotel and Convention Center to full function. Energy should be directed to bringing the Alexander Fulton Hotel back into appropriate commerce immediately in order to secure the City's investments and to ensure a proper exit strategy from and disentanglement regarding Alexandria involvement with the downtown hotels.

- It would be irresponsible for Alexandria officials to assist the Hotel Bentley without securing the City's own asset; indeed, this would constitute fiduciary neglect.

- Alexandria considers the paramount interest of the City to be the Alexander Fulton; it should take precedence as the more reasonable and immediate goal for Alexandria. Any agreement with public-private partnering must include an assessment of the Alexander Fulton because of its attachment to the Riverfront Center and the Alexandria's ownership of certain aspects of the properties. Alexandria will protect its assets, ownership interests, and the future convention business of the City first and foremost.

- While a disentanglement should ensure the functionality and optimization of the Alexander Fulton—with appropriate "claw backs" to ensure uses are not inconsistent with community goals—the private sector should be allowed to address the downtown hotel issues.

Timing for public partnering with hotels is questionable according to qualified analysts. However, the important assets already owned by the City of Alexandria must be secured. Many predictors and experts point to prolonged recessionary

Executive Summary, July-August 2011
Working Committee on Downtown Hotel Solutions and Mixed Use Options

activity surrounding the hotel industry and the prognosis for tertiary and sub-tertiary markets presents a mixed bag incapable of deep reliance.

- Many disinterested-party market studies question the glut of contrary industry "studies" supporting investing into hotel-motel public partnering in a direct fashion. Alexandria, however, for better or worse, has significant investments in publicly-owned property requiring attention to avoid total loss.

- Investment in related and supportive infrastructure, on the other hand, may make great sense for Alexandria in securing its assets.

- Regarding the overall market:

> "The overall convention marketplace is declining in a manner that suggests that a recovery or turnaround is unlikely to yield much increased business for any given community, contrary to repeated industry projections. Moreover this decline began prior to the disruptions of 9-11 and is exacerbated by advances in communications technology.
>
> "This analysis should give local leaders pause as they consider calls for ever more public investment into the convention business, while weighing simultaneously where else scarce public funds could be spent to boost the urban economy. . . .
>
> "With the commitment of such huge sums to convention centers and related facilities comes a serious second cost—the opportunity cost of not investing this money in other public goods, even those aimed at downtown revitalization and economic development. The taxes on restaurant meals, car rentals, and general sales taxes that pay for convention centers

are legitimate public revenue sources, which could be used for a broad array of local public purposes. The investment into downtown revitalization—including housing, retail, and infrastructure—could provide a substantial development stimulus and inducement to private investment, for example. And in any given city, investments in transportation, industry cluster development, schools, neighborhood development, or any number of other priorities may be likely to yield far more bang for the buck. These projects have greater direct appeal to local residents, and thus offer greater likelihood of success. In short, at a time when city finances are obviously stressed, the price of a failed convention and visitor strategy can be measured in terms of all the other investments, services, and fiscal choices that will be never realized as a result."

—*Brookings Institution*, 2005.

- According to an article by *The New York Times*, published July 31, 2008, "a record number of hotels are opening this year, and the timing could not be worse. . . . It hasn't turned into a hotel recession just yet, but we're certainly keeping an eye on the economy. . . . The hotels most likely to suffer are expected to be in smaller cities that are losing scheduled air service, which could reach as many as 100 by the end of the year, according to air transportation analysts.

- Some recent material provided by the local editorial board and provided to the Alexandria City Council in past reporting suggests a turnaround, particularly for small mid-sized cities in below secondary markets. However, these treatises a deal do not make! The reality for developers vis-à-vis banks is the true, objective measurement.

Executive Summary, July-August 2011
Working Committee on Downtown Hotel Solutions and Mixed Use Options

While these points about public investment remain a paramount concern, Alexandria's Downtown Hotels Initiative ("DHI") neither placed the City at increased risk for investment loss nor involved public investment into operations on material or going-forward bases. Moreover, during the time of the DHI, Alexandria was able to avoid expensive management agreements—placing the risk of losses on the operator and not the taxpayer—while Alexandria could neither sell nor offer the Alexander Fulton Hotel to developers without significant claw backs and strings. That being the case, there was no reason to avoid participating in a large-scale, "game changing" development opportunity on an opportunity cost basis. There was no one else in line offering to develop outside of massive public risk and subsidy.

- As has been explained, the DHI process occurred over a year's time during a period in which constitutional and title impediments disallowed Alexandria from extricating itself from the Alexander Fulton Hotel. Accordingly, there was little reason not to go after a large deal—since the argument is now shown not to hold water that Alexandria could have been "that much farther down the road in the absence of the DHI with regard to the Alexander Fulton." Alexandria could not have been further down the road. What is different now is Alexandria's resolution of legal impediments—or light at the end of the tunnel regarding them—allows a "runway" of activity to disentangle from the Alexander Fulton.

- During this DHI period, Alexandria was able to place the risk of loss for operating the Alexander Fulton on the potential developer. Prior to the DHI, Alexandria possessed the risk of loss of operations at the Alexander Fulton. Thus, from the day of the DHI's genesis—when Alexandria could neither sell nor place the Alexander Fulton in a long term deal without significant milestones being met—Alexandria was in a better position than the day before the DHI.

Executive Summary, July-August 2011
Working Committee on Downtown Hotel Solutions and Mixed Use Options

Capital One provided a significant legal obstacle rendering the constitutional impediment academic while title was clouded.

- The issues with the security-interest holder Capital One Bank just prior to and during the DHI made clean extrication regarding the Alexander Fulton impossible for Alexandria. The local governing authority's actions exacerbated the problems and added time and expense to the process.

- Even without the expropriation-related Alexander Fulton's (constitutional) problems preventing its outright sale before and during the time of the DHI, the clouded title and associated liens attached to the property made dealing with the hotel's re-deployment a zero-sum game calling for business-judgment resolution of title issues in conjunction with Court disposition.

Despite all these issues, the arbitrary closure of the Alexander Fulton or failure to fund certifiable and necessary capital needs that are property-preserving would, according to experts, cause loss to the appraised value of the Alexander Fulton properties on a level exceeding losses contemplated by Alexandria in funding reasonable and necessary capital requests. As such, the cost-benefit analysis preliminarily demands continued operation until a new operator-lessee or owner can be obtained.

- Local and national experts in hotel real estate estimate a conservative 50% loss to the Alexander Fulton's value the day it ceases to be a "going concern."

- If Alexandria provides no capital funding to its own asset for HVAC and elevator needs, among others, the hotel will be closed around October 31, 2011.

- If it closes, the real losses are just beginning for convention business as there may be a cascading effect regarding the Alexandria Riverfront Center.

Executive Summary, July-August 2011
Working Committee on Downtown Hotel Solutions and Mixed Use Options

All public incentives should be limited to infrastructure of a permanent, publicly-owned nature with few if any exceptions. Inducements and incentives, of a public nature, regarding a "global" hotel deal are predicated on Alexandria being convinced of the future operational viability of the Hotel Bentley property **as a hotel.** ***There must exist greater than a mere possibility of success. The plan for redevelopment must present a substantial probability of success. At this time, Alexandria and potential developers are winding down the latest process and creating the template for a new process. Headway is being made. But, with the light at the end of the tunnel on title and constitutional impediments at the Alexander Fulton being cleared, it must now be offered separately from a global deal on a first-some, first-served basis. Global desire must give way to separate operational reality.***

- If a global proposer can beat in time an Alexander Fulton-only developer, Alexandria would desire a larger-scale deal involving several properties.

- If an Alexander-Fulton developer can negotiate a deal with Alexandria and the Alexandria City Council finds the development goals protect the needs of the local industry, the Hotel Bentley will find itself in a harder recovery or commercially viable position than it did during the DHI.

- Alexandria must be mindful of the Hotel Bentley's storied past—which contains more failed attempts than successes. Business judgment application is critical to vetting public-private collaboration, even though some of the traditional business assumptions and requirements might be relaxed. Alexandria should consider any Bentley project as involving consideration of three assets (and possibly a fourth working together): two hotels, the Riverfront Center, and perhaps a parking garage.

The public demands of private collaborators seeking public assistance in the commercial realm: "Show us the money."

- Alexandria will heighten cash or cash equivalent requirements to negotiate. While refundable, the latest Term Sheets require a deposit to talk. Letters of commitment, Articles of Incorporation for involved entities, and other documents are necessary, but insufficient, to consider any deal regarding which public help is requested. Show skin in the game and one can discern how much an entity will fight to succeed is a common mantra in business and banking circles. Alexandria needs to see the operator has the same desire to make it work as the public. No skin in the game, no risk upon failure. This is not recommended by experts, and runs contrary to sound business judgment. It also makes public dollars inappropriate regardless of the fact that none may be generated at this time by a closed hotel.

- The argument some activity—even if subsidized—is better than none is rejected by this Administration.

The downtown hotels—and no longer just the Hotel Bentley—continue to be the subject of misleading information and too much political maneuvering by competitors, deal seekers, and politicos, and not enough actual business judgment application and public scrutiny of public requests for subsidization.

- The process has remained emotionally charged. Better communication is needed among interested elected officials entrusted with the ultimate decisions. Political posturing, overweening commitments, unmet promises, and a lack of disclosure by some interested parties have contributed to a stalled process and misunderstandings on the various positions of the parties regarding the common goals of restoration and functionality.

- This was not the case with Hospitality Initiatives Partnership ("HIP"), an entity that simply could not close its deal in this environment and perhaps chased too large a deal in this environment.

- Public support of the DHI cannot be predicated solely on the assessments of interested parties, which has been largely the case thus far. Most information has come from the developer or consultants for the development. Disinterested, objective decision makers must never abdicate their responsibility to assess proposals by any party. Adequate time spent on proposals and information gathering are crucial to making a decision.

- Decision makers cannot have conflicts of interest or be pre-sold on a plan before critically reviewing other plans. Requests for proposals are appropriate if public funding is being considered.

- Moreover, given that Alexandria may offer public support, a competitive process and generally the following considerations will be adhere to: (i) planning (*i.e.*, "master planning" or planning in the area with S.P.A.R.C.); (ii) how these developments preserve and capitalize on natural and cultural resources, fairly and inclusively distribute the costs and benefits of the development to equitably "grow" the entire City and this area; and (iii) the extent to which the proposed development or mixed-use choices smartly expand new opportunities for transportation, employment, and housing.

The potential for mixed-use opportunity offers real chance at permanency of function. It should not be overlooked.

- *If* the Bentley is a "key ingredient" to the redevelopment of downtown, then ensuring long term viability instead of plans for five years out should be central to discussions. The highest and best use of the Bentley might very well be, as one expert said, "a center of activity for visitors to Alexandria, bustling lobby, couple of good places to eat, lobby bar where business gets done, and upscale rooms for out-of-town visitors. Add to this large meeting rooms, a SPA for ladies, some retail shops and many places to meet/greet and I think you get the idea. Every city needs a Bentley and you have one."

- Alexandria's Administration believes a fully functional Bentley would have significant economic impact on the downtown region, create paying jobs and new dollars in the downtown area, and thus have a positive economic impact on the City.

- There might be support for long term leasing of a substantial portion of the hotel. The consequent responsibility for capital improvement and operations and maintenance would have to be sufficient to support a "boutique" style Hotel Bentley with retail, public and private office space, condominiums, and restaurant/entertainment space.

- The Alexander Fulton's highest and best use is as a hotel. Indeed, it arguably could be expanded on its own footprint and negate the need for hotel operations at the Hotel Bentley. This presents an opportunity and threat to the Hotel Bentley.

The Alexandria Riverfront Center ("ARC") involves several critical policy decisions about its use as part of any incentive such as it was used in the original DHI. Relatedly, there is a question about allowing the ARC to be managed by a professional third party.

- The policy decisions force a discussion about the original purposes of the ARC, the continued viability surrounding past and current uses and practices, use of the ARC in an incentive program, and whether the APA-CVB wishes to remain involved with ARC management versus Alexandria's needs and dependence on the APA-CVB for fair, impartial management.

- At this time, there is interest in a scaled-down DHI as long as the ARC is optimized.

- The ARC is an essential piece to development of the hotels in the downtown, and special attention needs to be paid to its highest and best performance moving forward even if there are challenges to past and current assumptions—and even if stakeholders are led down a totally new road. Everything needs to be on the table for discussion, keeping in mind the original purposes and funding.