



NOVEMBER 2015

SANTA MONICA HOTEL MARKET UPDATE

Ester Wan
Analyst



Driven by the tourism and tech industries, Santa Monica's lodging market continues to boom, reaching record levels. While the city has historically had a reputation for slow development, developers have persisted in recent years and the city has made leaps and bounds with several development projects currently underway. In addition to new build projects, investors are eager to enter the market as they look toward redevelopment opportunities.

Santa Monica, which is located to the west of the city Los Angeles, is a densely populated (pop. 89,736, 2010 census) beach community known for its oceanside location, numerous tourist attractions, and a high quality of life. This article will primarily focus on the new development and hotel trends within Santa Monica.

Area Economics

Santa Monica, often referred to as part of "Silicon Beach", has quickly become the heart of Los Angeles' fast-growing tech scene, comprising 25% of Santa Monica's workforce. Silicon Beach, which initially referred to Venice and Santa Monica, has expanded south along the coast and inland to Playa del Rey and Culver City. For example, in the past year, Sony Computer Entertainment and Yahoo, have left the core of Silicon Beach for Playa Vista.¹² The desirability of office space in Santa Monica, coupled with the city's limitations on new urban development, has created an insufficient availability and premium rental rates. In addition to the lack of affordable office space, soaring housing costs in Santa Monica have continued to pose a problem for local employers looking to hire the Millennial workforce.

According to the Q2 of 2015 REIS office space data for the Los Angeles market place, the Santa Monica submarket registered the third lowest vacancy rate (8.5%) behind Century City and Beverly Hills. In terms of the average asking lease rate, Santa Monica's \$51.84 per ft² is the highest in all of Los Angeles County. Forecasts for the remainder of 2015 and also into 2016 illustrate a continuation of this trend. The low office vacancy and average lease rates reflect Santa Monica's overall desirability relative to the Greater Los Angeles area.

Major Developments

Although Santa Monica has suffered from a long-standing aversion to high-density new development, developers have persisted in recent years and the city continues to flourish with a number of development projects in the works. According to the City of Santa Monica Planning and Community Development, more than 50 projects are in various stages of approval. These projects, which range from mixed-use projects to residential development, are primarily located along Santa Monica Boulevard or proximate to the coast. Some of the most notable projects are outlined in the following paragraphs.

The City of Santa Monica recently approved of a new Zoning Ordinance Update and Land Use and Circulation Element (LUCE) amendments in July 24, 2015, which regulates development in the city for the next two decades. Under the new zoning code, mixed-use development will be permitted along streets

¹ <http://www.santamonicanext.org/2015/01/lack-of-office-space-housing-squeeze-santa-monicas-growing-tech-industry/>

² <http://smdp.com/sony-leaving-santa-monica-for-playa-vista/132082>

with high levels of transit, in hopes of creating “Complete Neighborhoods,” places where residents have access to their daily needs within walking distance³. One of the new ordinances added to the zoning update was a new Beach Overlay District, which limits the development of hotels, motels, and large restaurants within Santa Monica’s Coastal Zone. According to City officials, with the new zoning law, some 20 new projects, including several major developments such as the Ocean Avenue Project, could begin making way through the planning approval process this year.

The city’s *Downtown Specific Plan*, which was conceived ten years ago, was readdressed by the city in June 2015 in order to attract more residents and visitors to the “unofficial enterprise zone that is comprised of a roughly 50-block radius around the intersection of Broadway and Main Streets in the center of the city.”⁴ The updated version of the *Downtown Specific Plan* include incentives such as re-zoning and expedited permission processes to attract more economic development activity to the downtown area. The revisions to the *Downtown Specific Plan* will be presented to City Council for review later this year.

The **(t) expo Line expansion** from Culver City to downtown Santa Monica – four blocks from the pier – is currently under construction and is expected to open in early 2016⁵. The 6.6-mile light rail line will extend from Culver City to Santa Monica, adding seven new stations to the west, in Palms, Westwood, and Santa Monica⁶. Once open, the Expo Line will connect downtown L.A. with Santa Monica by rail for the first time since the 1953 closing of the Santa Monica Air Line. The debut of the Expo Line’s - extension will also be utilized as a marketing tactic by the City of Santa Monica to shift how people get around: not only encouraging more “park-and-ride” commuters, but also walking more, taking the bus or taking the city’s new bike-share system, which is slated to launch later this year.

A newly designed promenade, the **Colorado Esplanade**, will offer a new gateway to the heart of Santa Monica. The Colorado Esplanade project is designed to realign 2nd Street and Main Street, upgrade infrastructure on Colorado Avenue between Ocean Avenue and 4th Street and connect the future downtown Expo Light Rail station to Tongva Park and the Santa Monica Pier. Key components of the project include the installation of a 20 to 30 feet wide sidewalk to accommodate an increase in pedestrian traffic from the light rail, and a separate “cycle track” to provide bike lanes in both directions. Infrastructure improvements began in early 2015 and are anticipated to be completed in time for the start-up of the new Expo Line rail service⁷.

The Frank Gehry-designed **Ocean Avenue project** is a 1.9-acre mixed-use site that will feature a luxury 22-story building with 125 hotel rooms, the replacement of 19 rent-controlled units, 22 condominium units for sale, a three building museum campus, a publicly accessible roof-top observation desk, as well as street-level restaurants and retail. The two existing historical buildings on the site – a Spanish Colonial

³ <http://www.smgov.net/Departments/PCD/Zoning/Draft-Standards/>

⁴ <http://www.keyt.com/news/santa-maria-revives-downtown-specific-plan/34311152>

⁵ <http://www.scp.org/news/2015/07/15/53138/trains-in-santa-monica-expo-line-begins-tests-near/>

⁶ <http://www.latimes.com/local/lanow/la-me-ln-expo-line-santa-monica-20150730-story.html>

⁷ http://www.smgov.net/uploadedFiles/Departments/Public_Works/Civil_Engineering/Esplanade%20FAQ.pdf

house and a Victorian-style house – will be preserved as part of the project and serve as office and retail spaces⁸. The project is currently seeking entitlements and no construction schedule has been released.

The **California Incline**, which is a local thoroughfare that connects the Pacific Coast Highway and downtown Santa Monica, is currently closed for a year-long rehabilitation project, as of April 2015. The roughly \$20 million project entails demolishing the existing 1,400 foot roadway, including the 750-foot-long bridge, and replace it with wider, more earthquake-safe structure, which will also include bike lanes and sidewalk. The link, which descends from Ocean Avenue to Pacific Coast Highway, connects the bluffs with the beach, and is used by 15,000 vehicles daily⁹.

Hotel Supply

The Santa Monica lodging supply currently includes approximately 34 properties with over 3,500 guestrooms. Room count has remained generally flat for the past ten years, with the most recent hotel openings from redevelopment projects including the Palihouse Santa Monica and the Shore Hotel in 2013 and 2011, respectively. Palihouse Santa Monica was rebuilt from the Embassy Hotel Apartments and reopened as a hotel in June 2013 following a major renovation¹⁰. The Shore Hotel, which was previously home to a Travelodge and the Pacific Sands motel, was the first new build hotel constructed in Santa Monica in a decade.¹¹ In general, very few new hotels have been built from the ground up in Santa Monica, due to the area's high barriers to entry and limited amount of developable land.

Current and proposed new hotel construction in Santa Monica has featured primarily of independent boutique-style or branded select- or limited-service properties. In addition to the four proposed projects, two existing hotels have submitted redevelopment plans to the city.

⁸ http://www.surfsantamonica.com/ssm_site/the_lookout/news/News-2015/March-2015/03_16_2015_Four_Downtown_Santa_Monica_Projects_Slated_for_Review_this_Year.html

⁹ <http://www.latimes.com/local/lanow/la-me-ln-california-incline-in-santa-monica-to-close-monday-for-yearlong-reconstruction-20150417-story.html>

¹⁰ <http://variety.com/2013/biz/features/embassy-hotel-palihouse-santa-monica-1200490725/>

¹¹ <http://www.travelweekly.com/Travel-News/Hotel-News/New-in-town-Santa-Monicas-Shore-Hotel/>

SANTA MONICA HOTEL DEVELOPMENT SUMMARY

Proposed Property	Product		Est. Open	Developer	Development Stage
	Type	Rooms	Date		
Courtyard and Hampton Inn & Suites	SS/LS	279	Q2 2016	OTO Development LLC	Under Construction
710 Wilshire	B	275	Q1 2018	Amgor Realty	Approved
Ocean Avenue Hotel	B	125	Q1 2019	Worthe Real Estate Group	Seeking Entitlement
The Plaza at Santa Monica	B	195		Metropolitan Pacific Real Estate Group	Application Pending
Proposed Redevelopment:					
Fairmont Miramar Redevelopment	FS	280		The Athens Group	Approved
Wyndham Expansion and Redevelopment	FS	211		FelCor Lodging Trust	Application Pending
	Total	1,365			

Key: FS=Full Service; ES=Extended Stay; LS=Limited Service; SS= Select Service; B=Boutique

Source: HVS, Build Central, San Francisco Business Times, developer and city planning department websites.

A dual-branded **Courtyard by Marriott** and the **Hampton Inn & Suites** is currently under construction on 6th and Broadway and are anticipated to open in mid-2016. The properties will be located across from the new Expo Line terminus and these properties will be among the first new select-service and limited-service hotels affiliated with nationally-recognized brands proximate to the beach in Santa Monica.

The **Wilshire Boulevard Project**, located at Wilshire and 7th Street, is a proposed mixed-use development, which includes a 275-room full-service boutique hotel project that will refurbish the existing office building and add an additional building to the parking lot on-site. Plans also include retail and restaurant space. According to a representative of the City of Santa Monica Planning, the project is under design review and is anticipated to open in 2018. As previously mentioned, the **Ocean Avenue Project** is slated to include a hotel component with 125 rooms to open in 2019.

The **Plaza at Santa Monica** is a proposed 2.5-acre mixed-use redevelopment located at the intersection of Arizona Avenue and 4th and 5th Street. The project includes a 193- room hotel, 200,000 square feet of office space, a 48-unit low income housing building, 40,000 square feet of retail space, 12,000 square feet of dedicated cultural space, and a public plaza and terrace. Conceptual plans were submitted to the planning commission in early June 2015 and are waiting to be approved.

In addition to the proposed hotel rooms, two existing hotels have submitted redevelopment plans to the city. The **Fairmont Miramar** has proposed for the rebuilding of the existing 10-story hotel and the construction of a 21-story tower that will feature 280 new hotel rooms, 120 luxury condominium units, and 40 affordable housing units. According to a representative from the City of Santa Monica, the plans for the Fairmont Miramar Redevelopment project are still under review with no announced construction schedule. The **Wyndham** redevelopment project calls for the addition of 211 hotel rooms, 25 condominium units, approximately 13,680 square feet of restaurant space, 3,600 square feet of retail, and 5,470 square feet of meeting space. The proposed project will replace the existing 7-story hotel built in 1967 with 280 guestrooms with the three new buildings with cascading heights ranging from five to 15 stories. The redevelopment project is in the review process with the city of Santa Monica.

Hotel Market Performance

Santa Monica has seen five consecutive years of RevPAR growth. According to recent HVS surveys of market participants, Santa Monica ended 2014 with an occupancy rate of 85%, an average rate near \$315, and a RevPAR of approximately \$270, which is a 9.0% increase from the year prior and a new all-time high. The year-to-date period through July 2015 registered an approximate 7.5% increase in RevPAR over the previous period, largely driven by strong average rate growth. With occupancy exceeding historical levels, local operators reveal that they will continue an average rate-driven strategy, particularly during the shoulder months in the first and fourth quarters, through the foreseeable future.

Corporate demand from the entertainment industry and “Silicon Beach” coupled with numerous tourist attractions, continues to drive the Santa Monica lodging market. The entertainment industry represents a significant source of revenue and employment for the Santa Monica area; MTV Networks, Universal Musical Group, and Lionsgate Universal are a few firms that conduct business there. Various development projects sponsored by both the city and private developers are anticipated to induce an influx in visitors into the Santa Monica market. The opening of the Santa Monica Expo Line, which will extend from Downtown Los Angeles, is expected to increase ridership by 64,000 people by 2030.¹²

Hotel Transactions

Transaction activity in strong markets with high barriers to entry like Santa Monica, are infrequent. Given the increases in the cost of land and the lengthy development process in this market, buying and repositioning an existing asset has become a much more common practice for investors looking to enter the market as opposed to undertaking a new construction project. The sparse number of hotel transactions in recent years reflects hoteliers desire to maintain ownership of profitable assets in this key market.

SANTA MONICA HOTEL TRANSACTIONS 2011-2015 YTD

Name	Sale Date	Buyer	Rooms	Price	Price/Room
Palihouse Santa Monica	Dec-12	Lighthouse Investments/Paligroup	38	18,000,000	473,684
Viceroy Santa Monica	Mar-11	LaSalle Hotel Properties	162	80,100,000	494,444

Source: HVS

At the time of sale, the former Embassy Hotel Apartments contained eight units that were residential apartments. The asset was purchased with the intension of converting to the property into a hotel under the Palihouse brand, the fourth location in the Los Angeles area for the Pali Group. Following a renovation, the Palihouse Santa Monica established itself as a hotel, featuring standard and residential-styled guestrooms. Prior to its 2011 sale, the Viceroy last sold in June 2000 for \$27.6 million, or roughly \$164,286 per room. Those owners had invested an additional \$20.3 million to renovate the property, reopening in 2002. This goes to show, patience in this market can be profitable.

¹² <http://www.smmirror.com/articles/Development/The-Big-Three-Santa-Monica-Construction-Projects/43176>

Conclusion

Overall, the outlook for the Santa Monica lodging market remains strong, supported by its attractive oceanside location, tourist demand generators, low office vacancy rates and rising rent rates, and major developments that will further enhance the landscape of the market. With demand at record peak and a continued lack of new inventory in the market, hoteliers have continued a rate-driven strategy. Although the city and its citizens continue to work with developers on the scale of proposed projects, it is clear that the city continues to attract strong interest from hotel developers and investors as there are a number of proposed new hotels and redevelopment projects in the market.



About HVS

HVS, the world's leading consulting and services organization focused on the hotel, mixed-use, shared ownership, gaming, and leisure industries, celebrates its 35th anniversary this year. Established in 1980, the company performs 4,500+ assignments each year for hotel and real estate owners, operators, and developers worldwide. HVS principals are regarded as the leading experts in their respective regions of the globe. Through a network of more than 35 offices and more than 500 professionals, HVS provides an unparalleled range of complementary services for the hospitality industry.

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HVS LOS ANGELES, established in 2013, is located in the South Bay region of the Los Angeles area and is readily accessible to Southern California's hotel and resort markets. HVS Los Angeles operates under the direction of Senior Managing Director Suzanne R. Mellen and Vice President Leah Dauer Murphy (the on-site practice manager). Our LA team has diverse academic backgrounds and hotel-related experience, with in-depth expertise in the numerous and varied lodging markets of Southern California.

About the Author



Ester Wan joined HVS San Francisco in 2014 as an Analyst and brings with her a strong passion for the hotel industry. She has appraised resorts and hotels throughout California and nationwide. Prior to HVS, Ester earned her operations stripes at the SLS Hotel in Beverly Hills and W Hollywood Hotel in Los Angeles, and at the Portman Ritz-Carlton in Shanghai, China. She also worked in the Accounting and Finance department at Kimpton Hotels in Boston. She earned her Bachelor of Science degree magna cum laude from the School of Hotel Administration from the Boston University. Ester hails from Irvine, California, and speaks conversational Cantonese. Ester can be reached at +1-415-268-0370 or ewan@hvs.com.