



City Council Agenda Item

City Council Meeting Date: December 6, 2023

TO: Honorable Mayor and City Council Members

FROM: Jeff Malawy, City Attorney
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SUBJECT: Report on Financial Feasibility of Pale Blue Dot's Proposed Development of a Space Center Project on Approximately 82 Acres Including and Adjacent to Ken Adam Park (APN 095-070-008)

Recommendation:

Staff recommends the City Council receive and file the report on the financial feasibility analysis presented by the City's consultant, Pro Forma Advisors LLC, regarding the proposed Pale Blue Dot Space Center Project.

Background:

The City entered into a Memorandum of Understanding (MOU) with Pale Blue Dot Ventures, Inc. (Pale Blue Dot or PBD) in July 2019. The purpose of the MOU is to provide a period during which the City will negotiate exclusively with Pale Blue Dot toward a proposed eventual development of a space center project on approximately 82 acres of City-owned property including and adjacent to Ken Adam Park (Property). Until the MOU expires, the City cannot negotiate with any entity other than Pale Blue Dot regarding the Property, and cannot consider approval of any developmental use for the Property other than Pale Blue Dot's proposed project.

Attachment 1 is Pale Blue Dot's October 2023 Project Summary document, describing the most recent Project concept.

At its meeting on April 18, 2023, the City Council reviewed findings from Keyser Marston Associates, a City contracted consultant, on Pale Blue Dot's Concept & Feasibility Study and Experience Design Plan (CFSEDP). After reviewing Keyser Marston's findings, the City Council directed staff to continue negotiating and preparing a Disposition & Development Agreement (DDA) for eventual consideration by the City Council, and directed staff to hire a consultant with revenue estimating experience for theme park attractions to review Pale Blue Dot's Concept & Feasibility Study.

After the April 18 meeting, Pale Blue Dot requested to submit an updated and revised financial feasibility analysis, and that the new City consultant should conduct a review of that updated Pale Blue Dot feasibility analysis.

Pale Blue Dot spent time updating its project plans and financial assumptions and estimates, and submitted its final updated financial feasibility analysis to the City on August 7, 2023.

On August 15, 2023, the City Council extended the expiration date of the MOU from September 6, 2023, to December 31, 2023, to allow time for the City's consultant to conduct its review after receiving Pale Blue Dot's updated financials.

Pro Forma Advisors Report

The City hired Mark Dvorchak of Pro Forma Advisors, LLC, to perform a review and report on Pale Blue Dot's final updated financial feasibility analysis. Mr. Dvorchak has led a variety of market analysis and feasibility projects for destination theme parks, amusement parks, water parks, and attractions around the world, including an analysis of Space Tourism potential for a NASA Spaceport master plan.

Mr. Dvorchak prepared an original report (Attachment 2). The findings and conclusions were presented at the City Council meeting on November 7, 2023. The City Council scheduled a special meeting for December 6, 2023, for Mr. Dvorchak to appear in person and present his findings and conclusions.

On November 24, 2023, Pale Blue Dot provided a comment letter on Mr. Dvorchak's report (Attachment 3). Mr. Dvorchak considered those comments and revised his report as he felt necessary. The primary revision Mr. Dvorchak made was to include San Luis Obispo County hotels and motels in his analysis. The revisions did not change Mr. Dvorchak's ultimate conclusions.

Mr. Dvorchak's revised and final report is Attachment 4.

On December 1, 2023, Pale Blue Dot agreed to make Mr. Dvorchak's reports public, and to make PBD's comment letter public. Therefore, they are attached to this staff report.¹

Simultaneously with all of the above, the City Attorney's Office and Pale Blue Dot have continued negotiating and drafting the DDA so that it can come to City Council for consideration and possible approval, which will govern the development and potential eventual sale of the property to Pale Blue Dot.

¹ Although the documents are still labeled confidential, Pale Blue Dot has agreed in writing to make them public. The documents and the information therein are public. That is why this staff report summarizes the findings and conclusions of the City consultant's report without including PBD's precise financial numbers and projections. The City has provided the City's consultant's full report to Pale Blue Dot.

Discussion

Confirming the Project's financial feasibility at this early conceptual stage is important so that the City Council is assured the Project is realistic and the benefits of continuing to pursue the Project outweigh the opportunity cost of holding back other potential uses of the land.

For this meeting, the City Council requested the staff report to include both the summary of findings from City's first consultant, Keyser Marston, and the City's second consultant, Mark Dvorchak of Pro Forma Advisors LLC.

Pro Forma Advisors Findings and Conclusions

Mr. Dvorchak prepared an evaluation of Pale Blue Dot's financial feasibility analysis of its conceptual space center project. Attachment 4 is Mr. Dvorchak's final report, the conclusions and findings of which are summarized as follows:

- 1) While the attraction design is not finalized, it is smaller and has less for guests to do than theme parks and major comparable space attractions. Most major space attractions offer genuine NASA facility tours in addition to the visitor centers. This may limit the length of stay for guests, the distance they would travel, and the amount they would pay for the attraction. Major changes to the attraction program would need to be reflected in the cost budgets.
- 2) The projected admission revenue per guest is much higher than both theme park and space attraction benchmarks. If these premiums are not attained, revenue targets may not be reached.
- 3) The projected additional spending by guests inside the attraction is high in absolute terms compared to benchmarks. A shorter length of stay limits potential spending on Food & Beverage and Retail in the attraction.
- 4) A shorter length of stay limits demand at the proposed 75-room hotel onsite. Additionally, due to the federal land use restrictions on the site, hotel guests must purchase their room in combination with a park ticket and park experiences must be integrated with the hotel stay. Because the hotel cannot operate as a hotel open to the general market, demand is further limited. Pale Blue Dot's projected occupancy rate is higher than Pro Forma would recommend.
- 5) Space camps are highly popular, and Southern California schools could provide strong demand. Projected space camp attendance is obtainable, but revenue per camper is higher than benchmarks. Generally, school camps are not high margin for-profit operations.
- 6) Pro Forma is not a cost estimation firm, but has reviewed the development cost budget. Pro Forma believes it compares to similar Entertainment Centers. The

development budget per expected annual visitor falls in a reasonable ratio for attractions. However, the absolute attraction budget is small when compared to theme parks.

- 7) The projected Operating Margins are based on theme parks, which are higher than Entertainment Centers² or Space attractions. Total operating expense levels may be reasonable, when viewed against lower revenue levels.
- 8) The presented project model allocates reinvestment in attractions at a level well below theme park averages needed to drive repeat visitation. Entertainment Centers do not require theme park level reinvestment, but may need a higher allocation than Pale Blue Dot projects to refresh attractions in the future.
- 9) Adjustments made based on Pro Forma Advisors' comments would likely lower the presented economic returns. However, the Project is likely to generate more revenue than it costs to operate. As long as there is a surplus, the facility would continue to operate under any ownership structure. Investors and lenders, after evaluating projections and financials, ultimately take on the risk of lower returns.

If the Project does not attract sufficient investment capital or commitments from lending institutions, then the Project will not be built. If the Project is built, or partially built, but is not successful and stops operating, then provisions in the Disposition and Development Agreement currently being negotiated between the City and Pale Blue Dot will be triggered as protections for the City, such as a right of the City to take back ownership and control of the property. However, Mr. Dvorchak's opinion is that if the Project begins operating and Pale Blue Dot's projections are not met, it is still likely to generate more revenue than it costs to operate, and therefore it is highly probable the Project would continue operating to generate cash flow, whether owned by Pale Blue Dot or by creditors, rather than cease operations.

Keyser Marston Findings and Conclusions

Kathleen Head and Tim Bretz of the Keyser Marston consulting firm prepared a financial evaluation of the conceptual space center project, based on Pale Blue Dot's projected financials as of April 2023. *It is important to note Pale Blue Dot revised its projected financials after the April 2023 Keyser Marston analysis and before the October 2023 Pro Forma Advisors analysis. The changes Pale Blue Dot made to its projected financials is on pages 56 to 58 of the Pro Forma Report (Attachment 4).* A summary of Keyser Marston's financial evaluation of April 2023 numbers is as follows:

² Pro Forma Advisors generally defines a Theme Park as offering 40+ attractions, themed environment, and specialty dining and retail options, with a 5-10 hour length of stay and 1M to 20M annual guests (Disneyland, Knott's Berry Farm, Universal Studios, Six Flags). An Entertainment Center is a smaller themed venue with average of 4-10 experiences per guest, 1-2 hour length of stay, lower-capacity rides and exhibits, and more focus on the regional market with a target of 100,000 to 400,000 annual guests (DisneyQuest in Orlando, FL, Joypolis in Tokyo and Shanghai). Space Attractions are centers such as Kennedy Space Center in Florida, U.S. Space & Rocket Center in Huntsville, AL, and Space Center Houston, with a 1-3 hour length of stay and 4-6 experiences per guest.

- 1) *Development Costs*: Keyser Marston's opinion is Pale Blue Dot's estimated development costs are materially lower than would be anticipated for a development of the proposed scope.
 - a. PBD did not include a direct cost contingency allowance, which is typically included in the direct cost estimates for real estate development projects.
 - b. Governmental permitting fees will exceed PBD's estimates.
 - c. PBD estimated taxes, insurance, legal and accounting costs are half or less than the typical range.
 - d. PBD's estimated marketing costs are significantly lower than the amount that would need to be spent to promote such a pioneering development.
 - e. PBD's estimated development management fee is 1/3 to 1/5 of the typical range.
 - f. PBD's total estimated indirect development costs are significantly lower, as a percentage of direct costs, than the typical percentage.
 - g. PBD did not include a soft cost contingency allowance. This type of allowance is typically included in the indirect cost estimates for real estate development projects.
 - h. PBD's estimates did not include construction and absorption period interest costs or loan fees.

- 2) *Revenue and Cash Flow*: Keyser Marston's opinion is PBD's operating expense estimates are lower than expected.
 - a. PBD estimates the project will achieve full stabilization in Year 3 of operations. This seems aggressive for such a large scale and untested development.
 - b. PBD's estimated Year 3 operating expenses as a percentage of revenue is likely an aggressive assumption as some revenue categories (e.g., food and beverage) will likely require higher operating expense percentages.
 - c. Specifically regarding theme park attraction revenues, Keyser Marston does not have the specific theme park operations experience in order to opine on the attraction revenues included in the Blue Dot estimates.

- 3) *Estimated Funding Sources and Investment Returns*: Keyser Marston's opinion is that, based on PBD's development cost and cash flow estimates, the Project could likely support the debt and equity required to fund the Project costs. However, this is based on what Keyser Marston considers to be aggressive assumptions by PBD. There is significant risk that the development costs will exceed PBD's estimates and that the cash flow and net operating income will be less than PBD's estimates. If more conservative assumptions are applied, it is likely that the Project would be unable to achieve the returns required to attract sufficient capital to develop the Project.

Fiscal Impact:

The City's staff costs, legal costs, and consultant costs for reviewing Pale Blue Dot's financial feasibility analysis are covered by the deposit made by Pale Blue Dot to the City

under the MOU, which covers City costs associated with negotiations of a potential disposition and development agreement for the proposed project, including fiscal analysis of the proposed project. The City has covered the cost of Mr. Dvorchak's appearance at this City Council meeting from the General Fund, as this additional, second presentation of Mr. Dvorchak's findings was not contemplated by the MOU.

Conclusion:

The City Council may simply receive and file this report tonight. On December 19, 2023, the City Council can decide whether to continue with the Project and extend the MOU, which currently expires on December 31, 2023. An extension of the MOU would allow the City and Pale Blue Dot to continue negotiating the Disposition & Development Agreement that would govern the development and potential eventual sale of the property, and ultimately bring it to City Council for approval.

Respectfully submitted,



Jeff Malawy, City Attorney

- Attachments:
- 1) Pale Blue Dot's October 2023 Project Summary
 - 2) Pro Forma Advisors Original Report
 - 3) Pale Blue Dot's Comment Letter to Pro Forma Advisors Original Report
 - 4) Pro Forma Advisors Revised and Final Report (revised after PBD's Comment Letter)