Memorandum

To: Nell Selander, Director of Economic & Community Development, City of South San Francisco

From: Darin Smith and Kaavya Chhatrapati, Economic & Planning Systems

Subject: Evaluation of Oyster Point Hotel Developer's Request for Extension
EPS #221017

Date: May 13, 2025

This memorandum provides an evaluation of Ensemble's request for a two-year extension of the Purchase and Sale Agreement (PSA) for the Oyster Point Hotel project. The developer has indicated that adverse changes in market conditions, including hotel performance metrics, financing availability, and construction costs, have significantly impacted the financial feasibility of the proposed 350-room hotel project on City-owned waterfront land. Ensemble is requesting additional time to allow market conditions to improve and restore project viability.

In response, Economic & Planning Systems (EPS) has prepared a targeted analysis to assess the validity of these claims. This memo compares market and financial conditions at the time the PSA was executed in 2021 with those at present. Specifically, we examine shifts in hotel market performance (e.g., RevPAR and occupancy), financing conditions (e.g., interest rates and capital availability), and development cost trends. The goal is to provide the City with an independent, data-driven assessment of whether current conditions reasonably justify a delay, and to clarify the extent to which any claimed infeasibility is supported by current market evidence.

As explained on the following pages, EPS concurs with the developer's claim that current market conditions are not optimally supportive of new hotel construction and may benefit from additional time for market conditions to improve. EPS further verifies that hotel construction has slowed throughout the Bay Area. Finally, EPS perceives that the hotel would be unlikely to be delivered by any other developer within the two-year extension period, given not only the market conditions but also the time that would be required to terminate the existing agreement, issue a new solicitation, select a new developer, and negotiate terms for a new Purchase and Sale Agreement.

Market Recovery Analysis: SF Airport Area (2018–2025)

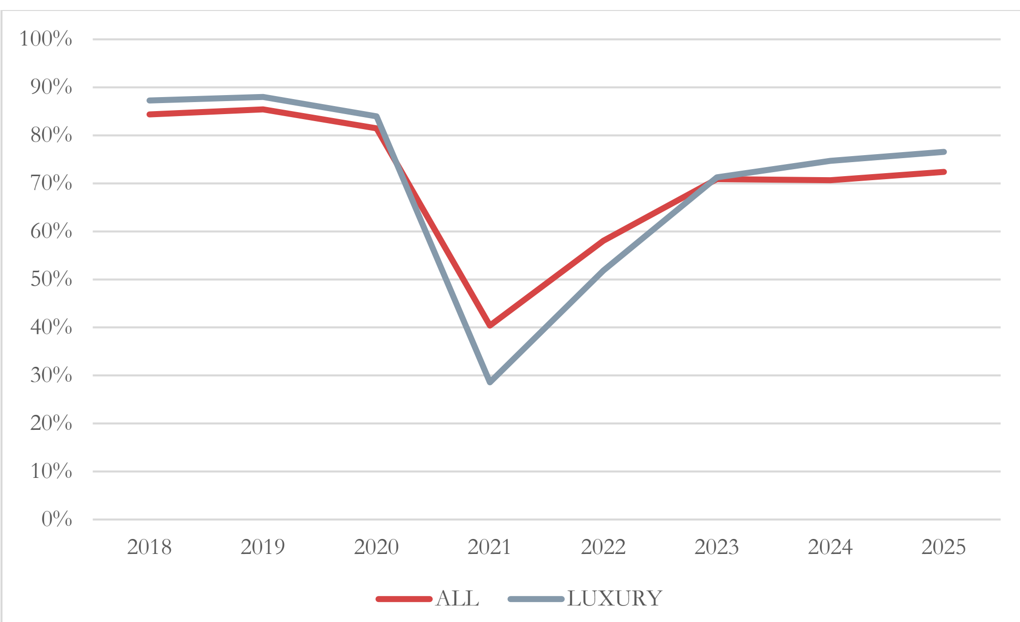
Market Area

EPS evaluated hotel market performance within the San Francisco Airport submarket to assess the credibility of the developer's claim that current conditions continue to undermine project feasibility. We analyzed both the full submarket, which includes 83 properties with 9,640 rooms, and a filtered set of 26 upper-tier hotels totaling 5,804 rooms. Upper-tier hotels are defined here as those classified by CoStar as Luxury, Upper Upscale, or Upscale. This subset reflects the likely market position of the proposed Oyster Point Hotel and serves as the primary basis for comparison.

Occupancy Trends

Occupancy for all hotels in the SF Airport submarket was 84.4 percent in 2018, fell sharply to 40.4 percent in 2021, and has since rebounded to 72.4 percent as of March 2025. This represents an 80 percent recovery of the ground lost during the pandemic. Among upper-tier hotels, occupancy was 87 percent in 2018, declined to 29 percent in 2021, and now stands at 77 percent, reflecting an 81 percent recovery. While general market hotels have recovered slightly more in relative terms, upper-tier hotels are performing better in absolute terms, with a higher current occupancy rate. This suggests a stronger resurgence in demand for higher-end accommodation, though occupancy remains below pre-pandemic levels.

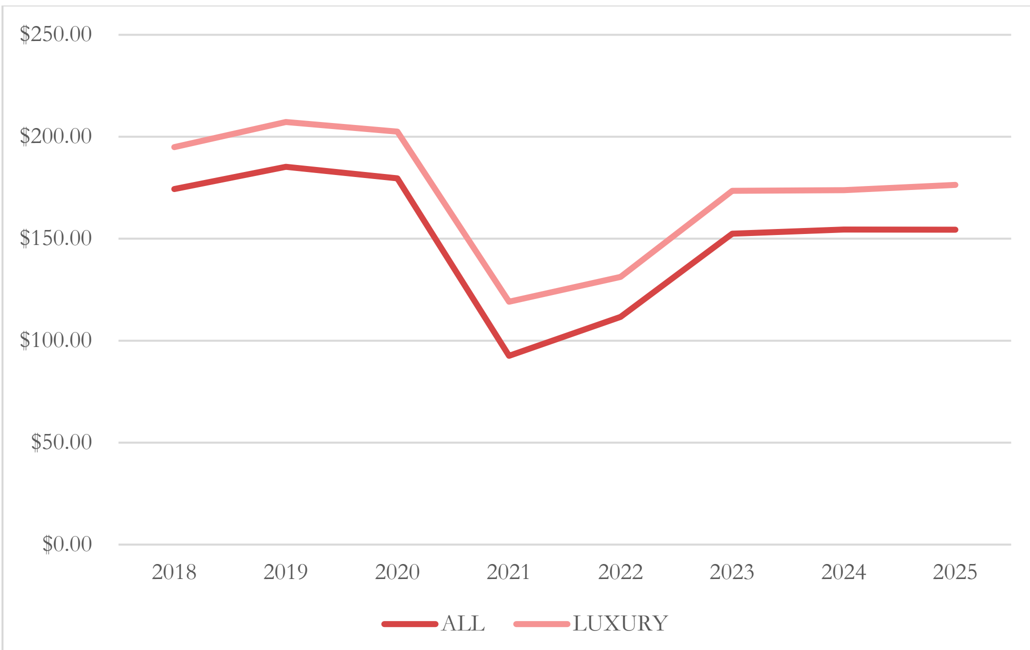
Figure 1: SFO Airport Submarket Area Hotel Occupancy All vs. Upper Tier



Average Daily Rate (ADR)

ADR for all hotels reached $174.36 in 2018, dropped significantly to $92.58 in 2021, and has since returned to $154.46 in 2025, an 88 percent recovery. For upper-tier hotels, ADR was $194.94 in 2018, declined to $119.11 in 2021, and has now reached $176.42, reflecting a 90 percent recovery. Both groups have shown a comparable rebound in rate, with upper-tier hotels maintaining a premium and recovering nearly in parallel with the broader market. This indicates that hotels in the top tiers have regained significant pricing power, even if room rates have not yet fully restored to pre-pandemic levels.

Figure 2: SFO Airport Submarket Area Hotel ADR All vs. Upper Tier



Revenue per Available Room (RevPAR)

RevPAR, which captures both occupancy and rate performance, was $147.11 for all hotels in 2018, fell to $37.39 in 2021, and climbed to $111.81 in 2025, representing an 83 percent recovery. For upper-tier hotels, RevPAR declined from $170.08 in 2018 to $34.03 in 2021, and now sits at $135.05, reflecting an 82 percent recovery. Both segments have followed a similar trajectory, with strong year-over-year gains since 2021, though neither has fully returned to pre-pandemic revenue levels.

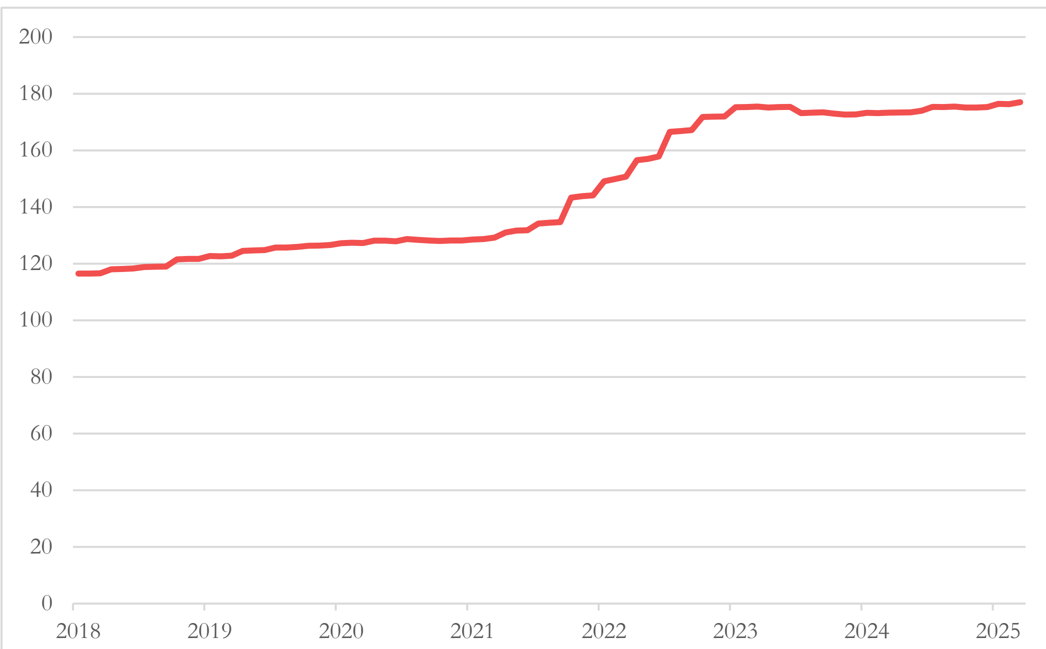
Figure 3: SFO Airport Submarket Area Hotel REVPAR All vs. Upper Tier

Development Cost Escalation

Construction Costs

To assess the developer's claim that rising construction costs have undermined project feasibility, EPS examined the Producer Price Index (PPI) for New Nonresidential Building Construction in the Western United States, published by the U.S. Bureau of Labor Statistics. This index tracks changes in material and labor inputs commonly used in commercial development. Figure 4 presents the full cost trajectory from 2018 to 2025, during which the index rose by approximately 52 percent. When the Purchase and Sale Agreement (PSA) was executed in December 2021, the PPI stood at 144.1. As of March 2025, it has risen to 177.0, an increase of approximately 22.8 percent over the period in which the developer has held site control. While the steepest surge in costs occurred in 2022, the data indicate that inflated costs have persisted into early 2025, adding real pressure to project budgets. Taken together, the graphs suggest that cost escalation is a legitimate concern, particularly given that hotel revenues remain below pre-pandemic levels.

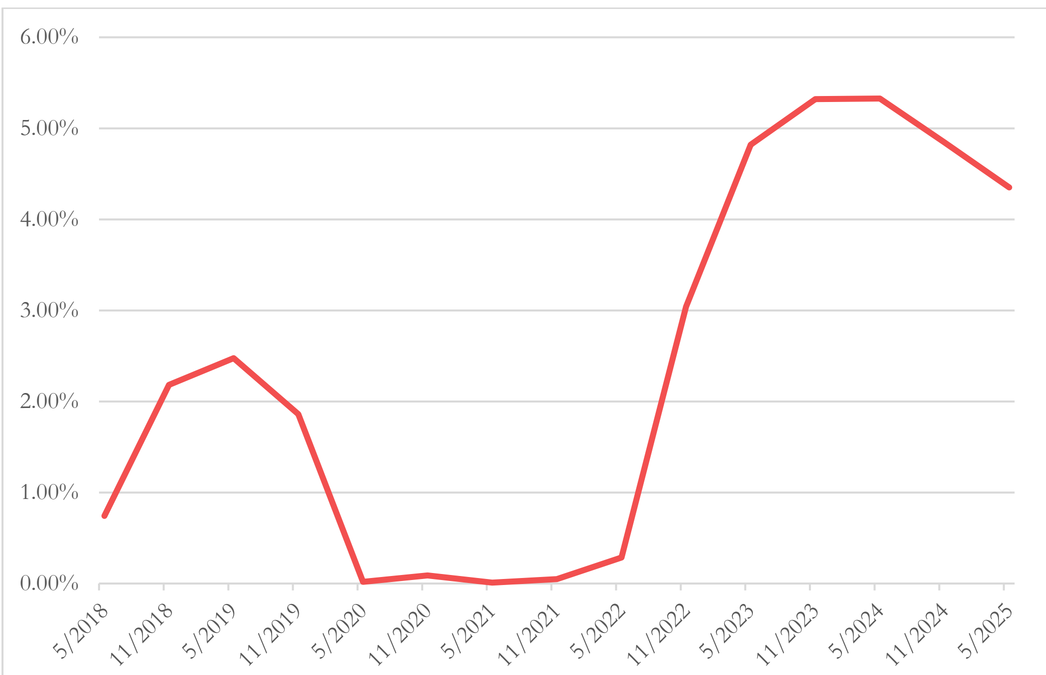
Figure 4: Producer Price Index (PPI) for New Nonresidential Building Construction



Financing Costs

To evaluate the claim that financing costs have significantly contributed to ongoing infeasibility, EPS reviewed trends in the Secured Overnight Financing Rate (SOFR), a widely used benchmark for variable-rate commercial lending. Although Ensemble was awarded the rights to develop the hotel in April 2018, and the Purchase and Sale Agreement (PSA) was executed in November 2021. At that time, SOFR stood at just 0.05 percent. As of May 2025, the rate has climbed to 4.35 percent, representing a dramatic increase of over 430 basis points in less than four years. This rise in baseline borrowing costs has had a substantial impact on the financial feasibility of hospitality development, particularly for projects reliant on floating-rate debt structures. Figure 5 illustrates long-term interest rate trends since 2018, highlighting the period of minimal borrowing costs from 2020 through 2021, followed by sharp acceleration beginning in mid-2022. Moreso than for construction costs, which had already begun escalating prior to the PSA, this spike in interest rates represents a new and largely unforeseeable development. Given the capital-intensive nature of hotel projects, the increased cost of debt materially affects return thresholds, capital availability, and deal timing, supporting the assertion that financing conditions have become materially more challenging since the deal was signed.

Figure 5: Secured Overnight Financing Rate (SOFR) Trend (2018–2025)



Conclusions

The analysis of hotel market performance within the San Francisco Airport submarket, particularly among upper-tier hotels comparable to the proposed Oyster Point hotel shows clear signs of improvement since the PSA was executed in late 2021. Occupancy, ADR, and RevPAR have each rebounded by more than 80 percent from their pandemic-era lows, and performance metrics continue to trend upward. While not yet fully returned to 2018 peak levels, the hotel market has broadly improved, and the data no longer reflects the kind of prolonged distress from a lack of demand that might independently justify a delay in project execution.

Still, numerous reports indicate that new hotel construction in the Bay Area has diminished greatly,[1] and that a number of existing properties are in distress.[2] These reports and the data gathered by EPS generally echo the developer's claims that a set of external inflationary pressures—namely, construction cost escalation, labor cost growth, and a sharp increase in borrowing costs – are key contributors to the project's current challenges. These factors represent meaningful shifts that likely were not fully priced into the deal at the time of PSA execution. We thus concur with the developer's claim that the feasibility of hotel development remains challenging under near-term market conditions and may benefit from an extended deadline.

As importantly, EPS believes that the City must consider the alternative to granting the developer the requested time extension. While there is not certainty that market conditions two years from now will fully support the commencement of the hotel construction, it is fairly certain that terminating the PSA with this developer would not result in another developer commencing the desired construction under equivalent or more favorable terms within the same two-year period. City staff has indicated that the previous solicitation process through which Ensemble was selected took over a year from the issuance of the solicitation to the signing of the Exclusive Negotiation Agreement with the selected developer, followed by another three-and-a-half years to reach accord on the PSA. If a resolicitation and negotiation process for the Oyster Point hotel begins immediately and takes even half as long as the original process – which was not unusually long for a public-private project in EPS's experience – the new developer would not start construction before the extended deadline being requested by Ensemble. As such, EPS does not perceive that the City would be foregoing a better or more expedited deal to deliver the Oyster Point hotel by denying the developer's request for extension.

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[1] Hotel Development Stalls in the Bay Area and All California;

[2] News | As San Francisco Bay Area hotels look for long-awaited turnaround, another falls into financial distress