HBPOA

Authorized BOC Plan for Holden Beach Pier Property

SUMMARY and CRITIQUE

January 15, 2022

OBJECTIVE. The Board of Commissioner's authorized Plan for the Purchase and financing of the Holden Beach Pier ("BOC Plan") states a **limited objective**, to restore the Pier Property to what it was 10 years ago. The BOC Plan describes a Community Project with four elements:

- *Restored Fishing Pier*. A safe and functioning 510' (in water) fishing Pier that is safe to use and has a 15-year useful life;
- *Restored Building*. Ground-level, 1-story, 2,000 to 4,000 sq ft with functioning restaurant.
- *Parking Lot.* 80-space paid parking; and
- *Emergency Access*. 50' wide parcel with 20' access way for fire and EMT.
- IT DOES NOT include a board walk, restrooms, food truck space, a white tablecloth restaurant, event venue or other added amenities that have been discussed from time to time.

INITIAL COST. IT IS estimated that restoration will initially cost the Town about $4.3 million.

PROJECT CAPITAL COSTS		NOTES
Purchase Pier Property	$3,250,000	[1]
Extension of Due Diligence Period	$50,000	[2]
Due Diligence Expense	$25,000	[3]
Engineering Study Expense	$50,000	[4]
Parking Lot Renovation	$0	[5]
Estimated Pier Repair	$900,000	[6]
Estimated Building Repair - Town	$50,000	[7]
Proposed Board Walk Construction (200' x 30')	$0	[8]
Proposed Restroom Construction - Plumbed	$0	[9]
Propose Food Truck Spaces (4)	$0	[10]
Mini- Campground	$0	[11]
Total Capital Cost	$4,300,000	

The BOC Plan appears allocate this Capital Cost to the four project elements, as follows:

Restored Fishing Pier	$ 900,000	Cost of repair
Restored Building	$ 150,000	Tax appraisal cost of repair
Parking Lot	$2,785,000	300' width of parcel divided by 350' total property width
Emergency Access	$ 465,000	50' width of parcel divided by 350' total property width
Total	$4,300,000	

FINANCING. Under the BOC Plan, this $4.3 million Capital Cost is financed, as follows:

- **$3,300,000** --- financed with 15-year public debt, subject to Local Government Commission ("LGC") approval. *NOTE. The BOC Plan fails to STATE that LGC approval is AN EXPRESS contingency in the Purchase Contract. The Town can terminate the purchase if LGC does not approve the debt*; and
- **$1,000,000** --- paid from BPART (occupancy tax) balances.

BOC PLAN: AMORTIZATION OF DEBT; ANNUAL DEBT SERVICE.

Although the BOC Plan assumes that the Town will finance the $3.25 Million purchase price for the Pier Property with LGC approved debt, but it excludes $465,000 cost that the plan allocates to the Emergency Access element for purposes of reaching its conclusion that project revenues cover debt service on that debt. In other words, *the plan compares projected revenue from the Pier Property to debt service for only 85% of the debt secured by that property. The BOC Plan offers no logical reason for this exclusion and comparison.* Moreover, the BOC Plan uses a very odd formulation of debt service on the $3.25 million purchase money debt. Ordinarily accountants use accrual accounting to spread debt service evenly over the term -in this case the 15-year expected life of the project using level principal and interest payments (like a home mortgage). The BOC Plan does not follow this convention.

The following table shows the impact of these accounting tricks on the plan's debt coverage conclusio

TERMS OF LGC DEBT:		NOTE
Beginning Principal Amount	$3,300,000	[12]
Term in Years	15	[13]
Ending Principal Amount	$0	[14]
Fixed Interest Rate	1.75%	[15]
Level Pmt (P&I)	$248,227	[16]
Emergency Access Portion	86%	[17]
Implied FMV of Emergency Access	$464,286	[18]

COMPARISON OF BOC PLAN & LEVEL PAYMENT DEBT SERVICE		NOTE	1/2 YR FY 22/23	2 FY 23/24	3 FY 24/25	4 FY 25/26	5 FY 26/27
BOC PLAN DEBT SERVICE							
Beginning Principal Balance		[19]	$3,300,000	$3,143,438	$2,938,448	$2,739,870	$2,547,818
Accrued Interest Payment		[20]	$28,438	$55,010	$51,423	$47,948	$44,587
Debt Service Payment		[21]	$135,000	$260,000	$250,000	$240,000	$230,000
Principal Balance Reduction		[22]	$106,563	$204,990	$198,577	$192,052	$185,413
Adjusted for Emergency Access (86%)		[23]	$115,714	$222,857	$214,286	$205,714	$197,143
TYPICAL 15 YR DEBT SERVICE							
Beginning Principal Balance		[24]	$3,300,000	$3,154,324	$2,961,298	$2,764,895	$2,565,054
Accrued Interest Payment		[25]	$28,438	$55,201	$51,823	$48,386	$44,888
Debt Service Payment		[26]	$124,113	$248,227	$248,227	$248,227	$248,227
Principal Balance Reduction		[27]	$95,676	$193,026	$196,404	$199,841	$203,338
Adjusted for Emergency Access (86%)		[28]	$106,383	$212,766	$212,766	$212,766	$212,766

The BOC Plan also ignores the impact of changes in market interest rates on forecasted debt service costs. In fact, the BOC Plan, the primary conclusion of which is focused on debt service, does not even state an assumed interest rate for the LGC-authorized debt. This critique has used the 1.75% fixed rate cited when the BOC originally authorized $3,250,000 of debt in late-September. It is not known if Truist Bank is still expected to be the lender, but it is known that rates have increased since September. The usual way to projected rates for this type of debt is to compare it with the comparable U.S. Treasury rate. On September 28, 2021, the mid-term U.S. Treasury rate was 1.55% so the rate for the Town's debt was about 113% of that rate. Current mid-term Treasury rates are higher, about 1.70%. Therefore, it should be expected that the Town's new rate will be about 1.92% (113% x 1.70%). That rate change translates to a increase of about $3,000 per year in debt service.

BOC PLAN DOES NOT ADDRESS AMORTIZATION OF BART FINANCED CAPITAL COST.

Good financial analysis practice for a development project of this type would address the level amortization of both the debt financed and cash financed components of total Capital Cost. Ordinarily, an analyst wants to illustrate for a decision maker what a public development project will cost (before any net revenue offset) over the projected life of the project. In other words, where the project is designed to provide a benefit or service to the public, it makes sense to ask the question, what will this benefit or service cost taxpayers each year on a level payment basis. This makes it possible to compare the cost of alternative projects on an apples-to-apples basis. The BOC Plan does not ask, much less answer this fundamental question because it addresses only debt service. This creates the misleading impression that a project is more or less costly depending on the extent to which the Capital Cost is debt financed.

The following table shows the annual amortization of the total expected capital cost of the Pier Project (separated between the debt financed and BPART financed components). This is the true annual cost that the BOC Plan should have presented.

Amortization of BPART Financed Capital Cost		NOTE	1/2 YR FY 22/23	2 FY 23/24	3 FY 24/25	4 FY 25/26	5 FY 26/27
BPART Capital Cost	$1,000,000	[31]					
Amortization Period	15	[32]					
Level Amortization Rate	1.75%	[33]]					
Annual Cost Amortization	$82,106	[34]					
Appx. No. of Households	2,300	[35]					
Beginning Balance		[36]	$1,000,000	$966,353	$949,506	$914,542	$848,441
Interest		[37]	$9,406	$18,259	$17,141	$16,004	$14,848
Annual Cost Amortization		**[38]**	**$41,053**	**$82,106**	**$82,106**	**$82,106**	**$82,106**
Ending Balance		[39]	$31,647	$63,847	$64,964	$66,101	$67,258
Annual Debt Service		[40]	$123,159	$246,317	$246,317	$246,317	$246,317
Annual Cost of Capital		[41]	**$164,211**	**$328,423**	**$328,423**	**$328,423**	**$328,423**
Per Household		[42]	$71	$143	$143	$143	$143

BOC PLAN REVENUE FORECAST.

The BOC Plan's revenue forecast presents only three revenue sources: (i) 80-paid parking spaces located on the Pier Property; (ii) 40-paid parking spaces located elsewhere in Town; and (iii) leasing the 4,000 sq ft currently derelict building on the Prier Property. Ironically, the plan does not expect any lease revenue from the Pier itself.

THE FOLLOWING IS THE BOC PLAN'S CORRECTED REVENUE FORECAST AFTER HBPOA POINTED OUT THAT THE PARKING REVENUE FORECAST WAS BASED ON AN ABSURD ASSUMPTION OD 70% AVERAGE OCCUPANCY DURING THE FULL APRIP THRU SEPTEMBER 6-MONTH SEASON. THE TOWN'S PARKING CONSULTANT (OTTO CONNECT) HADE BASED ITS REPORT ON AVERAGE OCCUPANCT OF ABOUT 30%. THIS CORRECTION HAD A VERY LARGE IMPACT. THE ORIGINAL PLAN FORECASTED TOTAL PARKING NET REVENUE OF ABOUT $215,000 PER YEAR FOR FY 24/25 AND AFTER – MORE THAN DOUBLE ITS REVISED FORECAST.

REVENUE SOURCES & OPERATING EXPENSES	NOTE	1/2 YR FY 22/23	2 FY 23/24	3 FY 24/25	4 FY 25/26	5 FY 26/27
Pier Parking Lot	[43]	$11,729	$35,583	$59,438	$59,438	$59,438
Other Parking Lot	[44]	$7,331	$22,240	$37,149	$37,149	$37,149
Building Lease(s)	[45]	$0	$50,000	$50,000	$50,000	$50,000
Insurance - Yearly	[46]	($2,500)	($5,000)	($5,000)	($5,000)	($5,000)
Maintenance - Yearly	[47]	($2,500)	($5,000)	($5,000)	($5,000)	($5,000)
Periodic Pier Inspection	[48]	$0	$0	$0	$0	($10,000)
NET REVENUE	[49]	**$14,059**	**$97,823**	**$136,587**	**$136,587**	**$126,587**

The Revised BOC Plan's revenue forecasts are based upon the following key assumptions.

- The Assumptions that (i) the 4,000 sq ft Pier Building can be put into leasable condition at the modest cost to the Town of $50,000, (ii) it can be leased as restaurant and retail space for $50,000 net ($12.50 per sq ft), and (iii) the tenant(s) will pay for all necessary leasehold improvements without requiring the Pier Building to be brought up to current code requirements, which would likely be cost prohibitive. Since the Pier Building tax valuation is about $100,000 the 50% of value building code rule effectively caps such leasehold improvements to $50,000. **The sole basis for this assumption is the undocumented opinions of Commissioner Murdock and Town Manager Hewitt apparently expresses at executive sessions of the BOC for which no minutes have been releases.**

The BOC Plan provides no independent basis for this opinion/guess. There is no indication that these opinions take into account the fact that tenants will be very limited in their ability to renovate the Building to suit their requirement.

- The Assumption that the Town's ability to lease the Pier and Building will not be adversely impacted by customer parking consideration for the tenant businesses. Ordinarily restaurants project a need for one parking space per 5 seats. This means that a 1,500 square foot restaurant (similar to, for example Provision Co.) would require at least 25-30 customer parking spaces. There are similar standard metrics for retail stores (based on sq. ft.) and fishing piers (based on length). It is fair to note that the three businesses the Town hopes to rents to will together require at least 40 of the Pier Lot's 80 spaces to accommodate their customers. **If those customers are going to have to pay for that parking as assumed in the BOC Plan that is going to make the restaurant, retail and pier all less attractive to customers, which will certainly impact what they are willing to pay in rent. There is no indication that this is accounted for in the BOC Plan.**

- Assignment to the Pier Property of the net revenue from 40 so-called "off-road paid parking spaces" (i.e. spaces in Town owned lots rather than in the street right-of-way ("ROW"). **The BOC Plan offers no explanation of why it makes sense to assign this paid parking revenue from lots that are not part of the Pier Purchase and would operate whether or not the Pier Property is purchase to as supposed analysis of the net cost of that purchase. The Town can, of course, have paid parking at lots elsewhere on the island even if it does not buy the Pier Property.**

- The Assumption that both the 80 paid sparking spaces on the Pier Property and the other 40 spaces will achieve 70% utilization during the 183-day parking season by FY 24/25. **Although the authorized BOC Plan implies this assumption on the report by the Town's paid parking consultant ("Otto Report") the Otto Report projects less than one-half that that occupancy rate. The BOC now acknowledges this and has "revised" the BOC Plan to significantly reduce its forecast of paid parking revenue from both the 80-space Pier Lot and the 40-space Other Lots.**

- The revised BOC Plan suggests a new source of revenue from renting six camper spaces on the Pier Property. However, the BOC Plan does not explain how it would be feasible to operate such a small campground on a revenue-positive basis or what this would do to the aesthetics of the project. Moreover, this micro-campground appears to be in violation of existing Town Ordinance Section 157.120, which establishes a much larger minimum size for campgrounds.

<u>FORECAST OF PROJECTED LEASE NET REVENUE – REAL WORLD</u>.

In the real world, financial analysts do not base projections of net revenues from leases based up on the undocumented opinions of interested parties, as the BOC Plan does. Absent actual lease commitments planners ordinarily look at average industry average capitalization rates (Cap Rate) based on the appraise fair market value (FMV)of the leased building to forecast net lease revenue.

Typical rental CAP Rates for restaurant and retail businesses are currently in the range of 7% - 8%. Therefore, the BOC Plan's projected rent of $50,000 per year implies a FMV for the building (after the $50,000 estimated expenditure by the Town) of $625,000 to $715,000. This is not a surprising FMV for well appointed, 4,000 sq ft restaurant/retail building up to modern building code located ocean front with adequate parking. However, that is not this building. The tax appraisal is $100,000 and the Town will spend $50,000 just to prevent it from being condemned. It cannot be significantly upgraded without running afoul of the building code 50% test. **Although the BOC Plan references no appraisal of the building as repaired, it is difficult to imagine a FMV that is more than double the tax value plus repair costs - $300,000 which would imply a market in the $20,000 to $25,000 range.**

<u>BOC PLAN FAILS TO ADDRESS ANY RISK ASSOCIATED WITH TOWN OWNERSHIP</u>.

Ownership of real estate, particularly oceanfront real estate is not without risks, but the BOC Plan offers no real analysis of those risks.

- *Restaurant Business Risk*. Although the BOC Plan does not propose for the Town to operate a restaurant business, about one-third of the net revenue it projects depends up on the ability of an unnamed restaurant business to continue to pay what appears to be a very premium rent on the building. It is cliché to note that restaurant businesses have a very high failure rate, particularly in the first three years on operation in a new location. There is a very real risk that even if the Town is able to put the building into leasable condition and rent it as forecast, that business may fail and the Town will be left owning a non-income producing building with less than $100,000 of leasehold improvements. It will certainly be more difficult to rent the second time-around.

- *Insurance and Replacement - Building*. The BOC Plan assumes that the Building can be insured for both fire and flood risks for about $5,000 per year. The Plan does not specify the replacement value in the policies, but it wopuld certainly not exceed $200,000 – 150% of the appraised value plus $50,000 repair. What the Plan does not note is that under the LGC authorized loan documents the Town would be obligated to rebuild the Building if it were destroyed by fire or flood. As discussed above that rebuild would be subject to current code and certainly would cost far more than replacement value insurance proceeds. Moreover, even if the Town could avoid the rebuild obligation, it would then give-up the $50,000 lease revenue it forecasts.

- *Insurance and Replacement – Pier*. As the BOC Plan notes, the Pier cannot be insured for flood/ major storm damage, but it does not note re-build obligation under the LGC authorized loan documents. There is no estimate in the Plan of what it would cost to re-build the Pier, but the Plan proposes to spend $900,000 over the next few years just to make it safe. The Plan suggests that in the event of such a disaster, the Town might be eligible for FEMA grant relief.

- *Environment Abatement Risk*. Although the BOC Plan does not mention it, the current owner has disclosed that there is an unlined pit on the Pier Property that was used for many years to dispose of grease generated by the restaurant. Grease disposal is a significant issue for restaurant operators and simply pouring the large amounts of grease into a whole in the ground has violated environmental rules for many years. Restaurants in North Carolina, like most states, are required to use a licensed service to collect and properly dispose of grease. It has been suggested that Town personnel have "looked into this" and that no clean-up will be required. The Purchase Contract provides for to environmental indemnities, and since no EPA assessment appears to have been done it is hard to credit the basis for this "no worries" assessment. Such clean-ups, if required are often very expensive.

<u>BOC PLAN DEBT SERVICE and CAPITAL COST COVERAGE FORECAST</u>.

The key conclusion of the BOC Plan is that Town revenues from the Pier Property – primarily paid parking and rent from leasing the pier and building – will more than cover debt service on the $3.25 Million once everything is operational. **HOWEVER, ONCE THE BOC PLAN IS CORRECTED FOR ITS ACKNOWLEDGED MISTAKE OF USING AN ABSURD 70% OCCUPANCY ASSUMPTION FOR PAID PARKING, THIS PRIMARY CONCLUSION IS NO LONGER TRUE.**

Moreover, as the following table illustrates, **absent** the accounting tricks designed to increase projected net revenue and decrease debt service, projected net revenue from the Pier Property, do not come close to "covering debt service" on the proposed $3.25 million LGC authorized debt; much less cover amortization of the additional BPART financed $1 million Capital Cost.

DEBT SERVIVE and CAPITAL COST COVERAGE	NOTE	1/2 YR FY 22/23	2 FY 23/24	3 FY 24/25	4 FY 25/26	5 FY 26/27
REVISED BOC PLAN						
BOC Plan Forecasted Debt Service	[50]	$115,714	$222,857	$214,286	$205,714	$197,143
Amortization of BPART Financed Capital Cost	[51]	$48,497	$105,566	$114,137	$122,709	$131,280
Revised BOC Plan Net Revenue	[52]	$14,059	$97,823	$136,587	$136,587	$126,587
Revised BOC Plan Debt Service Coverage	[53]	12.15%	43.90%	63.74%	66.40%	64.21%
Revised BOC Plan Capital Cost Coverage	[54]	8.56%	29.79%	41.59%	41.59%	38.54%
CORRECTED DEBT SERVICE						
Add Back Service on Excluded Debt	[55]	$19,286	$37,143	$35,714	$34,286	$32,857
Compute Debt Service as Level Pmt	[56]	($11,841)	($13,683)	($3,683)	$6,317	$16,317
Corrected Debt Service	[57]	$123,159	$246,317	$246,317	$246,317	$246,317
Corrected Capital Cost	[58]	$171,656	$351,883	$360,454	$369,026	$377,597
CORRECTED REVENUE						
Eliminate 40-non- Pier Spaces	[59]	($7,331)	($22,240)	($37,149)	($37,149)	($37,149)
Reduce rent to Cap Rate Basis	[60]	$0	($25,000)	($25,000)	($25,000)	($25,000)
Corrected Net Revenue	[61]	$6,729	$50,583	$74,438	$74,438	$64,438
CORRECTED COVERAGE RATIOS						
Debt Service	[62]	5.46%	20.54%	30.22%	30.22%	26.16%
Capital Cost	[63]	3.92%	14.38%	20.65%	20.17%	17.07%
CORRECTED ANNUAL CASH SHORTFALL	[64]	$164,927	$301,300	$286,016	$294,588	$313,159
Per Holden Beach Household	[65]	$72	$131	$124	$128	$136

<u>CONCLUSION</u>.

The central conclusion of both the Original and Revised BOC Plans - *that reasonable projected net revenue from the Pier Property will cover the debt service on the money borrowed to purchase the Pier Property* - **is clearly incorrect**. It does nor even come close. The BOC Plan appears to be a pseudo financial analysis designed to make the purchase seem cheaper and more attractive. This does not mean that purchasing the Pier Property so that it can be returned to what it was 10-years ago is not a good idea or a bad idea. It means, however, that it will be much more costly than its proponents claim.

There are two big take-aways from this Summary and Critique:

- The Pier Project envisioned by the BOC Plan is very limited and may not be attractive to many homeowners and renters. Basically, the Plan is to merely restore the derelict building and the derelict Pier to a safe operating condition without any significant upgrade or additions, more-or-less as the Pier Property was 10 years ago.

- This restoration will cost the Town about $300,000 per year in excess of reasonably projected net revenues from the parking lot, Building and Pier. That represents and annual cost of about $130 per household per year, which is expected to be borne out of other paid parking and BPART funds. This cost is not likely to put the Town at financial risk, but id begs the question of what other uses that money could be put to that homeowner might prefer.