HBPOA Analysis of $50,000 Annual Rent for Building

The BOC Plan assumes that the 4,000 sq. ft. Building will be rented for restaurant and retail space for $50,000 per year starting in FY 23/24, based up on the undocumented opinions of one Commissioner and the Town Manager. This assumption does not seem to have been thought through.

In the real world, commercial real estate rents are typically evaluated based upon so-called “Cap (capitalization) Rates – the ratio of gross rent to the FMV (fair market value) of the rented space. Currently, typical Cap Rates for restaurants and retail space North Carolina are 7% to 8%. Therefore, a $50,000 rent (as assumed by the BOC Plan) implies an FMV for the Building of between $625,000 ($50,000 / 8%) and $715,000 ($50,000 / 7%). The appraised tax value of the building is $100,000. If it is assumed that the tax value is 2/3 FMV and that the $50,000 Town renovation expenditure is fully reflected in FMV, the Building would have an FMV of $200,000 – less than 1/3 the value implied by the $50,000 assumed rent. Based on this estimated $200,000 value and a 7.5% Cap Rate the expected rent would be $15,000 per year. In short, $50,000 per year is an extraordinary rent to project for the Building.

The BOC Plan offers no specifics about the anticipate restaurant and retail businesses that are expected to pay more than three times normal market rent. For purposes of discussion, we will assume that most of the 4,000 sq. ft (75%) will be used for the restaurant, which will pay $37,500 in rent (75% of $50,000) The exact share should have little impact on rental estimate, since the economics of standard service restaurants and small retail stores are similar.

Restaurant industry rules-of-thumb help provide a picture of what this 3,000 sq. ft. restaurant would look like.

- *Projected Seating*. Rules of thumb for restaurant space planning estimate: (i) a ratio of 60:40 seating area to kitchen, storage, restrooms, etc.; and (ii) 12-15 sq ft per customer for standard sit-down service, implying 1,800 sq. ft seating 120-150 customers. In other words, a restaurant similar to Provision Co.

- *Space Cost as Per Cent of Sal*es. Standard service restaurants usually cannot support space costs that exceed 6% to 10% of gross sales (similar rates apply to retail). Therefore, the $37,500 assumed rent implies business generating $375,000 to $625,000 per year gross sales.

- *Kitchen Cost*. A kitchen for a standard service restaurant with seating for 120 – 150 customers typically cost $50,000 to $100,000, if furnished with used equipment. We are told that the existing kitchen equipment is in useable condition ant meets code per the due diligence inspection.

- *Restrooms*. Under applicable health and safety codes such a restaurant requires a men’s and women’s restroom. According to the due diligence inspection, the

Building has one non-functioning bathroom. While it is possible under those rules that a restaurant in the Building could use nearby public restrooms to meet this requirement, but only if it was a fully plumbed facility with hot and cold running water. The BOC Plan makes no cost provision for such a facility. This means that a tenant would have to accommodate the cost two bathrooms in its leasehold improvement plans.

Obviously, the Building's mid-island, ocean front location is very attractive. However, even if it is assumed that the assumed $50,000 rent could reasonably be assumed, it is very difficult to understand how the Building could be put into leasable and operable condition as restaurant and retail and retail businesses without exceeding renovation limitations in applicable building codes. The BOC Plans assumes that the Town will make $50,000 of engineering and safety renovation before leasing and that all additional leasehold improvements necessary to accommodate the tenant(s) business(es) will be paid for than them. Under applicable business code, if the cost of renovation to an old building exceeds 50% of its tax value, the building must be "brought up" to current code. The BOC Plan assumes that the Town's $50,000 of expenditures will be excluded from this 50% test, because they are for engineering and safety renovations necessary to merely make the Building occupiable. That exclusion won't apply to the tenant(s') renovations. Even if the valuation were increased for the Town's expenditures (something that is uncertain at this time), that means leasehold improvements must be limited to $75,000. Otherwise, the building will have to be brought up to current code, including being built on pilings like other oceanfront buildings; that is, it would have to be totally rebuilt. [Current building costs are in the range of $100-$150 per sq. ft. so the cost of a rebuild would be $400,000 to $600,000.] Given the costs of bathrooms, it may be difficult to keep tenant financed leasehold improvements within the 50% limit.