HBPOA Analysis of the Town's Plan for the Holden Beach Pier

February 16, 2022

KEY FINDINGS

1. The plan uses an interest rate of 1.75% instead of the actual rate from Truist of 2.75%.
2. The plan does not include all the property being purchased. The emergency access lot has been excluded, even though it is being purchased and financed together with the pier in a single transaction.
3. The plan does not amortize the $1,000,000 in repair costs and does not include the cost of building restrooms.
4. Paid parking revenue is significantly overstated.
5. Net revenue from four RV spots is not feasible since it doesn't include any operating expenses.
6. Net revenue of $50,000 from leasing the pier building is unrealistic based on appraised value and market comparisons.
7. The plan fails to address risks associated with insurance and replacement, environmental issues, and operating a restaurant.
8. HBPOA estimates net revenues will cover less than 20% debt service costs, not including repair cost coverage.
9. Parking revenue calculations were based on $4/hour and $20/day. The Town has voted to charge $3/hour and $15/day and to absorb the transaction fees.

CONCLUSIONS

1. Purchasing the pier will be much more costly than planned and will likely require the use of significant BPART resources.
2. The cost will likely exceed net revenues by about $300,000 per year – representing approximately 11% of total property tax revenues.
3. The plan to leave the pier and building "as-is" with no improvements might not be attractive to homeowners and renters.
4. An underwater inspection has still not been completed so repair costs have not been determined.

BACKGROUND.

The Board of Commissioners (BOC) approved a plan for the purchase and financing of the Holden Beach Pier at its meeting on December 21, 2021. That plan stated the objective of restoring the property to its condition 10 years ago and contained four elements:

1. *Restored Fishing Pier*. A safe and functioning 510' (in water) fishing pier that is safe to use and has a 15-year remaining useful life;
2. *Restored Building*. Ground-level, 1-story building with a functioning restaurant.
3. *Parking Lot.* 80-space paid parking lot; and
4. *Beach Access*. 50' wide parcel with 20' wide beach accessway.

The plan did 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.

The central premise of the plan was that net revenue from paid parking plus net rent from the property would more than cover debt service on the $3,300,000 15-year loan and would extend the useful life of the pier and building. Accordingly, additional capital costs estimated at more than $1,000,000 could be covered by the Town's excess occupancy tax (BPART) revenue.

After the analyst for HBPOA pointed out several errors in that financial analysis, including the plan's use of paid parking utilization assumptions 2.3 times greater than those forecast by the parking vendor, the BOC approved a Revised Plan at its meeting on January 18, 2022 forecasting that net paid parking revenue and net building rent would only cover about two-thirds of the debt service.

Since adopting the Revised Plan, the BOC has revised the paid parking plan to substantially reduce the number of paid parking spaces available, reduce by one-quarter the daily paid parking rates, and pay for the vendor's transaction fees. These changes will significantly reduce the net revenue available to cover debt service for the pier.

Please note the Revised Plan has not been updated accordingly, so the central premise is not supported by the data and realistic assumptions. Net revenue and rent will only cover less approximately 20% of debt service and the Town will likely have to rely significantly on BPART funding to both cover the remaining debt service and fund required safety and engineering repairs. In the event BPART funds are not sufficient, a property tax increase will be necessary – which is something the BOC has committed not to do.

HBPOA FINANCIAL ANALYSIS

COST PROJECTION

Under the Revised Plan, it is estimated that repair of the Pier and Building will initially cost the Town about $4.3 million.

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

FINANCING.

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

- **$3,300,000** --- financed with 10 to15-year public debt, subject to LGC approval; and
- **$1,000,000** --- paid from BPART (occupancy tax) balances.

SUMMARY OF KEY FINDINGS

KEY FINDING #1: REVISED PLAN UNDERSTATES THE INTEREST RATE ON THE INSTALLMENT FINANCING

The Truist Bank letter of intent (“LOI”) for Installment Financing included in the LGC application provides for a 2.75% fixed rate for a 15-year term. The Revised Plan still uses a lower 1.75% interest rate from an earlier LOI. The higher 2.75% rate included in the Town’s application to the LGC translates to an **increase of about $23,000 per year in debt service** [*calculated difference between level payment P&I on $3,300,000 for 15-years at 2.75% vs 1.75%]*. These terms may need to be renewed if the Purchase Contract and LGC approval are extended beyond February, in which case interest rates (and, therefore, forecasted debt service costs) could change.

KEY FINDING #2: REVISED PLAN EXCLUDES SOME OF THE PROPERTY BEING PURCHASED

Although the Revised Plan assumes that the Town will finance the $3,250,000 purchase price for the Pier Property with LGC approved debt, it excludes $465,000 the plan allocates to the Emergency Access parcel. In other words, the Revised Plan compares projected revenue from the Pier Property to debt service for only 6/7th (300’/ 350’) of the debt secured by that property. It is not clear how the Revised Plan anticipates this debt service – about $38,780 per year - on the Installment Financing will be covered but **excluding 15% of the Installment Financing from the Revised Plan forecast is obviously misleading to the taxpayer public about the true cost of the project.**

KEY FINDING #3: REVISED PLAN DOES NOT ADDRESS AMORTIZATION OF $1 MILLION ADDITIONAL CAPITAL COST.

Typically, financial analysis of a community development project of this type would address the level amortization of both the debt 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 over an extended life of 15-years, it makes sense to ask the question, “what will this benefit or service cost taxpayers each year on a level payment basis.” This approach makes it possible to compare the cost of alternative projects on an apples-to-apples basis.

The plan does not ask, much less answer, this fundamental question because it addresses only debt service on the $3,300,000 loan. This creates the misleading impression for the taxpaying public that a project is more or less costly depending upon the extent to which the total capital cost is debt financed.

At 2.75% over the 15-year useful life of the Pier Project, amortization of the additional $1,000,000 of safety and engineering costs necessary to make the pier and building safely useable by the public is $82,259 per year, in addition to the $271,455 per year debt service on the $3,300,000 installment financing. **Therefore, the total capital cost is 40% more than implied by the Revised Plan, so again the Revised Plan appears to mislead the Holden Beach taxpayer public regarding the true cost of the project.**

The cost of building ADA compliant restrooms is also not included in the plan.

REVISED PLAN REVENUE FORECAST

The BOC Plan's revenue forecast presents only four revenue sources: 1) 80 paid parking spaces located on the Pier Property; 2) 40 paid parking spaces located elsewhere in Town; 3) leasing the currently derelict building; and 4) revenue from direct short-term rental of 4 RV spaces on the Pier Property. The plan does not expect any lease revenue from the Pier itself.

KEY FINDING #4: REVISED PLAN SIGNIFICANTLY OVERSTATES PAID PARKING NET REVENUE FROM THE PIER AND 800-BLOCK LOTS BASED ON THE TOWN'S CURRENT PLAN

The original BOC Plan forecast that annual net revenue from the 80-space Pier Lot will increase to $143,440 ($1,793 per space/year) in FY 23/24 and subsequent years is based on an assumption that these spaces would be 70% utilized for a 183-day season at an average net revenue of $14 (70% contractual share x $20 per day gross). When this forecast was challenged by the HBPOA based upon the fact that it significantly overstated the forecast provided by Otto Connect to the Town in December 2021, the BOC Plan was revised downward to $81,040 ($1,013 per space/year) in FY 23/24 and subsequent years. In other words, the revised BOC Plan acknowledges that, until its calculations were challenged, it overstated net parking revenue by 177% ($1,793 per space/year / $1013 per space/year) or by $ 62,400 per year.

The Revised Plan states that this new forecast is based upon and consistent with the assumptions and forecast in the Otto Connect report, but the explanation for this forecast is literally incomprehensible. What is clear is the fact that this forecast net revenue overstates the actual Otto Connect report forecast for FY 23/24 and subsequent years by about 137%. The Otto Connect report, FY 23/24 forecasts net revenue for 246 spaces (Case 1) is $182,260 or $741 per space. Therefore, FY 23/24 forecast net revenue for the 80-space Pier Lot is $59,304 (80 spaces x $741 per space); a difference of $32,544. **In other words, even after making a 177% correction, the Revised Plan still has an unexplained overstatement of 137% in paid parking revenue ($1,013 per space/year versus $741 per space/year) from the pier parking lot.**

The original and Revised Plan also assigned net paid parking revenue from lots in the 800-Block of Ocean Blvd. West (more than one mile away) to the pier property for purposes of covering debt service. As the Revised Plan notes, net revenue from street parking is not generally permitted to be used for such purposes, but off-street parking revenue is not similarly restricted. That does not, however, explain why the taxpayer public should think that the revenue from these 800-Block lots had any logical relationship to the pier. Moreover, the same issues about the overstatement of net revenue with respect to the 80-space pier lot applied equally to the 40-spaces in the 800-block lots.

However, all of this is mooted by the fact that the new Parking Plan adopted by the BOC in February 2002 (after adopting the Revised Plan) eliminated the 40-spaces not on the pier property. **This reduces the net paid parking revenue forecast by the Revised Plan by $40,520 (40 x $1,013).**

KEY FINDING #5: NET REVENUE FROM 4-RV CAMPING SITES IS NOT FEASIBLE

The Revised Plan "discovered" and added $39,000 in additional revenue from four RV Camper sites on the pier property. The Revised Plan fails to explain how the Town could profitably maintain and rent the four RV-sites without incurring any operating costs or how this micro-campground could be economically feasible. The Revised Plan also fails to address a Town ordinance that requires a minimum size for a paid campground, even though the issue was raised with the BOC at the time the four RV Camper sites were first mentioned. While the Town can waive the ordinances for its own use it is hard to understand how that was the intent of the ordinance.

KEY FINDING #6: REVISED PLAN FORECAST OF NET RENT ON PIER AND BUILDING IS UNREALISTIC

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 expressed at closed-to-the-public executive sessions of the BOC for which no minutes have been released. The Revised 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 requirements.

- The Assumption that the Town's ability to lease the pier and building will not be adversely impacted by customer parking considerations 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 Company) 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 from which the Town hopes to secure rental revenue 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 parking, as assumed in the Revised Plan, the restaurant, retail and pier will all be 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.**

Typically, financial analysts do not make projections of net revenues from leases based upon undocumented opinions of interested parties. Absent actual lease commitments, planners ordinarily look at industry average capitalization rates (Cap Rate) based on the appraised 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 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 wellappointed 4,000 sq ft restaurant/retail buildings up to modern building code located ocean front with adequate parking. However, that is not the current pier 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.

KEY FINDING #7: THE PLAN FAILS TO ADDRESS ANY RISKS ASSOCIATED WITH TOWN OWNERSHIP.

Ownership of real estate, particularly oceanfront real estate is not without risks, but the Revised 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 upon 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 of 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 pier 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 would certainly not exceed $200,000 – 150% of the appraised value plus $50,000 of repairs. 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 <u>current</u> codes 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 Revised Plan notes, the Pier will not be insured for flood / major storm damage, but the plan fails to note that it would have an obligation to re-build the Pier 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 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 hole 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 pit has also not been identified in the property appraisal. The Purchase Contract provides for no 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.

KEY FINDING #8: DEBT SERVICE AND CAPITAL COST COVERAGE FORECASTS

	FY 21/22	FY 22/23	FY 23/24	FY 24/25	FY 25/26
15-AMORTIZATION at 2.75%					
Debt Service ($3.3MM Installment Financing)	$135,728	$271,455	$271,455	$271,455	$271,455
Amortize ($1.0 Additional Capital Cost)	$41,130	$82,259	$82,259	$82,259	$82,259
Total	$176,857	$353,714	$353,714	$353,714	$353,714
REVISED BOC PLAN ADJUSTMENTS TO DEBT SERVICE:					
Non-Truist LOI Interest Rate 1.755	($9,705)	($19,410)	($19,410)	($19,410)	($19,410)
Exclude 1/7th of Total Financing Amount	($19,390)	($38,779)	($38,779)	($38,779)	($38,779)
REVISED BOC PLAN DEBT SERVICE	$106,633	$213,266	$213,266	$213,266	$213,266
HBPOA NET REVENUE FORECAST:					
80-space	$31,371	$35,450	$39,528	$39,528	$39,528
40-space	$0	$0	$0	$0	$0
4-camper space	$0	$0	$0	$0	$0
Building & Pier Rent			$25,000	$25,000	$25,000
Insurance, Maintenance & Inspection Expense	($5,000)	($10,000)	($10,000)	($10,000)	($10,000)
HBPOA NET REVENUE	$26,371	$25,450	$54,528	$54,528	$54,528
REVISED BOC PLAN ADJUSTMENTS TO NET REVENUE:					
70:30 Sharing with Otto.	$17,429	$19,694	$21,960	$21,960	$21,960
40 Eliminated 800-Block Lot Spaces	$24,400	$27,572	$30,744	$30,744	$30,744
Assumed Additional Rent Building & Pier	$0	$0	$25,000	$25,000	$25,000
Assumed 4-Camper Spaces	$9,600	$38,400	$38,400	$38,400	$38,400
REVISED BOC PLANNED REVENUE	$77,800	$111,116	$170,632	$170,632	$170,632
HBPOA DEBT SERVICE COVERAGE	**19%**	**9%**	**20%**	**20%**	**20%**
REVISED PLAN DEBT SERVICE COVERAGE	**73%**	**52%**	**80%**	**80%**	**80%**
HBPOA TOTAL CAPITAL COST COVERAGE	**15%**	**7%**	**15%**	**15%**	**15%**
REVISED PLAN TOTAL CAPITAL COST COVERAGE	**44%**	**31%**	**48%**	**48%**	**48%**

SUMMARY AND CONCLUSIONS.

The Mayor and Commissioners appear to have decided in closed-session deliberations early last year that the Town should buy the pier property, renovate the pier and building, create an 80-space paid parking lot, and provide public beach access in order to create a public amenity for the Town. They then launched a campaign to sell this plan to the taxpayer public of Holden Beach. This campaign seemed to have three components: 1) stating the $3,250,000 purchase price was a bargain in the current “hot” real estate market; 2) painting an attractive and nostalgic image of this new amenity by citing pier and boardwalk projects in other resort communities; and 3) claiming that the pier project basically “paid for itself” or at least covered the debt service. The initial and Revised Plan were designed primarily to demonstrate the third component. The issue was never whether or not the Town had the tax base to support the purchase and renovation, but whether the pier project could be done without tapping that tax base. It was presented as an essentially no-cost and no-risk proposition.

1. The central conclusion of both the original and Revised 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 not correct. The purchase of the pier property will be much more costly than depicted in the Town’s Revised Plan, and that additional cost will likely require the use of significant BPART resources.

2. The purchase and restoration of the pier property will cost the Town about $300,000 per year in excess of reasonably projected net revenues from the parking lot and building. This amount represents approximately 11% of total annual property tax revenues. The cost is not likely to put the taxpayers at financial risk, but it begs the question of what other uses that amount of money could be spent on.

3. 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.