Financial Feasibility

To Lease, or not to Lease…

The question that tries potential Lessees' souls…

Fundamental Concepts

- An "investment" is ostensibly the application of capital coupled with the expectation of return.
- What is my intention?
- Project scope. What do I intend to do?
- Project risk. What could possibly go wrong…?
- What are my goals?
    - Return of investment?
    - Return on investment?
    - Return on, and of, investment?

Intrinsic *V.* Extrinsic Results

- Why am I undertaking this endeavor?
  - “Feel good”
  - “Appearances”
  - “Prove to Mom and Dad that their college money wasn’t wasted”
  - “Preserve a historic structure for the good of humankind”
  - “Preserve a historic structure, have some fun, and not go to the Poor House as a result”
  - “Take advantage of a unique opportunity to partner with the Federal Government”
  - “Help maintain historic legacy in a enthusiastic and productive environment and benefit in ways that cannot be measured by love or money”
- Infamous last words…
  - “Gee, we should have considered that more closely…..”
- How can you make a small fortune in the field of historic restoration?
  - Start out with a large fortune.
- Bottom line, define your goals, understand your capabilities, expect the best and the worst, be realistic.

Applications

- Financial feasibility is demonstrated as a function of the following:
  - Cash flow out (a “negative” sum)
  - Plus (meaning “added to”)
  - Cash flows in (a series of “positive” sums)
  - Factored by a required rate of return
  - Equals (=) Net Present Value (“NPV”)
- Possible results:
  - NPV is negative…this shows that you did not reach the required return rate
  - NPV is positive…you did better then expected
  - NPV is -0-…you got what you planned for
- This is “it”. Nothing more, nothing less.

Investment Examples

- Residential or Commercial note secured by a mortgage
  - Generally referred to as a “mortgage”.
- Who is the investor?
  - The Borrower…nope…
  - The Lender…yup, the entity that extends the capital is the investor.
- Describe the structure:
  - Borrower accepts capital investment from Lender and is obligated to repay.
  - Lender anticipates “return of” and “return on” capital invested.
  - The “return of” capital is called “amortization”.
  - The “return on” capital is called “return on” capital.

Results of Mortgaged Investments

- Who wins here?
  - Borrower is able to accomplish project goals.
  - Lender is able to accomplish investment goals, return on, and of, capital.
- How do we know the relationship has been successful?
  - For a fully amortized loan, NPV of invested capital is -0-.
  - Borrower was able to pay off debt based upon financial capability.
  - Lender has made his required return $$ and got his money back.
- So a fully amortized loan results in a successful investment.

Equity Investments & Return Requirements

- Mortgaged capital investment is usually partnered with the Borrower maintaining an “equity position”.
- Why? Because the Lender wants the Borrower to have “skin in the game”, and the Borrower wants to retain a larger portion of the returns to investment.
- So, as often happens, the Lender has an investment, the “mortgaged note”, and the Borrow has a separate investment, the “equity position”.
- Financed note and equity positions are usually expressed as a ratio, e.g. 70:30.
- Financial feasibility of the equity position is generally satisfied by:
  - Excess revenue returned to the equity position, or
  - Property appreciation at time of resale.
    - As there is no possibility of “resale”, a return to equity must be either intrinsic (joy, frollicking on the beach, great parties, & etc.) or result from revenue generated by operations.
    - Regardless, the equity position requirements must be satisfied if the equity investment is feasible.

Capital Investment by Developer

- Developer (lessee) undertakes project with intention of selling out finished product.
  - This scenario follows the basic “Feasibility Analysis” discussed earlier. If NPV is -0- or positive he has made a successful investment.
- Developer (lessee) is “end user”.
  - In this instance the Developer intends to complete the renovation project and subsequently occupy and/or operate the facility for the term of lease.
  - This is the scenario that is most likely to occur among “owner-occupant” or “citizen” applicants
  - How is this scenario structured and viewed as an “investment”?

“Historic” Leasing

- A lease under this RFP at Fort Hancock must return Fair Market Value to USA.
- NPS Gateway has published “minimum” rent requirements/guidelines for the various buildings covered by the RFP.
- NPS has made it clear that there will be a Common Area Maintenance (“CAM”) charge associated with use and occupancy.
- NPS has made it clear that the Lessee is responsible for payment of real estate taxes if the lease results in a “taxable estate” .
- So how is financial feasibility established under the Lessee/User-Occupant scenario?

Relative to the Invested Capital

- The lease must return FMV.
- The invested capital must be returned.
- The investment must provide a satisfactory rate of return to all parties.
- All real estate operational costs must be expended during the term of lease and continual investment must be made to keep the premises in good condition.
- OMG!!!!! This is sooooooooo complicated…NOT…now for the savvy investor strategy…
- How do you eat an elephant? Simple, one bite at a time.

Eating the Elephant, the “Main Bite”

- How is my investment returned?
  - Regardless of whether the investment is from the mortgaged or equity position, view the return of invested capital as a “reverse mortgage” (sic).
  - Whatever the annual payments to the mortgaged note would be should be viewed as “prepaid rent”.
  - In other words, the repayment of invested capital offsets the rent requirement until the invested capital has been repaid. This is the main incentive offered by the Lessor.
- Can this system fail?
  - Nope, not unless the term of lease necessary to offset the return of capital investment (payments) exceeds the maximum allowed under the law, ostensibly 60 years.

Eating the Elephant, the “Finer Aspects”

- If the major investment is financially feasible as demonstrated by a NPV calculation of -0- and satisfactory intrinsic reward, then how do we “assess” the occupational and operational aspects of the investment project?
  - Begin with the question, “Are the anticipated occupational and operational costs of this project expected to be higher? The same as? Or lower? Than a similar project outside the Park.”
  - Real estate taxes are expected to be “less”.
  - Electric, gas, telephone, cable, are expected to be “typical”.
  - Insurance will most likely include “flood”.
  - CAM is expected to be “typical”.

Finishing Bites

- So, if NPV = 0 and fixed and operational costs are expected to be the same as or less than is otherwise typical, what are we worried about?
  - Good question, let's explore the possibilities:
    - Fear of the unknown…if you follow a reasonable program of expectations and investment, an unusual level of concern should indicate a deficit of entrepreneurial incentive, be it personal or financial, or a lack of tolerance for entrepreneurial enterprise.
    - The solution is to reassess risk or undertake a different venture. The most savvy investors know when to "walk away".
    - It is equally possible that expectations are "too high" to be supported by the venture.
    - Bottom line, if the numbers do not work for you, walk away.

The End

- If at first you don’t perceive, review review again.
- Ask reasonable questions. USA/NPS is here to help. All concerned sink or swim together.
- Leasing at fort Hancock under the current RFP is a unique and exciting opportunity.
- We hope you are among the successful respondents.
- Last comments from the author:
  - There is no substitute for due diligence.
  - It is the potential Lessee’s obligation to conduct it’s own due diligence. Help is available but not in place of effort. There is a vast plethora of information on the topics of Fort Hancock and the leasing process. Brew a fresh pot and start reading.