

CBJ DOCKS & HARBORS BOARD
FINANCE MEETING AGENDA
For Tuesday, August 28th, 2012

- I. Call to Order** (5:00 p.m. to 7:00 p.m.) in the **Room 224, City Hall.**
- II. Roll Call** (John Bush, Tom Donek, Kevin Jardell, Scott Spickler, Michael Williams, and Eric Kueffner).
- III. Approval of Agenda.**

MOTION: TO APPROVE THE AGENDA AS PRESENTED OR AMENDED.

- IV. Public Participation on Non-Agenda Items** (not to exceed five minutes per person, or twenty minutes total).
- V. Approval of July 24th, 2012 Finance Committee Meeting Minutes.**

VI. Items for Action.

- 1. Mount Roberts Tideland Lease
Presentation by the Port Director

Committee Questions

Public Comment

Committee Discussion/Action

MOTION: TO BE DEVELOPED AT THE MEETING

- 2. Aurora Harbor Project Matching Grant Money
Presentation by the Port Director

Committee Questions

Public Comment

Committee Discussion/Action

MOTION: TO BE DEVELOPED AT MEETING

VII. Items for Information/Discussion.

- 1. Review of Lawson Report
Presentation by the Port Director

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VIII. Staff & Member Reports.

IX. Committee Administrative Matters.

1. Next Finance Committee Meeting September 25th, 2012.

X. Adjournment.



Port of Juneau

155 S. Seward Street • Juneau, AK 99801
(907) 586-0292 Phone • (907) 586-0295 Fax

From: Carl Uchytel, Port Director
To: Docks & Harbors Finance Committee
Cc: CBJ Attorney
Date: August 24, 2012
Re: Mt Roberts Tram – Appraisal

Executive Summary: This memo provides a very high level summation of documentation associated with the process to recalculate the lease rent at the Mt Robert Tram. As this a complex issue with case law involvement, I do not purport to have fully exhausted all issues relating to this matter. In summary, Docks & Harbors' process to reappraise the leased land results in a proposed annual increase from \$104K to approximately \$300K. The Goldbelt, Inc process has determined the parcel of land to be of no economic value and suggest the new annual lease rent to be \$0. In reaching this outcome, Goldbelt's appraiser concludes the land must be valued only as an aerial tramway site. It is the professional opinion of the Docks & Harbors' appraiser that the Goldbelt's valuation and techniques utilized was done so erroneously.

Background: Per the terms of the lease, Docks & Harbors hired Horan & Company to complete an appraisal to determine the "market value of the unimproved lands of the lease premises including the air rights easements at its highest and best use." In a report dated March 9th, 2012, Horan & Company established the market value of the 10,000 sq foot parcel to be \$3.3M based on the "direct sales comparative approach". Also per the terms of the lease, the rent is set at 10% of the appraised market value (8% was used in 2006 – the most recent adjustment), placing the rent between \$264K to \$330K.

The lease allows for the lessee to conduct a separate appraisal if the lessee does not concur with the lessor's appraisal. On July 10th, 2012, Goldbelt's appraiser (Reliant Advisory Services, LLC) determined the fee simple interest requirements of the lease (and conditional use) limits the vacant and unimproved property to only aerial tramway use. This is the point at which Reliant diverges from the Horan & Company appraisal assumption that the land be valued as unimproved at its highest and best use constrained only by the general zoning restrictions. The second issue is that Reliant then concludes that since it is not feasible to build the tram new in the current market the parcel has no value. The lease allows when the lessee and lessor appraisals do not concur, for the parties to negotiate in good faith to reach a fair market rent. Furthermore, if lessee and lessor cannot agree when acting in good faith, a third party independent appraiser shall be hired to select one or the other appraisal as most closely reflecting the fair market value. The independent mediator's decision is final under the terms of the lease.

Discussion: Upon receiving the Goldbelt appraisal, Horan & Company was contracted to review the content of the Reliant Advisory Services' report which is attached as an enclosure. Also included in the Reliant appraisal is a legal opinion drafted by Attorney Robert Spitzfaden advocating the land be valued subject to the terms of the lease and conditional use permit. At the core of the Reliant appraisal is the argument that the "best and highest use of the land unimproved" is limited under the terms of the lease to aerial tram use only. The logic continues that unimproved land which can only be used for this purpose with "no identifiable source of demand or probable buyer" renders the parcel uneconomical. The Reliant appraisal provides a financial feasibility analysis which supposedly supports this hypothesis by suggesting, due to negative cash when a calculated for "net operating income", Mount Robert tramway would not be built in today's market. The Goldbelt appraisal uses a valuation method known as "land residual technique" where net operating income and replacement cost for the entire tram enterprise is estimated and depreciated in establishing "highest and best usage". Citing a lack of similar parcels for comparison (i.e. other aerial tramways), the Reliant appraisal argues income capitalization techniques (land residual technique) is more appropriate in analyzing productivity of alternate uses as if the site was vacant (i.e. unimproved).

In contrast, Horan & Co utilized "direct sales comparative approach" following a procedure typically employed which relies on allocation technique, through interviews with buyers/sellers and analysis of market transactions to determine "highest and best uses". The Horan & Co review suggests, in this case, the land residual technique is not reliable, was applied in correctly and Reliant failed to use more appropriate techniques for which data was readily available.

Next Steps: The property value of the Mt Roberts Tram is the gold standard for many downtown and tideland leases. Our negotiations should be deliberate and in accordance with the terms of the lease. The extraordinary assumption that the property is of no value seems nonsensical. The following are potential courses of action:

- Resolve the legal opinion, encourage Goldbelt to retract their position and have them present a counter appraisal based on "direct sales comparative" or other appropriate approaches. This would allow for an apples-to-apples review.
- Per the terms of the lease, enter into good faith negotiations – recognizing the Reliant appraisal did not comment on the Horan & Co appraisal. This discussion is conspicuously absent and may suggest Reliant's concurrence with the Horan & Co finding. I strongly encourage that any counter offer provided by Docks & Harbors be made and supported with available and appropriate market information. It appears some negotiations in 2006 were conducted without consideration to the lease terms, which now places Docks & Harbors in a position limiting our leverage.
- Per the terms of the lease, allow the process to go to mediation. This would be a binding, third party decision to choose zero or \$300K as the one most closely reflecting fair market value. I believe a reasonable person would agree there is value to the leased land at the Mt Roberts Tramway.

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Encl: (1) Horan & Company Appraisal dated March 9th, 2012
(2) Reliant Advisory Services, LLC Appraisal dated July 10th, 2012
(3) Horan & Company Review of Appraisal dated August 9th, 2012

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REAL ESTATE APPRAISERS/CONSULTANTS

CHARLES E. HORAN MAI / WILLIAM G. FERGUSON, TIMOTHY W. RILEY, JOSHUA C. HORAN,
JAMES A. CORAK, AND SARAH ADAY

403 LINCOLN STREET, SUITE 210, SITKA, ALASKA 99835

Phone: (907)747-6666

Fax: (907)747-7417

commercial@horanappraisals.com

August 9, 2012

Carl Uchytel, PE Port Director
City and Borough of Juneau Docks and Harbors
155 S. Seward St.
Juneau, Alaska

RE: Review of Appraisal Prepared by Per E. Bjorn-Roli, MAI, on the Mount Roberts Tram Ground Lease Rent Renewal, Our File # 12-038

Dear Mr. Uchytel,

At your request, I have reviewed the appraisal of the Mount Roberts Tram terminal site prepared by Per E. Bjorn-Roli, dated July 10, 2012, effective date July 1, 2012, for Mr. Derek Duncan, Goldbelt Incorporated. The purpose of this review is to summarize the appraisal in a brief understandable manner and to contrast some of the differences in my appraisal which you may want to address prior to negotiations with the lessee. As we discussed earlier, you did not want a complete technical review of the work at this time. This review is intended to identify the issues which may be germane to your further negotiations. The scope of the review is confined to reading and summarizing the reviewed appraisal and making brief distinguishing references to my work.

This brief summary report is intended for your use to provide the Docks and Harbors Board guidance on how to proceed in negotiations with lessee, Goldbelt Incorporated, for the new base rent pursuant to its lease with the City and Borough of Juneau (CBJ) per City Ordinance (Serial No 94-42) referred to as the Lease. As you are aware, I prepared an appraisal of the property for the same intended purpose dated March 9, 2012.

Abbreviated Highlights of the Bjorn-Roli Appraisal and Comments on Contrast with Horan Appraisal

Issues	Bjorn-Roli Report	Horan Report
Identification of Property appraised:	Mount Roberts Tram, terminal site at 490 S. Franklin St., Juneau, AK. This is a 10,000 SF site plus air rights subject to the 1995 ground lease with the City/Borough of Juneau. It's appraised in the hypothetical condition as though it's vacant and unimproved.	Similar to Horan
Property rights appraised:	The appraisal describes this as the fee simple interest subject to the terms of the CBJ lease.	Horan appraised in fee simple not constrained by the terms of the lease.
Extraordinary Assumptions:	<ol style="list-style-type: none">1. Based on Spitzfaden legal opinion that renewal date should be July 1, 2012.2. Based on the appraiser's belief and	None

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the Spitzfaden legal opinion the only legally permissible use of the site is a tram and therefore the highest and best use of the site for establishing the market value/rent is limited to tram use.

Hypothetical conditions:	The subject is unimproved land.	Similar. No value to the improvements on the land.
Valuation date:	July 1, 2012, based on an extraordinary assumption the Spitzfaden legal opinion.	Horan effective date January 1, 2011, per lease document.
Highest and best use of the land unimproved:	Hold on a long-term basis for future long-term speculative tram development. The appraisal further concludes "as an uneconomic parcel, the subject has no identifiable source of demand or probable buyer." ¹	Develop as allowed by zoning and indicated by development of similarly situated properties such as retail buildings oriented towards the visitor industry.
Highest and best use determination methodology:	<p>Citing the Spitzfaden legal opinion and other sources, the appraiser presumes that the unimproved land valuation is to be constrained by the terms of the lease, narrowing the allowable use to the tram operation only.² The appraiser further notes "...in absence of the aerial tram use restrictions, the subject's highest and best use would be cruise-ship dependent retail, whose economies would justify a higher value of the site, assuming that is a legal use."³</p> <p>The appraiser notes: The highest and best use is constrained by the financial feasibility analysis.⁴ The table on Page 64 shows replacement cost new and negative cash flows presumably to land.</p>	<p>Horan comments-</p> <p>The Feasibility Analysis outlined on page 64 does not reflect market thinking that the land owner would expect no income. It is merely a test for whether the development would be feasible if built new. This analysis ignores the fact that two other parties are getting annual land lease income from the tram owners (DNR air space lease and the AJT on the top terminal) in excess of \$72,000 a year. (page 70 table). Even with that expense the tram enterprise has a positive going concern operating income (nearly \$1.6 million per year) which indicates its constituent parts (land, building, machinery, furnishing, etc.) contribute to the value. The land owner would expect a share of that income.</p> <p>This highest and best use conclusion is questionable even if one were to assume that the land value should be considered constrained by the lease terms because of the incomplete or incorrect application of methodology used.</p>

¹ Page 65 Reliant Appraisal

² Page 6 Extraordinary Assumption number 2

³ Page 9, Extraordinary Assumption number 2, used in the Reliant Appraisal.

⁴ Page 64 Reliant Appraisal which presumes the "going concern replacement cost would be the value an investor would put on the property to determine a feasible value or its component parts".

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Valuation technique: Land Residual Technique was used in this appraisal whereby the net operating income generated by the property was estimated.⁵ A replacement cost for the entire tram enterprise was estimated and depreciated for physical deterioration only.⁶ This concluded a depreciated cost value of over \$21 million without consideration for the economic constraints of the market place.

The appraisal describes on page 67, when the Land Residual Technique method is appropriate, by quoting the 13th Edition of the Appraisal of Real Estate, published by the Appraisal Institute. It states:

"Techniques like Extraction and Allocation have superseded the Land Residual Technique in Land Valuation because these other techniques rely on fewer variables subject to the appraiser's judgment and expertise and thus are more persuasive. In current practice the Land Residual Technique is used almost exclusively in highest and best use analysis to test the productivity of alternate uses of the site as though vacant."

This was clearly not the case portrayed in the report, based on the appraiser's own admission that good comparables were not available.

However, the appraiser was able to develop a net operating income which was subject to three land leases in the past, the CBJ lease, a DNR air rights lease and the AJT lease for the mountain top tram terminal. Historically there has been income to the land paying their land leases.

Horan relies on the allocation techniques whereby through interviews with buyers and sellers and analysis of several market transactions, an allocation is made between the land and building components of sales of properties with similar Highest and Best uses.

Horan comments-

1. The proper use of this technique requires an estimate of the building **value** not just a theoretical partly depreciated replacement cost. Due to the extensive economic obsolescence not estimated, page 66-67, the suggested **improvement value is overstated at \$21,365,000.** (Page 81)
2. Since Bjorn-Roli concluded a different highest and best use it may be reasonable to use different land value techniques. Some that may be applicable in this analysis would be Allocation, Extraction, and Ground Rent Capitalization. For instance, the appraiser was aware of two land rents that he could have capitalized for tram use for the subject project; the DNR air space lease and the AJT on the top terminal. Together they are renting for over \$72,000 a year.⁷ If capitalized at 8% to 10% would suggest the mountaintop site and air rights might be worth \$720,000 to \$900,000.

It is beyond the scope of this review to demonstrate how these other techniques would apply but the Land Residual is admitted to be one of the least reliable as indicated the Bjorn-Roli report itself. - see adjacent excerpt from page 67.

In summary, the land residual technique is not reliable, was applied incorrectly, and other more reliable techniques for which data was readily available were not used. I could elaborate further if need be but it is a moot point if highest and best use is incorrect.

⁵ See table and conclusion page 70 Reliant report, going concern NOI \$1,597,972.

⁶ See conclusion page 81, \$35,609,800 RCN less \$14,243,920 Physical Depreciation only.

⁷ See Table on page 70, Ground Lease Payments.

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Value \$ 0 \$3,330,000
 conclusion:

Comment on Legal Opinions Used in the Appraisal

One of the foundational issues is the appraiser's reliance on the Extraordinary Assumption that the highest and best use value of the land is constrained by the terms of the lease itself and must be valued as an encumbered aerial tram site. I am not an attorney and am not qualified to render legal opinions; however, as an appraiser I must read and understand legal documents to ensure proper understanding of various property rights, appraisal instructions, etc. In this case, I would advise the CBJ to seek an attorney's advice on these issues to determine whether or not the appraisal was responsive to the requirements of the lease. For your consideration I make the following observations.

The lease specifies that the appraiser is to estimate "the fair market value of the unimproved land of the Leased Premises including the Air Rights Easement at its highest and best use." (Sec 5 (d) (3) of the Lease). The lease document contains a formula for calculating rent which includes among other things a percentage calculation of the "fair market value" of the unimproved land of the leased premises plus other considerations. Even if the CBJ modified the rent calculation formula through the John Stone April 2006 letter, the lease instructions for estimating the fair market value of the unimproved land of the leased premises has not changed. The appraiser is never instructed by the original lease or its modifications to estimate "market rent".

Goldbelt's appraiser relies on his extraordinary assumption in part due to the legal opinion produced by Goldbelt Inc's attorney, Robert Spitzfaden, which among other things suggests that the CBJ's conditional use permit, which was granted to the property developer, limits the allowable uses of the land rather than permits a conditional use in addition to all the generally allowable uses under the existing zone code. The lease document itself may contain a variety of agreements and obligations that specify a more limited use than the general fee simple unimproved value of the land as it would be available for its highest and best use. The opinion says the actual use as an aerial tramway is the highest best use due to lease and zoning restrictions.⁸ He goes on to cite examples where courts have indicated such may be the case for whole properties for estimating fair market rent such as medical facilities and hotels. The subject lease never requires an appraisal of the value of the whole property. The lease does not require an appraisal to estimate the market rent of the property for the use to which the Lessee desired to put in, an aerial tram. However, the legal opinion appears to address these issues as if that were the case.

In addition to the Spitzfaden opinion, Goldbelt's appraiser cites an article from the Appraisal Journal Fall 2011 entitled *Ground Leases: Rent Reset Valuation Issues*, as additional backup for concluding a highest and best use that is constraint by the lease. This article makes a clear distinction between leases which instruct the appraiser to estimate "market value" of the land at its highest and best use for the purpose of a rent recalculation and a lease which instructs the appraiser to estimate "market rent". This article affirms through various court opinions citing instructions to the appraiser that when **fair market rent** is estimated, the use of the property for which it is leased is to be considered. When the lease instructs the appraiser to estimate highest and best use **fair market value** of the land as though vacant for the application of a rental adjustment formula, it is appropriate to estimate the fair market value at its highest and best use not constrain by the lease terms. This latter situation is our case. Please see page 319 of the article attachment to the Bjorn-Roli appraisal.

To me, a reading of the lease seemed plain enough; that the intent had been to recapture the highest and best use market value of the land as an adjustment to the base rent every three years as the lease term continued on. This

⁸ Splitzfaden opinion Section IV Page 7.

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appears to have been the case from the beginning of the lease. The rental calculations made in 2006 was based on the assessed fee simple market value of the land at its highest and best use. This has been my experience with the numerous other leases which we have appraised with similar clauses for the city and other private and public agencies throughout Alaska for the last 30 years.

This review summarizes and comments on materials that I assume readers and reviewers of this report would be familiar with and include the following:

1. Retrospective Market Value Appraisal Mount Roberts Tramway Lands Leased from CBJ, by Charles Horan, MAI, report date March 9, 2012. Among other things this report includes a copy of the Lease and the April 3, 2006 John Stone rent adjustment letter.
2. 490 S. Franklin St. CBJ Ground lease appraisal by Bjorn-Roli, MAI, report date July 2012. Among other things this report includes a copy of the Robert S Spitzfaden legal opinion and the Fall 2011 Appraisal Journal article titled "Ground Leases: Rent Reset Valuation Issues"

This summary review is based on the definitions of market value and other terms cited in the above referenced appraisals. Please see the attached Certification and Assumptions and Limiting Conditions.

Please call if you have any questions or comments.

Respectfully submitted,



Charles E. Horan, MAI
Horan & Company, LLC

CEH/sa

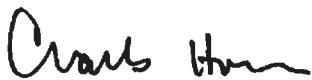
GENERAL ASSUMPTIONS AND LIMITING CONDITIONS

1. It is assumed the data, maps and descriptive data furnished by the client or his representative are accurate and correct.
2. The opinions are based on information and data from sources believed reliable, correct and accurately reported. No responsibility is assumed for false data provided by others.
3. No responsibility is assumed for building permits, zone changes, engineering or any other services or duty connected with legally utilizing the subject property.
4. This appraisal was made on the premise that there are no encumbrances prohibiting utilization of the property under the appraisers' estimate of the highest and best use.
5. It is assumed the title to the property is marketable. No investigation to this fact has been made by the appraisers.
6. No responsibility is assumed for matters of law or legal interpretation.
7. The value estimates are made subject to the purpose, date and definition of value.
8. The report is to be considered in its entirety and in light of the appraisals cited; the use of only a portion thereof will render this appraisal review invalid.
9. The signatory of this appraisal report is a member of the Appraisal Institute. The bylaws and regulations of the Institute require each member and candidate to control the use and distribution of each appraisal report signed by such member. Therefore, except as hereinafter provided, the party for whom this appraisal report was prepared may distribute copies of this appraisal report in its entirety to such third parties as selected by the party for whom this appraisal report was prepared; however, selected portions of this appraisal report shall not be given to third parties without the prior written consent of the signatories of this appraisal report. Further, neither all nor any part of this appraisal report shall be disseminated to the general public by the use of advertising media, public relations media, news media, sales media or other media for public communication without the prior written consent of signatories of this appraisal report.

CERTIFICATION OF APPRAISAL REVIEW

I certify that, to the best of my knowledge and belief:

- The statements of fact contained in this report are true and correct.
- The reported analyses, opinions, and conclusions are limited only by the reported assumptions and limiting conditions and are my personal, impartial, and unbiased professional analyses, opinions, and conclusions.
- I have no present or prospective interest in the property that is the subject of the work under review and no personal interest with respect to the parties involved.
- I have performed an appraisal of the property that is the subject of the work under review within the three-year period immediately preceding acceptance of this assignment. This work is cited in the report.
- I have no bias with respect to the property that is the subject of the work under review or to the parties involved with this assignment.
- My engagement in this assignment was not contingent upon developing or reporting predetermined results.
- My compensation is not contingent on an action or event resulting from the analyses, opinions, or conclusions in this review or from its use.
- My compensation for completing this assignment is not contingent upon the development or reporting of predetermined assignment results or assignment results that favors the cause of the client, the attainment of a stipulated result, or the occurrence of a subsequent event directly related to the intended use of this appraisal review.
- My analyses, opinions, and conclusions were developed and this review report was prepared in conformity with the Uniform Standards of Professional Appraisal Practice.
- I have made a personal inspection of the subject of the work under review.
- No one provided significant appraisal, appraisal review, or appraisal consulting assistance to the person signing this certification.



Charles E. Horan, MAI

8/9/2012

Date of Report