

# MARINAS FALLING IN VALUE,

## trend expected to continue through 2009

*With so many listings not selling and more likely to come online in 2009, a price correction must result.*

BY JOHN SIMPSON

As readers of *Marina Dock Age* know, there are many construction, design, equipment, and management changes that happen to marinas over time. This article will discuss several elements—a near perfect storm of developments and events that are currently affecting marinas' values and their impacts on the industry.

### Values down

With the exception of certain high-end or niche marinas (such as yacht, megayacht, and sailing marinas), marinas' market values have decreased. Although the sky is not falling, value changes have been great in many markets, especially speculation markets and areas that are now saturated with dockminiums.

Many marina owners did not increase slip fees this past spring or summer for the sole purpose of keeping existing customers in their slips. From the current evidence this trend should continue with more marinas holding the line.

Yet even with no increase in rental rates, values for most marinas will still decline over the next 12 to 18 months or perhaps even longer. We anticipate expenses will increase—even if payrolls are trimmed and repairs or renovations are kept at modest levels, market value will still trend downward. The reason is capitalization rates, also known as cap rates.

### Defining of cap rates

A cap rate is a number that turns net income into value. If you have a marina with \$100,000 in net operating income and a 10 percent cap rate, that's a market value of \$1,000,000 (\$100,000 divided by 0.10). The net operating income is 10 percent of the value of a marina.

Another way is to look at its inverse—the net income multiplier. In this case, the market is paying 10 times net income to buy a marina; the cap rate is the in-

verse of the net income multiplier (1 divided by a 10 times multiple). Note that as cap rates go up, the net income multiplier goes down. For example, at a cap rate of 11 percent, the net income multiplier goes down to 9.09.

Cap rates for marinas have increased between one and three percent in most markets. Using the example above, an increase from 10 percent to 11 percent lowers market value to \$909,000 (\$100,000 / 0.11). This variance is due to market niche. The higher on the scale a marina is in its market, the smaller the cap rate changes. Yes, there are plenty of exceptions to this. Boat dealership marinas that were once hot commodities are now in trouble. If marinas have no other special draw, their incomes have been impacted the most.

### Listings up, demand down

For anyone wishing to sell his marina, the most noticeable difference between today's current conditions, compared to a year or two ago, is the availability of competitors. Whereas the inventory of marina listings was materially below one percent of the total inventory in 2006, it is now approximately five percent. This does not include private listings, which are impossible to track.

That's not to say that listing prices are materially lower. The value in use of a marina (i.e. the value using the existing income and expenses) and the price that most marinas ask are still disconnected from market realities.

The big difference is not the price but the players looking to acquire. The deal has to make financial sense, and therefore, buyers are only interested in properties where no disconnect exists. The purchaser who was looking for high-rise waterfront condominium entitlements and "upside potential" is gone. Hence, demand is way down. Sellers have not yet realized their value is confined to what is now in place, not what the future poten-

tial might be. If entitlements are in place, they currently hold little value to a new investor. It will be years before it makes financial sense to develop paper projects. With so many listings not selling, a price correction must result.

### The credit crunch

Today our nation is at a pivotal point in its history. Many major financial institutions and pillars of commerce have been acquired, closed, or become conservators for the federal government. The two key watchwords are uncertainty and fear. Turbulence throughout world economies will cause additional institutions to become insolvent. No one knows what direction interest rates, inflation, and fuel prices will go. Global stock markets are in turmoil with trillions of dollars of wealth having already evaporated.

It comes as no surprise that marinas are facing several credit problems that will need to be confronted head-on. Balloon payments will come due, and property values for many marinas are lower than they were when the notes were first created. Some marinas may be faced with potential "cram-down" situations. Capital improvement plans such as upgrading slip utilities and replacing docks are being put on hold. That in turn, could affect the need for more capital when a marina owner cannot or should not wait to make these improvements.

Most lenders have scaled back their marina financing. Therefore, it depends on local lenders, finance companies, and hard-money lenders to finance the industry. In all three cases, the lenders must hold their own paper because there is no mortgage bundling and no secondary market for marina mortgages. Expect loan-to-value ratios to lag behind other property types with the potential for more interest rate spread between investment grade real estate and marina loans. It is anticipated that marina lending in 2009 will be significantly more difficult.

## Clean marina differentiation

Boaters are starting to make Clean Marinas a primary consideration in deciding which marina they will patronize. Rates are often higher in Clean Marinas, although much of this can be attributed to service and amenity differentials. Any manager or owner who has taken the time to create a Clean Marina is usually at the top of his profession. Where it is really noticeable is in occupancy. Whereas three to five years ago the number of boaters who selected a marina based on this designation was not that great, now it has reached a sufficiently critical mass to be noticed. Expect more marinas to climb onboard. (For additional information, see related story on page 45.)

## Boat dealership and entitlement demand is dead

The sun has set on waterfront condominium development for the second time. Those marinas that went through an expensive approval process to develop high-rise projects and have not sold out have seen their investments largely evaporate with the market. Purchasers of dockominium slips have diminished resale value. For both dockominium owners and developers, foreclosure rates are sure to rise. Some developers are finding that they have to learn the marina business the hard way or walk away from their investments.

The huge profits once enjoyed by boatbuilders and boat and motor dealers have entered a period of hibernation. Well-established dealers who have successful track records will streamline operations and emerge well positioned during the next upswing. The others have already begun the shakeout process.

## Haves and have-nots

It's easy to see the correlation between rental rates and services/amenities when doing a slip rental survey. What is not so obvious are occupancy patterns.

Up until this spring/summer season, many marinas benefited from the "trickle-down" or "next-in-line" effect. When Marina A with the best service/amenities is full, Marina B with the second best becomes full. When Marina B becomes full, Marina C with the third best becomes full, and so on.

This year that trend changed as vacancy rates increased in the middle and lower tiers. The trickle-down effect was still present, but boats were pulled from the water in these two tiers. The net effect was an increase in vacancy overall for many middle and lower tier marinas.

## Industry employment

The shortage of highly skilled laborers and management continues. What is new is that many marinas streamlined payrolls and expanded the roles of existing personnel. Some hard decisions were made, and many more marinas that didn't make cuts this year will make them in 2009.

As for wage increases, most marina owners expect wages to stay flat except for highly skilled departments, and even here increases will be modest.

## Capital improvement

When it comes time to do some belt tightening, one of the easiest places to start is cutting back on repairs and maintenance. Marinas curtail dock improvements until discretionary income returns. When that is not enough, maintenance gets cut below the minimum level necessary to keep the facility in its current condition. This is not good because it offers the potential for allowing depreciation to accelerate from the effects of weathering. The result is the creation of a "capital improvement bubble." If it goes on long enough, boaters will notice, and eventually some will switch to a competitor with higher levels of repairs and maintenance.

Another way to minimize expenses is to delay capital improvements altogether, like deferring basic maintenance that just makes the capital improvement bubble "bigger."

What eventually happens is that the capital improvement expense becomes so high that the marina is forced to refinance. A marina owner would then require a larger mortgage. The result is higher debt service that often causes lower cash flow because such a large capital expenditure often does not fully translate into a proportionate increase in total revenues.

Expect this trend to increase during this recession until the credit crunch abates. The demand for new marina loans that include capital improvements will sig-

nificantly increase when this occurs.

## Solutions

It may seem that it is a time of doom and gloom, but that just isn't the case. Top-tier marinas are doing just fine. Bottom-tier marinas have it the worst. Middle-tier marinas are either weathering the storm or trying not to sink, depending on their debt service level. Marinas rebounded from the savings and loan crisis of the 1990s, and they will again.

Finally here are some solutions that could assist the marina industry in improving appraisal values.

*Standardized accounting procedures*—It's amazing how diverse bookkeeping is for marinas. Your lender needs to understand your marina's finances in order to have sufficient comfort to make that loan.

*New underwriting criteria from lenders*—Value in use rather than future upside potential is what loans should be based on. Marinas that are performing well are suffering from perception problems. Using market-derived cap rates and the current income stream will provide lenders with the security they need to lend.

*A recognized study showing marina performance*—This will allow lenders to compare marina incomes and expenses to the market. Every property type has one except the marina industry.

*Tax authorities have to stop assessing a marina on a possible future value of development*—Marinas have much in common with public need agricultural properties, which get large breaks on their assessments. It's true that development is great when the market is in a growth phase, but marinas are part of the character of our waterfront communities. More states and counties need to follow the lead of states like Florida where marina assessments are being reworked for value in use, not speculative land development.

The bottom line is cash flow, now more than ever. ⚡

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