

## ***Commercial Marina Seabed Rents***

***By Darren Vaux***

***The various government agencies responsible for marina seabed leases in Australia are inconsistent in their approach to marina rentals. This inconsistency, and the resulting uncertainties and associated risks, has a direct impact on the incentive to invest in new facilities and the viability of existing facilities subject to Government seabed leases.***

Traditional valuation methods often have limited application to the determination of seabed, and associated facilities, land rents in commercial marinas. In most cases, the landlord is a government monopoly and the tenants have rights (through the ownership of property or other leasehold or proprietary rights) that exclude free market competition from determining rental levels. These valuation methods also seek to maximise the return to the landlord by setting rents at the *perceived limit of affordability for the tenant* which ultimately may be to the commercial detriment of the landlord if it reduces the propensity for of investors to invest in expanding and renewing facilities.

Put simply, the seabed landlord has a static asset where the return is directly related to the scale and density of the development that is delivered and operated by the Lessee/Investor. As a result, it is in the Seabed Lessor's commercial interest to encourage and facilitate maintenance, development and investment.

Government landlords' obligations to their stakeholders are more than just fair commercial return. They should seek to encourage investment in commercial marinas in order to create improvements in infrastructure leading to enhanced environmental, safety, employment and economic outcomes. Rental levels and security of tenure should be set to encourage investment which in turn will deliver higher direct and indirect returns to government in absolute terms.

Consideration should be given to the economic multiplier effect that marinas have on the boating industry and the community in general as they facilitate public access through the land/water interface. The Marina Economic Impact Study currently being undertaken by Professor Ed Mahoney on behalf of the MIAA will provide empirical evidence to justify these assertions and provide measurable economic and employment outcomes that flow from marina investment and operation.

To fully appreciate affordable seabed rentals, the nature of the marina business needs to be considered. There are two distinct parts to a marina business: first the operating business, which employs staff, takes business risks and builds goodwill (The "Revenue Business"); second the investment in buildings and infrastructure which seeks to achieve a return on the invested capital and risk.(The "Capital Business"). The Seabed Landlord's return should be considered at the Capital Business level and not at the Revenue Business level. This is a true reflection of the participation of the land provider as there is a sharing of the 'rental return'

achieved from the capital deployed in land, buildings and infrastructure. The matter to be determined is what proportion the land plays in the investment (which can be determined through a residual land calculation that properly considers development and investment risk), and the cost of capital. In virtually all seabed leases the Government Landlord takes no risk and is otherwise indemnified by the Lessee through guarantees and insurance. The entire capital and operating risk is born by the Lessee and this must be factored in when determining the fair split of return to the Lessee and Lessor for their contributions of capital.

The added complication is that, within a given location, the government landlord has a monopoly and, as result, is fully armed with the market intelligence of the current lease and rental status of all of its tenants. Marinas are somewhat unique in this regard; retail and commercial tenants have land based comparisons to determine fair market rent. Marinas, by their very nature, do not have the flexibility of relocation of the business goodwill to an alternate location. This critical co-dependency of goodwill and location makes marinas vulnerable to exploitation in rental negotiations with their government monopoly landlord.

So what is the solution?

Placing the Lessor/Lessee relationship in a positive context, it is worth exploring what the two parties typically want from the relationship:

**Landlord (Government Agency)**

- Fair return on assets for the Public
- Allocation of risk to the Lessee
- Delivery of publically accessible infrastructure
- Acceptable environmental outcomes
- Acceptable OH&S outcomes
- Employment and economic development

**Lessee (Marina Operator)**

- Security of tenure
- Certainty in costs (rent)
- Return on capital relative to risk
- Return for operating risk
- Potential for growth and expansion
- Protection of goodwill and growth in business value

This is more readily understood in context of the risks that are typically absorbed by the marina operator in the conduct of the marina business:

- Wet lease risk ( Security of tenure and rental increases)
- Planning risk in redevelopment
- Construction risk in development
- Operating risk – employment
- Operating risk – safety
- Operating risk – environmental
- Operating risk - compliance
- Revenue risk – Market changes and competition
- Regulatory risk ( restrictive changes)
- Public liability risk

In summary, the Landlord provides access to the seabed and the Lessee takes the risk on invested capital, operating, and market risk, and indemnifies the Landlord for

public liability risk. It is on this basis that the marina business model can be analysed, and the relative contributions of the parties considered for the purpose of determining the appropriate sharing of returns. Return is related to capital and revenue, which has led to the use of “**Business Case**” models, and ultimately **turnover rents**, as a simple approach to the sharing of return. This can work, providing there is an appropriate appreciation of the separation of capital and operating risks and revenues.

To achieve the objectives of the parties, turnover rents need to be fair and sustainable, in context of the risk allocations outlined above. This can only be determined by analysis of the relative contribution of the land to other components of a marina business.

To compare a marina operation to other classes of commercial investment, there needs to be a separation of the marina business from the marina investment. For example, with a commercial office building on leasehold land, the investor invests capital to build the building and rents the tenancies out for return. Where there is a land lease with turnover arrangements, the Landlord would receive a return relative to the rental income, which is typically in the range of 10-15% of rental income. The landlord does not, however, also take a proportion of the profit for each of the tenancies, as this has already been factored into the rent that each of the tenancies pays to the Sublessor, based on market influences.

In the case of a marina, the marina operator (as distinct from the marina investor) should expect to make a margin for the effort and risk of operating the marina. The difference between the margin and the operating expenses is the amount of return that can be shared between the capital providers (landlord and investor). Simplistically, if the operating margin is 20%, and the expenses as a proportion of gross revenue is 60%, then the margin to be shared between the capital providers is 20% of gross revenue. Where the land is seen to contribute 20% to the capital, the land return would be 20% of 20%, which equals 4% of gross revenue.

In reality, marina locations and scale change the relativity of expenses and land, so the rental levels that are sustainable vary considerably. As an example, if we adopt a 20% gross operating profit (“GOP”) as a reference point, the following sets out the turnover percentages that would apply for different operating costs as a proportion of turnover relative to different percentages of land contribution.

Land Rent as percentage of Investment Return at 20% GOP

Operating expenses/ Gross Revenue	15%	20%	25%
70%	1.5%	2.0%	2.5%
60%	3.0%	4.0%	5.0%
50%	4.5%	6.0%	7.5%

At a land component of 20%, a range of turnover rents from 2.0% to 6.0% would be applicable, depending on the Operating Cost/Gross Revenue ratio. A 25% land component would see the top end rise to 7.5%. This is a simplistic approach, but the medium range of affordable turnover rents for marina berthing of 4-7% is supported by more sophisticated discounted cashflow analysis, taking into account the weighted cost of capital.

In addition to marina berthing, consideration should be given to the various components of the marina business. As such, business activities at commercial marinas can be divided into four categories:

1. Rental returns, where the revenue is derived by conferring a right to use property for a fee such as berth Licences, mooring licences, tenancy rentals, dinghy or other storage etc.
2. The supply of goods such as fuel, gas, fenders and ropes, chandlery and the sale of new and second hand boats.
3. The supply of services such as haulout, antifoul, shipwright, mechanical, electrical, trimming, rigging, detailing and other services involving the supply of both labour and materials.
4. Food and beverage including, provisions, kiosks, cafes and restaurants.

Each of the above categories has a unique combination of capital, cost of goods sold, labour, and risk, to deliver the right goods or service to the customer. As a result, the gross margin and its relationship to the rights conferred under a wet lease (or land Lease) vary between categories, as does the sustainable and appropriate levels of rent that should be paid as a proportion of gross revenue. The revenue of each of these different business components should not just be aggregated, but rather considered in isolation depending on the particular circumstance of each marina.

Rents could thus be structured to take into account the profit making potential of the rights conferred under the Lease taking into account the financial effort (Capital, general expenses, goods and labour) required to realise the return, proving the landlords return reflects the capital contribution, and not the operating effort and risk.

The other variable to be taken into account is the economies of scale through which the relationship between fixed and variable costs changes with the scale of the facility.

Research by Pitcher Partners (1) on behalf of the Boating Industry Association of NSW in 2008, demonstrated that the sustainable level of wet lease rent of marina berths in Sydney Harbour ranges between 6% and 8% of gross turnover, excluding GST. The key consideration here is what contribution does the land make to the business? Given the scarcity of marina berths in Sydney Harbour, berth revenues are at the upper end when considered nationally and as such, the sustainable rental levels in other areas are likely to be considerably lower.

The key variable that affects rental affordability is the proportion of cost to gross revenue. This in turn is affected by the scale of the facility, diversity of services and accommodation offered, and the charge rates for marina berths as a product of location and competitive supply.

It is essential that the industry work together and share information and experiences in dealing with Government agencies on the issue of marina rents. The MIAA will continue to work with the State BIAs and Marine Queensland in supporting its members in this endeavour. In any event, most marinas would fit within the range of 4%-7% of gross berthing income as an affordable seabed rental with the upper end of the range reserved for larger marinas in demand areas with limited supply.

#### REFERENCES:

(1) Pitcher Partners, September, 2008 – Report to the Boating Industry Association on sustainable rent for marina concession holders. (publisher?)

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