



## THE CITY OF KEY WEST

Post Office Box 1409 Key West, FL 33041-1409 (305) 809-3700

# MEMORANDUM

## EXECUTIVE SUMMARY

**To:** Key West Bight Board

**CC:** David Fernandez

**From:** Marilyn Wilbarger, RPA, CCIM

**Date:** February 2, 2012

**Reference:** Key West Bight Upland Rent Escalation and Late Fees

### **ACTION:**

Per the Boards Request this action item is to consider amending rent escalations and adjusting late fees for the upland leases at the Key West Bight.

### **BACKGROUND:**

#### **RENT ESCALATION**

In 2006 the rental rates were adjusted to market rates for the Key West Bight leases and were based upon the comparative data available at that time. The annual percentage increases in rent had been previously established pursuant to the original financial investment pro-forma prepared by Goodkin Research that was done in conjunction with the acquisition of the property.

In the marketplace, real estate investment is considered long term, illiquid, with inherent risk. Therefore recognizing this and the decrease in purchasing power or the time value of money, the revenues produced must be increased to account for inflation, and to maintain the expected rate of return.

In multiple year leases it is not unusual for a landlord to require the tenant to pay a higher rent by adjusting the base rent on a pre-agreed method, annually. The three most common types of adjustments are:

**Stepped Method:** This method is used when the tenant desires to keep the rents lower at the outset and agrees to higher increase throughout the term to achieve both the Landlord and Tenant's respective goals. The loss to the landlord by using this method is in present value however this loss is offset by higher rent values in the later years of the term.

*Key to the Caribbean – average yearly temperature 77 ° Fahrenheit.*



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**Consumer Price Index (CPI) Method:** The CPI is published monthly by the United States Department of Labor and cites the change in the cost of living which is determined by measuring the change in the cost of purchasing goods and services during the month. The CPI acts as a price indexing scale for landlords to measure the gain or loss of the dollar and therefore, by utilizing the index, to adjust rents so that the landlord can be assured that the net rent is not eroding during the term of the lease.

**Percentage Increase:** This method is utilized to establish fixed increases in rent that provide both pre-determined revenue to the Landlord and known or fixed expenses to the Tenant. The basis for determining the percentage increase can be specific to a particular investment or investors and much like stepped or indexed increases it is utilized to prevent erosion to the value of the dollar.

### **Additional Rent**

Most commercial leases are structured as Triple Net which means the tenants are required to pay their share of the operating expense, property taxes and the insurance for the property as additional rent. Due to the mixed uses at the Key West Bight an arbitrary methodology was established by the Maximus study that does not fully allocate the ownership expenses further eroding the financial return. In 2011, the CRA contributed \$402,944 in property tax, repairs and maintenance that would typically be paid by the tenants.

To further understand the impact of rising rents an analysis was prepared to illustrate the relationship of the rent to sales from the period of 2000-2011 and includes average yearly percentage increase in sales, and average percentage of sales to rent for the period as well. This report was previously provided to the Board under separate cover to provide time for individual review. Several conclusions may be drawn from the data provided and staff will not attempt to summarize all of the variables here.

Any one of the methods described herein or variations thereof can be utilized with the goal of operating the property in a manner that will achieve the original investment's expected rate of return to the CRA. When comparing the current rental rates at the Key West Bight with the Market Rent Study that was conducted in 2011, the current rents and the increases are within the stated ranges, and the operating costs are below market. However, the Board may elect to amend the leases to establish an alternative method, as it deems appropriate.

### **LATE FEES**

Most of the leases at the Key West Bight call for rent and late fees to be assessed as excerpted here:

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**4. RENT** - All rentals provided for herein shall be payable in advance, without prior demand therefore and without deductions or setoffs for any reason whatsoever on the first day of each and every month of the term hereof.

**4.1 Late Charges.** Any monthly rental not received by the fifth day of the month shall incur a late fee equal to fifteen percent 15% of the amount in arrears. In addition, all payments received after the due date shall incur a **\$50.00** administrative fee to cover the costs of collecting and processing late payments. LANDLORD shall have no obligation to accept less than the full amount of all installments of rental, additional rental or other amounts due hereunder and interest thereon which are due and owing by TENANT to LANDLORD. If LANDLORD accepts less than the full amount owing, LANDLORD may apply the sums received toward such TENANT'S obligations, as LANDLORD shall determine in its sole discretion, without waiving LANDLORD'S remedies for default.

**4.2 Interest on Rent.** Rent and additional rent not paid within fifteen (15) days of when due shall bear interest from the date due until paid at the highest rate permitted by law.

Late fees are typically established by the Landlord to prompt timely payments of rent and much like rent escalation may be established in various ways. The lease calls for 15% after the 5<sup>th</sup> day which is certainly a stiff penalty however the accounts receivable have remained minimal as a result of the amount of the potential late fee. The lease also provides for interest to be charges after the 15<sup>th</sup> day of the month.

The Board may elect to amend the leases to reduce the late fees or establish an alternative method of application thereof or leave the fees in place which requires no action at this time.