

NETZER & ASSOCIATES

Real Estate Appraisal & Consulting

November 3, 2006

File No. 26-019

Ms. Evelyn Tseng
Revenue Division
City of Newport Beach
3300 Newport Boulevard
Newport Beach, CA 92663

Re: Appraisal Services
Commercial Tidelands – Newport Harbor
Newport Beach, California

Dear Ms. Tseng:

In accordance with your request and based on a review of the information provided on October 16, 2006 entitled “Contracts And Agreements” I have completed further analysis regarding the business uses set forth in the information provided. This letter contains eight pages and is to be considered a supplement to, and read in conjunction with, my October 9, 2006 appraisal, which is identified as File No. 26-019. All of the information included in my prior appraisal, including the Certification, Assumptions and Limiting Conditions, definitions, descriptions and analysis apply to this letter. This letter applies specifically to SECTION A – Commercial Entities @ Fixed Locations and the additional businesses not previously addressed.

This analysis is completed based on your representation of the “Contracts and Agreements” that apply to those businesses operating in the tidelands and were not specifically addressed in Exhibit A of the Professional Services Agreement. The list of “Contracts and Agreements” is attached to this letter for reference. Based on the list provided and our discussions, the primary uses that are not addressed specifically in my report are the yacht clubs and three restaurants – The Galley, Ruby’s Diner and Newport Beach Fish Company.

Based on the list of “Contracts and Agreements” provided the following outlines the basic terms of the lease or agreement with the individual restaurants. It should be noted that I have not reviewed the specific leases and/or agreements that apply to the individual properties and the summary is based on the summary provided.

The Galley Cafe

Location:	Balboa Yacht Basin
Lease Date:	January 1, 1988, options exercised 1/1/1999 & 12/31/2003
Lease Expiration:	December 31, 2008
Base Rent:	\$17,500
Percentage Rent:	6.0% of all gross sales
2004/05 Rent Paid:	\$38,263
Maintenance:	Lessee

Ruby's Diner

Location: Balboa Pier
Lease Date: July 1, 2000, w/ two 5-year options to renew
Lease Expiration: June 30, 2015
Base Rent: \$30,000, with increases 7/1/2008 & 7/1/2012
Percentage Rent: 6.0% of all gross sales to \$1,000,000
 6.5% of all gross sales over \$1,000,000
2004/05 Rent Paid: \$96,492
Maintenance: Lessee maintains premise, City maintains pier

Newport Beach Fish Company

Location: Newport Pier
Lease Date: June 14, 1987, w/ two 5-year options to renew
Lease Expiration: June 14, 2007 (original 15 year term ended by Settlement Agreement, then term extended 5 years.
Base Rent: \$21,130.32, with CPI increases 7/1/2008
Percentage Rent: 5.0% of gross sales
2004/05 Rent Paid: \$57,982
Maintenance: Concessionaire

The following is a summary of the relevant market data that applies to the restaurants that operate within the tidelands at various jurisdictions along the coast.

RESTAURANT PERCENTAGE RENT RATES SEPTEMBER 2006							
Jurisdiction	San Diego Port	City of San Diego	Dana Point*	Newport Beach **	Port of L.A. (San Pedro)	L.A. County	Ventura County***
Food	3.0%	3.0%	9.0%	3.0%	3.0%	3.0%	3.0%
Beverage	5.0%	5.0%	9.0%	5.0%	5.0%	5.0%	5.0%

* Dana Point charges an additional 1.0% for Common area maintenance & 1/4% for parking management.

** Food and Beverage charges are from Balboa Bay Club Lease.

*** Channel Islands Harbor

Based on the market data uncovered, **I have concluded that market rent for a restaurant operation is three-percent of gross income from food sales and five-percent of beverage sales.**

It should be noted that the sales of food and beverages and the base rent for a restaurant will vary based on several factors and not all of the rental data within a specific market area will be uniform, but should be of assistance in establishing base rental rates. As an example of the divergent base rent and percentage rent paid, the following table is a summary of twelve

restaurants located in Dana Point Harbor including all levels of service from a delicatessen to full service sit down restaurants with bar service. The table sets forth the monthly base rent per square foot, the annual gross sales, the percentage rent paid and the analysis includes the monthly percentage rent per square foot and the combined base and percentage rent per square foot.

DANA POINT RESTAURANT SALES JULY 2005 to JUNE 2006							
Name	Suite Size (Sq.Ft.)	Base Rent /Sq.Ft.	Total Gross Sales	Gross Sales /Sq.Ft.	% Rent Paid	Monthly % Rent /Sq.Ft.	Total Rent /Sq.Ft.
Beach Cities Pizza	1,511	\$1.99	\$474,312	\$313.91	\$6,823	\$0.38	\$2.37
The Brig	4,589	\$1.63	\$1,397,120	\$304.45	\$35,741	\$0.65	\$2.28
El Torito	7,142	\$2.10	\$3,400,238	\$476.09	\$126,021	\$1.47	\$3.57
Gemmell's	2,313	\$1.30	\$386,509	\$167.10	\$1,438	\$0.05	\$1.35
Harbor Deli	1,512	\$1.79	\$790,100	\$522.55	\$38,709	\$2.13	\$3.92
Harbor Grill	3,999	\$3.75	\$3,341,269	\$835.53	\$120,714	\$2.52	\$6.27
Harpoon Henry	11,036	\$1.36	\$2,877,031	\$260.70	\$78,933	\$0.60	\$1.96
Hava Java	514	\$1.95	\$109,525	\$213.08	\$1,080	\$0.18	\$2.13
Jolly Roger	6,187	\$1.21	\$1,647,765	\$266.33	\$58,299	\$0.79	\$2.00
Proud Mary's	2,193	\$1.14	\$748,172	\$341.16	\$37,335	\$1.42	\$2.56
Turk's	1,911	\$1.83	\$1,127,206	\$590.00	\$59,449	\$2.59	\$4.42
Wind N' Sea	11,688	\$1.28	\$3,609,207	\$308.80	\$144,829	\$1.03	\$2.31

The above table indicates that the base rents for all types of restaurants ranges from \$1.14 to \$3.75. All of the restaurants pay 9.0-percent of their gross sales in percentage rent with an additional 1.0 percent for CAM and 0.25-percent for parking maintenance. After paying their percentage rent the total monthly rent ranges from \$1.35 to \$4.42 per square foot. All of the leases were re-negotiated in 2002 and have similar basic lease terms. The presentation of this data is included to show that estimating "base" or "minimum" rent by comparison to other restaurant properties is difficult due to the differing physical and locational characteristics of the comparable rental data and supports the conclusion that the most equitable method of restaurant leasing is based on a percentage of the gross sales subject to some negotiated base or minimum rent.

Establishing Base Rent

All of the data presented reflects the total rent being charged but does not address the issue of "Base Rent", or the minimum fixed rent that these businesses pay in conjunction with their leases. In terms of establishing a fixed "Base" or "Minimum" rent for the above business operations, the interviews completed and the lease agreements reviewed indicate that due to the varying physical and locational characteristics (both along the coast and within the individual harbors) of the operations, trying to compare one operators "Base" rent to another is impractical and is not generally an "apples-to-apples" comparison. The most common method of establishing a base rent, or fixed minimum rent, is to take 75-percent of the prior three years

gross sales and apply the concluded percentage to this figure. As an example only, the following methodology is used to establish the base rent for a hypothetical business operating in the tidelands:

Gross Sales 2003:	\$90,000
Gross Sales 2004:	\$100,000
Gross Sales 2005:	<u>\$110,000</u>
Gross Sales – 3 year average:	\$100,000
x 75-percent:	<u>x 0.75</u>
3 year Avg. to apply Percentage:	\$ 75,000
Percentage Rent Factor – 7.0%:	<u>x 0.007</u>
Annual “Base” or “Minimum” Rent:	\$ 5,250

In this example the fixed annual “Base” rent is \$5,250, or \$437.50 per month. The tenant pays the “base” rent either monthly or quarterly, with any “overage” rent paid based on a percent of sales at year end. The overage rent is offset by the fixed annual rent. Using the above figures as an example, and assuming the sales continued the upward trend the total rent in 2006, based on annual sales of \$120,000, would be calculated as follows:

Gross Sales 2006:	\$120,000
x Percentage Rent Factor - 7.0%:	<u>x 0.07</u>
Total Percentage Rent:	\$ 8,400
Less – Fixed Base Rent @ \$5,250:	<u>-5,250</u>
Total Overage Rent Due:	\$ 3,150

In this example, the business operator would pay “overage” rent of \$3,150 based on the percentage clause in the lease.

Yacht Clubs

As previously noted, the list of “Contract and Agreements” includes the Bahia Corinthian Yacht Club (BCYC) and the Balboa Yacht Club (BYC). The following is a summary of the information provided that pertains to their agreements:

Bahia Corinthian Yacht Club

Location:	1601 Bayside Drive
Use:	Marina, lease encumbers tidelands
Lease Date:	May 7, 1998
Lease Expiration:	May 6, 2033
Base Rent:	\$48,977
Adjustment:	5/7 of each years % rent adjusts to weighted average in the rate /lineal foot of slips in comparable marinas
Percentage Rent:	Not set forth

Maintenance: Lessee maintains premise

Balboa Yacht Club

Location: 1801 Bayside Drive
Use: Yacht Club, lese encumbers upland parcel
Lease Date: August 29, 1999
Lease Expiration: August 31, 2029
Base Rent: \$5,549
Adjustment: Adjusts in 2008, 2011, 2014, 2017, 2020, 2023 and 2026, basis of adjustment is not set forth
Percentage Rent: Not set forth
Maintenance: Lessee maintains premise

The above summaries indicate that the two yacht clubs have agreements for different property types. The Bahia Corinthian Yacht Club has an agreement for the use of tidelands that is to be used for marina purposes. The rental rates for marinas are discussed in Section D of my report. My conclusion of market rent set forth in Section D is that submerged tidelands that are used for marina purposes and are not leased in conjunction with the upland parcel have a market rent of 22.0-percent of the gross slip income. This figure applies to the marina at the Bahia Corinthian Yacht Club.

In contrast, the Balboa Yacht Club has an agreement for the upland parcel and the information provided does not indicate if the City or the Club own the improvements. Based on the very limited data uncovered regarding yacht club leases, the Port of San Diego structures their yacht club leases on a fixed minimum with a percentage clause based on the permitted uses (food & beverage, charters, marina, etc...), most of which have been previously discussed either in this supplement or in other sections of my appraisal. In terms of percentage of club dues the Port of San Diego receives 10.0-percent of all dues income. The lease with the Balboa Bay Club provides the City of Newport Beach with 6.0-percent of the dues income. The Ventura Port District is currently negotiating with the Ventura Harbor Yacht Club and was not at liberty to discuss the lease negotiations until the lease is finalized. The Dana West Yacht Club, in Dana Point Harbor, is subject to the new Management Agreement with Orange County paying a management fee to the harbor operator based on a percent of the gross income and the percentage being charge to the yacht club by the operator was not disclosed.

Based on the limited information available regarding yacht club leases I have concluded that **the fair market rent for a yacht club, excluding any other uses discussed in other sections of this report, is between six- and 10.0-percent of the total dues income.**

Certification

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

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, unbiased professional analyses, opinions and conclusions.

I have no present or prospective interest in the property that is the subject of this report, and I have no personal interest or bias with respect to the parties involved.

I have no bias with respect to the property that is the subject of this report or to the parties involved in the assignment.

My engagement in this assignment was not contingent upon developing or reporting predetermined results.

My compensation is not contingent upon the reporting of a predetermined value or direction in value that favors the cause of the client, the amount of the value estimate, the attainment of a stipulated result, or the occurrence of a subsequent event.

The reported analyses, opinions, and conclusions were developed, and this report has been prepared, in conformity with the Code of Professional Ethics and Standards of Professional Appraisal Practice of the Appraisal Institute, which include the *Uniform Standards of Professional Appraisal Practice*.

The use of this report is subject to the requirements of the Appraisal Institute relating to review by its duly authorized representatives.

I have made a personal inspection of the property that is the subject of this report.

No one provided significant professional assistance to the person signing this report.

In accordance with the USPAP Competency Provision, I certify that I have the knowledge and experience to complete this assignment and have appraised this property type before.

Disclosure of the contents of this appraisal review is governed by the Bylaws and Regulations of the Appraisal Institute. In furtherance of the aims of the Institute to develop higher standards of professional performance by its Members, the appraiser may be required to submit authorized committees of said Institute copies of this report and any subsequent changes or modifications thereof.

The Appraisal Institute conducts a voluntary program of continuing education for its designated members. MAI's who meet the minimum standards of this program are awarded periodic educational certification. As of the date of this report, James B. Netzer has completed the requirements under the continuing education program of the Appraisal Institute.

I have personally conducted an inspection of the real property identified in Exhibit A to the Contract For Services, which is the subject of this report. Based upon my investigation and

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analysis, I have formed the opinion that the subject properties have the following values as of September 30, 2006:

The market rent for restaurants that operate in the tidelands is 3.0 percent of the food sales and 5.0 percent of the beverage sales.

The market rent for a yacht club, excluding any other uses discussed in other sections of this report, is between six- and 10.0-percent of the total dues income.

Respectfully submitted,

James B. Netzer, MAI
California General Appraiser No. AG003143

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Attachment A – Contracts and Agreements