

National Park Service  
U.S. Department of the Interior  
Commercial Services Program



# Leasehold Surrender Interest (LSI) Valuation Alternative Formula

Concessions Management Advisory Board  
September 2010



# Authority for Use of Alternative Valuation Formulas for LSI in NPS Concession Contracts

- Use of Alternative Valuation Formula
  - Section 405(a)(4) of Public Law 105-391 authorizes the inclusion of alternative LSI value formulas in concession contracts estimated to have an LSI value in excess of \$10M



# Background: Standard LSI Formula



- LSI value for applicable improvements provided by a concessioner under a National Park Service (NPS) concession contract as defined in 36 CFR Part 51 (“standard formula”) is as follows:
  - The initial construction cost of the related capital improvement;
  - Adjusted by (increased or decreased) the same percentage increase or decrease as the percentage increase or decrease in the Consumer Price Index from the date the Director approves the substantial completion of the construction of the related capital improvement to the date of payment of the LSI value;
  - Less depreciation of the related capital improvement on the basis of its condition as of the date of termination or expiration of the applicable LSI concession contract, or, if applicable, the date on which a concessioner ceases to utilize a related capital improvement.



## Section 405 (a) 4: Two Alternative LSI Formulas



- A. Construction costs (initial LSI value) is straight-line depreciated in accordance with the tax laws and regulations of 1998
  - Formula can be used 9 years after the passage of the law on any contract with more than \$10M in LSI
  
- B. The Secretary may use an alternative formula that is determined necessary in order to provide a fair return to the Government and to foster competition for the new contract by providing a reasonable opportunity to make a profit under the new contract
  - Public comment required for Alternative B

# NPS Proposed Use of an Alternative LSI Formula GRTE Signal Mountain Lodge (GRTE-003-11)



- Use of the alternative formula is a contract by contract determination
  - Formula designed for the specific operational and financial circumstances of a particular contract
- NPS published notice for comment in the Federal Register of its intent to use the Alternative Valuation Formula for LSI in the GRTE003-11
  - on February 1, 2010 and on May 26, 2010
- NPS published final decision on use of the LSI alternative for GRTE003-11 on September 3, 2010



# Proposed Alternative LSI Formula – GRTE-003-11



- Original NPS proposed-alternative LSI formula had three components:
  1. Initial LSI value (as of the commencement of the contract);
  2. New LSI value, i.e., that credited during the term of the contract (as described in the next slide); and
  3. No additional LSI for fixture replacements.

# Comments Received:



- NPS received comments from 2 entities to the initial notice and a comment from 2 entities to the second notice.
- In consideration of the comments, NPS re-examined the financial and other circumstances of the new contract and the proposed LSI alternative, leading to adoption of a final LSI alternative for the for the GRTE-003-11 Contract.

# Final LSI Alternative Formula – GRTE 003-11



1. Reduces the initial LSI value under the new contract on an annual straight-line depreciation basis over a 40-year recovery period regardless of asset class
2. Reduces the LSI value in capital improvements (*including fixtures*) constructed or installed during the term of the contract on an annual straight-line depreciation basis over a 40-year recovery period regardless of asset class



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# BACK UP SLIDES FOLLOW





# Necessity of the Proposed Formula

- The NPS has determined after scrutiny of the financial and other circumstances involved in the proposed contract, that utilization of the proposed alternative formula, as compared to the Standard Formula is necessary in order to:
  1. Provide a fair return to the Government from the revenues of the proposed contract; and
  2. Further competition for the proposed contract by providing a reasonable opportunity for the concessioner to make a profit under the new contract



# GRTE Alternative Formula Components



## 1. Initial LSI Value

- The reduction on a monthly straight-line depreciation basis applying a 40-year recovery period regardless of asset class
- No adjustment for the installation (including replacement) of fixtures during the term of the proposed contract

**AND**

## 2. New LSI Value

- The reduction in any new structures or major rehabilitations constructed during the term of the new contract based on straight-line depreciation applying a 40-year recovery period regardless of asset class
- The construction cost of new capital improvements will include the costs of installed fixtures
- Any installation (or replacement) of fixtures after the initial construction would not alter the established LSI value in the improvements

# Proposed Formula for GRTE – Summary



1. Depreciates all asset classes composing LSI value over a 40-year recovery period; and
2. Eliminates adjustments of the initial LSI value as a result of the installation (or replacement) of fixtures during the contract term

# Conclusion



- Standard formula is unique to NPS concessions
  - Not readily understood by hospitality/retail industry
  - Problematic for competition
  - Uncertainty as to ending LSI value
- Alternative formula is standard practice in commercial leasing industry
  - Easy to understand
  - Provides certainty of payout
- The public comment period closed March 3, 2010

# Final Alternative Formula



- Internal rate of return expectation based on industry norms for a particular service type
  - Franchise fee is the difference between the industry norm IRR and the IRR for the particular operation (standard NPS practice for setting franchise fees)
- IRR remains similar to that of the standard formula
  - Concessioner gets some of initial cash outlay (LSI) back over the life of the contract rather than at the end
- Increases cash flows (lower franchise fee) of concessioner and may decrease taxable net income of concessioner
  - Provides more cash to the operator during the contract term
  - Potential faster depreciation
  - Reduces return (LSI) at end of contract

# Prospectus Status



- Offers responding to the prospectus for GRTE 003-11 are due December 10, 2010
- An additional question submittal period is open through October 1, 2010, 4 pm MDT.





# Final LSI Alternative Formula GRTE-003-11



- The minimum franchise fee reflects the financial consequences of the alternative formula
- Estimated reasonable opportunity for profit to the new concessioner is projected to be the same whether the new contract included the standard formula or the alternative formula
- The alternative formula will not lower the projected returns to the new concessioner but will reduce the speculative nature of LSI value under the standard formula



# Final LSI Alternative Formula GRTE 003-11



- Provides a recovery period (40 years) for LSI
  - Easier than Internal Revenue Code of 1998
- Reasonable opportunity for profit projected using internal rate of return (IRR) analysis
  - Initial cash outlay and cash flows throughout the contract term
- LSI divided by the recovery period (40 years); that amount is used as the annual depreciation
  - Example
    - $\$10\text{M LSI} / 40 \text{ (years)} = \$250\text{K annual depreciation}$
    - 10 year contract, total depreciation = \$2.5M