



**CITY OF WICHITA FALLS  
INTER-OFFICE MEMORANDUM**

**TO:** Mayor and City Council Members

**FROM:** Darron J. Leiker, City Manager  
Jim Dockery, Assistant City Manager/CFO

**DATE:** October 2, 2009

**SUBJECT:** Analysis of Castaway Cove Water Park

---

This memorandum has been drafted to provide the City Council with an overview of the staff analysis regarding the offer from the owners/operators of Castaway Cove Water Park to sell the park to the City. The staff has worked diligently on this issue in an effort to quickly, but thoroughly, evaluate the financial status and operating conditions of the Park. In this due diligence, five years of financial records of the Castaway Cove Limited Partnership have been evaluated, Appraisal District records have been reviewed, other water parks have been contacted, American National Bank (ANB) has been contacted regarding the primary loan to the investor group, Murphy Davis, Sr. has been involved regarding possible debt financing methods if the City were to purchase the Park, in depth discussions have taken place with Dr. Louis Wilson, General Partner, as well as with Dave Simon and Kent Lemasters of AmusementAquatic Management Group (AMG), and existing contract documents and recent safety inspections have been reviewed. Additionally, the operating conditions of the Park's infrastructure has been visually inspected by City staff.

**Background of the Water Park:** The Water Park is formed as a Texas Limited Partnership consisting of 27 local investors. It consists of 21.4 acres of land (16 acres of Water Park and 5.4 acres of Parking), and was opened for business in June of 2004. The Park offers over 40,000 square feet of water areas and its features include two slide towers (with 5 slides), "Lazy" compulsion river, tidal wave pool, sport pool, interactive multi-level children's play system, sand volleyball court, full service stage area and group pavilions. It also offers a full service concession stand and numerous "family friendly" and "adult friendly" gathering areas. Since February of 2006, the Park has been managed by AMG, a California-based water park management and consulting firm, through a full service management agreement.

The financial records provided to the City indicate that the initial capital cost to construct the Park, including land, was \$5,878,000. There was also \$310,000 in capitalized start-up costs and loan origination fees, bringing the total initial capital investment for the Park to \$6,188,000. It should be noted, that this price does not include the 49 acres of undeveloped land surrounding the Park. Since 2004, an additional \$600,000 in capital assets (principally the Sidewinder attraction at \$407,000) has been made to the Park, bringing the total capital investment over the six years to \$6,687,000.

Approximately 63% of the total capital investment (\$4,234,000) was borrowed from American National Bank with a five year balloon note. As a result, very little of the principal was paid off in the first four years, leaving approximately \$3.8 million in principal to be paid off. This note was originally due to be paid off in December 2009; however, ANB has agreed to a two year extension before the debt is called. This note is secured by the land, equipment, furnishings and all other personal property owned by the Partnership.

In addition to the primary loan from ANB, approximately 3% of the total capital investment (\$202,000) was borrowed from the general contractor to pay for the cost of change orders that occurred in the final phases of construction. This note was refinanced in 2008 with First National Bank of Wichita Falls bearing interest of 8% annually through September 2012. Very little of the principal of this note has been paid and over \$170,000 is still due. This note is secured by a Deed of Trust on the 49 acres of undeveloped land surrounding the Park.

Finally, during 2008, the Partnership borrowed approximately 6% of the total capital investment (\$407,000) to construct the new Sidewinder attraction. The money for this attraction was partially borrowed from the investor group and the remainder from the supplier of the attraction. Approximately \$387,000 would be required to pay off this note.

The remaining cost for the total capital investment at the Park has come in the form of cash from the investors. Over the years, the investor group has paid approximately 28% of the total capital asset (\$1,844,000) from cash contributions.

**Asking Price and Fixed Asset Value:** As noted above, the total capital asset cost for the park stands at \$6,687,000. However, because many of the assets are six years old, it is necessary to determine the accumulated depreciation on the Park to arrive at a current value, or fair market price. Arriving at the depreciated value of the Park is not an exact science because standard depreciation schedules for water parks really don't exist. In addition, comparable selling prices for water parks of identical size that have six years of life exhausted is unattainable. Therefore, the staff utilized information from the Wichita County Appraisal District, information on the Castaway Cove Balance Sheet, and a detailed fixed asset listing with

depreciation schedules typically used in financial accounting to arrive at a price range for the Park.

The Wichita County Appraisal District has a tax appraised value on the Park of \$3,140,000. The method used by the Appraisal District considered the construction cost, comparable land values, and Marshall & Swift building cost index to determine typical loss in value due to physical deterioration and external obsolescence.

The Castaway Cove Balance Sheet as of August 2009 shows the current fixed assets to be valued at \$1,274,000. However, this figure is too low because the depreciation of property and equipment was determined using an accelerated cost recovery system for federal income tax purposes. For example, all of the assets except the land were depreciated at 7 years or less. This depreciation schedule is acceptable for many of the assets at the Park like furnishings, computer equipment, kitchen appliances, fencing, etc., but is too aggressive for assets such as buildings, parking, slides, concrete decks, and water pools. In addition, their financial reports indicate that the Castaway Cove Partnership was able to allow for a 50% first year bonus depreciation under the Jobs and Growth Tax Relief and Reconciliation Act of 2003 for qualified assets purchased between May 2003 and January 2005. Furthermore, a similar one-time bonus depreciation of 50% was allowed under the Economic Stimulus Act of 2008 for qualified assets acquired during 2008 (principally the Sidewinder attraction). Therefore, the value of their capital assets as reported on their Balance Sheet is significantly less than the current value of the Park.

The third method used to help determine the current value of the Park is what the City refers to as the Straight Line Financial Accounting System. This system is similar to the IRS system used but applies “reasonable” expectations of life expectancy for each asset category. It also is based on the physical inspection of the Park to determine remaining useful lives of the assets. This system applies the following depreciation schedules to the Park’s assets:

<b>Description of Asset</b>	<b>Depreciation Schedule</b>
Land and Betterments	No Depreciation
Buildings, Bridges, Pavilions and Decks	20 Years
Parking Area, Slides and Aquatics	12 Years
Shade Structures and Pools	10 Years
Office Equipment	5 Years
Machinery and Equipment	7 Years
Furniture and Fixtures	7 Years

Using this depreciation schedule, the value of the Park is \$4,033,000. Therefore, staff places the present value of the Park at a range between \$3,140,000 and \$4,033,000. The asking price from the Limited Partnership is to pay off the

outstanding debt, which is approximately \$4.3 million. This appears to indicate that the Partnership is slightly upside down on its remaining notes.

**Operational Finance Information and Pro Forma:** Even if the City and the Partnership can agree on a purchase price for the Park, before a decision should be made to purchase this asset, we need to be sure that the Park does not become a future drain on our taxpayers. To help ensure that property tax dollars are not required after the purchase, the operating revenue needs to be sufficient to cover all annual operating expenses and generate enough funds to set aside for repairs and/or replacements to Park assets when they have exhausted their useful lives. The reason why it is important to establish this replacement fund is because the Park is six years old, and will soon begin to need repairs/replacements of components (computers, kitchen appliances, furnishings, fences, slides, parking, pools, etc.). On a \$6 million facility that will be fully depreciated in about 15 to 20 years, staff recommends that approximately \$350,000 be set aside annually in a capital reserve fund to keep the Park in good operating condition. Without this reserve fund, every time a significant repair is needed at the Park, we will be required to spend General City Funds or approach the 4B Corporation as we have for MPEC.

A review of the Partnership's operating income statements for the last five years indicates that the attendance levels at the Park have been fairly consistent, ranging from a low of 77,395 in 2005 to a high of 94,252 in 2008. The five year average attendance has been 86,843, and the last two year average has been 91,326. Operating revenues have averaged \$1,400,000 over the last five years, and \$1,576,000 over the last two years. These revenues include daily ticket sales, season passes and group rates, merchandise sales and rentals, and food and beverage sales. These figures indicate that the average revenue per capita is approximately \$17.25.

Operating expenditures, including cost of goods sold, has averaged \$1,243,000 over the last five years. The last two year average expenditure level has been \$1,316,000. As a result, the operating income for the Park before debt service, has averaged \$260,000. However, after paying annual debt service obligations, the Park has averaged a net operating loss of \$320,000 per year.

The Partnership has suggested that *"the City can completely pay for the operation of the park from park revenue, as well as debt service – even in the first season, without any additional cash from the City or taxpayers."* However, their assumptions include increases to attendance levels and significant reductions to expenses, which we believe are either too optimistic or entirely inaccurate. For instance, their revenue projections assume that the local economy will improve by next summer, resulting in rebooking of 50% of the losses that occurred in 2008 to season passes and group sales. They have assumed an attendance level of 94,460, which has never been achieved at the Park. The highest attendance level since its inception

was 94,252, which was in 2008 when the excitement was at its peak after the new Sidewinder attraction was just put into operation. Also, their pro forma assumes that the City could save \$28,500 in utility costs for water/sewer and trash service, \$8,500 in landscaping costs, \$57,000 by not purchasing general liability insurance, and \$78,000 in capital reserve costs. We don't agree with these assumptions because the City will be required to pay the Water/Sewer/Sanitation enterprise funds for utility services, any landscaping done internally still has a cost associated with the work, general liability insurance on this type of facility might still be advisable, and capital reserve contributions not only shouldn't be cut, but really need to be four to five times higher than the \$78,000 the Partnership was required to deposit, per the loan terms from ANB.

We do agree that the City could save approximately \$100,000 in annual property and sales taxes because of our tax exempt status. Attached to this report is an operating income statement showing the last two years of operations at the Park and a first year pro forma for the Park under City ownership. It should be noted, that the City's pro forma assumes that we are able to continue charging rates currently in place, and attendance levels remain at 88,000 visits. It also assumes that the City debt finances \$4 million to be paid off in 15 years, at 5% annual interest. Lastly, it reflects the savings from property and sales taxes, and the additional capital reserve funding. As indicated in the pro forma, under these conditions, it is reasonable to expect that the City could generate an operating income of approximately \$340,000 before capital reserve and debt service requirements. Assuming all of this \$340,000 is placed in reserve for future repairs as recommended, the operational revenue should be sufficient to cover annual operating costs and build a reserve fund for needed repairs, but will not be sufficient to make the debt service payments. Therefore, a funding source like 4B Sales Taxes would be required to finance the purchase of the Park (with no expectation of being repaid), but continued operations after the Park is purchased should not need General Fund (property tax) subsidy unless the attendance drops drastically or we lower prices.

**Intangible Benefits of the Park:** The first and probably most important intangible benefit of the Water Park is the quality of life it adds for our community. In the past six years, over 450,000 visits have been made to the Park, illustrating that the facility is appealing to a large customer base. Also, this Park is important to the Convention and Visitors' Bureau for helping to attract tourism and offering convention visitors to the community another recreational draw to help us compete. One can also argue that Castaway Cove is the type of recreational amenity that folks considering relocating to Wichita Falls would look for and value; especially young families. The Park also provides full-time and seasonal employment for 175 individuals with an annual payroll of \$500,000. Furthermore, with six years of operating experience, the City is in a much better position to achieve financial projections than it would be starting from scratch. In addition, there is benefit in the Castaway Cove logo and marketing brand penetration. In other words, a large community segment already

knows about and positively identifies with this facility. Lastly, with the management company in place, the City will not have to search for experts to run the day to day operations or to market the facility.

**Physical Conditions of the Park:** Several of the City staff toured the facility on Monday of this week. Representatives from Parks and Recreation, Public Works, Building Inspection, Building Maintenance, and City Management participated in the tour. After the tour, staff conducted a meeting to discuss the physical conditions of the Park. The consensus of the group was that it was a nicely constructed park, but is now beginning to show signs of wear and tear that should be addressed. The main buildings, slide towers, concrete decking and walkways, pavilions, bridges, and parking area were all in average to good condition. However, the fencing, wooden picnic tables and lifeguard stands, water pools, landscaping, water slides and chemical buildings were beginning to show significant signs of wear and tear. Overall, the staff rated the conditions of the Park about 6.5 on a scale of 1 to 10, with 10 being perfect.

**Financing Options to the City and Timing:** Assuming that the City would be required to pay approximately \$4 million for the Park, it is not financially feasible to purchase the Park with cash. Even though the Park is eligible for 4B Sales Tax Funding, the cash position of the 4B Fund stands at approximately \$2 million and the 2010 budget is virtually committed with annual debt service, MPEC improvements, and on-going operating costs.<sup>1</sup> Additionally, General Fund Reserves remain at appropriate levels and should not be considered a viable source for cash financing. Therefore, if the Park is purchased, staff recommends that it be financed with debt paid by the 4B Sales Tax Fund.

Essentially, we have three debt financing mechanisms available to the City: (1) issuance of General Obligation Bonds; (2) issuance of Certificates of Obligation; and (3) restructuring the outstanding loan with American National Bank. With any of these financing mechanisms, staff recommends that the maturity of this debt be no longer than 15 years. Although it would be acceptable to go with 20 year maturities on a new water park, Castaway Cove is already 6 years old and will fully depreciate before 20 years.

What is significantly different about these three approaches is the timing at which bond/loan proceeds would be available, and election requirements. If General Obligation Bonds were issued, a general election of the citizenry would automatically be required, and the earliest that election could be held would be on the uniform election date in May 2010. Bond proceeds would then be available to purchase the Park around July 2010.

---

<sup>1</sup> This project would also be eligible for 4A economic development funding if approved by the voters through a referendum.

If Certificates of Obligation were issued, an election is not mandatory, but after notice of intent to issue CO's is made, the public would have 30 days to protest the issue by submitting a valid petition to the City Clerk signed by 5% of the qualified voters. If that petition did not materialize, the City could proceed with the bond ordinance and funds would be available within 60 to 90 days from that point. If a petition was successfully submitted, then an election would have to be conducted in May 2010 before the ordinance approving the issuance of CO's could be approved by the Council and proceeds would not be available until July 2010.

Restructuring the loan with American National Bank would not require an election, because bank loans are subject to annual City Council appropriation of the debt service requirements, and technically do not commit future City Councils. However, direct bank loans must be restructured with the bank on an annual basis and they also must be shown on our books as a current liability as opposed to a long term liability. Typically, these loans carry a higher total interest cost than GO bonds or CO's; but in this particular instance, ANB may be willing to negotiate better terms due to the circumstances of the existing debt. This financing mechanism is definitely the quickest, but may draw criticism because it does not allow the public a method to trigger a referendum, like the other options.

**Recommendation:** If it was clear that the operation of this park would be a future drain on the City's General Fund budget (without an offsetting tax rate hike), staff would not hesitate to recommend against buying this facility. However, the historical operating data and pro forma shows that the Park revenues can support its annual operating expenses and future capital replacement costs. The only City funding that should be required is the amount needed for the initial purchase of the Park, which could come from debt financed by the 4B (or 4A) Sales Tax Fund. This pro forma assumes we keep the prices at the current levels. After talking with AMG and hearing how the pricing categories were set, we would strongly recommend this.

We believe there are many intangible benefits of having this water park remain viable in our community. It is staff's recommendation that we pursue the acquisition of this facility and begin negotiations with the owners on a final purchase price. As stated earlier, it is our opinion that the current market value is in the range of \$3,140,000 to \$4,033,000. This project merits close consideration during the staff/council Capital Planning Workshop later this month when a multitude of other city projects will be discussed and prioritized.

If you have any questions about this information, please do not hesitate to stop by or give us a call.

## CASTAWAY COVE WATER PARK INCOME STATEMENTS AND PRO FORMA

	<u>2008</u>	<u>Forecast 2009</u>	<u>City Pro Forma 2010</u>
Park Attendance	94,252	88,400	88,000
Per Capita Revenue	17.07	17.46	17.29
 <b><u>Revenue</u></b>			
Admissions	1,215,558.72	1,167,788.70	1,150,000.00
Rentals	21,322.70	19,250.00	19,000.00
Retail	51,506.41	50,039.00	50,000.00
Food/Beverage	312,548.21	295,680.00	292,000.00
Corporate Sponsorship	3,750.00	8,000.00	8,000.00
Other Revenue	4,339.01	2,500.00	2,500.00
Total Revenue	1,609,025.05	1,543,257.70	1,521,500.00
Cost of Sales	146,555.11	142,500.00	138,000.00
Gross Revenue	1,462,469.94	1,400,757.70	1,383,500.00
 <b><u>Expenses</u></b>			
Labor/Taxes	579,895.24	554,500.00	544,083.00
Marketing	133,386.44	140,162.00	140,162.00
Insurance	75,144.13	68,623.00	68,623.00
Contract Entertainment	1,500.00	-	-
Property Tax	71,237.24	78,667.22	-
Operating Licenses/Permits	13,405.96	14,500.00	14,500.00
Travel & Business	3,961.10	3,640.00	3,640.00
Outside Prof Services	49,342.15	45,350.00	34,000.00
Office Supplies	3,488.08	3,235.00	3,235.00
Office Equipment	-	-	-
Recruitment/Relocation	966.13	2,432.00	2,432.00
Dues and Subscriptions	980.00	1,000.00	1,000.00
Operating Supplies	60,701.75	56,800.00	55,427.25
Printing	512.38	-	-
Employee Uniforms	9,128.20	1,500.00	1,500.00
Telephone	11,344.63	7,848.00	7,848.00
Postage	8,871.37	1,775.00	1,775.00
Utilities	138,632.36	128,250.00	130,000.00
Pest Control	707.55	600.00	600.00
Equipment Rental	13,311.26	14,250.00	14,250.00
Outside Maint Services	-	-	-
Minor Repairs & Maint	17,657.68	21,000.00	21,000.00
Cash Over/Short	922.47	850.00	-
Contingency Expense	1,963.12	750.00	-
Total Operating Expense	1,197,059.24	1,145,732.22	1,044,075.25
Operating Income Before Debt/Capital Reserves	265,410.70	255,025.48	339,424.75
Capital Reserve Fund	73,072.87	78,029.00	339,424.75
Debt Service	444,210.86	497,753.36	385,000.00
<b>Net Income/(Loss)</b>	<b>(251,873.03)</b>	<b>(320,756.88)</b>	<b>(385,000.00)</b>

Prepared by city staff - October 2, 2009