October 12, 2009

Mr. Jim Broadwell
Project Manager
The Jekyll Island Authority
100 James Road
Jekyll Island, GA 31527

Dear Mr. Broadwell:

The Jekyll Island Authority ("JIA") engaged Bay Area Economics ("BAE") to conduct an independent peer review of a report prepared by Bleakly Advisory Group ("Bleakly Report") as well as review comments provided by interested parties related to recommended changes to the JIA's residential land lease policy. This letter summarizes our findings and presents an alternative set of recommended changes to the residential land lease policy.

BAE conducted its review within the overall goals and objectives framework set by the JIA to:

- Encourage the improvement of the island's existing residential structures;
- Adopt policies and lease agreement that are more consistent with other public and privately leased land policies in other comparable areas;
- Implement residential lease fee structures that reflect market values and adjust to changes in market values over time;
- Formulate a methodology for transitioning existing leases to new policies; and
- Address the JIA's long-term revenue needs to assure its financial viability.

1: Peer Review of Bleakly Report

Overall, the Bleakly Report is a solid, comprehensive study of JIA's residential land lease policy. The public policy at question is complex and has many moving parts. The consultants clearly identify key issues and for the most part provide data and analysis to support their recommendations. There are several areas in the analysis, however, where we think matters should be re-examined, more explanation given to support certain findings or recommendations, or new concepts explored. As part of this review, BAE has also drawn from comments submitted by members of the public and we refer to these comments throughout this peer analysis.

1.1: Recommended Lease Rate as Half a Percent (0.05%) of Unit Value. The Bleakly Report originally recommended that the JIA consider adopting a half-percent (0.5%) lease rate based upon the value of the land and improvements. This recommendation was made after a presentation of best practices for residential land leases. The report indicates that other landowners set rates for long-term land leases ranges between four-tenths-of-one percent (0.4%) and six percent (6.0%) of land value with many having a CPI escalator every five years. In subsequent revisions of its recommendations, the Bleakly Report suggested a quarter percent (0.25%) lease rate on land value as determined by Glynn County.

While the CPI escalator is a standard term, the quarter percent (0.25%) of land value appears at the very low end of the case studies presented and is far below the original JIA land lease rate at four point eight percent (4.8%) of land value. Of the case studies, the range for residential land leases in Palm Springs, CA, Hawaii, Vancouver, B.C., State of Idaho, State of Montana, Brazos River Basin, TX, all range between four percent (4.0%) and six percent (6%) of land value. In the one case of Navarre Beach, FL, the lease rate is set at four-tenths-of-one percent (0.4%) percent of selling price of property (land and improvements) in order to advance a public purpose: encouragement of redevelopment of lands prone to hurricane damage. The Bleakly Report does not cite a public purpose that might justify it. On page 32, the Bleakly Report stated "the proposed new lease structure should be more in line with practices for comparable, publicly owned residential land leases around the country." Neither the original nor the revised recommended rate appears to be consistent with this principle or the original percentage rate set by the JIA itself.

It should be noted that one of the public purposes of the JIA is to ensure that Jekyll Island be accessible and affordable to the people of Georgia. The complication is whether the concept of affordability encompasses the idea of implicit public subsidy of residential land leases for specific owners[1] at the expense of providing broader access to Jekyll Island for non-owners that could be funded through higher residential land lease rates. If a lower overall residential land lease rate is contemplated and desired, the public purpose served should be explicitly stated. This might be a challenge since the original rate was four-point-eight (4.8%) percent of land value and the JIA had the same affordability mandate at the start of its residential land lease program fifty years ago.

[1] Please see Section 2.1 for a fuller description of this issue.

1.2: Application of the Proposed Half-Percent (0.5%) Lease Rate on Improvement Values. The original Bleakly Report proposed that the 0.5 percent lease rate apply to land and improvements. The inherent problem with applying this rate on improvements is that improvements are not the property of the JIA until the end of the term when improvements revert to the state. Any proposal to increase residential land lease rates should focus on land value (e.g., lot value) since that is the only asset owned by the state during the term of the lease.

There is another problem with the proposed rate structure related to applying the half percent (0.5%) rate on improvements. The Bleakly Report recommends that an owner receive a rent discount of fifty-percent (50.0%) percent of his or her new base rent for three years if an investment of over $50,000 is made in the property. This recommendation is made as a way to encourage re-investment in homes on the island. However, as pointed out in a comment submitted by a member of the public, this suggested structure may actually dis-incentivize owners from investing in their property since they "lose" a portion of the value of the improvement through having to pay increased rent over the life of the lease –notwithstanding three years of partially abated rent. BAE concurs with this comment. We do note that in a subsequent refinement of the recommend new lease structure, the Bleakly Report shifted to a one-quarter-of-one percent (0.25 %) of land value model and has cured this potential problem.

To summarize our thoughts on the matter of encouraging reinvestment, it is our opinion that no credit or other discount really is necessary to encourage investment or conversions to the new lease structure. Owners will have sufficient motivation to improve their properties once lease terms are extended to permit financing and re-financings and if the percent of value lease rate is restricted to land value only.

1.3: Analysis of Comparative Tax and Fee Burden. The Bleakly Report presents (starting on page 22) an analysis of the comparative holding costs of a property at Jekyll Island and other coastal areas of Glynn County. The costs are defined as property taxes, JIA lease payments, water and sewer rates, fire fees, and other costs. The consultant concludes that owners of water-front lots enjoy a significant cost advantage and owners of interior lots have comparable (or slightly less favorable) costs to owners of lots elsewhere in comparable locations in the county. When the analysis is restricted to property taxes and related fees and charges for municipal services, we concur with the findings.

However, when the lease costs for Jekyll Island are added in Table 12 on page 24 without adding the imputed land "rent" for owners of lots outside Jekyll Island, this potentially understates significantly the "total cost of ownership" between Jekyll Island residential property owners and owners of residential properties elsewhere in the county. For example, a purchaser of an interior property at St. Simons/Sea Island for which the land is valued at $206,852 (Table 11) would by paying "land rent" equivalent of $12,411 (either to a bank as part of a mortgage or as the opportunity cost of the owners equity, given an overall 6 percent rate of return, for example). Adding in the imputed land rent to Table 12 would result in a large +/- $12,109 positive difference instead of $302 negative one when comparing owners of interior properties at Jekyll Island with owners of similar properties elsewhere.[2] In the case of water-front or water view parcels, if the imputed rent were included, the advantages in "total cost of ownership" enjoyed by Jekyll Island lot owners would be significantly more than is stated. Similarly, the notion of imputed rents is missing from the analysis of new lease rates on page 40 of the Bleakly Report.

Overall, Jekyll Island leaseholders will continue to receive significant economic benefits under the new lease rates proposed by the Bleakly Report. While a higher base rent rate, such as five percent (5.0%) of land value, would be consistent both with the initial rate set by the JIA as well as the case studies presented, it may not be feasible (see discussion at end of Section 3).

1.4: Six Percent (6.0%) Annual Appreciation Assumption. For the purposes of forecasting potential revenues to the JIA under a new residential lease program, the Bleakly Report utilizes a six percent (6.0%) annual appreciation rate to calculate future property values. This rate is based upon an examination of historic appreciation trends over a long period of time (1979 through 2008). In addition, this assumption drives findings presented on page 44 related to the JIA's capture of property appreciation.

Carrying this six percent (6.0%) annual appreciation forward to estimate future potential lease revenues to the JIA under different changes in residential lease policy may not be realistic and may overstate estimated revenues. Nationally, the sharp increase in home prices was concentrated between 2001 and 2006 and there is a consensus among housing economists that housing in most markets will not appreciate to the same degree in the future as experienced in the recent past.

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[2] In fact, Jekyll Island leaseholders benefit from positive rent from the value of their leasehold with the JIA. Please refer to Section 2.1 to see how existing Jekyll Island leaseholders have benefited from an effective transfer of land value from the state to leaseholders.

What is not clear in the case of Jekyll Island is how the distribution of appreciated values accrued over the 29-year period cited by the Bleakly Report. If the long-term average is significantly influenced by the gains from the last boom cycle, then it could be argued that a lower annual appreciation rate should be used to estimate JIA revenues, say four percent (4.0%). If the distribution of gains were strong over several market cycles, then the six percent (6.0%) assumption would be appropriate. No annual data are presented in the materials that BAE received to permit an independent review of these trends. In the absence of such data, BAE recommends that a lower annual rate of appreciation be used to forecast JIA revenues.

1.5: $2,500 Transfer Fee. The original Bleakly Report recommends an across-the-board $2,500 transfer fee when leaseholds are transferred. A subsequent refinement of this concept exempts inter-spousal transfer from the proposed fee. Others have suggested a lower fee in the amount of $1,000. The concept of a transfer fee is appropriate but should be subject to periodic escalation either through an inflation-index or by JIA ordinance so that the level of the fee keeps up with land values. Otherwise, the value of a fixed fee will diminish in real terms over time.

While the revised Bleakly Report recommendation of a $1,000 transfer fee is a good start, BAE would offer an additional “percent of land value” concept for the JIA to consider. For example, a one percent (1.0%) transfer fee on land value applied to an interior lot valued at $203,000 would yield a $2,030 payment to the JIA. A two percent (2.0%) rate would yield $4,060. The fee would be paid by the seller as is customary in Georgia and the charge would be one of many on a seller’s closing statement. By fixing this fee as a percent, there would be no need to escalate the rate since it naturally would track land values.

Exemptions from any percentage transfer fee should acknowledge the fact that certain transfer are not for consideration such as inter-spousal and inter-family transfers, transfers to trusts or corporations, transfers related to securing mortgages, transfers related to tenancy-in-common, and gift transfers. BAE recommends that the JIA follow the Georgia Revenue and Taxation Code exemptions set for the state’s real estate transfer tax. Any percentage-based transfer fee should be levied on transfers for consideration to third-party buyers.

If a percentage-based transfer fee is adopted by the JIA, then the overall transfer fee program could be revised to the following:

- Inter-spousal leasehold transfers – No charge
- Other leasehold transfers that would as fee title transfers qualify for exemption under Georgia law from the state real estate transfer tax – $500
- Leasehold transfers from sale of property for consideration (e.g., non-exempt real estate transfers) – one percent (1.0%) of land value as determined by Glynn County

This revised set of transfer fees charges a nominal amount ($500) to cover JIA's administrative costs to process necessary lease notice provisions and changes to the authority's accounting systems.

1.6: Lease Escalations. The original Bleakly Report recommends a three point eight-five percent (3.85%) cumulative annual escalation every five years during the lease term. In a subsequent refinement, the Bleakly Report refined its recommendation to a cumulative annual three percent (3.0%) escalation every five years. Several public comments were received by the JIA indicating problems with the concept of a fixed escalation when many leaseholders receive Social Security that may move differently than the fixed historic-CPI escalation proposed by the Bleakly Report. If base rent is set at a percent of land value as recommended, no escalation is necessary since assessed value will move with market values over time. Fixing the annual land lease rent to the county's assessed value for land, will put the JIA on equal footing with its leaseholders –all will move up and down together.

Treating base rent as percent of land value also cures an equity issue raised in some comments. All leaseholders with lots of equal value would pay the same base rent subject to the same changes annually regardless of when the lease was originally signed.

2: Other Observations on JIA's Residential Land Lease Program

There are a number of issues that have not been raised in the discussions and presentations regarding the JIA's residential land lease program. BAE would like to offer the following general observations to inform the JIA's policy deliberations:

2.1: Shift of Land Equity from State of Georgia to Leaseholders. One significant effect of the flat land lease rates implemented many years ago is that the state effectively "lost" a substantial amount of equity in its land over time. We raise this point not to recommend that the JIA recapture this "lost" equity[3], but to provide an overall context to the JIA and its stakeholders for judging proposed changes to the JIA's residential land lease program.

As noted in the Bleakly Report on page 12, the original lease rate was approximately four-point-eight percent (4.8%), or say five percent (5.0%) of lot value for the purpose of our example. Capitalizing the average annual land lease rent of $334 by five percent (5.0%), yields an original average lot value of $6,680. At the time of the lease origination on average the State of Georgia, through the JIA, owned an asset worth $6,680 and it captured one hundred percent (100%) of that value through leasehold rent payments. Over time, the value of the state's asset remained the same, $6,680, but the value of the lot increased along with all real estate in the Jekyll Island market to the current assessed average of $262,000.[4]

Due to the lack of escalations and/or re-appraisals in the original residential land leases, the value of the state's parcel not captured by land lease rent payments transferred to the leasehold in the form of a higher value for the leasehold estate (e.g., the lease held by the homeowner). Thus on an average basis, this transfer means that of the $262,000 average lot value, the State of Georgia retains "equity" of $6,680 while the leaseholder captures $255,320 of the lot value as leaseholder equity. Figure 1 illustrates this phenomenon.

To express this concept in other words, consider what a buyer of a Jekyll Island lot on a fee-title basis from the State of Georgia –as encumbered by existing leaseholds and improvements– would likely be willing the to pay for an annual cash flow of $334 for forty years.[5] Assuming a five percent (5.0%) discount rate, this buyer would be willing to pay

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[3] This will occur naturally for existing leases that expire without modification, see Section 2.2.

[4] Average assessed land value as calculated in the Bleakly Report, see page 10.

[5] This is a hypothetical scenario to illustrate an economic point; Georgia law does not

no more than the present value of this cash flow, e.g.: $6,680.[6]

Now from the leaseholder perspective, what would a buyer be willing to pay for residential leasehold on Jekyll Island? The buyer would evaluate the leasehold and come to the conclusion that they get use of a parcel worth $262,000 at an annual rent of $334. They would be willing to bid up the price of the leasehold to the point where the combined land lease payment and financing costs (both costs of debt and down payment) nearly reach the same for a similar property offered on a fee title basis.[7] This is how the value of the leasehold estate owned by the leaseholder increases in value over-and-above what may be attributed to the owner's improvements alone.

With 627 lots on Jekyll Island, a rough order magnitude of the transfer of equity from the state to leaseholders is $160 million. Leaseholders have enjoyed significant economic benefits through this transfer by cashing out upon refinancing or sale of their leasehold, and obtaining loans for home improvements, remodeling, investments, or other purposes by pledging their leasehold as collateral.

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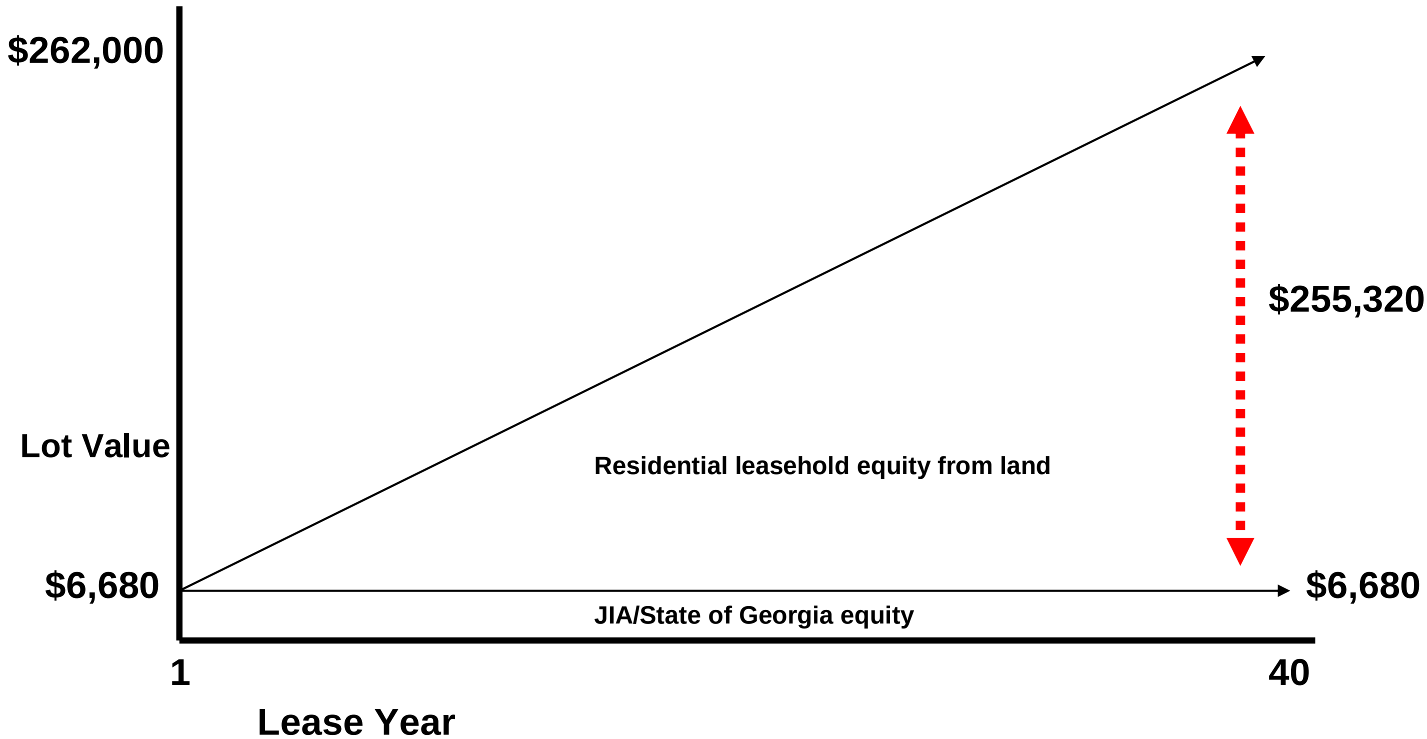
permit the sale of land on Jekyll Island.

[6] This does not factor in any speculative discounted value of receiving improvements in 2049; which would result in a higher value of the leased fee owned by the State of Georgia.

[7] BAE has researched other ground lease communities and local brokers have reported to us that the market value for homes on ground leases ranges from zero to fifteen percent lower than the market value for comparable homes sold on a fee-title basis. This is also supported by academic studies of residential fee simple (or freehold) versus leasehold valuations. Hence, we use the term "nearly reach" to acknowledge that the market may discount home values on Jekyll Island due to the land lease ownership structure.

Figure 1: Shift of Land Value to Leaseholders



2.2: The Value of Leaseholds Expiring in 2049. Section 2.1 explained how land value effectively transferred to leaseholders during the first decades of their leases. This process will likely reverse as the leases approach the end of their term in 2049. Jekyll Island leaseholders will likely experience a loss of value in their leaseholds, e.g., "home equity." At what point and how fast this will occur cannot be predicted since it depends on the condition of individual homes and market conditions.

Figure 2 illustrates three scenarios with numbers derived from the averages presented in the Bleakly report. Scenario A illustrates a slow initial decline in the early years of the remaining lease term with rapid value decline closer to the termination date. Scenario B reflects a straight-line reduction in value while Scenario C indicates a rapid initial decline followed by a slower rate of decline in later years. There are few studies of this issue to learn from. Chartered Surveyors in the United Kingdom have prepared analyses of leasehold values for homes and flats compared to value of "freeholds" (e.g., fee simple) that indicate sharp declines in value for leaseholds with fewer than forty-years remaining in the term[8]. A study of apartment ground leases in Marina Del Ray in Los Angeles, California modeled Scenario A as likely for those properties.[9] BAE's scope for this peer review report does not permit an in-depth study of which trend is most likely and many of the issues identified in the cases of leaseholds in the U.K. and Marina Del Rey apartments are not comparable to single-family homes on Jekyll Island. This illustration is not meant to be exact but merely demonstrate potential leasehold value trends over the remaining term of the original leases.

The key leasehold economic dynamic to consider is this:

[8] See Beckett and Kay, *Leasehold Relativity in Mortgage Dependent Markets* (http://www.beckettandkay.co.uk/pfds/two_line_graphs.pdf) and *Graphs of Relativity: Leasehold Value as a Percentage of Freehold Vacant Possession Value* (2009; Second Revision) (http://www.beckettandkay.co.uk/pdfs/graph_of_graphs.pdf).

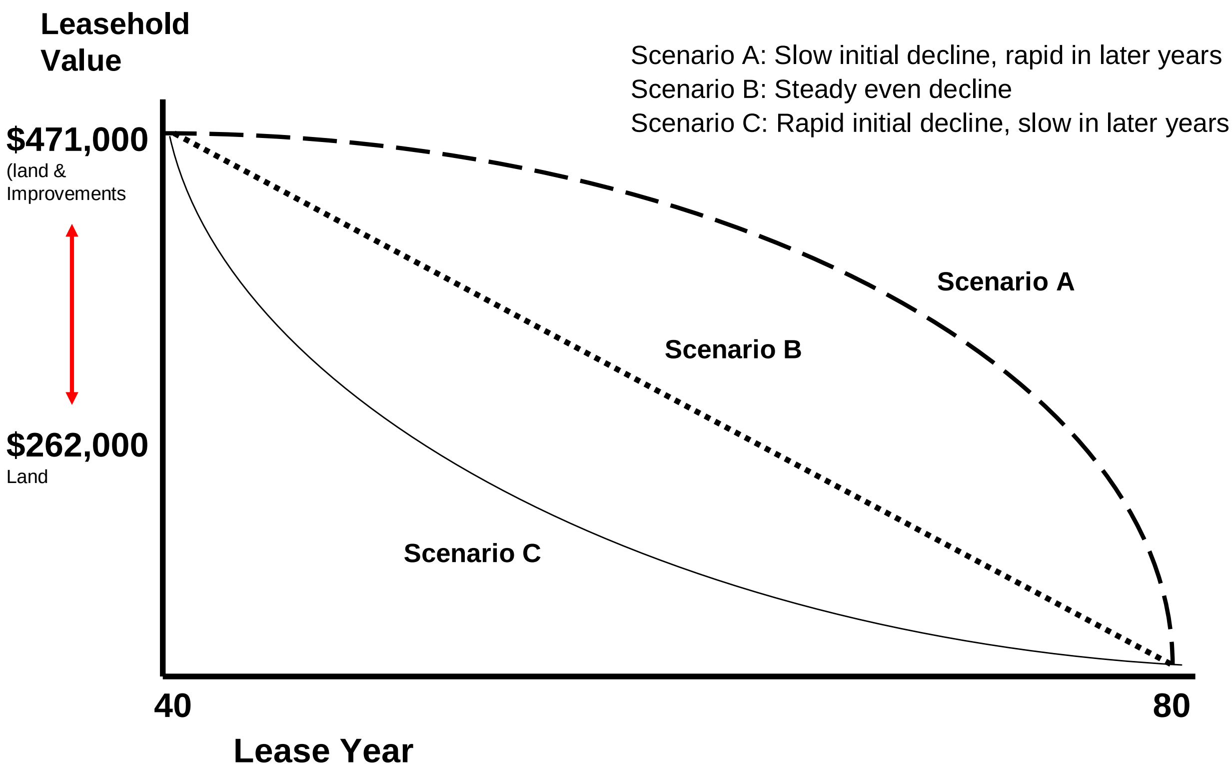
[9] See *Long Term Ground Leases, the Redevelopment Option and Contract* Incentives, Working Paper, Lusk Center for Real Estate, University of Southern California, January 2000.

- **If a buyer had a choice between two homes on Jekyll Island, one with a lease expiring in 2049 that cannot be financed conventionally and another expiring in 2089 that could be readily financed, would the buyer be indifferent and willing to pay the same price?**

- **A rational buyer would place a lower value on a lease with the shorter term. As years pass and the remaining term shortens, the price a buyer would be willing to pay will decline sharply from today's valuation.**

At the end of the term, the State of Georgia, through the JIA, owns not only the land but the improvements on the land. The leaseholder realizes zero termination value. The state now has one-hundred percent (100.0%) equity in the property –the near reverse of today's situation. But this is not a desired outcome since it is highly likely that owners will not make significant improvements to their homes in the last few years of the lease, thus undercutting JIA's objective to encourage maintenance and property reinvestment.

Figure 2: Future Leasehold Value Trend with Original Term – No Extension



2.3: Commercial Lodging Fees for Residential Property-Owners As indicated by the Bleakly report on page 14, almost half of private homes are offered for rent. These homes are essentially being used by their owners as commercial, income-producing properties. The JIA levies a Hotel-Motel Excise Tax rate of five percent (5.0%) on both commercial lodging enterprises on the island, such as the Jekyll Island Club Hotel, as well as on all private residences and condominiums that are offered for rent for periods up to thirty days.

In addition to payment of applicable room taxes, JIA may wish to consider requiring leaseholders to obtain a license when renting their home on a commercial basis. A license fee could be levied pursuant to JIA ordinance that could be modified from time to time. Part of the package of lease amendment terms and conditions would be language requiring a license but the license fee itself would not be part of the lease. BAE recommends consideration of an initial license fee rate of two-tenths of one percent (0.2%) on the value of the land and improvements as established by Glynn County. This rate is pegged to both land and improvements to reflect the fact that the rental income will be related both to location (where the parcel is) and the quality of lodging (the improvements). This license requirement would only be triggered when a leasehold property is actually used commercially; a leaseholder could bring their home on and off the rental market as they please. If an owner ceases to operate a commercial rental program they would notify the JIA and the license requirement would no longer apply in the next fiscal year. Families that share a home or individuals that use their property as a second home would not be subject to the license requirement. Application of a license requirement and levy of a license fee would not be inconsistent with the goals and objectives of the residential land lease policy since this class of owners are using their property for commercial purposes.

2.4: The Relationship between Residential Lease Rates and Glynn County Property Tax Collections

Leasehold estates at Jekyll Island are subject to a possessory use tax collected by Glynn County based upon the assessed value of the leasehold interest in land and improvements. While the county provides courts, libraries, and emergency management services, public safety services are not provided; these are provided by JIA and the State of Georgia. Building and construction permits are issued by the county but separate fees and charges are levied for these services. Overall, the county receives ad valorem property tax revenue while the JIA suffers from significantly below market lease revenues and must also provide a portion of the high cost public safety services.

The BAG report suggests that increased residential land lease rates might trigger decreases in tax assessments by Glynn County (see page 5 and on page 40). The text on page 40 appears to be unclear as to county practice but assumes a decrease would result. This point needs to be refined and more investigation made into Georgia assessor standards and practices to confirm the assumption.

Also, as an aside, the JIA could consider asking the Georgia Legislature to set a cap on property taxes received by Glynn County from Jekyll Island due to the revenue/service provision imbalance. This idea is in addition to those presented by BAG on page 39 in the "Other Recommendations" section. One approach would be to freeze the assessed value base at fiscal year 2010 levels (so as to not make the County worse off in the short term) and implement a higher residential land lease rate, promising in effect a cap on local property taxes.

Finally, any new lease should anticipate and provide for any future change in Georgia property tax law. The proposed structure recommended in this memorandum ties that lease rate to the assessed land value as set by the Glynn County assessor. If in the future a property tax limit is adopted (such as Proposition 13 in California), assessed value would be frozen or rise by some fixed rate that may or may not track changes in market values. In such event, an alternative basis for determining land value should be clearly spelled out in the lease.

3: BAE Recommended Residential Land Lease Program Changes

After reviewing the Bleakly Report and comments from the general public, as well as holding discussions with JIA senior management, BAE offers the following recommendations:

1. The JIA needs to clearly identify a window during which the proposed changes will be honored by the JIA to leaseholders seeking term extensions. BAE recommends that the JIA only offer these terms for a twelve (12) month period commencing in calendar year 2010. In the absence of a clear window, existing leaseholders will not have an incentive to convert to the new lease structure.

2. All leases converted would extend to 2089.

3. For leaseholders that convert their existing lease within the twelve (12) month conversion period, the following land lease rate terms would apply:

a. Lease rate of four-tenths-of-one-percent (0.4%) of land value as determined by Glynn County.

b. Five (5) year rent discount at fifty percent (50.0%) of new base rent during years 2010 through 2014.

c. Owners with Georgia homestead exemptions filed with Glynn County would be eligible for fifty percent (50.0%) rent discount years 2015 through 2019.

d. Owners with commercial rental programs would be required to obtain a license from JIA and pay license fee per JIA ordinance (proposed as two-tenths-of-one percent (0.20%) of land and improvement value as determined by Glynn County).

e. Leaseholds would be subject to a transfer fee as follows:

   - Free for inter-spousal transfers.

   - $500 for interfamily transfers or transfers with no consideration that would qualify for exemption under Georgia Tax and Revenue Code for the state property transfer tax.

   - One percent (1.0%) of land value for transfers with consideration (e.g., non-exempt transfer pursuant to Georgia real estate transfer tax statute).

4. For leaseholders that convert their existing lease after the expiration of the twelve (12) conversion period, the following land lease rate terms would apply:

   a. Lease rate of five percent (5.0%) of land value as determined by Glynn County; adjusted to then-current assessed land value every ten years; no discounts.

   b. Owners with commercial rental programs would be required to obtain a license from JIA and pay license fee per JIA ordinance (proposed as two-tenths-of-one percent (0.20%) of land and improvement value as determined by Glynn County).

c. Leaseholds would be subject to a transfer fee as follows:

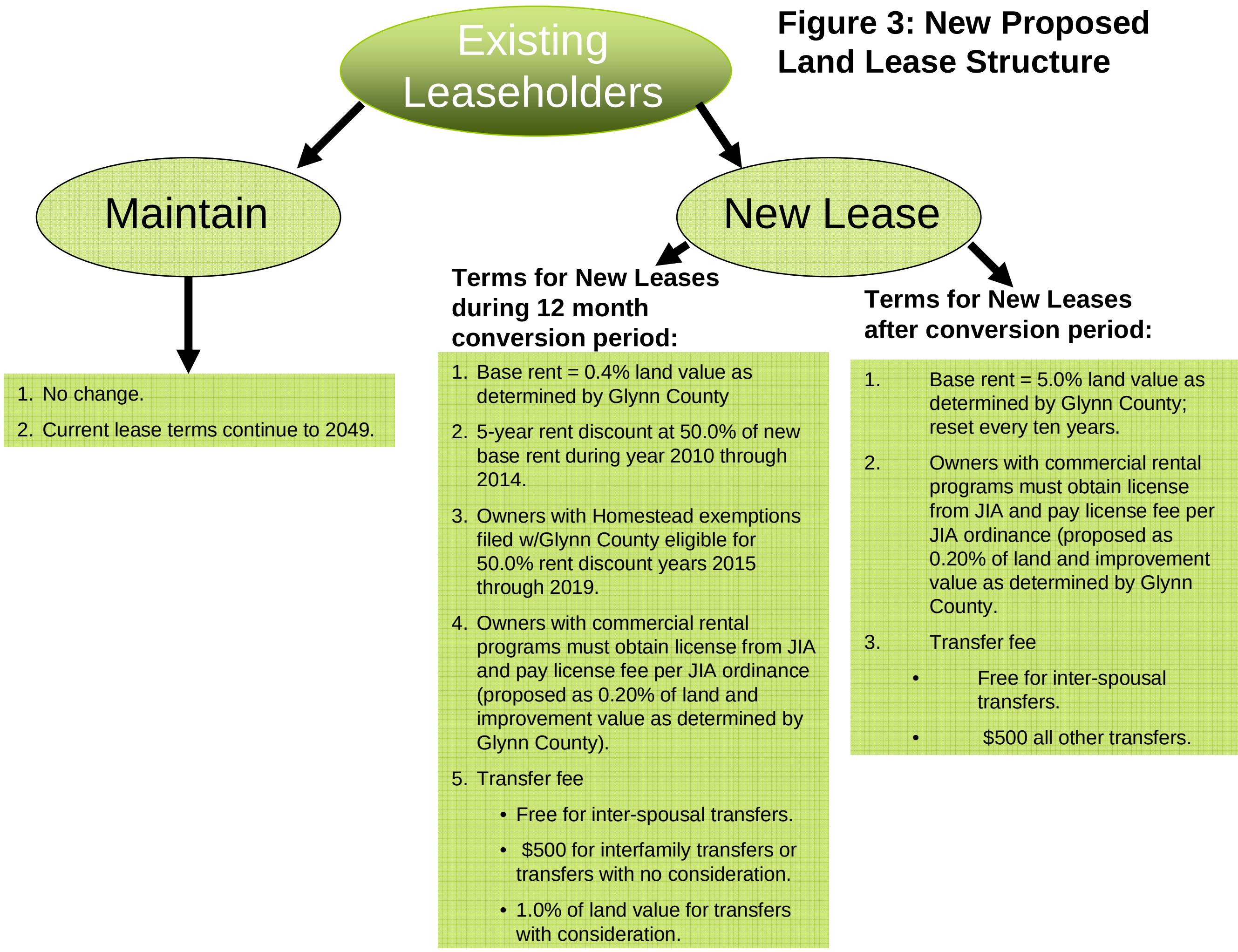
  - Free for inter-spousal transfers.

  - $500 for all other transfers.

As in all the other proposed residential land lease policy recommendations that have preceded this set, Jekyll Island leaseholders would not be obligated to take any action and could continue to hold their lease until the end of the original term. Some have suggested in public comments that there would be potential savings by not converting their lease or have only calculated the nominal cumulative sum of additional rent payments. Still others have said that leaseholders have rights granted under the current leases to 2049. All these statements are true. But what is missed in these comments is that by holding out, leaseholders would risk certain diminution of leaseholder equity over time, wiping out any savings from lower lease payments or value of rights under the existing lease.

A summary of options is presented in Figure 3. BAE believes that the recommend changes in policy for leases converted during the twelve (12) month conversion period are highly favorable to existing Jekyll Island leaseholders. For residential properties in use as private residences and family vacation units, leaseholders would only experience a modest increase in absolute dollar rental rates. Leasehold inter-family transfers, gifting and other transfers not involving consideration would be exempt from the JIA transfer fee. Leaseholder equity in their improvements and leasehold estates would be preserved. Terms recommended for the twelve month conversion period and after, however, are less favorable but ensure that leaseholders can retain the equity in their improvements (but not in the leasehold estate, e.g., the land).

Figure 3: New Proposed Land Lease Structure



The recommended package for leaseholders converting in the twelve month conversion period also addresses many of the comments received from the public. Concerns were expressed that a fixed CPI escalation may not move at the same rate as Social Security payouts. This is addressed by pegging changes in rent payments to changes in assessed land values without fixed escalations. Other stakeholders expressed a desire to keep the JIA residential land lease policy clear and understandable. This is achieved by eliminating complicated formulas, credits for rehabilitation, and by setting the discount schedule to a fixed schedule irrespective of whether any transfers occur or not. One idea for an additional five-year rent credit for owners with homestead exemptions is proposed under this recommendation in response to comments received by the JIA.

5: Conclusion

All stakeholders appear to be passionate in their desire to maintain Jekyll Island as a unique and attractive community. There is a strong consensus for a fair and reasonable set of changes to the JIA residential land lease. We believe that the set of recommended policy changes best serves the broad interests of all stakeholders and we submit them to you for your consideration.