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August 14, 2020

Mr. Brian Froelich, AICP  
Senior Planner  
City of Capitola  
420 Capitola Ave.  
Capitola, CA 95010

**Re: Monarch Cove Inn Property Broker Opinion of Value (BOV)**

Dear Mr. Froelich;

Kosmont Real Estate Services, Inc. ("KRES") dba Kosmont Realty ("KR"), a licensed California brokerage firm (Department of Real Estate License #02058445), is pleased to present this broker opinion of value ("BOV") in connection with the Monarch Cove Inn ("Property") located at 620 El Salto Drive in Depot Hill neighborhood of Capitola ("City"). APNs for the four parcels are 036-142-27, 036-142-28, 036-143-31, 036-143-36.

The BOV considers the Property's zoning/allowable uses, current market and economic conditions, and other relevant data/information to evaluate the range of fair market value of the Property.

### Valuation Summary

For hotel use, KR estimated stabilized long term net operating income and used market cap rates to estimate the "As Is" value of continued hotel operations. This analysis does not include mortgage interest or other financing costs. The value of the property in hotel use is \$3.1 million.

For residential use, KR compiled per acre land sale comp data and made adjustments as appropriate given the Property's allowable density and location to estimate the value of the Property for residential redevelopment and as a single family residence, which was its original use. The average value for those two residential scenarios is \$4.25 million (\$3.9 million and \$4.6 million).

The Property's estimate of value was derived from the Sales Comparison Methodology with supportable adjustments, and Income Capitalization Methodology as shown below.

### Value Summary

	<i>Bldg / Land Area</i>	<i>Estimated Value</i>
Residential Zoned Land	61,000	\$3,900,000
Residential Reuse of Buildings	5,000	\$4,600,000
Hotel Use	5,000	\$3,100,000

## **I. BACKGROUND AND OBJECTIVE**

In 2020, the City initiated a zoning change for the Property from Commercial to R-1 Residential. As part of the Local Coastal Plan review, the California Coastal Commission (“CCC”) requested an independent 3<sup>rd</sup> party study to assess the feasibility of the Property to continue as a visitor serving facility. The Property was built in 1886 and has undergone many renovations and continues to have extraordinary maintenance needs.

Due to its small size of 11 rooms and regulations limiting special events (i.e., weddings), the Property has been unable to generate sufficient net operating income to cover the annual debt service. CCC has requested an independent evaluation of the Property value in current hotel use, as well as a valuation of the Property with a residential rezoning.

### **Property Orientation**

KR toured the Property, gathered information on building size and condition and reviewed the parcel data to identify the Property dimensions, as well as gathered info on hotel revenue and operating cost trends. KR also interviewed owners and reviewed financial statements regarding extraordinary maintenance costs associated with the historic building.

### **Market Research**

KR gathered Santa Cruz/Capitola hotel operating data from CoStar/STR to understand the Property’s competitive position in the local market. KR gathered hotel sales comps to understand per room values and capitalization rates. KR also gathered data on single family homes sales values and undeveloped residential land sale comps in the Capitola area.

### **Permitted Uses – Residential & Commercial Zoning**

KR gathered information from the City on underlying R-1 residential density (3 single family units), as well as allowable uses on the hotel Property under the current commercial zoning, with the various regulations imposed, as discussed later.

### **Market Conditions**

It is important to note that residential home values have seen extraordinary appreciation in the past two years across California, especially in suburban areas away from large metropolitan centers, subject to various lockdown constraints. Demand for housing and prices may soften with mortgage rates spiking by over 200 basis points since January 2022.

## **II. Property Information**

### ***Location***

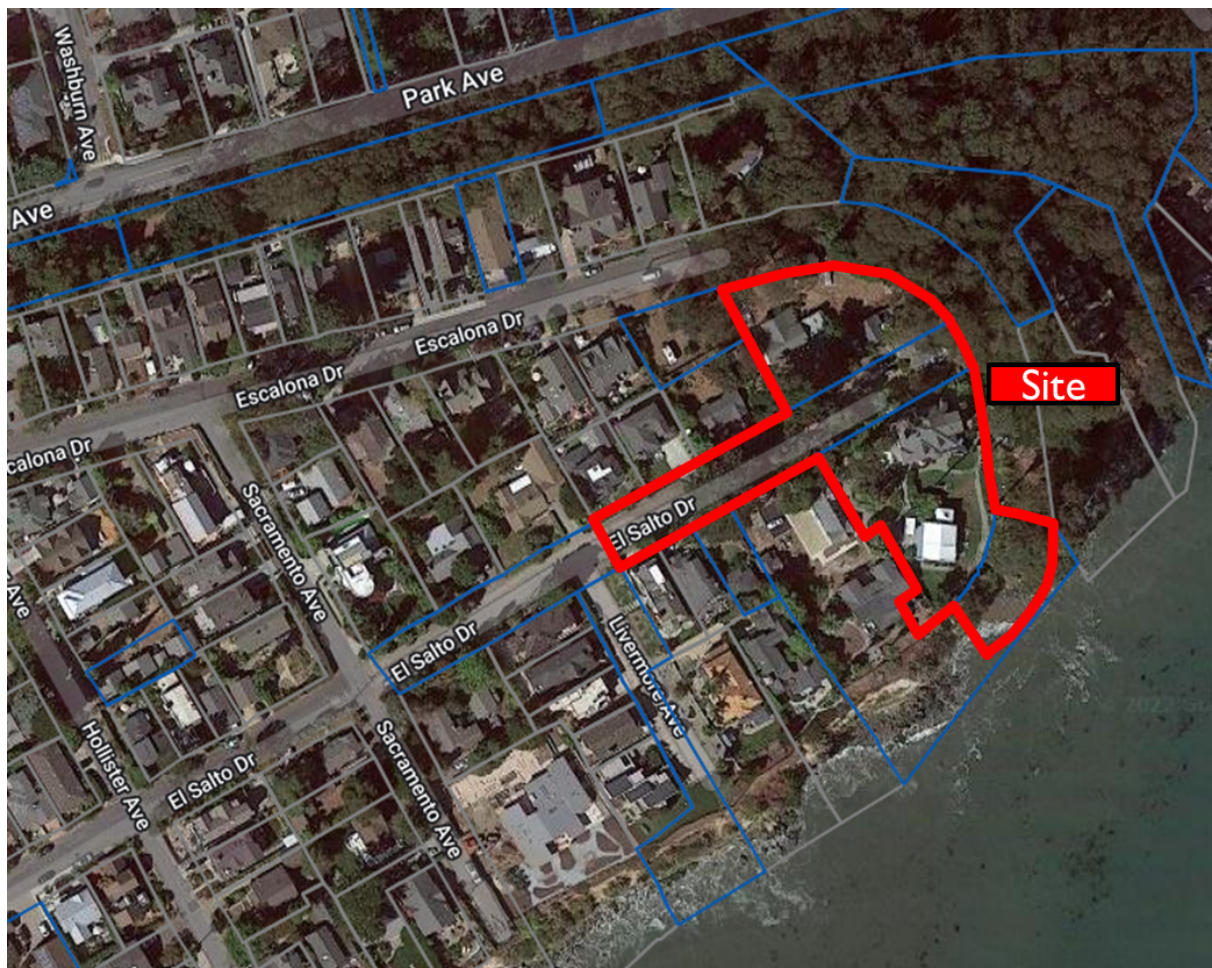
The Property is located on a beachfront cliff in the Depot Hill neighborhood of the City, which is adjacent to Santa Cruz, about 35 miles southwest of San Jose via SR 17. It is located at the end of a narrow cul-de-sac at 620 El Salto Drive.

A City Location Map, Property Aerial Map, Parcel Maps, and Property Photos are provided as Exhibits A, B, C, and D, respectively.

### **Existing Conditions**

The Property is comprised of 4 parcels. In the 1989 General Plan the City designated three parcels as Visitor Serving (V-S) with the fourth parcel 036-143-36, zoned Parks and Open Space (P/OS).

The Property is a 61,000 SF irregular shaped lot. The Property contains a 4,000 square foot 120-year old Victorian building, that currently has 9 guest rooms. The Property also has two guest houses, a garage, and an outdoor event pavilion. Due to adjacent neighbor complaints about noise and parking on the street, the lodging now operates under a Conditional Use Permit (“CUP”) that restricts special events to no more than two per week and six per month. Events during the week (M-F) are limited to 40 people and during weekends limited to 75 people.



### *History*

The Monarch Cove Inn was originally developed as a single-family estate in the late 1880's with the construction of a ~4,000 SF main house. The family also owned most of the property along the El Salto Drive. Over the years, many parcels were sold to other individuals who built single family homes.

In 1991, the family converted the Property into a visitor serving facility called the Monarch Cove Inn. While primarily a hospitality facility, the major source of revenue was outdoor weddings and special events prior to CUP restrictions.

The Property is surrounded by single family residences to the north and west and the Pacific Ocean on the south. In the 1880's, the Property was surrounded by a 60-foot wide Escalona Drive right of way connecting to Grand Ave. The majority of Grand Avenue has been eroded away and right of way is now a pedestrian path.

### **III. Valuation Methodology**

Standard methods for the valuation of real estate include replacement cost methodology, income capitalization methodology, and the sales comparison methodology.

#### ***Replacement Cost Methodology***

The replacement cost methodology was not considered to be an accurate determinate of value because the current building improvements are an historic structure.

#### ***Income Capitalization Methodology***

KR utilized the income capitalization methodology to value the Property in current hotel use.

#### ***Sales Comparison Methodology***

KR utilized the sales comparison methodology for both the hotel use and for residential use based on recent comparable property sales in the immediate area.

### **IV. a. Valuation Analysis - Residential**

To estimate the value of the Property as residential use, KR used the Sales Comparison Method and surveyed comparable vacant land sales over the last three years in Capitola/Santa Cruz. Finding comparable sales is difficult due to the unique character of the subject Property (120-year old Victorian on 4 parcels with cliffside ocean views).

As shown in the table below, four (4) comparable homes were recently evaluated on a price per square-foot of building basis:



**Home Sales Comparables**

<i>Address</i>	<i>Location</i>	<i>Sale Date</i>	<i>Home Size SF</i>	<i>Sales Price</i>	<i>\$/PSF</i>	<i>Use</i>
<b><u>SUBJECT PROPERTY</u></b>						
620 El Salto Drive	Capitola	N.A.	5,000	n.a.	n.a.	Hospitality
<b><u>SALE COMPARABLE</u></b>						
709 El Salto Drive	Capitola	4/29/22	1,467	\$1,630,000	\$1,111	Single Family
30 Moran Way	Santa Cruz	Listed	2,160	\$2,699,000	\$1,250	Single Family
602 El Salto Drive	Capitola	8/27/21	2,760	\$2,900,000	\$1,050	Single Family
501 El Salto Drive	Capitola	9/28/20	2,630	\$2,090,000	\$ 795	Single Family
<b>Average Sales Price/PSF</b>					<b>\$1,050</b>	

Source: Redfin, Homes.com, Zillow

Based on the above comparable sales transacted between 2020 and 2022, home values range from approximately ~\$800 PSF to ~\$1,200 PSF with an average of \$1,050 PSF. Due to significant appreciation in home values in past two years, the first two sales listed are most comparable to the subject Property, despite being new construction, and would indicate a value of \$1,200 PSF for equivalent condition.

*Adjustments*

In order to determine a fair value for the subject Property in residential use, KR made the following adjustments for the 4,000 SF Victorian building foundation repair/earthquake retrofit and conversion of hospitality to single family use:

Preliminary Value	5,000 SF x \$1,200 =	\$6,000,000
Less: Foundation Repair (\$200/SF) /1		(800,000)
Less: Conversion from Hospitality (\$150/SF) /2		<u>(600,000)</u>
Adjusted Value in Residential Reuse		<u>\$4,600,000</u>

/1 Foundation cost estimate provided by engineering firm hired during the 2014 redevelopment planning

/2 Conversion cost estimates per KR, based on discussions with Owner.



### Residential Zoned Land

KR examined land sales for residentially zoned land in the Capitola/Santa Cruz area. Due to limited development and sales transaction activity because of negative market factors/conditions caused by the Covid-19 pandemic (e.g. rise in construction costs), there were few land sales for residential development. Therefore, KR utilized sales comparables dating back to 2019, as shown in the table below.

#### Residential Land Sales

Address	Location	Sale Date	Lot Acres	Sales Price	\$/Acre	Use
<b><u>SUBJECT PROPERTY</u></b>						
620 El Salto Drive	Capitola	N.A.	1.4	n.a.	n.a.	Hospitality
<b><u>SALE COMPARABLE</u></b>						
1260 7 <sup>th</sup> Ave	Santa Cruz	12/13/19	0.95	\$1,580,000	\$1,600,000	Vacant Land
217 Protrero St	Santa Cruz	10/9/19	0.21	\$ 600,000	\$3,000,000	Single Family
961 Beach St	Santa Cruz	1/25/19	0.50	\$1,135,000	\$2,270,000	Vacant Land
<b>Average Sale Price/Acre</b>					<b>\$1,400,000</b>	

Source: CoStar

The sales comparables shown in the table above represent a wide range of values due to location and allowable density with an average of \$1.4 million per acre. The last two sales are most comparable to the subject Property, but allow for much higher density. With a lower density allowed on Subject, KR estimates the value of subject Property with residential zoning for 3 units to be \$2.8 million per acre or \$3.9 million.

### IV. b. Valuation Analysis – Hotel

To estimate the value of the Property for continued hotel use, KR used the Income Capitalization Method and projected net operating income and market capitalization rates. Table 1 on the following page shows that the net operating income has ranged from \$140,000 to \$170,000 with an average of \$150,000, excluding the significant negative impact Covid-19 had on the hotel's 2020 operations.



Table 1

Monarch Cove Inn Financial Performance					
	2017	2018	2019	2020	2021
Occupancy Rate	81%	79%	64%	55%	82%
Average Daily Rate	\$ 171	\$ 178	\$ 200	\$ 173	\$ 193
Room Revenue (net of TOT)	\$ 557,000	\$ 564,000	\$ 515,000	\$ 382,000	\$ 634,000
Other Revenue	46,000	58,000	42,000	14,000	29,000
Total Revenue	\$ 603,000	\$ 622,000	\$ 557,000	\$ 396,000	\$ 663,000
Operating Costs	\$ 463,200	\$ 463,000	\$ 387,000	\$ 357,400	\$ 523,400
Net Operating Income	\$ 139,800	\$ 159,000	\$ 170,000	\$ 38,600	\$ 139,600

Source: Monarch Cove Inn

**Capitalized Value**

Hotel capitalization rates are typically higher than those for industrial, retail and apartments as the risk level is greater. KR’s survey of hotel sales in the San Jose / Santa Cruz area indicates market capitalization rates from 5% to 7%, with a 9-room Victorian Inn listed (listed in July 2022) at 6.2% cap rate. KR believes a 5.5% capitalization rate is appropriate for the Property. With average net operating income of \$150,000, the supportable sales value is estimated at \$2.7 million.

**Hotel Sales Comparables**

KR researched hotel sales in the Capitola / Santa Cruz area since 2018. Several properties were found with a wide range of size, location and type of construction.

Hotel Sales						
Address	Location	Sale Date	Bldg SF	Sales Price	\$/PSF	Use
<b><u>SUBJECT PROPERTY</u></b>						
620 El Salto Drive	Capitola	N.A.	5,000	n.a.	n.a.	Hospitality
<b><u>SALE COMPARABLE</u></b>						
Beach St Inn	Santa Cruz	10/20/21	20,000	\$14.1 million	\$700	Hospitality
118 1 <sup>st</sup> St	Santa Cruz	9/22/21	3,100	\$1.93 million	\$615	Hospitality
Darling House 314 W. Cliff	Santa Cruz	8/30/19	7,870	\$5.0 million	\$1,160	Hospitality
Capitola Hotel 210 Esplanade	Capitola	6/20/18	3,400	\$3.0 million	\$890	Hospitality
<b><u>Average Sales Price/PSF</u></b>					<b>\$900</b>	

Source: CoStar



The last two sales represent properties located in commercial area by the water with ocean views. The 118 1<sup>st</sup> St. property is a 9-room Victorian property being rehabbed and converted into a Bed and Breakfast. It is located two blocks from the beach, but with limited ocean views and represents a strong comparable given the need for major renovation. Considering the Property's premium views and the need for renovation, KR estimates the fair value of subject Property based on Sales Comparison Methodology to be \$700 PSF or \$3.5 million.

Reconciling the Income Approach and Sales Comparison Approach for Hotel use results in an average value of \$3.1 million.

#### V. Conclusion – Broker Opinion Value

Based on the Sales Comparison Methodology with supportable adjustments, and Income Capitalization Methodology, KR estimates the value of the Property under two alternative residential scenarios (average of \$4.25 million) and as hotel (\$3.1 million) as shown below.

<b>Value Summary</b>		
<b>Costar</b>	<b>Bldg / Land Area</b>	<b>Estimated Value</b>
Residential Zoned Land	61,000	\$3,900,000
Residential Reuse of Buildings	5,000	\$4,600,000
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*Note: This evaluation is a Broker Opinion of Value ("BOV"). It is not an appraisal, which generally provides a more detailed evaluation of value and related property characteristics. BOV based on typical market conditions, which do not reflect extraordinary events that can impact supply/demand market characteristics which in turn impact property valuation.*

Respectfully Submitted:

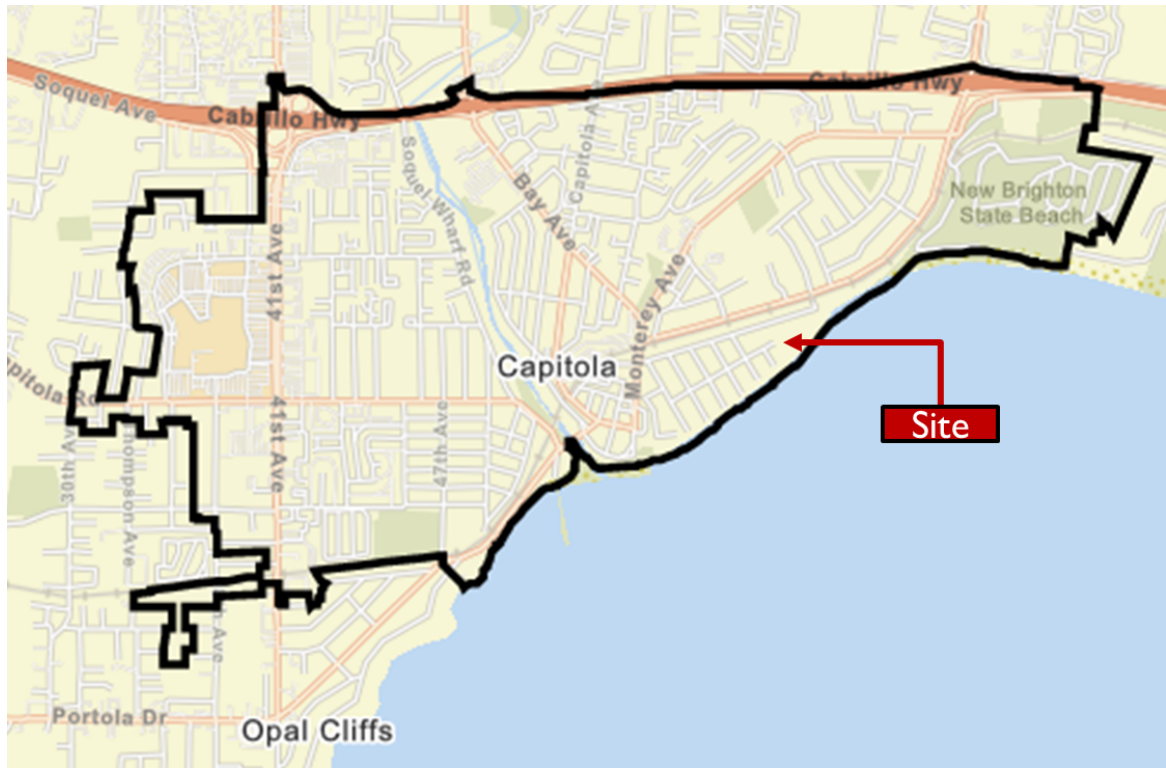
**Kosmont Real Estate Services  
doing business as "Kosmont Realty"**

Larry J. Kosmont, CRE®  
Chairman & CEO



### Exhibit A1 – City Location Map

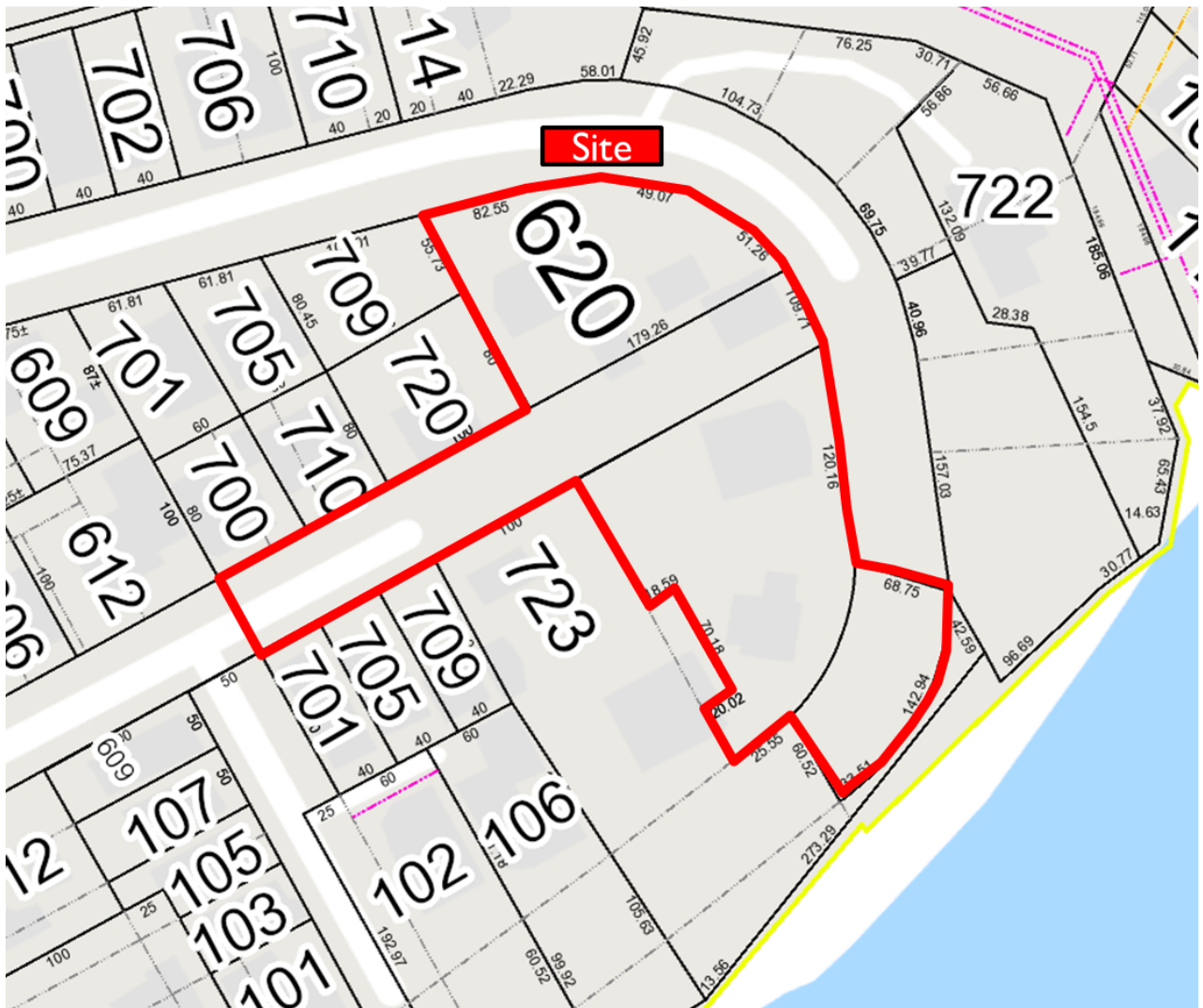




**Exhibit B – Property Aerial**



**Exhibit C – Assessor Parcel Map**



## Exhibit D – Property Photos

### Main House



**Event Pavilion**



**Entrance on El Salto Drive**



**Ocean View from backyard**



**Guest House**

