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**VOLUME I
ANALYSIS OF QUEEN MARY/
SPRUCE GOOSE COMPLEX**

**PREPARED FOR THE
PORT OF LONG BEACH
AND
CITY OF LONG BEACH**

**PREPARED BY
ECONOMICS RESEARCH ASSOCIATES
IN ASSOCIATION WITH
KOTIN, REGAN & MOUCHLY**

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Section I

INTRODUCTION

The Queen Mary/Spruce Goose complex is Long Beach's most prominent tourist attraction. During the first part of the 1980s the complex was operated by the Wrather Corporation. In 1988, the Walt Disney Company purchased Wrather and assumed the operating responsibilities for the property.

Disney's current lease with the City of Long Beach through its Board of Harbor Commissioners expires as of September 30, 1992. Disney has expressed their desire to discontinue operation of the complex at the termination of their contract, but has offered to remain in an operating capacity for a three-month period beginning October 1, 1992, and ending December 31, 1992. Recently, the Board of Harbor Commissioners elected to close the hotel portion of the operation at the end of September. The Port is currently negotiating with Disney to run the tour through the end of the year.

Economics Research Associates (ERA) and Kotin, Regan, & Mouchly (KRM), have been retained by the Port and City of Long Beach to examine the economic feasibility and impacts of potential uses for the complex, and to recommend an appropriate strategy for the Queen Mary complex and surrounding property. This report represents the conclusion of the Phase I work effort of the Consultant Team, which consisted of the economic analysis of the Queen Mary complex (this did not include analysis of the Londontown retail operation). The second phase of work will include recommendations and analyses of the surrounding Queensway Bay development area, and will be completed in September under subcontract to Ehrenkrantz and Eckstut Architects.

Our Phase I effort has been presented in several documents, including this three-volume final report, and an interim report which focuses on the hotel operation. These documents are listed below:

1. **Volume I — Final Report, Analysis of the Queen Mary/Spruce Goose Complex, dated July 1992.**
2. **Volume II — Research Appendix, Analysis of the Queen Mary/Spruce Goose Complex, dated July 1992.**
3. **Volume III — Cost and Engineering Study, Queen Mary/Spruce Goose Complex, dated July 1992.**
4. **Interim Report — Analysis of Hotel Queen Mary, dated June 1992.**

This first volume final report presents our findings, conclusions, and recommendations. For ease of reading, detailed research and analysis have been placed in the second and third volumes.

Following this Introduction, the first volume final report has been organized into the following sections:

- II. **Summary and Conclusions**
- III. **Methodology**
- IV. **Site and Facilities**
- V. **Available Markets**
- VI. **Historical Attraction Performance**
- VII. **Maintenance Costs**
- VIII. **Screening Analysis**
- IX. **Economic Analysis and Projections — Short-Listed Uses**
- X. **Financial Feasibility of Selected Uses**
- XI. **Economic Fiscal Impact**

The team of consultants included the following firms, with ERA as the prime contractor:

- **Economics Research Associates — Market and Economic Analysis, Project Management**
- **Kotin, Regan, & Mouchly — Financial, and Economic Impact Analysis**
- **Rados International Corporation — Cost and Engineering Analysis**

Additionally, the following firms and individuals contributed their expertise in the selection and analysis of potential use options for the complex:

- **Jani International**
- **Leisure Resources International**
- **Donald J. Hall**
- **Harrison Price Company**
- **The Port and City of Long Beach**

Section II

SUMMARY AND CONCLUSIONS

This section sets forth the conclusions of our findings and our recommendations. The supporting analysis, research, and documentation for these conclusions are located in the body of this report and in Volumes II and III.

FACILITIES

The Queen Mary/Spruce Goose complex is located on some 50 acres of property on Pier J within the Queensway Bay Planning District of the Port of Long Beach. The complex consists of the Queen Mary which includes: the 365-room Queen Mary Hotel with 70,000 square feet of meeting and exhibit space; approximately 8,000 square feet of retail space; four restaurants; and the Queen Mary Tour exhibit areas. The Queen Mary/Spruce Goose complex also includes the Spruce Goose facility, a domed attraction of approximately 60,000 square feet, and the Londontown retail facility.

HISTORICAL PERFORMANCE

The facility has been operated over the last 10 years by two companies: the Wrather Company and the Walt Disney Company. During the early 1980s, the facility experienced high levels of attendance due to the addition of the Spruce Goose attraction. During this period of time, the complex produced operating income before capital expenditures. This was primarily due to the addition of the Spruce Goose which temporarily boosted attendance, as well as strong attraction and hotel markets through the early and mid 80s. As the impact of the Spruce Goose waned, and the hotel market softened, performance of the facility declined. Additionally, after capital expenditures, the complex lost money in all but one year during the last 10 years. Historical operating income before and after capital expenditures is shown in the text table below, and is as reported to the City of Long Beach Auditors Office by attraction management.

<u>Year</u>	<u>Operating Income</u>	<u>Income After Capital Expenditures</u>
1982	(\$1,250)	(\$ 5,020)
1983	\$4,120	\$ 2,014
1984	\$7,524	(\$ 3,170)
1985	\$6,438	(\$ 4,732)
1986	\$5,500	(\$ 6,222)
1987	\$4,506	(\$ 8,547)
1988 ¹	\$ 624	(\$ 4,900)
1989	\$2,145	(\$ 2,170)
1990	(\$7,345)	(\$10,811)
1991	(\$4,153)	(\$7,966)

Disney began management of the attraction as the markets continued to soften. Under Disney management, attraction and hotel performance continued to decline. Operating income continued its downward trend, which began during the earlier years, and turned negative in 1990. Disney attempted to revive the attraction through heavy marketing, promotion, special events, and entertainment. However, these efforts produced few results. The project is currently suffering from serious operating deficits, still faces a weak market, and is in need of much costly repair.

It is the consultant team's opinion that the primary problem with the Queen Mary complex is not its management. The problem is the product and its markets. The attraction has lost money for nine of the last ten years under two operators. The attraction has inherently low visitation, is passive, has somewhat difficult access, is located on the waterfront so that it only has half a market geographically speaking, and is situated in one of the U.S.'s most competitive attraction markets. The hotel while upgraded by Disney, still has rooms half the size of hotels of similar price, and is facing a very over-built market with shrunken demand. Poor performance in the last several years has been exacerbated by the recession and weak attraction and hotel markets.

Balancing the facility's poor performance history has been the value of the facility to the City of Long Beach as an icon. The Queen Mary's image and presence is associated with

¹1988-1991 fiscal year.

the City of Long Beach probably more than any other structure or activity. The Queen Mary is a high visibility tourist attraction, and serves as an amenity for visiting conventioners as well.

MARKETS

The complex benefits from proximity to the greater Los Angeles/Orange County resident and tourist markets. These markets include approximately 11.3 million residents, and approximately 25 million overnight visitors per year. The more immediate Long Beach market includes some 430,000 residents, and annual tourism of approximately 2 million visitors. These residential and tourist markets represent strong markets for a variety of the uses being considered for the Queen Mary/Spruce Goose complex.

The Los Angeles area market is highly competitive for commercial recreation attractions. Additionally, the recession has dampened market demand for attractions over the last several years. The local hotel market is extremely weak currently due to decreased demand and an overbuilt inventory. These markets should experience a slow recovery over the next several years.

MAINTENANCE COSTS

ERA's engineering consultant, Rados International Corporation, analyzed the present physical condition of the Queen Mary and provided estimates of the minimum required investment to bring the complex up to industry standards, and the annual cost to maintain the ship at that level. It is estimated that a total investment of approximately \$27 million will be required to bring the ship up to standards. This consists of items requiring immediate attention, totaling approximately \$6 million, and items requiring replacement or repair over the next three to five years consisting of \$21 million. The major expenses requiring maintenance on the ship include a dry docking inspection, asbestos abatement, deck replacement, HVAC system replacement, firemain replacement, and water-tight bulkhead replacement.

Once the ship is brought up to industry standards, annual maintenance is estimated to require a total of \$4.8 million. This assumes that the lower decks of the ship will be mothballed, and that the promenade sport and sun decks will remain operational.

USE ANALYSIS AND OPERATING ECONOMIC PROJECTIONS

Over 60 potential uses and/or operating strategies were identified for the Queen Mary/Spruce Goose complex. These uses were screened by the consultant team and the Port and City of Long Beach to arrive at a short list of four potential new uses and four operating and/or disposition strategies.

The following objectives were determined for any use of the Queen Mary:

1. Minimize square footage and deck space used to reduce maintenance cost.
2. Use existing physical configuration as much as possible to reduce costly retrofitting requirements (including asbestos abatement, handicap access, material hauling costs, and others).
3. Maximize revenue through intensive, high earnings generating use of deck space.
4. Increase local market appeal to reduce dependence on tourists.
5. Maintain tour if possible.
6. Create nighttime as well as daytime use.
7. Maximize potential revenues to the City and Port.
8. Abide by various guidelines regulating use.

Based on these objectives and a matrix analysis of the uses, the short list is shown below with the feasibility of the various options.

<u>Use/Operating Strategy</u>	<u>Feasible</u>
1. Entertainment center--including dining entertainment, retail, and limited tour	Infeasible
2. Casino/card club	Feasible
3. Timeshare	Infeasible
4. Maritime museum with aquarium on-shore	Infeasible
5. Operation under current conditions	Infeasible
6. Partial operations	Infeasible
7. Mothball	Feasible
8. Disposition--sink, scrap, or sell	Feasible

Of the four new uses proposed, only one was determined to be feasible--the casino/card club. The consultant team thought it appropriate to include a moderate-scale card

club with the entertainment center as the most appropriate use for the Queen Mary. This option proved to generate annual revenues ranging from \$42 to \$75 million over a 10-year forecast period, and net operating income ranging from \$5.4 million to \$11.5 million over the same period.

The operating strategies considered, that is, operating under current conditions, or with a more limited operations, proved both to be infeasible. Our projections for the current operations options considered the following factors:

- A slowly recovering hotel market
- A slow economic recovery contributing to a more favorable attractions market
- Decreased operating expenses due to a lower level of business volume
- Operating efficiencies derived from a new operator managing the facility under industry standards (operating expenses were adjusted downward in the areas where Disney expenses were higher than industry standards)
- Continued, although slowed, attendance erosion due to lack of reinvestment and the passive nature of the attraction

Based on these and other factors, we have projected operating revenues under current conditions to range from some \$40 million in the initial year, expanding to \$47 million by Year 10. Overall, this represents a level slightly less than current revenues during the first year of the projection period increasing to historic average levels by about Year 5, and slightly surpassing historic levels by Year 10. Growth in revenues in real terms when accounting for inflation is actually negative, and reflects similar declines in real revenue growth of the Queen Mary/Spruce Goose complex under both Wrather and Disney management. Operating expenses have been projected to total some \$43 million in Year 1, expanding to \$59 million in Year 10. The expenses projected are somewhat lower than those during the recent years, reflecting the above noted efficiencies. Given the above revenue and expense projections, we have projected net operating income at -\$3.4 million in Year 1, declining to -\$10 million by Year 10. While these operating losses are not as extreme as in current years, reflecting recovery markets and more efficient operations, they are still losses and indicate the fundamental product and market problems with this complex.

The economic projections for the limited operation take into account the following factors:

- The tour will be considerably downscaled from its current level with only the top three decks available for viewing.
- Attendance erosion will continue due to lack of reinvestment in the attraction and the passive nature of the facility.
- Operating efficiencies will be experienced under new management, and considering lower business volumes.

Based on the above and other assumptions, gross revenues are projected at approximately \$13 million in the first year and at slightly under \$15 million by Year 10. Operating expenses, including cost of goods sold, are estimated at some \$23 million in Year 1, increasing to about \$30 million by the tenth year. The limited operations of the facility are projected to sustain operating losses of nearly \$10 million in the initial year and reaching \$15 million by Year 10. This option proves to be infeasible due to a lack of revenues necessary to support the high maintenance costs on the ship. Our analysis indicates that it is more economically advantageous to generate higher levels of revenues through more intensive use of the deck space rather than to limit the operations and attempt to contain expenses.

The non-operating and disposition options are all, in a sense, feasible. Mothballing the facility would cost approximately \$1.4 million, and while not generating any direct revenue, would have very limited annual maintenance expenses of roughly \$1 to \$2 million per year.

Sinking the vessel would cost approximately \$4.7 million, with some possible additional cost for asbestos abatement. Scraping the vessel would cost approximately \$7 to \$9 million due to the need for complete asbestos removal. Selling the vessel could generate revenues ranging from roughly \$4 to \$5 million (although the sale cost cannot be exactly determined). However, cost of this option would be approximately \$4 million due to the need for removal of some asbestos material and the breakwater to remove the ship.

FINANCIAL FEASIBILITY

The financial feasibility of the options which produce operating income (Options 1 and 2), and the base case analysis, have been considered in light of the need for a land lease payment to the Port, and the need to support debt service for the required maintenance on the ship. Based on minimum Port market returns on industrial land, it is estimated that a \$2.3 million land lease payment would be appropriate for the various uses of the ship. When deducting this amount from net operating income, the base case analysis cannot support the debt and lease payment due to its high negative income. The entertainment center, Option 1, similarly, cannot pay a land lease to the Port and generate a positive return on investment. The entertainment center with the card club (Option 2) does provide sufficient income to support the debt necessary to finance the maintenance costs of the ship and to provide a reasonable return on equity of 21 percent (as measured by prefinancing internal rate of return).

The conclusion of the team's financial and economic feasibility analysis is that due to the extremely high maintenance costs required on the ship, the only use which produces a reasonable level of return is the entertainment center with the card club. It is very difficult for any operating facility to pay for such a high level of up-front capital expense which is not directly related to the appeal or market draw of the facility. While it is typical for land based attractions and real estate developments to pay for infrastructure improvements which may not be directly associated with market appeal and draw, these improvements typically account for a more moderate portion of overall investment. With the Queen Mary this is clearly not the case. The \$27 million maintenance requirement represents over 80 percent of the overall investment required to open the facilities being considered.

Obviously, to the extent the required maintenance costs can be amortized over a longer period of time the economics of the various uses will be improved. Similarly, a shorter term operation which would not need to undertake the full maintenance program would have a better economic outlook than a long-term operation required to pay for the full amount. Our economic projections assume a ten-year operating period with all of the maintenance costs paid for within a three-year period as specified by Rados International Corporation

Economic Impact

The economic and fiscal impact of Options 1 and 2 and operating the ship under current conditions are shown in the text table below.

	<u>Base Case Current Operations</u>	<u>Option 1 Entertainment Center</u>	<u>Option 2 Entertainment Center and Card Club</u>
Expenditure Impacts (millions)	\$50.1	\$41.3	\$62.5
Employment Impacts	1,114 ²	598 ³	841 ³
Fiscal Impacts (millions)	\$ 1.1	\$ 0.83	\$ 0.88

As indicated, operating the attraction under current conditions, while suffering from severe operating losses, does contribute significantly to spending and employment in the City of Long Beach. Total expenditure impacts are projected at \$50 million. Total employment impact is estimated at 1,100 jobs (includes part time and seasonal jobs), and total fiscal impact is projected at \$1.1 million. Option 1, the entertainment center, generates approximately \$41 million in expenditure impact, would have an employment impact of approximately 590 jobs (full time job equivalent), and a fiscal impact of approximately \$800,000. Option 2, the entertainment center/card club, generates the highest level of expenditure impact with an estimated \$63 million in direct and indirect expenditures in the City of Long Beach. This option would generate an estimated 841 jobs (full time equivalent), with a fiscal impact of approximately \$900,000.

RECOMMENDATIONS

The Queen Mary has been an icon to the City of Long Beach for over 25 years. The facility has benefited the City as a focal point of tourism activity, and as a distinct part of the City's image and skyline. At the same time, the Queen Mary has suffered serious financial

²Includes part time and seasonal.
³Full time equivalent.

losses under several management teams. Additionally, the ship is currently in need of very costly repairs. These repairs are difficult to support with all but a few operating options.

The consultant team has found that almost immeasurable subsidies will be required to operate the ship under its current conditions. Of over 60 alternative uses considered for the ship, only one use proved to generate sufficient revenue to support the high maintenance cost requirements of the ship.

In consideration of the icon value to the community, and the economic realities of the ship's operation, it is this consultant team's opinion that the entertainment center with the card club option be the only option considered for the long term operations of the ship. Otherwise, we would recommend the mothballing of the ship which would have a fairly limited cost, but would preserve the ship as an icon to the City for some years, until such a time that the deterioration of the ship requires scraping, or an opportune time arrives to sell the ship.

As the Phase II masterplanning process for the Queensway Bay area evolves, consideration of high income-generating surrounding land uses may make some of the infeasible options for the Queen Mary a possibility. To the extent land-based attractions can subsidize ship maintenance costs, shipboard activities will not have the same demands placed upon them in terms of income generation. It is unlikely, however, that any land-based facilities could contribute sufficient income to make the operation of the ship under current conditions a viable option.

Section III

METHODOLOGY

The Consultant Team worked closely with the Port and City of Long Beach in our analysis, and with the Port and City solicited and reviewed input from the public. Our basic methodology is set forth in Figure III-1.

As indicated there are three primary options for the complex:

1. Operate under current or improved current conditions
2. Mothball, remove or sell the facilities
3. Modify the use

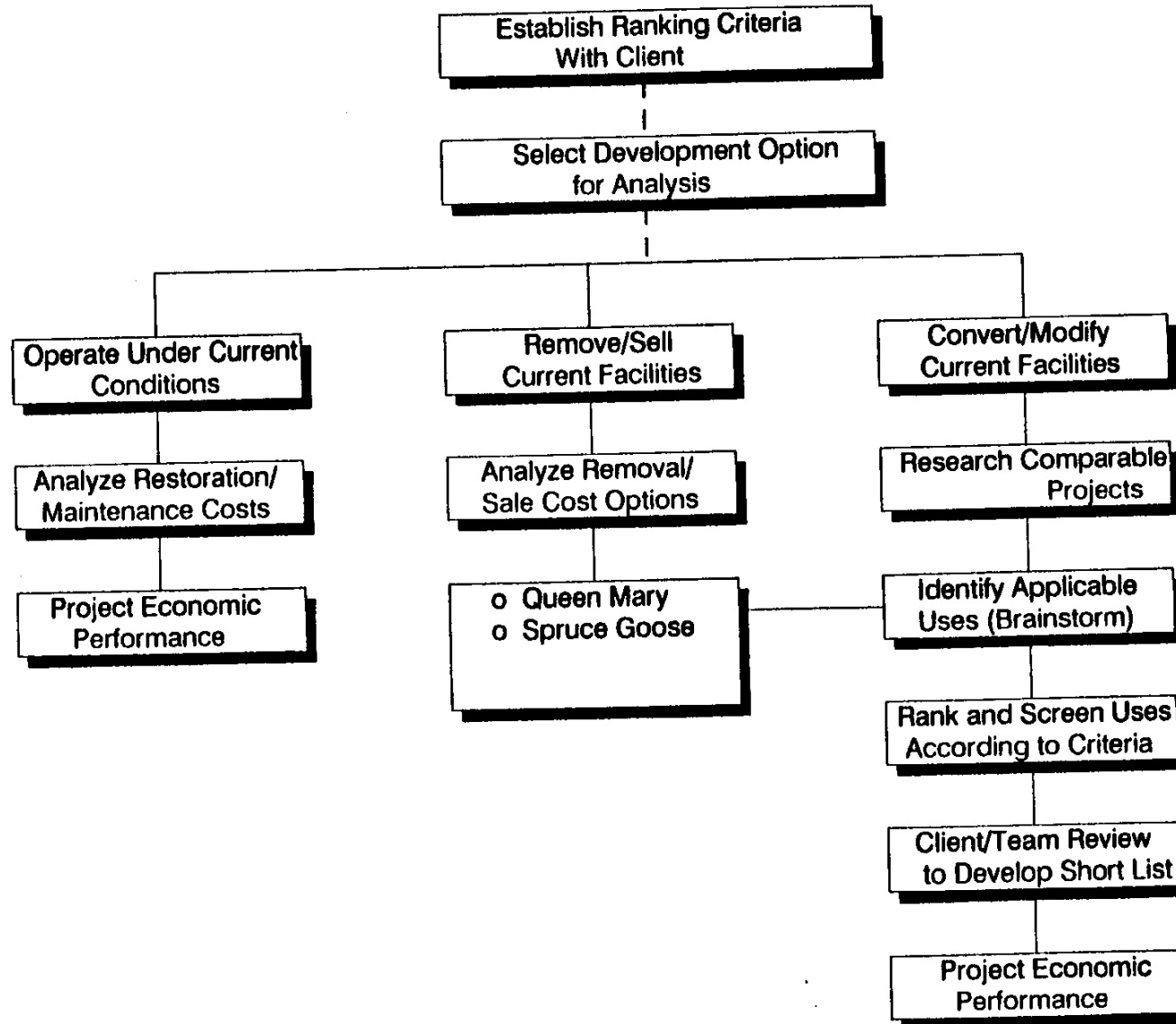
The Team analyzed the economic implications of all three of these potential strategies. For strategies one and three, our methodology included a review of historical performance, market analysis, projection of operating economics, analysis of ship maintenance needs and costs, financial performance projections, and economic impact analysis. For strategy two we evaluated the costs and benefits associated with the various disposition options. While analysis of the first and second strategy consisted of looking at only several options, the evaluation of the third strategy required a more in-depth analytical effort.

For the third strategy, modifying the facility's use, the Team's first step was to identify the potential uses for the complex. This consisted of three substeps. First, ideas were solicited from the community, and unsolicited proposals previously submitted to the Port and City were reviewed. Second, the consultant team met to "brainstorm" potential uses. Finally, ERA and the Port and City had a second "brainstorm" session to further identify and screen potential uses. This process resulted in the identification of over 60 potential uses and/or operating strategies for the complex.

The second major step for the third strategy was to screen the 60 uses and to identify a short list of uses which showed the highest potential. To accomplish this task,

Figure III-1

QUEEN MARY/SPRUCE GOOSE ANALYSIS METHODOLOGY



ERA developed a matrix analysis which evaluated the various uses taking into account various economic, physical, operating, regulatory, and other factors. Our matrix analysis ranked the proposed uses. The top 15 uses were then reviewed and analyzed by ERA and the Port and City of Long Beach. ERA and the Port and City then jointly designated a short list of uses to be studied further. The short list consisted of four new uses and one new operating strategy. These short-listed uses were then evaluated relative to their economic feasibility.

Section IV

SITE AND FACILITIES

The Queen Mary/Spruce Goose Complex is located on some 50 acres on Pier J within the Queensway Bay Planning District of the Port of Long Beach.

The Queen Mary measures 1,019 feet in length with a gross tonnage of 81,237. It contains 12 decks. It includes exhibit/tour areas, a hotel, restaurants and retail shops. The attraction also presently includes the Spruce Goose. Main Street of Londontown is located at the entrance to the attraction and has limited food and merchandise outlets.

TOUR/EXHIBIT AREAS

The three top decks, The Promenade Deck, Sun Deck and Sports Deck are open for visitors as well as specific working areas below. (The Main, A and B decks house the hotel.) The Promenade Deck includes the main public areas, Piccadilly Circus retail shops, the Wedding Chapel, Royal Salon, Queen's Salon, The Chelsea cafe, Observation Bar, and Promenade Cafe.

The ship's visitor areas and exhibits include:

- Engine Room
- Royal Theater
- Bow
- Stateroom Exhibits
- Fire Station
- Officers Quarters
- Bridge and Wheelhouse
- World War II Display
- Dining Room Exhibits
- Passenger Services Exhibits

HOTEL QUEEN MARY

The Hotel Queen Mary's 365 rooms are located on three decks of the ship, the Main, A and B Decks and primarily within the former first-class area. Some of the cabins in the first-class area were enlarged by combining two adjoining rooms, while rooms in the former second-class areas were created by combining two to three original cabins.

The hotel rooms on the Queen Mary are in a variety of configurations and are smaller than typical hotel rooms. The small rooms on the Queen Mary contain approximately 200 square feet and the larger ones about 315 square feet. There are also five suites. Standard high-quality hotel rooms contain approximately 350 to 400 square feet.

Amenities to the hotel include the Sun Deck exercise room which is exclusively for hotel guests and three restaurants (which are open to the general public) — Sir Winston's, The Chelsea and the Promenade Cafe. Hotel guests currently pay reduced admission charges (half the adult price) for the Queen Mary/Spruce Goose tours.

BANQUET/MEETING SPACE

Banquet and meeting space is located on the Promenade Deck, Main Deck, and B, D, E, F and R decks. There are 15 function rooms with 28,350 square feet of meeting space on the Queen Mary, and 45,000 square feet of exhibit space. Meeting rooms range in size from 310 to 9,000 square feet. Seating capacities range from 25 to 600 theater-style. The largest meeting rooms are the Grand Salon on the R deck, the Britannia Salon on the main deck, and the Queen's Salon on the Promenade deck. There are three exhibit halls on the Queen Mary which are 12,000, 18,000, and 15,000 square feet on the D, E, and F decks. Further, the Spruce Goose Dome contains 60,000 square feet of exhibit space.

RESTAURANTS

There are three full-service restaurants on the ship. These are the formal Sir Winston's located on the Sports Deck which offers continental cuisine, the semiformal Chelsea Cafe and

the casual Promenade Cafe. The Observation Bar is located on the Promenade Deck. The Grand Salon, which was the original First Class dining room, is the site of a Sunday Champagne Branch.

Her Majesty's Sweet Shoppe on the Promenade Deck offers baked goods, coffees and candy. There is a snack shop and an ice cream stand on the Sun Deck which are open on a seasonal basis and the Verandah Grill on Promenade Deck which features fast food items.

RETAIL

The Promenade Deck includes a collection of retail shops, the "Piccadilly Circus Shops."

These are:

- House of Heraldry — family coats-of-arms
- Bit of Britain — gifts, clothing
- Royal Crystal Arts — crystal items
- Press Museum — newspapers
- Crown Jewelry — fine jewelry
- Schilling Saver

Estimated total current retail space is about 8,000 to 9,000 square feet.

SPRUCE GOOSE

The Spruce Goose is displayed under a clear-span aluminum dome. The dome contains roughly 60,000 square feet of exhibit space. The attraction includes the Kodak Theater and a small amount of merchandise and food and beverage space.

Section V

AVAILABLE MARKETS

The following paragraphs provide a brief overview of the City of Long Beach and its resident and visitor markets. The definition of available markets differ according to the specific use being considered. We have delineated appropriate market areas for each specific use deemed fit to warrant analysis and these are discussed in detail in Section IX.

LONG BEACH OVERVIEW

The City of Long Beach is located in the southern coastal portion of Los Angeles County, approximately 22 miles south of downtown Los Angeles. It comprises 50 square miles. As of the 1990 Census, Long Beach residents numbered some 429,400, with the City having the fifth largest population in the State. The Port of Long Beach is the busiest port on the west coast in terms of tons of cargo handled. The City is well located with respect to regional freeway access and is linked by light rail to downtown Los Angeles by the Los Angeles Metro Blue Line. The City's airport, Long Beach Municipal Airport, is served by three scheduled air carriers.

AVAILABLE RESIDENT MARKET

The Queen Mary complex is located within a large dense resident market which includes approximately 11.3 million persons living within the Greater Los Angeles and Orange County region. This includes some 429,400 local Long Beach residents.

Median age of the Los Angeles/Orange County area is 30.8 years which is slightly younger than that of the State as a whole (31.5). The average household size is 2.9. Detailed statistics relating to age and income characteristics of the Los Angeles/Orange County and Long Beach area populations are found in the Appendix tables.

AVAILABLE VISITOR MARKET

Over the last two years, Long Beach has attracted an average of approximately 1.9 million overnight visitors per year and between 850,000 and 900,000 day visitors, as shown below:

Overnight Visitors	
Hotel/Motel	744,000
Household	1,158,000
Camping	<u>13,000</u>
Subtotal	1,915,000
Day Visitors	<u>857,000</u>
Total	2,772,000

The Long Beach visitor market is a subset of the Los Angeles region's visitor market which receives a total of approximately 25 million overnight visitors a year.

Included within the hotel/motel visitor category are over 300,000 convention delegates. The Long Beach Convention and Visitors Council (LBCVC) is responsible for convention sales bookings which include blocks of hotel rooms. Hotel roomnights booked by the LBCVC have grown from just over one thousand in 1982 to 132,000 in 1992. A 198,000-square-foot expansion to the Long Beach Convention Center is currently under construction and slated for completion by summer of 1994. The new convention center will contain 334,000 square feet of space including 224,000 square feet of exhibit space, 63,000 square feet of meeting rooms and a 21,000-square-foot ballroom. The expanded convention center will allow Long Beach to be more competitive in the group meetings market. Detailed Long Beach and Los Angeles area tourist data are in the Appendix.

Hotel Industry Trends

There are a total of 4,700 hotel rooms in 17 properties containing 100 or more rooms in Long Beach. Occupancy rates have been declining in recent years and were 68 percent in 1991, and estimated by Pannell Kerr Forster at 62 percent for 1992 year to date.

The poor performance of the Long Beach hotel market reflects business cutbacks, flat demand and oversupply. The City has been impacted by cutbacks and concerns over the financial health of McDonnell Douglas and by United Airlines leaving Long Beach Airport. In addition, the Long Beach Hilton at the World Trade Center opened in January 1992 and added 393 rooms to the hotel room inventory in an already weak market. Demand has been weak in the Long Beach market and overall in the Los Angeles regional market due to the recession which has led to a decline in both the group meetings travel market segment and in pleasure travel. Detailed hotel industry statistics are shown in the appendix and discussed in our interim report.

Adding to the already ailing hotel market in the Greater Los Angeles Region is the negative impact arising from the this spring's civil disturbance. These events were widely publicized in the media are expected to impact the level of tourism to the region for some time. Clearly, the effects are already being felt in the visitor industry, with the hotel segment among those to feel the impacts first. In a recent study for the Los Angeles Visitors and Convention Bureau, ERA projected that hotel occupancies would be significantly impacted.

ERA's analysis indicated that international tourism will be most heavily affected, with declines of about 30 percent during this summer. Over the longer term, international tourism is projected to be off by 15 percent. While domestic tourism (which includes business travel) is forecasted to decrease less severely, declines of at least 15 percent during this summer and 5 to 10 percent over the long term are expected. These declines in the level of tourism are forecasted to lead to declines in hotel occupancy rates of approximately 12 percentage points during this summer and 5 percent in the longer term for the overall Los Angeles region.

Section VI

HISTORICAL ATTRACTION PERFORMANCE

This section of the report reviews the historical operating and financial performance of the Queen Mary/Spruce Goose attraction. In addition, the underlying reasons for its basically poor performance over the course of its history as an attraction in Long Beach are also discussed.

ATTRACTION ATTENDANCE

Attendance peaked in 1984 at 1.6 million, a reflection of the first full year with the Spruce Goose on site and the strong attractions market in general during the 1980s. As shown in Table VI-1, attendance has been eroding since 1984 at a compounded average rate of approximately 9 percent per year, while during much of this time the attractions industry was showing attendance gains generally ranging from 5 to 6 percent per year. The Queen Mary/Spruce Goose attraction has registered an attendance gain in only one year since 1984. In 1989, attendance increased 1 percent over 1988. It may be relevant that admission prices were not increased in 1989.

The Queen Mary/Spruce Goose complex is experiencing a common phenomena in the attractions industry: attendance erosion. Attractions require a steady annual reinvestment program to create repeat visitation. This is particularly true of attractions with a passive nature or those which can not rely strictly on tourists. The Queen Mary/Spruce Goose complex falls into both of these categories, and without major reinvestment, attendance at this facility will continue its downward trend.

ATTRACTION PRICING

Admission prices have increased substantially during the last decade, as indicated in Table VI-2. In 1981, adult admission was \$6.00. By 1986 it had more than doubled, and

in 1992 it reached \$17.95. Queen Mary/Spruce Goose price increases have averaged nearly 9 percent on a compounded annual basis since 1984. An adult admission price of \$17.95 is extremely high compared to other attractions with similar lengths of stay. For shorter length-of-stay commercial facilities (it is estimated that the length of stay at the Queen Mary complex is 2 to 3 hours) adult admission price usually ranges from \$7.00 to \$13.00.

PER CAPITA EXPENDITURES

ERA analyzed per capita spending by category over a 10-year period and during the last 4 years under Disney operations. In order to allow for meaningful comparisons in spending at the attraction over different time periods, per capita expenditures for admissions, food and beverage and merchandise were adjusted using the consumer price index. Unadjusted and CPI adjusted per capita expenditures are shown in Table VI-3 and discussed below.

Admissions per capita expenditures have increased 8 percent per year since 1984 (average annual compounded rate) and a little less than 3 percent per year over the last 4 years, reflecting recessionary impacts. When adjusted for inflation, admissions per capita increased by about 3 percent per year from 1984 to 1991 and actually decreased by about 2 percent per year since 1988.

Spending in the food and beverage category registered average annual gains of 11 percent from 1984 to 1991, or roughly 6 percent per year when adjusted for inflation. During the last four years of operation, increases in food and beverage spending have dropped to a rate of just under 2 percent per year. When adjusted for inflation, spending in this category has actually shown no growth, but instead has declined by 3 percent a year since 1988. Similarly, merchandise spending grew at an average annual rate of 9 percent over the seven-year period (pre-inflation), but dropped to 2 percent a year since 1988. When inflation is taken into consideration, merchandise spending has decreased by about 2 percent per year since 1988. The decline in spending can be partially attributed to the recession and its impact on discretionary spending.

HOTEL QUEEN MARY

In ERA's interim report the Hotel Queen Mary was addressed in detail. The hotel's historical performance is reviewed here. For the detailed analysis refer to the interim report.

Historical occupancies are shown in Table VI-4. As indicated, the occupancy level increased from a low of 47 percent in 1981 to a high of 76 percent achieved in 1985 and 1986. Occupancies have dropped since 1986, but stayed above 70 percent through 1988. Occupancies have declined sharply since 1988, dropping to 60 percent in 1991. This primarily attests to a very poor market and a lower quality product, rather than to any management deficiencies. As discussed in the Available Market section of this report, the Southern California hotel industry has been performing poorly in terms of occupancies in the last few years due to economic recession, tourism declines and excess inventory in many areas. Occupancy rates have been declining in recent years in Long Beach also, and the poor performance of the Long Beach hotel market reflects business cutbacks, flat demand and oversupply. Demand has been weak in the Long Beach market and overall in the Los Angeles regional market due to the recession which has led to a decline in both the group meetings travel market segment and in pleasure travel. In addition, the small sizes of the rooms put the Queen Mary at a disadvantage in a market which has become extremely competitive and has seen the addition of nearly 1,600 rooms over the last six years. Detailed hotel information is shown in the Appendix.

FINANCIAL PERFORMANCE

ERA reviewed the financial performance of the attraction from 1982 through fiscal 1991. The Wrather Corporation operated the attraction from 1981 to 1988. The Walt Disney Company acquired the assets of Wrather Corporation, which included the lease to operate the attraction, and began operating the Queen Mary/Spruce Goose attraction in February of 1988.

ERA examined annual financial statements from 1982 through 1991 and discussed financial performance with Wrather and Disney executives. This included a review of detailed information by department which was supplied to us by Disney on a confidential

basis. While some of this information therefore cannot be disclosed, we were able to analyze and draw conclusions from it. Our analysis of revenues, expenses and operating income are discussed in detail below and a summary income and expense statement from 1982 through 1991 is provided in Table VI-5.

Revenues

Gross revenues have been essentially flat since 1985 and have remained at a level of approximately \$43 million. Gross revenues grew from \$19 million in 1982 to \$41 million in 1984 and have generally stayed at the \$42 or \$43 million level since 1985. The strong growth during the early 1980s again reflects the addition of the Spruce Goose and its impact on attendance. A strong attractions market environment was also a contributing factor. When adjusted for inflation, revenues steadily declined during the post-Spruce Goose period, under both Wrather and Disney management.

Expenses

Expenses have remained fairly constant from 1985 through 1989. In 1990 operating expenses increased substantially, by over 25 percent. This was mainly due to increased expenditures for entertainment and sales and marketing and clearly represents a strong attempt by Disney to bring the attraction up to their high standards and increase attendance. Marketing costs were about \$5 million, or approximately 12 percent of gross revenues in 1991, compared to the more typical 6 to 9 percent in the theme park industry and 5 to 7 percent in the hospitality industry. Entertainment expenses were approximately \$4 million for the same year, which is a significant increase over entertainment expenses in the 1980s. However, the increase in marketing and entertainment costs did not positively impact attendance. Given Disney's successful history of attraction marketing, this is an indication of the fundamental product and market difficulties of the Queen Mary/Spruce Goose complex. These difficulties include low repeatability, passive entertainment, and an intensely competitive attractions market. It should be noted, however, that while Disney provided

financial support, it did not promote the Queen Mary/Spruce Goose complex as a Disney attraction. Clearly, there is significant value attached to the Disney name, but this value was largely unrealized in the case of the Queen Mary/Spruce Goose.

Net Income

We have reviewed operating income both before and after deducting for capital expenditures. These are discussed separately here.

Net Operating Income

Net income from operations was positive from 1983 through 1989, although it declined steadily from 1984 to the present time. Net operating income is expressed before depreciation interest and taxes. Operating losses of approximately \$7 million were sustained in 1990 and \$4 million in 1991, as shown in the text table below and in Table VI-5.

<u>Year</u>	<u>Operating Income</u> (000)	<u>Income After Capital Expenditures</u> (000)
1982	(\$1,250)	(\$ 5,020)
1983	\$4,120	\$ 2,014
1984	\$7,524	(\$ 3,170)
1985	\$6,438	(\$ 4,732)
1986	\$5,500	(\$ 6,222)
1987	\$4,506	(\$ 8,547)
1988	\$ 624	(\$ 4,900)
1989	\$2,145	(\$ 2,170)
1990	(\$7,345)	(\$10,811)
1991	(\$4,153)	(\$ 7,966)

Note: All income figures are as reported to the City of Long Beach auditors office by Wrather and Disney management.)

Income After Capital Expense Deduction

When capital expenses are deducted from operating income, all years with the exception of 1983 showed a loss as indicated in the text table. Clearly, the complex has suffered serious operating losses over the last 10 years under both Wrather and Disney management.

SUMMARY

The declining pattern of attendance and overall downward financial trends discussed above demonstrate the inherent limitations in the attraction product itself. Static attractions like the Queen Mary/Spruce Goose which do not actively engage the visitor, characteristically produce a short length of stay and do not generate repeat visitation. These are inherent to the product, rather than being attributable to the ability of the operator. The addition of the Spruce Goose in 1984 temporarily had a positive impact on attendance. However, as soon as the novelty wore off, attendance began its steady decline. In recent years this pattern has been exacerbated by the recession and weak markets.

The hotel performance is clearly dependent to a great extent on general market conditions. When the market was strong, it performed fairly well in terms of occupancies. In recent years, the market has been very soft, there has been more competition, and the hotel operation has suffered.

Balancing these factors is the fact that the Queen Mary represents an icon to the City of Long Beach. While it is difficult, if not impossible to measure this value in quantitative terms, the Queen Mary's image and presence is associated with the city probably more than any other structure or activity. In interviewing tourism officials, it is clear that the Queen Mary has the highest visibility in terms of tourist attractions and plays a role (how large is unknown) in the decision-making process of conventions coming to the city. While the attraction's historical performance has been a financial drain, it is important to consider its "icon value" when making any decisions relative to its future.

Table VI-1

QUEEN MARY/SPRUCE GOOSE
HISTORICAL ATTENDANCE
1981-1991¹

<u>Year</u>	<u>Annual Attendance (000)</u>	<u>Percent Change</u>
1981	500	--
1982	540	8%
1983	1,400	159
1984	1,606	15
1985	1,292	(19)
1986	1,077	(17)
1987	1,014	(6)
1988	885	(13)
1989	898	1
1990	876	(2)
1991	808	(8)
 <u>Average Annual Compounded Rate</u>		
1984-1991		(9%)

¹1988-1991 Disney fiscal year.

Source: The Walt Disney Company, Port of Long Beach, and
Economics Research Associates.

Table VI-2

QUEEN MARY/SPRUCE GOOSE
HISTORICAL PRICING

<u>Year</u>	<u>Adult Admission</u>	<u>Percent Change</u>
1981	\$ 6.00	—
1982	6.00	0%
1983	7.00	17
1984	8.70	24
1985	10.95	26
1986	13.95	27
1987	14.50	4
1988	14.95	3
1989	14.95	0
1990	17.50	17
1991	17.50	0
1992	17.95	2
 <u>Average Annual Compounded Rate</u>		
1981-1992		9%

¹1988-1991 Disney fiscal year.

Source: The Walt Disney Company, Port of Long Beach, and
Economics Research Associates.

Table VI-3

QUEEN MARY/SPRUCE GOOSE
PER CAPITA EXPENDITURES

<u>Year</u>	<u>Admissions</u>	<u>CPI Adjusted</u>	<u>Food and Beverage</u>	<u>CPI Adjusted</u>	<u>Merchandise</u>	<u>CPI Adjusted</u>	<u>Other</u>	<u>CPI Adjusted</u>
1982	\$ 6.03	\$ 8.76	\$16.80	\$24.41	\$1.57	\$2.28	\$2.14	\$3.11
1983	3.05	4.35	9.29	13.27	1.99	2.84	1.48	2.11
1984	7.59	10.36	9.51	12.98	2.30	3.14	1.49	2.03
1985	9.21	12.02	12.45	16.25	3.06	3.99	2.18	2.84
1986	11.16	14.11	15.60	19.72	3.56	4.50	2.81	3.55
1987	11.52	13.97	16.30	19.76	3.81	4.62	3.23	3.91
1988	12.03	13.94	18.98	22.00	3.97	4.60	3.27	3.79
1989	11.29	12.45	20.26	22.35	4.36	4.81	3.70	4.08
1990	12.86	13.39	19.54	20.34	4.85	5.05	4.74	4.93
1991	13.04	13.04	19.92	19.92	4.27	4.27	6.22	6.22
<u>Compounded Annual Growth Rate</u>								
1984-1991	8%	3.3%	11.0%	6.3%	9.0%	4.5%	22.6%	17.3%
1988-1991	2.7%	(2.2%)	1.6%	(3.2%)	2.0%	(2.4%)	23.9%	17.9%

Source: The Port of Long Beach, The Walt Disney Company, and Economics Research Associates.

Table VI-4

**HOTEL QUEEN MARY¹
HISTORICAL OCCUPANCY
1981-1991**

<u>Year</u>	<u>Hotel Queen Mary²</u>	<u>Long Beach Competitive Hotels</u>
1981	47%	--
1982	57	--
1983	65	--
1984	69	--
1985	76	--
1986	76	--
1987	72	70%
1988	74	70
1989	69	71
1990	67	69
1991	60	68
1992 (year to date)	n.a.	62

n.a. means not available.

¹365 rooms.

²1988-1991 Disney fiscal year.

Source: The Walt Disney Company; Port of Long Beach; Pannell Kerr Forster, and Economics Research Associates.

Table VI-5

SUMMARY OF REVENUES AND EXPENSES

	<u>1982</u>	<u>1983</u>	<u>1984</u>	<u>1985</u>	<u>1986</u>	<u>1987</u>	<u>1988fy</u>	<u>1989fy</u>	<u>1990fy</u>	<u>1991fy</u>
REVENUE										
Room Rentals	\$4,680	\$5,765	\$7,472	\$7,990	\$8,138	\$7,881	\$7,506	\$7,425	\$7,265	\$6,999
Food & Beverage	9,072	13,008	15,275	16,086	16,807	16,533	16,329	18,192	17,115	16,096
Merchandise	849	2,799	3,695	3,960	3,800	3,868	3,569	3,917	4,253	3,453
Tour Admissions	3,259	4,272	12,183	11,897	12,017	11,679	10,768	10,141	11,261	10,539
Other	<u>1,154</u>	<u>2,066</u>	<u>2,392</u>	<u>2,820</u>	<u>3,027</u>	<u>3,271</u>	<u>2,894</u>	<u>3,321</u>	<u>4,149</u>	<u>5,030</u>
Total Revenue	\$19,014	\$27,910	\$41,017	\$42,753	\$43,789	\$43,232	\$41,066	\$42,996	\$44,043	\$42,117
OPERATING EXPENSES										
<u>Cost of Goods</u>										
Food & Beverage	\$2,804	\$3,923	\$4,506	\$4,570	\$4,772	\$4,666	4,522	5,233	4,761	4,377
Merchandise	\$458	\$1,199	\$1,688	\$1,658	\$1,584	\$1,644	\$2,109	\$1,506	\$1,933	\$2,154
Autos										<u>\$465</u>
Total Cost of Goods	\$3,262	\$5,122	\$6,194	\$6,228	\$6,356	\$6,310	\$6,631	\$6,739	\$6,694	\$6,996
Labor	\$10,461	\$11,686	\$15,551	\$16,619	\$17,444	\$18,520	\$10,541	\$11,028	\$11,831	\$11,114
Other Expenses	6541	6982	11748	13468	14489	13896	\$23,270	\$23,084	\$32,863	\$28,160
TOTAL OPERATING EXPENSES	\$20,264	\$23,790	\$33,493	\$36,315	\$38,289	\$38,726	\$40,442	\$40,851	\$51,388	\$46,270
NET OPERATING INCOME	(\$1,250)	\$4,120	\$7,524	\$6,438	\$5,500	\$4,506	\$624	\$2,145	(\$7,345)	(\$4,153)
CAPITAL EXPENSES	\$3,770	\$2,106	\$10,694	\$11,170	\$11,722	\$13,053	\$5,524	\$4,315	\$3,466	\$3,813
NET INCOME	(\$5,020)	\$2,014	(\$3,170)	(\$4,732)	(\$6,222)	(\$8,547)	(\$4,900)	(\$2,170)	(\$10,811)	(\$7,966)

Source: City of Long Beach, Walt Disney Company and ERA

Section VII

MAINTENANCE COSTS

ERA's engineering consultant, Rados International Corporation, analyzed the present physical condition of the Queen Mary and provided estimates of the minimum required investment to bring the complex up to maritime industry standards and the annual cost of maintaining the ship at that level. The estimated costs pertain to items requiring immediate attention and to deferred repairs that should be made within three to five years. The detailed analysis is provided in Volume III of this report.

COSTS OF BRINGING SHIP UP TO INDUSTRY STANDARDS

A total investment of approximately \$27 million is required to bring the ship up to industry standards.¹

Items requiring immediate attention total approximately \$6 million and deferred maintenance items total \$21 million. This deferred maintenance has been treated as a required capital expenditure of all ship operating options not as an operating expense. The major expenses pertain to the hull and mechanical systems. Cost of repairs to the hull are estimated at \$19.7 million and \$7.3 million for the mechanical system on the ship. The major items needing repair, replacement, or removal include the watertight bulkheads, the decks, the HVAC system, asbestos, removal, and the fire main, and a drydocking inspection. A drydock inspection is also necessary.

ANNUAL MAINTENANCE

Once the ship is brought up to industry standards, annual maintenance is estimated to require a total of \$4,853,000. This includes:

¹Industry standards refers to an accumulation of codes required for the safe and acceptable operations of the ship. These include the Uniform Building Code, national fire codes, national electric does, O.S.H.A., and the maritime classification societies such as the American Bureau of Shipping, Lloyds of London, United States Coast Guard, International Maritime Consulting Organization, and Safety of Life at Sea.

Hull and structural maintenance	\$2,025,000
Mechanical Piping systems	2,770,158
Electrical system	58,000

This annual maintenance applies to all of the operating options considered by the Consultant Team (all options utilize the same basic physical space on the ship).

Section VIII

IDENTIFICATION AND SCREENING OF POTENTIAL USES AND OPERATING STRATEGIES

As discussed in our methodology section, the Consultant Team identified and screened a large number of potential new uses and operating strategies for the Queen Mary/Spruce Goose complex. This included uses proposed by the public, the Port and City, and the consultant team. The identification and screening process and the results of these analyses are discussed below.

USE IDENTIFICATION AND SCREENING PROCESS

The consultant team identified potential new uses for the Queen Mary/Spruce Goose complex by means of several brainstorming sessions, and by soliciting and reviewing uses and operating strategies submitted to the Port and City by the public. A complete list of the publicly submitted proposals reviewed by the Consultant Team is listed in the Appendix.

Our process focused on the Queen Mary; however, uses and strategies for the Spruce Goose were also considered. The Londontown facility was excluded from our analysis. The team focused on the Queen Mary for several reasons. These include its high maintenance cost, its history of financial loss, and the ability of the Port and City to control its destiny. This is as opposed to the Spruce Goose which has comparably modest maintenance costs, is owned by the Aero Club of Southern California, and under the terms of Disney's lease with the Port must be removed with the dome at the termination of the lease in September, 1992.

Over 60 uses were identified in this process. These included uses in the following categories: commercial recreation and retail, public and cultural facilities, institutional uses, office and commercial, lodging and clubs, programmatic concepts, and operating options. The various uses in these categories were then screened utilizing a

matrix analysis. Our matrix analysis rated the identified uses and operating strategies using several factors. These included the following:

1. Physical Compatibility with the Space Available on the Ship/in the Dome.
2. Market Demand for the Use.
3. Operating Income Potential.
4. Revenue Potential to the City/Port.
5. Development Cost and Space Modification Requirements.
6. Compliance with State Tidelands and Other Regulatory Guidelines.
7. Overall Rating by Consultant Team.
8. Public Acceptance of the Use.

The complete matrix analysis is shown in the Appendix.

RESULTS OF SCREENING PROCESS

The above screening process resulted in a short list of uses and operating strategies which the Consultant Team, and the Port and City of Long Beach felt represented the most acceptable and financially viable alternatives for the Queen Mary/Spruce Goose Complex. The short list included four potential new uses for the Queen Mary. These are as follows:

1. An entertainment center combining restaurants, retail, and themed entertainment venues.
2. A card club/casino.
3. A timeshare development.
4. A maritime museum combined with an aquarium onshore.

The short list also included four operating/disposition strategies for the ship.

These are:

1. **Base Case** — operate under current conditions (assuming the hotel is open and the Spruce Goose stays).
2. **Partial Use** — mothball the lower decks and retain a limited tour, restaurants, and retail, on the Promenade, Sun, and Sports decks.
3. **Mothball** — mothball the entire ship but retain it as an icon.
4. **Disposition** — dispose of the ship by sinking, selling, or scrapping.

Several options were also considered for the Spruce Goose. The new uses considered for the Spruce Goose include:

1. **Aviation Museum** — retaining the Spruce Goose.
2. **Maritime Museum** — serving as the onshore space for a Maritime Museum which would have the Queen Mary as its chief exhibit.
3. **A Card Club/Casino.**
4. **A Public Recreation and Aquatics Center.**
5. **A Sports Complex** — including tennis, exhibition volleyball, public aquatics, and other sports exhibition space.
6. **An Indoor Waterpark, Swimming Complex** (similar to the Centrum Complex in Europe).

The operating/disposition strategies considered for the Spruce Goose include:

1. **Base Case** — operate under current conditions with the Queen Mary.
2. **Operate as a Stand-Alone Attraction** — assuming the Queen Mary is not operational and a separate admission is required for the Spruce Goose.
3. **Disposition** — the plane and the facility are disposed of.

The above short-listed strategies were analyzed further by ERA to assess their economic feasibility. This analysis is discussed in the subsequent section.

Section IX

ECONOMIC ANALYSIS AND PROJECTIONS SHORT-LISTED USES

INTRODUCTION

In this section, the economic potential of the short-listed uses for the Queen Mary/Spruce Goose complex are discussed. The concept for the various uses are outlined, the market demand reviewed, and the operating economics projected. While all of the short-listed uses have some merit, we have focused our analysis on the capability of the uses to generate high revenues which can support the maintenance cost of the ship. Subsequent to ERA's analysis of the operating economics of the various uses, KRM utilized ERA's conclusions to develop a financial and economic impact model (discussed in Sections X and XI.)

Of the four new uses examined for the Queen Mary, two proved feasible from an operating perspective. These were the entertainment center, and the entertainment center combined with a card club. For these two uses ERA projected detailed operating economics, which are discussed in detail below. The other two uses, the timeshare development and the maritime museum were not feasible. It became apparent at different points in our analysis that these two uses were infeasible. At that point we halted our analysis and summarized our findings. These are discussed below.

OPTION 1 — ENTERTAINMENT CENTER

Concept

Entertainment centers are a concept which evolved in the 1980s to satisfy demand for urban entertainment, eating, and shopping experiences. The centers combine specialty retail with themed restaurants, bars, clubs, and attractions. Typically, one admission price covers admission to multiple entertainment venues. The centers cater to both daytime eating and shopping, as well as nighttime entertainment, with the primary emphasis on the nighttime activities.

The concept for the Queen Mary Entertainment Center was developed with the following objectives in mind:

- Increase resident market attendance. Studies by Wrather indicated that tourism support alone was insufficient to support the Queen Mary Complex and that stronger resident market attendance was necessary.
- Maintain tourism appeal and ability to tour the Queen Mary. The concept calls for retaining a limited tour of the Promenade, Sun, and Sports deck.
- Create nighttime as well as daytime activities and attendance.
- Work within the existing available space. ERA's engineering consultant has indicated that any change in space configuration would be very costly due to asbestos problems, the requirement to upgrade handicap access to the new ADA standards, and material handling costs (difficulty of shipboard access for construction materials).
- Limit space usage to upper decks to reduce maintenance costs.

Based on these objectives, and the primary objective of financial viability, ERA reviewed the available spaces on the upper decks of the ship, and developed a concept which would effectively utilize this space. This concept is shown in Table IX-1.

Table IX-1

SIZING OF ENTERTAINMENT CENTER COMPONENTS

<u>Component</u>	<u>Location</u>	<u>Use Options</u>	<u>Size (sq.ft.)</u>
<u>Restaurant</u>			
Promenade Cafe	Promenade Deck	Restaurant	4,100
Chelsea Cafe	Promenade Deck	Restaurant	2,000
Sir Winstons	Sports Deck	Restaurant	3,500
Carts	Promenade & Sports Deck	Food & Beverage	n.a.
Queen Salon	Promenade Deck	Dinner Theater, Comedy Club, Card Club	<u>6,400</u>
Subtotal Restaurant			16,000
<u>Entertainment/Attractions</u>			
Observation Lounge	Promenade Deck	Music Club (Jazz, Gay 90s, Dance)	4,600
Royal Salon/Kings View Rooms	Promenade Deck	Sports Bar, Billiards, Magic Club	4,000
Wedding Chapel/Chapel, Victorian Room	Promenade Deck	Sports Bar, Billiards, Magic Club, Maze	3,300
Brittania Salon	Main Deck	Specialty Film, Card Club, Music, Comedy Club	9,000
Veranda Grill	Sun Deck	Music/Dance	4,000
Exhibit/Display Area	Sun Deck, Sports Deck	Museum, Tour	<u>15,000</u>
Subtotal Entertainment/Attractions			39,900
<u>Retail</u>			
Piccadilly Circus/Port Side Offices	Promenade Deck	Specialty Retail	11,000
Total			<u>66,900</u>
Total Visitor Area Support (at 20%)			<u>13,000</u>
Total Complex			79,900

Source: Economics Research Associates.

The concept calls for retaining and upgrading the existing restaurants, expanding the retail space, and converting the ballroom and salon areas to clubs featuring music, magic, comedy, sports, billiards, and other clubs generally themed around the Queen Mary past. A dinner theater as a separate charge has also been included in the concept. The project would include full usage of the Promenade, Sport, and Sun decks and partial usage of the Main deck. The total project size would be approximately 80,000 square feet. The estimated cost for the proposed concept is \$4.8 million (a detailed conceptual cost estimate is shown in Volume III of this report).

Comparable Projects

ERA surveyed comparable entertainment centers, specialty retail centers, and dinner theaters. The detailed survey information on these facilities is shown in the Appendix while their general characteristics as applicable to our analysis are discussed below.

Examples of entertainment centers include Church Street Station and Pleasure Island in Orlando, Florida, the Dallas West End in Dallas, the planned City Walk at Universal City and to a certain extent the historic Tivoli Gardens in Copenhagen. The general characteristics of selected facilities are shown in the text table below.

<u>Entertainment Center</u>	<u>Size (sq.ft.)</u>	<u>Admission</u>	<u>Attendance</u>
Church St. Station	125,000	\$15.95	1,500,000
Pleasure Island	135,000	13.73	2,500,000 ^e
Dallas Alley	160,000	5.00	800,000
City Walk	210,000	n.a.	n.a.

e = estimate.

n.a. means not available.

Financially, entertainment centers tend to generate sales per square foot similar to specialty retail centers, with restaurants generating from \$300 to \$500 per square foot, and retail from \$250 to \$450 per square foot. Per capita expenditures for the entertainment components typically range from \$10 to \$20 including admissions and alcohol.

Dinner theaters tend to generate less attendance than entire entertainment centers due to capacity and product limitations, but higher per capita expenditures. Attendance generally ranges from 100,000 to 500,000 persons per year depending on the scale of the facility and the frequency of the shows. Admission prices at dinner theaters typically range from \$24 to \$40 which includes dinner, the show, and sometimes one drink. Further alcohol expenditures are in addition and range from \$2.00 to \$5.00 per capita.

Market Evaluation

Entertainment centers derive demand from both tourist and resident markets. Long Beach has a very large, dense resident market consisting of nearly 3.0 million persons within a 15-mile radius which is the primary drawing distance for a center of this type (detailed market characteristics are shown in the Appendix). Additionally, Long Beach benefits from a substantial overnight tourist market of nearly 2 million persons per year, and good convention business (entertainment centers have strong appeal to conventioners).

While there are some specialty retail complexes in the area, the most successful of which is Shoreline Village, ERA does not consider these directly competitive with the proposed concept. The entertainment center has a stronger entertainment, restaurant, and nighttime orientation than specialty retail centers. Currently, there are no comprehensive entertainment centers of the type proposed in the Long Beach, South Bay, or Northern Orange County markets.

The proposed center's location in the Queen Mary will give it a unique appeal unmatched in the market. The established image of the Queen Mary as an area attraction, its historical significance, and its early 1900s finishes will contribute to the appeal and value

of such an attraction. Overall, ERA feels there is a strong market for this type of attraction; indeed, Disney recommended a similar component as a major element in their planned development.

Economic Projections

Based on the available markets, the performance of comparable attractions, the historical performance of the Queen Mary tour, and the unique characteristics of the proposed concept, ERA projected the economic performance of the Queen Mary Entertainment Center.

Attendance

Attendance at the facility will be derived from both residents and tourists. Three separately gated areas will receive attendance under this concept; the entertainment center, the limited tour, and the dinner theater. The attendance projections for the entertainment center are shown in Table IX-2.

As indicated in the table, it is projected that initial-year attendance at the entertainment center will equal some 750,000 persons. This initial-year attendance is projected to expand to 830,000 by Year 5 and 900,000 by Year 10.

In addition to the entertainment center, attendance will be generated by the limited tour which will remain on the Queen Mary and charge a separate admission. This attendance will consist of entertainment center visitors who choose to go on the tour, as well as daytime visitors to the tour only. Two factors will impact the attendance of the proposed tour relative to the current tour; its lower price, and the significantly limited nature of the tour relative to the existing one. It is expected that on balance, attendance will be lower than that experienced in recent years. Attendance for the tour is projected at 640,000 persons for Year 1 (some 20 percent less than currently attending), declining slightly over the years to 580,000 in Year 5 and 550,000 in Year 10. Continued attendance erosion is expected on the tour portion of the project. It is felt however, that the entertainment center can slow the rate of

Table IX-2

ENTERTAINMENT CENTER
ATTENDANCE PROJECTIONS
1992

Market Size

Primary Resident Market (0-15 miles)	2,997,000
Primary Tourist Market (Overnight Visitors to Long Beach)	1,915,000

Penetration Rates

Primary Resident	12.0%
Primary Tourist	15.0%

Estimated Attendance

Primary Resident	360,000
Primary Tourist	287,000
Other ¹	<u>103,000</u>
Total	750,000

¹Residents and tourists outside of primary market areas, estimated at 14 percent of total attendance.

Source: Urban Decision Systems; Long Beach Convention and Visitors Bureau; and Economics Research Associates.

decline from its historical average of 9 percent per year (since the addition of the Spruce Goose) to roughly 2 percent per year.

Finally, the dinner theater, while part of the entertainment center, will have a separate admission, and separate attendance. Dinner theater attendance is projected at 185,000 persons per year. Dinner theater attendance is expected to remain relatively stable due to capacity limitations.

Per Capita Expenditures and Sales

Per capita expenditures have been projected for the various gated components of the entertainment center based on recommended admission prices, and typical sales for other items such as snacks and alcohol. For the non-gated areas including the restaurants, and retail area, sales have been analyzed on both a per capita and a square foot basis to reflect historical Queen Mary sales, the sales generated at comparable facilities, and the fact that these areas will benefit from patronage from the entertainment center, the tour, and the general public.

ERA recommends an admission price of \$12.95 to the entertainment center, \$6.95 to the limited tour, and an average admission price of \$30 to the dinner theater (actual admission price will vary relative to time and day of show). Based on these prices, and accounting for discounts for groups, children, seniors, and others, per capita admission expenditures are projected at: \$11.65 for the entertainment center, \$4.86 for the limited tour, and as mentioned, \$30 for the dinner theater.

The entertainment center concept calls for some 11,000 square feet of restaurant space (not counting the dinner theater, and including support space). The Queen Mary restaurants are currently generating estimated sales of \$423 per square foot (this figure excludes sales associated with Londontown and the Spruce Goose). With the addition of the entertainment center and expansion and improvements of several of the restaurants, it is

estimated that sales will increase some 10 percent on a square foot basis or to \$440 per square foot in the initial year.

Additional food and beverage sales will be derived from alcohol and snack purchases in the clubs and alcohol purchases at the dinner theater. It is estimated that the clubs will generate per capita food and beverage expenditures of \$3.40, and the dinner theater will generate \$2.50 per capita expenditures for alcohol assuming one free drink is included with the meal.

Current retail sales at the Queen Mary (not including Londontown and the Spruce Goose) are estimated at roughly \$250 per square foot. ERA believes that these sales will expand with the increased space and variety of goods, and with the addition of the entertainment center. Retail sales have been projected at \$275 per square foot, or a per capita expenditure of some \$4.00 in the initial year.

All expenditures have been adjusted over the ten-year projected period to account for inflation and changing attendance.

Operating Revenues, Expenses, and Net Operating Income

Based on the above factors, ERA has projected the operating economics of the entertainment center. The basic assumptions of our analysis are as follows:

1. The facility will be professionally, operated, managed, and marketed by an experienced team in the attractions and retail business.
2. The concept will be designed by attractions and retail industry experts and will be implemented according to the highest quality standards of these industries.
3. Inflation of 4 percent.
4. Operating expenses and cost of goods sold are based on standard industry ratios modified to reflect the specific concept and historical expenses with the

exception of maintenance and utilities. Maintenance and utilities are based on actual ship requirements established by ERA's engineering consultant. Annual maintenance expense assumes that the required deferred maintenance discussed earlier is performed.

5. Other detailed assumptions of the operating economic projections are indicated in the Appendix.

Our projections are shown in Table IX-3.

As indicated, gross revenues for the entertainment center are projected to range from approximately \$28 million in the initial year to nearly \$45 million by Year 10. Cost of goods sold is estimated to range from some \$5 million to \$8 million during the same period. Operating expenses are projected to be some \$23 million in the initial year, expanding to approximately \$35 million by Year 10.

While entertainment centers can generate fairly strong operating incomes, the proposed entertainment center's projected operating income is very modest compared to revenues. This is due to the extraordinarily high maintenance costs of the ship compared to more typical maintenance for a land-based operation, and to higher utility charges associated with ship systems operations. Net operating income is projected at some \$1 million for the initial year, expanding to slightly over \$2 million by the end of the projection period.

Although net operating income is projected as positive for this use, and it is thus "feasible" from an operating perspective, this level of income will be insufficient to support the cost of deferred maintenance on the ship. As mentioned in the maintenance section of this report, deferred maintenance has been treated as a capital expenditure required for any operation of the ship, not an operating expense.

Table IX-3

PROJECTED OPERATING REVENUES, EXPENSES AND OPERATING PROFITS

Option 1 - Entertainment Center

	<u>1</u>	<u>2</u>	<u>3</u>	<u>4</u>	<u>5</u>	<u>6</u>	<u>7</u>	<u>8</u>	<u>9</u>	<u>10</u>
<u>REVENUES (000)</u>										
Admissions - Ent. Center	\$8,740	\$9,330	\$9,950	\$10,610	\$11,310	\$12,190	\$12,820	\$13,490	\$14,190	\$14,920
Admissions - Mus. & Tour	\$3,110	\$3,108	\$3,105	\$3,134	\$3,196	\$3,259	\$3,323	\$3,388	\$3,455	\$3,523
Food and Beverage	\$7,500	\$8,010	\$8,540	\$9,110	\$9,710	\$10,460	\$11,010	\$11,580	\$12,180	\$12,810
Merchandise	\$3,000	\$3,200	\$3,420	\$3,640	\$3,880	\$4,190	\$4,400	\$4,630	\$4,870	\$5,120
Dinner Theater	\$6,000	\$6,240	\$6,490	\$6,749	\$7,019	\$7,300	\$7,592	\$7,896	\$8,211	\$8,540
Gross Revenues	\$28,350	\$29,888	\$31,505	\$33,243	\$35,115	\$37,399	\$39,145	\$40,984	\$42,906	\$44,913
Less: Cost of Goods Sold	\$4,670	\$4,960	\$5,270	\$5,590	\$5,940	\$6,370	\$6,680	\$7,020	\$7,370	\$7,730
Net Revenue	\$23,680	\$24,928	\$26,235	\$27,653	\$29,175	\$31,029	\$32,465	\$33,964	\$35,536	\$37,183
<u>DIRECT OPERATING EXPENSES (000)</u>										
Wages, Salaries	\$10,430	\$10,860	\$11,300	\$11,930	\$12,600	\$13,420	\$14,040	\$14,710	\$15,400	\$16,110
Advertising & Promotion	\$1,810	\$1,890	\$1,970	\$2,070	\$2,190	\$2,330	\$2,440	\$2,560	\$2,680	\$2,800
Maintenance & Repair	\$4,853	\$5,047	\$5,249	\$5,459	\$5,677	\$5,904	\$6,141	\$6,386	\$6,642	\$6,907
Operating Supplies	\$680	\$710	\$740	\$780	\$820	\$880	\$920	\$960	\$1,000	\$1,050
Utilities	\$1,902	\$1,978	\$2,057	\$2,139	\$2,225	\$2,314	\$2,407	\$2,503	\$2,603	\$2,707
Contract Entertainment	\$910	\$940	\$980	\$1,040	\$1,100	\$1,170	\$1,220	\$1,280	\$1,340	\$1,400
General & Administrative	\$1,810	\$1,890	\$1,970	\$2,070	\$2,190	\$2,330	\$2,440	\$2,560	\$2,680	\$2,800
Total Direct Operating Expenses	\$22,680	\$23,610	\$24,570	\$25,930	\$27,390	\$29,170	\$30,530	\$31,970	\$33,470	\$35,030
<u>OPERATING INCOME (000)</u>										
Operating Income	\$1,000	\$1,318	\$1,665	\$1,723	\$1,785	\$1,859	\$1,935	\$1,994	\$2,066	\$2,153
Less: Land Lease	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0
Net Operating Income	\$1,000	\$1,318	\$1,665	\$1,723	\$1,785	\$1,859	\$1,935	\$1,994	\$2,066	\$2,153

OPTION 2 — ENTERTAINMENT CENTER AND CARD CLUB

Concept

A casino and/or card club was the second short-listed use to be analyzed by ERA. ERA considered this concept as a stand-alone facility on the Queen Mary, but upon analysis of this idea we modified the concept to be a combination project consisting of a moderate sized, upscale card club with an entertainment center. Our rationale for this concept included the following:

1. Casinos are not legal in the State of California. Developing a full-scale casino on the Queen Mary would require a modification to the state constitution. This would undoubtedly prove to be a long process with questionable probability of success.
2. Our interviews with card club operators indicated that large contiguous spaces (20,000 square feet or more gaming area plus support space) are necessary for successful operations of a large card club. The Queen Mary has several moderate-scaled spaces on its upper decks (approximately 5,000 to 9,000 square feet) which are ideally suited for a more limited card club. Combining these spaces into a larger complex would be difficult, costly, and could be undesirable from a club operations and security perspective.
3. While there are some larger conference, exhibit, and banquet spaces on the lower decks (18,000-square-foot, 12,000-square-foot and 15,000-square-foot spaces D, E and F decks, and 9,000-square-foot and 3,000-square-foot spaces on the R deck), these spaces are essentially inaccessible from the promenade and other upper decks, where the tour, retail, and restaurants are located, and the D, E and F deck spaces are designed with a central atrium which would prohibit the use of certain spaces due to lack of ceiling space for security cameras. The absence of continuity in space use would create certain maintenance, operating, utilities, and rehabilitation problems. Should the Port and City decide that a larger card club is desirable, however, ERA would recommend that these spaces be examined by card club operators and designers as possible locations.
4. The operation of a card club would require approval by municipal authorities and the public. A moderate-scaled club combined with an entertainment center may

have a better chance of municipal and public approval than a large facility with its attendant image and operational challenges.

5. A large card club located on the Queen Mary would set the tone for the surrounding development on the Port side of Queensway Bay. This situation would be exacerbated with a hotel element. A moderate-scaled club combined with the entertainment center would not run the same risk of tainting the surrounding development as a larger scale club.
6. A moderate-scale card club with an upscale orientation would be very synergistic with the entertainment center. The club would benefit from, and broaden the market appeal of the entertainment center, could share resources with the center, and would serve as a strong revenue producer to complement the entertainment center operation.

Based on these issues, ERA has recommended and analyzed a moderate-scale card club with an entertainment center as the second major option for the Queen Mary. We have not completely ruled out the possibility of a larger card club on the Queen Mary, a phased expansion of the card club, or a large card club with a hotel element. These options, however, would face the above noted challenges, and would need to be analyzed by the Port and City with card club operators, designers, naval architects, and in consideration of the above risks and challenges.

The physical configuration of the entertainment center with the card club is identical to that of the entertainment center with the exception that the card club has been placed in the largest available space, the Britannia Salon. The major club assumed to be occupying that space was shifted to the observation lounge, and the club in the observation lounge eliminated. The entertainment center with the card club would thus have one less themed club.

The estimated development cost of the entertainment center with the card club is \$4.9 million. A detailed cost estimate is provided in Volume III of this report.

Comparable Projects

Card clubs have been expanding in the Greater Los Angeles area over the last ten years as a form of legalized gambling. The Normandie Club in Gardena has been in existence for some 40 years, however, the other clubs in the area were built in the 1980s. Card clubs provide a range of poker, and Asian games. The clubs are distinguished from casinos in that there are no "games of chance" such as roulette, slot machines, and black jack, and gamblers do not bet against the house. The facilities also tend to have smaller gaming areas than typical casinos, and are not directly associated with resort hotels, as are most casinos.

The general characteristics of the areas major card clubs are shown in Table IX-4 (detailed characteristics are shown in the Appendix). As indicated, the large clubs are over 100,000 square feet. The clubs have from about 40 to 180 tables each. The high-revenue-generating clubs typically contain 150 tables or greater, with 150 square feet of space per table required plus support space. The larger clubs provide restaurants, show and meeting rooms, and other support facilities.

Card clubs generate very high levels of revenues, which are typically taxed by local authorities at rates ranging from 7 to 14 percent. The clubs, therefore, provide very high levels of tax revenues to the local municipality. The gross revenues and taxes of the area clubs are shown in the text table below.

<u>Card Club</u>	<u>1991 Gross Revenues (millions)</u>	<u>1991 Tax Revenues (millions)</u>
Commerce Club	\$76	\$10
Bicycle Club	\$90	\$11
Normandie & Eldorado Clubs	\$36	\$ 5

Card clubs' revenues are primarily derived by a fee paid per hand by gamblers. The fee per hand varies with the betting limit on the games. Betting limits can range from \$2 to \$1,000. Low-stakes poker games typically require per hand fees of \$3 to \$5, while the Asian

Table IX-4

PHYSICAL CHARACTERISTICS OF
SOUTHERN CALIFORNIA CARD CLUBS

<u>Club/Location</u>	<u>Year Opened</u>	<u>Number of Tables</u>	<u>Size Facility/ Casino (sq.ft.)</u>	<u>Amenities</u>
Commerce Casino City of Commerce	1984	177	130,000/ 30,000	2 restaurants, coffee shop, deli, ballroom (capacity 600), lounge
Bicycle Club Bell Gardens	1984	170	101,000/ n.a.	Restaurant, bar, meeting room, bakery, barbershop
Normandie Club Gardena	1980 ¹	80	n.a.	Restaurant, showroom (capacity 240)
Eldorado Club Gardena	1967	42	60,000/ 29,000	Restaurant , bar, buffet
<u>Proposed</u>				
Hollywood Park Inglewood	1993-94 ^e	150-200	150,000 ²	Restaurant, boutiques, intertrack wagering

n.a. means not available. e = estimate.

¹12 years in this location, 40 years in Gardena.

Source: Economics Research Associates.

games which are the most profitable have per hand fees of \$5 to \$10 for the low-stakes games and from \$30 to \$100 for the higher stakes games. The Asian games profitability comes from not only high stakes, but also larger numbers of persons per game. Typically poker games are limited to 4 to 6 players per game. Some of the Asian games can accommodate up to 20 players per game. Total revenues at card clubs have historically ranged from \$100,000 to over \$600,000 per table, per year.

Market Evaluation

Our market conclusions for Option 1 apply to the entertainment center portion of Option 2. That is, we have assumed that the entertainment center portion of the project will perform at the same market level with the card club as without. While the entertainment center will have one less club, we feel that the addition of the card club will broaden the market appeal of the complex, and thus, compensate for the loss of the one club. Comments regarding the specific market for the card club follow, and represent the consultant team's analysis of the market after interviewing card club operators.

There are currently four major card clubs within approximately 25 miles of the Queen Mary, with one additional club being planned by Hollywood Park in Inglewood. While there are quite a few clubs in the market, all of them are performing well, and the addition of new clubs in the 1980s did not have a negative impact on existing clubs. We feel that the scale of the Los Angeles market, and the increasing orientation of the card clubs towards a more upscale environment which can compete with Las Vegas for gamblers' dollars bodes well for an expanding market for this sort of facility.

The location of a card club on the Queen Mary provides some distinct market advantages. First, the facility is close to the Orange County market which card club operators feel is a strong untapped target market. Orange County has high income levels, many professionals, and Asian and other ethnic communities, all of which are good markets for card clubs. Secondly, the Queen Mary has good access via the Long Beach freeway to other Asian communities such as Monterey Park and Garden Grove. Thirdly, the Queen Mary is

well situated to capture convention business from the Long Beach Convention Center which is currently undergoing expansion (the card club will also provide a good marketing tool to sell conventions in Long Beach). Finally, the Queen Mary is isolated from residential areas, has a large parking area, and has interior spaces, which, while smaller than those typically required, are designed with quality decor and designed such that a moderate sized card club could be fairly easily retrofitted into them.

Overall, ERA feels that the market is strong for a card club on the Queen Mary. The planned facility should be capable of capturing a fair share of the market, and generating revenues on the level of a moderate-scale facility.

Economic Projections

Based on the above analysis, and the previous analysis of the entertainment center, ERA projected the economic performance of the entertainment center with the card club.

Per Capita Expenditures and Sales

The previous per capita expenditures projected for the entertainment center have been adjusted to reflect the fact that there will be one less themed club in this option due to the addition of the card club. The entertainment center in this concept will have four clubs as opposed to five. Because the appeal of the entertainment center is based on the critical mass of both its clubs and the retail and restaurants we have not reduced admission expenditures on a linear basis with the loss of one club. It is ERA's opinion that an admission expenditure reduction of 10 percent is appropriate in this case. Per capita admission expenditures under this concept are thus estimated at \$10.48, which implies an admission price of roughly \$11.65.

There will also be a modest reduction in food and beverage and merchandise expenditures associated with the loss of the one club. We have estimated that there will be a 10 percent reduction in food and beverage expenditures in the clubs (assuming restaurant sales remain fairly constant at about \$440 per square foot), or a 3 percent reduction in food

and beverage expenditures overall. This equates to a food and beverage per capita expenditure for the clubs of about \$3.00 or a total food and beverage per capita expenditure of \$9.70. Merchandise expenditures are projected to decline about 5 percent to \$3.80 per capita or approximately \$260 per square foot.

Regarding per capita expenditures for the other gated facilities, the limited tour and the dinner theater are projected to remain the same as in Option 1.

Card club sales projections are based on sales per table found in comparable projects. Sales per table tends to expand significantly the larger the size of the facility, and with increasing ability to provide space for Asian games. We have projected sales per table of \$300,000 in the initial year, increasing to \$400,000 by Year 5, and \$450,000 by Year 7 and thereafter. While this level is lower than that obtained at the larger clubs, it is consistent with the clubs having smaller table counts. Sales per table projections include gaming and food and beverage revenue.

We have assumed that the card club will be located in the Britannia Salon, an approximately 9,000-square-foot space. This space should accommodate roughly 50 tables using industry standard ratios of 150 square feet per table plus support space.

Operating Revenues, Expenses, and Net Operating Income

Based on the above factors, and the factors and assumptions previously discussed under Option 1, the operating economics of Option 2 are indicated in Table IX-5.

As shown, gross revenues for the entertainment center are somewhat lower than in Option 1, beginning at \$27 million in Year 1, and expanding to \$43 million in Year 10. Gross revenues from the card club operation more than compensates for this minor loss. Gross revenues from the card club are projected to be \$15 million in the initial year, expanding to \$32 million by Year 10.

Cost of goods sold and operating expenses have been calculated in the same manner as in Option 1. Cost of goods sold are projected at \$4.5 million initially, growing to some

Table IX-5

PROJECTED OPERATING REVENUES, EXPENSES AND OPERATING PROFITS

Option 2 - Entertainment Center and Card Club

	<u>1</u>	<u>2</u>	<u>3</u>	<u>4</u>	<u>5</u>	<u>6</u>	<u>7</u>	<u>8</u>	<u>9</u>	<u>10</u>
REVENUES (000)										
Entertainment Center/Museum										
Admissions - Ent. Center	\$7,860	\$8,390	\$8,950	\$9,550	\$10,180	\$10,970	\$11,540	\$12,140	\$12,760	\$13,420
Admissions - Mus. & Tour	3,110	3,108	3,105	3,134	3,186	3,259	3,323	3,388	3,455	3,523
Food and Beverage	7,280	7,770	8,290	8,840	9,420	10,150	10,680	11,230	11,810	12,430
Merchandise	2,850	3,040	3,250	3,460	3,690	3,980	4,180	4,400	4,630	4,870
Dinner Theater	6,000	6,240	6,490	6,749	7,019	7,300	7,592	7,896	8,211	8,540
Gross Revenues Ent. Cent.	27,100	28,548	30,085	31,733	33,505	35,659	37,315	39,054	40,866	42,783
Card Club										
Gross Revenues Card Club	15,000	16,900	18,928	21,091	23,397	24,333	28,470	29,608	30,793	32,025
Total Gross Revenues	42,100	45,448	49,013	52,824	56,902	59,992	65,785	68,662	71,659	74,807
Less: Cost of Goods Sold	4,530	4,810	5,110	5,420	5,760	6,170	6,470	6,800	7,140	7,500
Net Revenue	37,570	40,638	43,903	47,404	51,142	53,822	59,315	61,862	64,519	67,307
DIRECT OPERATING EXPENSES (000)										
Entertainment Center/Museum										
Wages, Salaries	9,970	10,370	10,800	11,390	12,020	12,790	13,390	14,010	14,660	15,350
Advertising & Promotion	1,730	1,800	1,880	1,980	2,090	2,220	2,330	2,440	2,550	2,670
Maintenance & Repair	4,853	5,047	5,249	5,459	5,677	5,904	6,141	6,386	6,642	6,907
Operating Supplies	650	680	700	740	780	830	870	910	960	1,000
Utilities	1,902	1,978	2,057	2,139	2,225	2,314	2,407	2,503	2,603	2,707
Contract Entertainment	870	900	940	990	1,050	1,110	1,160	1,220	1,280	1,330
General & Administrative	1,730	1,800	1,880	1,960	2,090	2,220	2,330	2,440	2,550	2,670
Op. Exp. Ent. Center	\$21,680	\$22,550	\$23,470	\$24,750	\$26,130	\$27,610	\$29,110	\$30,460	\$31,880	\$33,370
Card Club										
Op. Exp. Card Club	\$10,500	\$11,830	\$13,250	\$14,764	\$16,378	\$17,033	\$19,929	\$20,726	\$21,555	\$22,417
Total Direct Expenses	\$32,180	\$34,380	\$36,720	\$39,514	\$42,508	\$44,843	\$49,039	\$51,186	\$53,435	\$55,787
Total Operating Exp.	\$32,180	\$34,380	\$36,720	\$39,514	\$42,508	\$44,843	\$49,039	\$51,186	\$53,435	\$55,787
OPERATING INCOME (000)										
Net Operating Income	\$5,390	\$6,258	\$7,183	\$7,891	\$8,634	\$8,978	\$10,276	\$10,676	\$11,084	\$11,520

Source: Economics Research Associates

\$7.5 million in Year 10. Operating expenses for the entertainment center in this option are somewhat lower than in Option 1 to account for the loss of one club. Operating expenses for the entertainment center are estimated at roughly \$22 million in the opening year, increasing to \$33 million by Year 10.

Operating expenses for the card club have been projected using card club and casino industry standards. Card club operating expenses are estimated at 70 percent of revenues. This ratio is at the low end of the range for operating expenses relative to revenues. However, ERA feels that due to the limited scale of the operation, and the benefits which will be derived from shared resources with the entertainment center, the facility should be capable of performing at this level. Operating expenses for the card club are projected at \$10.5 million in Year 1, expanding to \$22 million by Year 10.

Net operating income for Option 2 is the strongest of all of the options analyzed by ERA. Net operating income is projected to be roughly \$5.4 million in the initial year, expanding to some \$11 million by the end of the forecast period. Net operating income is expressed before depreciation, interest, taxes, and any lease or gaming tax payment.

This option proves to be feasible, and would contribute significantly to the support of the deferred maintenance necessary on the ship. A large-scale card club could also be feasible assuming that some of the ship's larger spaces could be designed to accommodate such a club, that developer/operator interest could be found, and that such a project would be approved. We would expect a larger club to earn revenues and income commensurate with those found at comparable clubs in the Los Angeles area.

OPTION 3 — TIMESHARE RESORT

Concept

The concept for timesharing the Queen Mary consists of converting all or a portion of the Queen Mary hotel to timeshare units. Timeshare units enable purchasers to occupy resort units for a specific length of time each year over a period of years. A key feature of timeshare units is their ability to be placed on international timeshare exchange networks, and to be traded for timeshare use in other locations.

The objective of Option 3 would be to pay for the deferred maintenance cost of the ship by selling units, and to pay for the annual maintenance cost of the ship by charging an annual maintenance fee which is typical in the timeshare industry.

We analyzed two concept alternatives. The first alternative would be to use the hotel rooms as they are, and attempt to market them. The hotel rooms are mostly one bedroom, with an average size of about 200 square feet, and without cooking facilities. Typical timeshare units are one to three bedrooms, with an average size of 1,200 square feet, and with full kitchens. Because of the obvious shortcomings of the Queen Mary's hotel rooms relative to typical timeshare units, a second alternative was considered.

The second timeshare alternative consists of expanding the size of the rooms, and adding cooking facilities. This alternative would provide a smaller inventory of larger but higher quality units.

Comparable Projects

ERA surveyed comparable timeshare resorts in California and elsewhere in the U.S. The details of our survey are presented in the Appendix. Selected summary level information on timeshares is shown in the text table below.

Average Number of Units in Project	40-50
Range of Units in Projects	40-750
Average Unit Size (square feet)	1,200
Average Unit Price	\$8,750
Average Annual Maintenance Fee	\$300
Range of Absorption (units/year)	10-60
Typical Amenities	Pools, spas, sauna, exercise room, tennis, golf

Market Evaluation

While there is theoretically a market for timeshare units on the Queen Mary due to its California oceanfront location, and its association with the historic Queen Mary, there are also numerous difficulties associated with this sort of use.

The first alternative of attempting to sell the rooms as they are has several problems. First, the rooms are very small, and while prices could be discounted to account for this fact, we question whether units of this type would be marketable. It is unlikely that such small units would receive annual repeat visitation. They would therefore need to be exchangeable on the timeshare networks. Due to the wide disparity between these units and those typically offered on exchange programs, this would be a problem. Additionally, the rooms have no cooking facilities, and the ship has limited other resort amenities which are typical for timeshare projects. Overall, we believe the market for units under this first alternative may be limited, and inherently costly and risky to attempt to penetrate.

The second alternative of expanding the rooms would eliminate or reduce some of the above mentioned product and marketing problems. However, this alternative would face its own unique set of challenges. First, the market for such shipboard, low amenity units would still be questionable, and risky to pursue. Second, the costs for expansion of the units and the addition of cooking facilities would be prohibitive. Asbestos abatement would be required for this area of the ship which would cost multiple millions of dollars; the new ADA handicap requirements would need to be met which would include access to the hotel area as well as internal modifications within the units themselves; and utility supply and venting

for kitchen facilities would be extremely costly, and difficult if not impossible from an engineering perspective. Thirdly, the units would not be marketable without some assurance that the other facilities on the ship (retail, restaurants, etc.) would be available for owners' use over the long term. This would imply the need to find a long-term operator of these facilities. Fourthly, potential buyers would be faced with unpredictable levels of maintenance which would be higher than expected and would thus dissuade them from purchase. Fifthly, it is not clear how the ownership of the entire ship would be structured. It is unlikely that the entire ship would be owned solely by the timeshare owners. Thus, a secondary entity would need to be responsible for partial ship ownership, maintenance, and liability.

A final factor which could limit the success of this option is the State Tidelands regulations. Approval of timeshare projects can not be guaranteed due to the private ownership nature of such a development. Private residential ownership is not allowed under state tidelands regulations. However, resort hotels are considered a recreation use and are thus allowed. Similar resort ownership projects in the past have required numerous concessions for approval which would impact the project financially.

Economic Analysis

While there are clear market constraints to the timeshare concept, we have performed a brief analysis to determine if such a product could reasonably support maintenance costs of the ship. A reasonable level of absorption for such units would be 25 per year. Each unit consists of 5-week intervals. Thus a total of 1,250 intervals would be sold per year under this assumption.

Assuming the annual maintenance cost of the ship is similar to current estimates of approximately \$8 million per year, each interval owner for the first year could conceivably be required to pay a maintenance fee of \$6,400. This would decline as more units are sold; however, it is clear that such a maintenance fee requirement would make such a project infeasible. Indeed, the sales price of the interval units themselves would most likely be in the range of \$6,500 to \$7,500.

Given the market, product, regulatory, and economic constraints faced by this option, it is our opinion that such a development would be highly risky, and would prove to be infeasible.

OPTION 4 — MARITIME MUSEUM

Concept

Most major port cities have some type of tribute to their links and dependence on water as a means of transportation, commerce and culture. These institutions can be true museums which use collections of artifacts, interpretive material and other means to focus on the maritime history of a particular period or place; restoration projects, which maintain, preserve and present to the public a particular artifact (usually a ship); or memorial parks, which focus on a particular group of people or events. The more successful maritime museums in terms of attendance have broadened their somewhat narrow appeal by incorporating them into mixed-use complexes which often include aquariums.

The concept considered to be the most appropriate for the Queen Mary would be to incorporate a maritime museum into a larger mixed-used development which would include an aquarium developed on shore and which would also include an emphasis on programmatic elements. This will be addressed in the Phase II analysis. The concept would enable visitors to walk aboard the Queen Mary although all internal spaces would be closed and mothballed. Thus, the Queen Mary would serve as the primary exhibit. Other exhibits would include exhibits removed from the Queen Mary and replicated on shore, and exhibits dealing with the history of the Port of Long Beach or other maritime subjects. Approximately 25,000 square feet of exhibit space would be needed on shore. The museum is not recommended as a stand-alone facility.

Comparable Facilities

ERA surveyed a number of existing maritime museums and aquariums in order to obtain information regarding their physical and operating characteristics, particularly level of attendance and economic performance. These data provide a frame of reference from which to examine the potential economic feasibility of a maritime museum associated with the

Queen Mary in Long Beach. Characteristics of the surveyed maritime museums and aquariums are provided in the Appendix tables and salient points are discussed below.

Nine maritime museums were surveyed, including three west coast facilities: Los Angeles Maritime Museum, San Diego Maritime Museum and San Francisco Maritime National Historical Park. Six of the surveyed maritime museums feature historic ships.

The Los Angeles Maritime Museum is located in San Pedro, in close proximity to the proposed maritime museum in Long Beach. The museum structure is a converted ferry boat terminal. It includes 25,000 square feet of exhibit space and displays ship models and paintings. The museum also includes a library and amateur radio station.

Of all of the surveyed maritime museums, Mystic Seaport Museum is the closest comparable to the proposed maritime complex. Located on the banks of the Mystic River in southeastern Connecticut, it is the largest and one of the most heavily visited of the surveyed maritime museums. It is fashioned after a typical 19th Century eastern seaport village. The 17-acre Seaport includes tall ships, historic buildings, a preservation shipyard, planetarium and exhibit buildings. Visitors see restored sailing ships, extensive collections of ship models and paintings, boating building and repair shops, and a small craft collection.

Attendance

It appears that maritime history is a relatively specialized interest. Even in the large cities reviewed, all of which have major tourist markets, most maritime museums have modest levels of attendance. Attendance at the surveyed museums is summarized below:

San Francisco Maritime National Historical Park	485,000
South Street Seaport	450,000
Mystic Seaport Museum	432,000
USS Alabama Battleship Memorial Park	321,000
Patriots Point Naval & Maritime Museum	290,000
Los Angeles Maritime Museum	200,000
San Diego Maritime Museum	175,000
Vancouver Maritime Museum	100,000
Philadelphia Maritime Museum	90,000

As shown, there are four surveyed maritime museums which achieve annual attendance of over 300,000. These are San Francisco Maritime National Historical Park; Mystic Seaport Museum in Mystic, Connecticut; South Street Seaport Museum in New York City; and USS Alabama Battleship Memorial Park located in Mobile. All of these museums feature ships. South Street Seaport Museum, which is located within the South Street Seaport specialty center complex in New York, attracts only about 100,000 visitors to the museum building itself but draws 450,000 visitors annually when including excursionary boat tours. It should also be noted that San Francisco Maritime National Park includes a substantial amount of free attendance.

Several factors appear to be significant in attracting the higher volume of visitors: the presence of ships, the museum being part of a themed environment which includes demonstrations (as opposed to only static exhibits), and a historic maritime tradition in the area. The modest attendance typically found at maritime museums is a function of their passive and static nature, not unlike the Queen Mary and Spruce Goose.

Admission Prices

Admission prices at maritime museums are generally low, around \$5.00 for adults. There are two notable exceptions. Patriots Point charges \$8.00 and Mystic Seaport charges \$14.00 which are at the level of many commercial recreation attractions. However, Mystic Seaport's 3.5- to 4.0-hour length of stay is much longer than the 1 to 2 hours most maritime museums realize due to the wide variety of activities it offers. It should also be mentioned that even with this high admission price Mystic Seaport is able to draw very high attendance for a maritime museum.

Financial Performance

Maritime museums do not normally generate enough income to cover their operating expenses. The more successful ones cover from 80 to 90 percent of their operating expenses from earned revenue, with the balance supplied from memberships, contributions and

endowments. No maritime museums are able to pay for their capital development costs from operations.

Market Evaluation

Maritime museums draw the majority of their attendance from tourist markets. Long Beach receives nearly 2 million overnight visitors annually. In addition to Long Beach overnight visitors, who are considered to be the primary tourist market, the museum will benefit from its exposure to visitors to the Greater Los Angeles region. This secondary tourist market consists of recreation-oriented overnight visitors to the Greater Los Angeles region, less visitors to Long Beach and less residents of other Southern California counties. This includes some 11.7 million visitors.

The available resident market includes persons residing within an approximate 15-mile radius of the Queen Mary, which is considered to be the primary market for a maritime museum at the subject location. This is a dense market with some 5,105,000 residents.

There is one existing maritime museum located in the market area, Los Angeles Maritime Museum. Due to its limited scale, we do not consider it to be directly competitive. We would suggest the possibility of the Los Angeles Maritime Museum joining in a cooperative effort.

Attendance

The attendance volume projected for the maritime museum is a function of several factors, including the size of the available resident and tourist markets and the ability of the facility to penetrate these markets. Based on the attendance characteristics of the surveyed maritime museums, the locational and other attributes of the Queen Mary, and assuming an adjacent aquarium is built, attendance has been projected for this use.

Table IX-6 presents penetration rates and total projected attendance for the maritime museum as of 1992. As indicated attendance of 514,000 is projected. The Queen Mary is located in a tourist corridor, the ship is known worldwide and the ship would be the

Table IX-6

**MARITIME MUSEUM
ATTENDANCE ANALYSIS
1992**

Market Size

Primary Resident Market (0-20 miles)	5,105,000
Primary Tourist Market (Overnight Visitors to Long Beach)	1,915,000
Secondary Tourist Market (Balance of Recreation-Oriented Visitors to Los Angeles)	11,700,000 ¹

Penetration Rates

Primary Resident	2.5%
Primary Tourist	13.0%
Secondary Tourist	1.0%

Estimated Attendance

Primary Resident	128,000
Primary Tourist	249,000
Secondary Tourist	<u>117,000</u>
Subtotal	494,000
Other Southern California Residents	<u>20,000</u>
Total	514,000

¹Does not include Southern California residents.

Source: Urban Decision Systems; Long Beach Convention and Visitors Bureau;
Los Angeles Convention and Visitors Bureau; and Economics Research
Associates.

museums's main exhibit. We would thus expect the maritime museum to generate attendance at the upper end of the range for maritime museums.

Economic Evaluation

We expect that the maritime museum could operate on a break-even basis, but would not generate enough income to pay for development costs or to cover any of the maintenance costs of the ship. This use is therefore considered infeasible.

OPTION 5 — OPERATION UNDER CURRENT CONDITIONS

Concept

To provide a base case analysis, ERA modeled the continued operation of the Queen Mary/Spruce Goose complex under current conditions. We have assumed the following for this analysis:

1. The Spruce Goose remains on site.
2. The Queen Mary hotel is open.
3. A new operator is found for the complex.
4. No major new attractions/expansions occur during the ten-year projection period.
5. The deferred maintenance required on the ship is performed in the recommended time frame.

Other assumptions are noted below under the Economic Projections heading.

Comparable Projects

The chief comparable project for this analysis is the historical operation of the complex itself. As discussed in Section VI of this report, ERA reviewed the operations and financial performance of the facility under Wrather and Disney management, and discussed the facility with both Wrather and Disney executives.

To summarize our findings in Section VI, the complex produced operating income before capital expenditures during the Wrather years. This was primarily due to the addition of the Spruce Goose attraction which temporarily boosted attendance, as well as strong attraction and hotel markets through the early and mid-80s. As the impact of the Spruce Goose waned, and the hotel market softened, performance of the facility declined. Additionally, after capital expenditures, the complex apparently lost money in all but one year during the pre-Disney management period based on information received from the City of Long Beach Auditing Office. Disney began management of the attraction as the markets

continued to soften. Under Disney management, attraction and hotel performance continued to decline. Operating income continued its downward trend, which began during the Wrather years, and turned negative in 1990. Disney attempted to revive the attraction through heavy marketing, promotion, special events, and entertainment. However, these efforts produced few results. The project is currently suffering from serious operating deficits, still faces a weak market, and is in need of much costly repair.

It is the consultant team's opinion that the primary problem with the Queen Mary complex is not its management. The problem is the product and its markets. The attraction has lost money for nine of the last ten years under both Wrather and Disney management. The attraction has inherently low repeat visitation, is passive, is located on the waterfront so that it has only half of a market geographically speaking, and is situated in one of the U.S.'s most competitive attraction markets. While Disney has upgraded the hotel rooms on board the ship, the hotel still has rooms half the size of hotels of similar price, and is facing a very overbuilt market with shrunken demand.

Market Evaluation

The attraction market in Los Angeles has been impacted negatively in the last several years by the recession and a drop-off in tourism. In 1991, major attractions in the Los Angeles basin began an unprecedented lowering of prices in an attempt to capture new resident market business. The 1992 attractions market has experienced a convergence of two trends; a slight increase in resident market demand due to the waning recession and pent-up demand from the recession, and a decline in tourist market demand due to the LA riots, earthquakes, and other factors. It is our expectation that both the residential market and tourism market will recover slowly from their current state.

The hotel market in Long Beach and Los Angeles continues to suffer from an over-supply of rooms and poor demand. We expect this situation to continue for several years in Long Beach, after which the hotel market should begin to improve as tourism rebounds, and growth in economic activity generates business and group demand.

Part of the Queen Mary's recent poor performance is clearly due to bad markets. Based upon this fact, we have projected attraction attendance to remain stable for the first year of the projected period, and to decline at a slower rate than in recent years. From the attraction's peak attendance shortly after the installation of the Spruce Goose in 1984, attendance has declined at an average rate of 9 percent per year. After the initial drop-off in attendance which commonly occurs several years after the addition of a major attraction, the attraction's decline has slowed somewhat with attendance decreases in recent years averaging about 3 percent per year. We have projected attendance to be stable in Year 1, decrease by 3 percent per year in Years 2 and 3, decrease 2 percent in Year 4, and decrease 1 percent thereafter. We feel this represents a reasonable attendance erosion profile reflecting an attraction with recovering markets but no reinvestment in major attractions.

The poor hotel market has also contributed to the weak performance of the complex causing declines in occupancies and room rates at the Hotel Queen Mary. We have, thus, projected a slow recovery in the hotel market, with increasing occupancies at the Hotel Queen Mary. Since 1981, hotel occupancies at the Queen Mary have risen and fallen, with an average occupancy during the period of 65 percent. We have projected occupancies to remain at estimated current levels of 50 percent for the first year, climbing to 55 percent in Year 2, 60 percent in Year 3, and 65 percent in Year 4 and thereafter.

Economic Projections

Per Capita Expenditures and Room Rates

Projected per capita expenditures for the facility in Year 1 are shown in the text table below.

Admissions	\$13.04
Food	20.52
Merchandise	4.40
Other	<u>4.79</u>
Total	\$42.75

Admissions expenditures have been projected to be the same as the 1989 to 1991 average admission per capita. We have projected this level of admissions to remain stable for three years. This is to adjust for the fact that the attraction is currently overpriced, and will require several years of inflation for the price to be appropriate. The current overpriced situation is due in part to the fact that the Queen Mary complex raised prices at an average rate of 9 percent per year after the opening of the Spruce Goose, while other attractions raised prices an average of only 5 or 6 percent per year during the same period.

Food and merchandise expenditures have been projected to increase on an inflationary basis from current levels throughout the projection period. This accounts for the balancing factors of increasing hotel demand coupled with declining attraction demand, and general price increases. Other expenditures have been inflated on a per capita basis from 1989 through 1991 averages to account for broad fluctuations in certain of these years.

Room rates have been projected to remain at the current level of \$82 for Years 1 and 2, to reflect the soft hotel market. Room rates have been inflated at 3 percent per year thereafter.

Operating Revenues, Expenses, and Net Operating Income

The operating revenues, expenses, and net operating income for Option 5 are shown in Table IX-7. Operating revenues are estimated to equal some \$40 million in Year 1, expanding to \$47 million in Year 10. Overall this represents a level slightly less than current revenues during the first years of the projection period, increasing to historic average levels by about Year 5, and slightly surpassing historic levels by Year 10. This revenue stream accounts for declining attraction attendance, and a slowly recovering hotel business. The growth in revenues in real terms when accounting for inflation is actually negative, and reflects similar declines in real revenue growth of the Queen Mary/Spruce Goose complex under both Wrather and Disney management. Inflation in this option has been projected at a short-term rate of 3 percent (as opposed to 4 percent in Options 1 and 2) to reflect the short-term interim solution nature of this option.

Table IX-7
Projected Operating Revenues, Expenses and Operating Profit/Loss

Option 3 - Current Use
(000's)

	<u>1</u>	<u>2</u>	<u>3</u>	<u>4</u>	<u>5</u>	<u>6</u>	<u>7</u>	<u>8</u>	<u>9</u>	<u>10</u>
<u>REVENUES</u>										
Room Rentals	\$5,427	\$5,970	\$6,643	\$7,340	\$7,487	\$7,712	\$7,943	\$8,181	\$8,427	\$8,680
Admissions	\$10,432	\$10,119	\$9,816	\$9,908	\$10,103	\$10,302	\$10,505	\$10,712	\$10,923	\$11,138
Food and Beverage	\$16,414	\$16,399	\$16,385	\$16,539	\$16,864	\$17,197	\$17,535	\$17,881	\$18,233	\$18,592
Merchandise	\$3,519	\$3,515	\$3,512	\$3,545	\$3,615	\$3,686	\$3,759	\$3,833	\$3,908	\$3,985
Other	\$3,832	\$3,828	\$3,825	\$3,861	\$3,937	\$4,014	\$4,093	\$4,174	\$4,256	\$4,340
Gross Revenues	\$39,623	\$39,832	\$40,180	\$41,193	\$42,006	\$42,911	\$43,836	\$44,781	\$45,748	\$46,736
Less: Cost Goods Sold	\$6,683	\$6,677	\$6,671	\$6,734	\$6,867	\$7,002	\$7,140	\$7,281	\$7,424	\$7,570
Net Revenues	\$32,940	\$33,154	\$33,508	\$34,458	\$35,139	\$35,909	\$36,695	\$37,500	\$38,323	\$39,165
<u>DIRECT OPERATING EXPENSES</u>										
Labor	\$10,578	\$10,982	\$11,412	\$11,930	\$12,383	\$12,863	\$13,361	\$13,879	\$14,417	\$14,977
Non-Labor	\$9,200	\$9,591	\$10,005	\$10,496	\$10,891	\$11,309	\$11,743	\$12,193	\$12,662	\$13,148
Subtotal	\$19,778	\$20,572	\$21,417	\$22,426	\$23,274	\$24,171	\$25,103	\$26,072	\$27,079	\$28,125
<u>UNDISTRIBUTED EXPENSES</u>										
G & A	\$1,468	\$1,512	\$1,557	\$1,604	\$1,652	\$1,702	\$1,753	\$1,805	\$1,859	\$1,915
Repairs and Maint.	\$8,000	\$8,240	\$8,487	\$8,742	\$9,004	\$9,274	\$9,552	\$9,839	\$10,134	\$10,438
Credit Card Comm.	\$271	\$279	\$287	\$296	\$305	\$314	\$323	\$333	\$343	\$353
Utilities	\$2,477	\$2,551	\$2,628	\$2,707	\$2,788	\$2,872	\$2,958	\$3,047	\$3,138	\$3,232
Management Fee	\$1,585	\$1,593	\$1,607	\$1,648	\$1,680	\$1,716	\$1,753	\$1,791	\$1,830	\$1,869
Marketing	\$2,774	\$2,788	\$2,813	\$2,883	\$2,940	\$3,004	\$3,068	\$3,135	\$3,202	\$3,271
Subtotal	\$16,575	\$16,964	\$17,380	\$17,880	\$18,370	\$18,882	\$19,408	\$19,950	\$20,507	\$21,080
Operating Income/Loss	(\$3,412)	(\$4,382)	(\$5,288)	(\$5,848)	(\$6,505)	(\$7,144)	(\$7,816)	(\$8,522)	(\$9,263)	(\$10,040)

Source: Economics Research Associates.

Operating expenses have been projected using the same rationale as expressed in ERA's interim report. That is, we have accounted for typical variable and fixed expenses to adjust operating expenses downward in light of lower business volume, and adjusted operating expenses to industry standards where Disney operating expenses exceeded these standards (primarily in marketing, general and administrative expenses, cost of goods sold, and entertainment). Detailed operating expense assumptions are shown in the Appendix. Direct and undistributed operating expenses are projected to total some \$36 million in Year 1, expanding to \$49 million in Year 10. This level of operating expense assumes efficient and industry-standard operations of this facility by an experienced new operator. The expenses shown are somewhat less than those during the Disney years.

Given the above revenue and expense projections, we have projected net operating income at (\$3.4 million) in Year 1 declining to (\$10 million) by Year 10. While these operating losses are not as extreme as in current years, reflecting recovering markets and more efficient operations, they are still losses and indicate the fundamental product and market problems with this complex.

OPTION 6 — LIMITED OPERATION

Concept

ERA examined the option of continuing to operate the tour, but downscaling it considerably. Under this use option, the tour would consist of the Promenade Deck, Sun Deck and Sports Deck. In addition, the existing restaurants and retail shops would remain in operation. Tour attendees would not be able to go below the Promenade Deck and, therefore, would not see the working areas of the ship that are now open. The hotel would also be closed. This operating option assumes that a new operator would be found to manage the downscaled attraction. It also assumes that the Spruce Goose would be no longer on site.

The concept calls for mothballing all of the decks below the Promenade Deck in order to preserve the ship. This would entail one time costs on the order of \$1.4 million. Initially this use was considered as a means of retaining the ship and offering a scaled down tour while trimming maintenance costs.

Comparable Projects

The only comparable for the limited tour option is the historical performance of the existing Queen Mary tour modified to reflect the scaled down nature of the limited tour concept.

The historical performance of the Queen Mary has been discussed in Section VI, and is briefly summarized here. The Queen Mary tour attendance was 808,000 during 1991. Tour attendance has been declining at a rate of about 9 percent a year since 1984. The rate of declining attendance has slowed in recent years and is averaging about 3 percent per year now. The complex produced operating income before capital expenditures during the Wrather years, but after deducting capital expenses has lost money in all but one year under Wrather. It has continued to decline under Disney management.

Market Evaluation

The existing attraction draws from large tourist and resident market bases. The available markets consists of some 1.9 million overnight visitors to Long Beach, and overnight recreation-oriented visitors to the Los Angeles area and 11.3 million residents of the Los Angeles/Orange County region. These same markets would be available to a scaled down tour, although the attraction's ability to penetrate these markets would be reduced.

Economic Projections

Attendance

The existing tour attracted approximately 808,000 visitors during 1991. A scaled down version of the tour would generate lower attendance due to the limited content and experience which would be provided. Attendance is projected at 640,000 for Year 1, which represents a 20 percent decrease from the current level of tour attendance. Attendance erosion is expected to continue, translating into a decline to 584,000 by Year 5 and approximately 555,000 in Year 10.

Per Capita Expenditures and Sales

Per capita expenditures in Year 1 for tour admission, food and beverage items and merchandise are shown below:

Admissions	\$ 4.86
Food/Beverage	11.25
Merchandise	3.00
Other	<u>1.25</u>
Total	\$ 20.36

These estimates are based on lowering of the adult admission price to \$6.95 to reflect the limited character of the tour. Per capita admission expenditures are estimated at \$4.86 in Year 1, accounting for children and group discounts. Food and beverage spending is

estimated at \$11.25 in the initial year. This is high for a short stay attraction, and takes into account the presence of the restaurants which would remain open to the general public. Merchandise expenditures have been reduced from current levels to account for the shorter length of stay.

Revenues, Expenses and Net Operating Income

Based on the above factors, ERA has projected the operating economics of the limited tour. The following assumptions were utilized in our analysis:

1. Operating expenses and cost of goods sold are based on standard industry ratios adjusted to reflect the specific concept, historical expenses, and operating efficiencies derived by new management and lower business volume, with the exception of maintenance and utilities.
2. Maintenance and utilities are based on actual ship requirements established by ERA's engineering consultant (see Section VII). Annual maintenance expense assumes that the required deferred maintenance discussed earlier is performed.
3. A lower inflation rate (3 percent) has been utilized to reflect this use as an interim rather than long-range solution for the Queen Mary.

Our financial projections are provided in Table IX-8.

Gross revenues are projected at approximately \$13 million in the opening year and at slightly under \$15 million in Year 10. No real growth is indicated, due to the projected continued attendance erosion. Operating expenses including cost of goods sold are estimated at \$13.7 million in Year 1, increasing to \$18.2 by the tenth year. The limited tour is projected to sustain operating losses of nearly \$10 million in the initial year and reaching \$15 million by Year 10. Upon detailed examination, this option was not considered to be viable primarily due to the need to support high maintenance costs. It was determined that the maintenance costs would be about the same for the limited tour as for the entertainment

Table IX-8

**Projected Operating Revenues, Expenses
and Operating Profit/Loss
Option 4 - Partial Operation
(000)**

	1	2	3	4	5	6	7	8	9	10
<u>REVENUES</u>										
Room Rentals	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0
Admissions	\$3,110	\$3,108	\$3,105	\$3,134	\$3,196	\$3,259	\$3,323	\$3,388	\$3,455	\$3,523
Food and Beverage	\$7,200	\$7,194	\$7,187	\$7,255	\$7,398	\$7,543	\$7,692	\$7,843	\$7,998	\$8,155
Merchandise	\$1,920	\$1,918	\$1,917	\$1,935	\$1,973	\$2,012	\$2,051	\$2,092	\$2,133	\$2,175
Other	\$800	\$799	\$799	\$806	\$822	\$838	\$855	\$872	\$889	\$906
Gross Revenues	\$13,030	\$13,019	\$13,007	\$13,129	\$13,388	\$13,652	\$13,921	\$14,195	\$14,474	\$14,760
Less: Cost Goods Sold	\$3,120	\$3,117	\$3,114	\$3,144	\$3,206	\$3,269	\$3,333	\$3,399	\$3,466	\$3,534
Net Revenues	\$9,910	\$9,902	\$9,893	\$9,986	\$10,182	\$10,383	\$10,587	\$10,796	\$11,009	\$11,226
<u>DIRECT OPERATING EXPENSES</u>										
Labor	\$5,900	\$6,074	\$6,254	\$6,471	\$6,729	\$6,997	\$7,276	\$7,566	\$7,867	\$8,181
Non-Labor	\$4,700	\$4,839	\$4,982	\$5,155	\$5,360	\$5,574	\$5,796	\$6,027	\$6,267	\$6,517
Subtotal	\$10,600	\$10,913	\$11,236	\$11,626	\$12,089	\$12,571	\$13,072	\$13,592	\$14,134	\$14,697
<u>UNDISTRIBUTED EXPENSES</u>										
G & A	\$900	\$1,030	\$1,061	\$1,093	\$1,126	\$1,159	\$1,194	\$1,230	\$1,267	\$1,305
Repairs and Maint.	\$4,853	\$4,999	\$5,149	\$5,303	\$5,462	\$5,626	\$5,795	\$5,969	\$6,148	\$6,332
Utilities	\$1,902	\$1,959	\$2,018	\$2,078	\$2,141	\$2,205	\$2,271	\$2,339	\$2,409	\$2,482
Management Fee	\$521	\$521	\$520	\$525	\$536	\$546	\$557	\$568	\$579	\$590
Marketing	\$912	\$911	\$910	\$919	\$937	\$956	\$974	\$994	\$1,013	\$1,033
Subtotal	\$9,088	\$9,420	\$9,658	\$9,918	\$10,201	\$10,492	\$10,791	\$11,099	\$11,416	\$11,742
Operating Income/Loss	(\$9,778)	(\$10,431)	(\$11,001)	(\$11,558)	(\$12,108)	(\$12,680)	(\$13,275)	(\$13,896)	(\$14,541)	(\$15,214)

Source: Economics Research Associates

center and card club. Therefore, it is more economically advantageous to generate higher levels of revenues through more intensive use of this deck space.

OPTION 7 — NON-OPERATING AND DISPOSITION OPTIONS

Four non-operating options for the Queen Mary were explored. These are:

1. Mothballing
2. Sinking
3. Scrapping
4. Selling

Preliminary cost estimates for each of these alternatives are provided in the following paragraphs. These cost estimates were made based on the Rados International report dated January 15, 1992. Further investigation by Rados International as part of the current study has revealed several additional problems, most significant of which is related to asbestos-containing material. These may lead to increased costs due to removal of this material. The magnitude of the impact on the estimated costs related to the asbestos treatment are discussed under each alternative.

Mothballing Vessel

Mothballing the ship would preserve it either on a short-term or long-term basis depending on the extent and process used. Mothballing would allow for the preservation of the vessel's exterior and interior. The mothballing option could preserve the vessel as an icon in Long Beach while eliminating most of the maintenance cost requirements. It could also be considered an interim solution which would allow the Port and City to defer making a final decision as to the ship's fate.

There are two methods of mothballing the interior. The passive method seals selected portions of the interior from exterior atmospheric changes and thus slows down corrosion of metal and aging of wood. This method does not protect the ship from cold and heat. Moisture could be controlled using silica gel canisters. The active method uses dry air to seal selected areas of the ship which is a requirement for long-term preservation. Because of the

space configuration, a combination of the passive and active would be preferred, according to Rados International.

The preservation of the exterior of the ship for long-term storage would require the cleaning and painting of the superstructure, hull and hull bottom.

The costs of mothballing the ship are summarized below:

Vessel Cleaning	\$ 81,000
Disconnect Services	22,000
Mothball (Dry Air Humidifiers)	<u>1,293,000</u>
Total	\$1,396,000

Mothballing will not require the removal of asbestos. Some protection for employees would be required during the mothballing process, but overall impact on costs would be low. A minimal annual maintenance cost would be required in this option consisting of primarily security and fire system maintenance. Estimated annual maintenance cost under this option would be some \$1 to \$2 million.

Sinking Vessel

The ship could be made into an artificial barrier reef, or simply sunk. If made into an artificial barrier reef, it could be used as a scuba dive area. It could also be used as a destination for tourist submarines in which case it could possibly generate some revenue and become an operational use.

There are established regulations pertaining to the sinking of vessels. The Department of Fish and Game would control the scuttling location and a permit from the Coastal Commission would be required to use the ship as an artificial reef depending on the location. If the ship was not able to be used as an artificial barrier reef, and were it to be sunk, a permit would be required from the Environmental Protection Agency.

The estimated cost of turning the Queen Mary into an artificial reef is \$4.7 million. The most significant cost would be an estimated \$3.8 million to remove the breakwater.

Some asbestos containment would be required if the ship were sunk and this would moderately impact costs.

Some of the costs might be recovered by auctioning valuable items with historical significance such as wood panelling and inlaid wood sculptures; furnishings and momentos from the ship, or selling other pieces of the Queen Mary as souvenirs in a well-situated merchandise shop.

Scrapping Vessel

The Queen Mary contains 44,165 long tons of high-grade steel and 20 million rivets, piping, machinery valves, etc. The value of the steel, brass and copper scrap is estimated at \$884,000. Valuable items on the ship could also be auctioned. The cost of preparing the ship for scrapping (which includes removal of the breakwater) is estimated at \$4.8 million. In addition, the asbestos-containing material would have to be removed. While a detailed study has not been conducted, it is estimated that asbestos removal would cost on the order of \$5 million. Thus, scrapping the Queen Mary would carry total costs on the order of \$7 to \$9 million. This estimate does not take into consideration any monetary gain from the auction of Queen Mary valuables.

Selling Vessel

There have been numerous inquiries to the Port from parties interested in possibly acquiring the Queen Mary. Rados International has estimated that the sales price for the Queen Mary could range from \$3.8 to \$4.5 million.

The major cost associated with selling the Queen Mary would derive from the removal of the breakwater which is estimated at almost \$3.8 million. However, selling of the vessel would necessitate the removal of some asbestos-containing material from the ship.

OPTIONS FOR THE SPRUCE GOOSE

Introduction

The consultant team also considered options for the Spruce Goose attraction. Our analysis of the Spruce Goose has not been as detailed as that of the Queen Mary for several reasons. First, the Spruce Goose does not have the same high maintenance requirements of the Queen Mary, and is thus not in the same financially precarious position.

A second and perhaps stronger reason is that the Port and City of Long Beach have little control over the ultimate location and operation of the Spruce Goose. The plane is owned by the Aero Club of Southern California. The Aero Club released a Request for Proposals in May 1992 to which it received six responses from parties interested in removing the Spruce Goose. The Aero Club is currently negotiating with three of these parties, and is not negotiating with the City or the Port. Additionally, under the terms of Disney's lease, Disney is obligated to remove the plane and the dome at the lease's termination. It is thus highly unlikely, without strong Port and/or City intervention, that the Spruce Goose will remain as an attraction in Long Beach. It is possible that Disney could be convinced to leave the dome. However, its fate in this case will be a function of the second phase masterplan, and whether or not it is advantageous to use the dome should it remain.

Use Options

Despite the fact that the most probable option for the Spruce Goose is its departure, the team has reviewed potential use options for the facility, and performed a brief analysis of the facility should it remain as a stand-alone attraction. The potential uses developed by the team were outlined in Section VIII of this report, and to reiterate are: an aviation museum, use as on-shore space for the maritime museum concept described above in Option 4, a card club, a public recreation and aquatics center, a sports complex, and an indoor waterpark.

These uses were reviewed for the strength of their economic contribution to overall site maintenance requirements. The maritime museum, as discussed above, would not earn

sufficient income to pay for the maintenance costs of the ship. The aviation museum likewise would generate little income towards overall maintenance requirements. Both of these uses would be well suited to the space in the dome and should be considered if other surrounding development made it possible for nonprofit institutions to locate there.

Similarly, the public recreation and aquatics center, and the sports complex would be uses compatible with the physical space in the dome. However, these public uses typically break even at best, and often require subsidies. Additionally, such public recreation uses may be incompatible with other more commercial uses planned for the site area.

An indoor waterpark in the dome would benefit from the existing physical enclosure which tends to be one of the most expensive elements of an indoor waterpark. The size of the domed area is also appropriate for this use. However, indoor waterparks are typically developed in cold climates in inland areas to provide a warm swimming experience to an area which has none. This is clearly not the case in Southern California, where miles of beaches, surf, good weather, and existing outdoor waterparks would dampen the market opportunity for such a facility.

The card club option proves to be the most reasonable use for the Spruce Goose dome of those reviewed. The dome area is of sufficient size to develop a full-scale 150- to 200-table card club. Card club operators agreed that this would be a good location for a club. A large stand-alone card club at the Spruce Goose dome would face the same image and other challenges discussed previously, with the exception, of course, that the large space is readily available without need for structural modification. Based on our research of card clubs, it is our opinion that a large card club at the Spruce Goose could be very successful financially if it were approved. We would expect the performance of such a facility to rank with the more successful facilities in the Los Angeles area.

Performance as a Stand-Alone Attraction

Because the Spruce Goose is a very short length-of-stay facility with inherently low repeat visitation, its success as a stand-alone attraction is highly dependent on what takes

place in the surrounding development. It is difficult, therefore, to model the market and financial performance of such a facility in the absence of a detailed masterplan for the surrounding area. We have therefore indicated a range of stable-year performances at the facility which could be reasonably expected assuming the Queen Mary is no longer operational, but some other visitor-oriented activities take place on the site.

Under such conditions, and based on the historic performance of the complex, and performance of similar short length-of-stay attractions, we would expect the Spruce Goose to achieve annual attendance ranging from some 250,000 to 350,000 persons. This assumes a recommended admission price of \$6.95 for adults. Rough estimates of reasonably achievable per capita expenditures are shown in the text table below.

Admissions	\$4.86
Food and Beverage	1.25
Merchandise	2.00
Rental and Other	<u>1.75</u>
Total	\$9.86

Based on the above range of potential performance, and actual current staffing and operating costs for the Spruce Goose, a stable-year indication of potential income is shown in the text table below.

Gross Revenues	\$3,000,000
Operating Expense	
Labor	\$ 615,000
Nonlabor	800,000
Cost of Goods Sold	<u>540,000</u>
Total	\$1,955,000
Net Operating Income	\$1,045,000

Gross revenues were calculated by applying a a median level of attendance of 300,000 persons per year to per capita expenditures. Operating expenses were calculated

using actual current operating labor requirements, augmented to provide for marketing, financial, and general management labor currently being used jointly with the Queen Mary. An estimated staffing schedule with costs is shown in the appendix. Other operating costs were estimated based on budgets for similar modest-scaled attractions, Spruce Goose utility and maintenance requirements, and standard attraction industry ratios.

As indicated, the Spruce Goose may have the potential to be a profitable attraction on a stand-alone basis. This possibility would of course be increased were the surrounding property to be developed with compatible visitor-serving land uses. The facility has limited maintenance and staffing requirements, and thus could be operated fairly efficiently.

Section X

FINANCIAL FEASIBILITY OF SELECTED OPTIONS

As discussed in Section IX, only two alternative use options have been identified as potentially feasible from an operations standpoint i.e. operating income exceeds normal operating expenses including on-going ship maintenance costs. This section analyzes the ability of these two options to support the \$27 million deferred maintenance cost on the ship. Operations under current conditions (Option 5) are also examined to determine the subsidy level required under this option.¹

METHODOLOGY

KRM constructed a computerized financial model to analyze the two use options. The model output is structured into four sections: assumptions statement, economic activity, fiscal revenues by category, and financial feasibility analysis. The model calculates the various impacts over a 30-year period on a zero inflation (primarily for fiscal revenue analysis) and 4 percent inflation basis. The detailed model runs are contained in the appendix.

For the Base Case, KRM utilized ERA's operating pro forma and current employment levels represented by Disney in order to estimate economic and fiscal impacts.

The financial feasibility analysis measures both before-financing and after-financing return on total capital and equity investment. Based on investment return criteria, the analysis determines the level of private investment that is supportable by the income generated under each option. This supportable investment is then compared to the required capital costs of each option. The analysis presented in this section assumes 4 percent annual inflation.

¹The reader will note that there are slight differences in certain individual items between ERA's operating statements and those projected by KRM. These are due to varying calculation mechanics, rounding, and varying time assumptions used by KRM for the purpose of fiscal and economic impact analysis. These differences are immaterial to the analysis.

MAJOR ASSUMPTIONS

Capital Costs

Deferred Maintenance

The Queen Mary has significant maintenance problems that have not been adequately addressed. Rados International Corporation has estimated the minimum investment required to bring the ship up to acceptable comfort and safety standards to be \$27.1 million, with almost \$6.0 million required on immediate items. In the pro forma analysis, the remaining \$21.1 million is assumed to be spent over three years following the immediate budget items.

Leasehold Improvements

To convert the Queen Mary into the proposed entertainment complex will require additional investment for refurbishing and improving the restaurants, ballrooms and gift shops. Rados has estimated the refurbishment cost to be \$4.8 million for the entertainment center (Option 1), and \$4.9 million if a card club is included (Option 2).

Start-Up Costs

In addition to the capital costs for physical improvements, substantial startup costs will be required for each option, including design, promotion, and other organizational costs. These costs are estimated to be in excess of \$1.0 million for each option.

In summary, the continued operation of the Queen Mary will require a significant capital investment, as follows:

**Capital Costs
(\$ millions)**

	<u>Base Case "As Is"</u>	<u>Option 1 Entertainment Only</u>	<u>Option 2 Entertainment and Card Club</u>
Deferred Maintenance	\$27.1	\$27.1	\$27.1
Refurbishment	NA	4.8	4.9
Startup Costs	<u>NA</u>	<u>1.0</u>	<u>1.0</u>
Total	\$27.1	\$32.9	\$33.0

Financing

Due to the high risk operating nature of the use options, private debt financing would be likely subject to high underwriting standards. The analyses which include financing are based on a 1.5 debt coverage ratio at an average interest rate of 12 percent and a 15-year term. The remaining equity is assumed to require a 25 percent to 30 percent yield to attract investors. This is equivalent to an 18 percent to 20 percent return on an all cash investment, which is 5 percent to 6 percent above institutional quality real estate investment thresholds and, in our opinion, is reasonable for these types of uses.

Land Lease Payments

An additional factor in establishing the viability of alternative use operations is the project's ability to generate sufficient income to pay the Port of Long Beach a market rate of return on the 45 acres of land (exclusive of water area) current utilized by the Queen Mary project. Discussions with Port officials indicate that the land would have a minimum value of \$12 per square foot for industrial uses to as high as \$30 or more per square foot for commercial uses.

Using an initial 10 percent return on land value, consistent with Port policy, the Queen Mary operation would need to generate \$2.3 million in additional operating income to pay reasonable land rent based on the minimum industrial land value (45 acres x 43,560 square feet/acre x \$12/square foot x 10 percent). The analysis also incorporates percentage lease terms based on current Port guidelines in the detailed projections (5 percent of gross revenues of retail, entertainment, and other revenues; 3 percent of gross food and beverage revenues).

FINANCIAL ANALYSIS — MINIMUM PORT LAND LEASE

KRM analyzed the Base Case together with the two selected options incorporating the required capital improvements, land lease payments and financing costs. The results are summarized in the text table below for the stabilized operating year.

	Stabilized Pro Forma (1992\$ 000s)		
	Base Case "As Is"	Option 1 Entertainment Center	Option 2 Entertainment and Card Club
Net Operating Income - 1996	(\$ 5,000)	\$ 1,800	\$ 7,100
Less: Land Lease Payments	<u>2,300</u>	<u>2,300</u>	<u>2,300</u>
Net Income Before Debt Service	(\$ 7,300)	(\$ 500)	\$ 4,800
Supportable Debt	\$ 0	\$ 0	\$22,000
Required Equity	27,100	32,900	11,000
Pre-Financing Internal Rate of Return	NM ¹	(3.9%)	21.3%
Required Front-End Subsidy to Generate Return on Investment	NM ¹	\$23,000-24,000	NA

¹Not measurable.

The Base Case shows such a significant and increasing annual deficit that no front-end subsidy would make it a feasible operation. However, over a 30-year time period, a front-end subsidy of about \$100 million would be needed for this option just to fund the present value of the projected operating losses.

Option 1 requires a \$23-24 million front-end subsidy to represent a feasible project. Put another way, Option 1 would support an initial private capital investment of \$9-10 million of the \$33 million required investment.

Option 2 generates sufficient cash flow to fund all capital improvements and pay minimum ground rent. With expected inflationary increases, the Option 2 project should also be able to pay additional ground rent or a potential modest tax on gaming revenue.

Financial Analysis — No Land Lease Payments

For purposes of illustration only, KRM also analyzed the viability of the Base Case and Option 1 alternatives to assess whether elimination of land rent to the Port as an operating subsidy would support total private funding of capital costs.

**Stabilized Pro Forma
(1992\$ 000s)**

	Base Case "As Is"	Option 1 Entertainment Center
Net Operating Income - 1996	(\$5,000)	\$ 1,800
Less: Land Lease Payments	<u>-0-</u>	<u>-0-</u>
Net Income Before Debt Service	(\$5,000)	\$1,800
Supportable Debt	\$ -0-	\$8,000
Required Equity	27,100	24,900
Pre-Financing IRR	NM ¹	7.8%
Required Front-End Subsidy to Generate Acceptable Return on Investment	NM ¹	\$11-12,000

¹Not measurable.

As indicated, the Base Case still does not support any level of private investment since continuing cash flow deficits are generated by the operation.

Option 1 now generates some positive income such that \$8.0 million in debt financing is supportable. However, the rate of return on invested capital is below acceptable levels, and a front-end subsidy of \$11-12 million still would be required to generate acceptable returns.

Section XI

ECONOMIC AND FISCAL IMPACTS

In this section, the economic and fiscal impact of the Queen Mary complex on the City of Long Beach is discussed. The economic and fiscal impact has been determined for the operations of an entertainment center on the ship (Option 1), an entertainment center with a card club (Option 2), and under current operating conditions. Economic impact has been measured in terms of direct and indirect impact, and jobs created. The analysis is based upon the alternative development programs and operating assumptions developed by ERA coupled with ratios of taxes and economic conversion tables developed by KRM to generate direct and indirect economic and fiscal revenue impacts.

TOTAL ECONOMIC IMPACT

Analysis Assumptions

Estimation of total economic impacts takes into account various inter-industry relationships and the impact of re-spending of direct economic impacts on total output, earnings and employment. The method used to determine such impacts is based on an input-output model which traces the impact of a dollar in direct spending multiplied, or total output, earnings, and employment (i.e. a dollar of direct output in any industry will be spent for wages and salaries, equipment and services, etc., which will result in subsequent rounds of spending by the recipients of these monies which will produce further rounds of spending in the economy). The sum of all the recycling of expenditures is commonly referred to as indirect economic impacts. Indirect economic activity was estimated by the Southern California Planning Model (SCPM) and was utilized to derive estimates of selected indirect fiscal impacts. Other analysis assumptions are shown in the Appendix.

Analysis Results

The summary of estimated total economic impacts of the Queen Mary complex is shown in Table XI-1. The economic impact is shown on a stable year basis. As indicated, the direct spending generated by Queen Mary operations generates substantial total economic impacts under all three scenarios. Total expenditure impact is estimated at some \$50 million per year under current operating conditions, \$41 million per year under the entertainment center operating option (Option 1), and over \$62 million per year under the entertainment center with card club option (Option 2). While operating under current conditions is clearly unprofitable, the level of expenditures which the ship generates, nevertheless, produces a substantial economic impact.

The Queen Mary complex also generates a high level of employment under all three operating options. Direct and indirect employment generated by the complex is estimated at some 1,100 jobs under the current operations scenario, approximately 600 jobs with the entertainment center option (Option 1), and some 840 jobs were the ship to be operated as an entertainment center with a card club (Option 2). It should be pointed out that the jobs shown under current operations include part time and seasonal jobs. The total employment impact is thus not totally comparable to Options 1 and 2 (the employment impact in Options 1 and 2 are full time employee equivalents).

FISCAL REVENUE IMPACTS

Analysis Assumptions

The revenue impacts to the City of Long Beach will be offset to some extent by costs of municipal services associated with the project. No allowance for costs has been estimated for this analysis.

The development and operation of Queen Mary will result in substantial revenues to local agencies. The vast majority of all impacts fall into four categories:

1. Hotel taxes (transient occupancy taxes) on hotel business generated by Queen Mary visitors.
2. Sales taxes on guest expenditures for food, beverage and merchandise sold in the entertainment center, hotels and retail facilities.

3. Property taxes generated by the new construction.
4. Utility taxes and license fees collected by the City on power, water, telephone and other utility user charges, and business license fees.

The analysis excludes a variety of other fees and taxes that would generate additional revenue to the City, and assumes that other one-time fees (for example, various building permit and inspection fees), City enterprise activities and other development fees either are not impacted directly by the project or are revenue neutral (revenues offset by additional municipal costs). The analysis excludes consideration of potential revenue from possible taxes such as a gaming tax on card club revenues. Other cities in Southern California with card club facilities have gaming taxes at rates ranging from 7 percent to 14 percent of defined gross revenues.

Other Technical Assumptions

Except where explicitly noted, all dollar figures presented in this section are stated in 1992 dollars (i.e. assuming no inflation). Numbers referenced as "adjusted for inflation" assume a 4% annual rate of inflation. The analysis assumes that existing tax policies and rates will continue for the indefinite future.

Operating assumptions and detailed projections at 0 percent and 4 percent inflation, respectively, are in the Appendix.

Sources of Impact

The analysis distinguishes between fiscal revenue impacts according to the source of investment or spending which generates the impact, as follows:

1. Direct Impacts - Revenue impacts generated directly from the investment or from guest spending at Queen Mary facilities.
2. Induced Impacts - Revenue impacts resulting from expenditures generated by Queen Mary visitors in local hotel and retail establishments.
 - a. For both alternative options, KRM estimated annual demand of 40,000 hotel room-nights by non-local Queen Mary visitors based on ERA's data.

- b. Daily spending was estimated at \$80 per occupied room-night and \$40 for additional local retail expenditures.
 - c. For the Base Case, hotel demand was assumed to be absorbed by the Queen Mary Hotel.
 - d. Induced retail demand was estimated at \$10 per room-night in other Long Beach retail establishments.
3. Indirect Impacts - Multiplied impacts on fiscal revenues from recycling of expenditures in the City of Long Beach.

Analysis Results

Based on the above assumptions, the fiscal impact of the three operating scenarios analyzed for the Queen Mary is shown in the text table below.

	<u>Base Case</u> <u>"As Is"</u>	<u>Option 1</u> <u>Entertainment</u> <u>Only</u>	<u>Option 2</u> <u>Entertainment</u> <u>Only</u>
Fiscal Impacts (millions)			
Direct Revenues from Queen Mary	\$1.00	\$.48	\$.51
Induced Revenues in Long Beach	.01	.31	.31
Indirect Revenues	<u>.05</u>	<u>.04</u>	<u>.06</u>
Total	\$1.06	\$.84	\$.88

As indicated, even though operations under current conditions are unprofitable, its top line revenue generation produces the highest fiscal impact of the three alternative operating scenarios. Fiscal impact for this option is roughly \$1 million per year. The entertainment center with the card club generates the second highest fiscal impact at about \$900,000 per year. Finally, the smallest operation from a gross revenue standpoint, the entertainment center, produces an annual fiscal impact of some \$800,000.

Cumulative Impact on Fiscal Revenue

Over a 30-year period, the alternative Queen Mary use options will generate \$27-29 million in fiscal revenue to the City of Long Beach, slightly less than the current use

due to the impact of elimination of the Queen Mary Hotel. Assuming 4% inflation, total fiscal revenue ranges from \$44-\$47 million. The present value of 30-year fiscal revenues ranges from \$11.1-\$11.9 million for the two optional use configurations, compared to \$14.3 million estimated for the current Base Case use.

	<u>Millions</u>		
	<u>Base Case</u> <u>"As Is"</u>	<u>Option 1</u> <u>Entertainment</u> <u>Only</u>	<u>Option 2</u> <u>Entertainment</u> <u>Only</u>
Annual Fiscal Revenue (1992\$)	\$ 1.0	\$.83	\$.88
30-year Total	32.0	27.2	28.8
30-year Inflated Total ^{1/}	56.8	44.0	47.0
Net Present Value at 9%	14.3	11.1	11.9

1/ At 4% annual inflation.

Table XI-1

**ECONOMIC IMPACT IN LONG BEACH
(Stabilized Year—1992\$)**

	<u>Base Case "As Is"¹</u>	<u>Option 1 Entertainment Only</u>	<u>Option 2 Entertainment and Card Club</u>
<u>Expenditure Impacts (millions)</u>			
Direct Spending at Queen Mary	\$39.6	\$29.4	\$46.9
Induced Spending in Long Beach	1.0	4.4	4.4
Indirect Economic Activity	<u>9.5</u>	<u>7.4</u>	<u>11.3</u>
Total	\$50.1	\$41.2	\$62.6
<u>Employment Impacts</u>			
Direct Jobs at Queen Mary	985 ²	403	603
Induced Jobs in Long Beach	25	115	115
Indirect Jobs	<u>104</u>	<u>80</u>	<u>123</u>
Total	1,114	598	841

¹Base Case includes Londontown impacts which are excluded from other options.

²Direct jobs are as reported by Walt Disney Company and include parttime and seasonal employees.

Source: Kotin, Regan & Mouchly.



Los Angeles
San Francisco
San Diego
Chicago
Boston
Washington, D.C.
Fort Lauderdale

**ANALYSIS OF QUEEN MARY/
SPRUCE GOOSE COMPLEX**

**PREPARED FOR THE
PORT OF LONG BEACH
AND
CITY OF LONG BEACH**

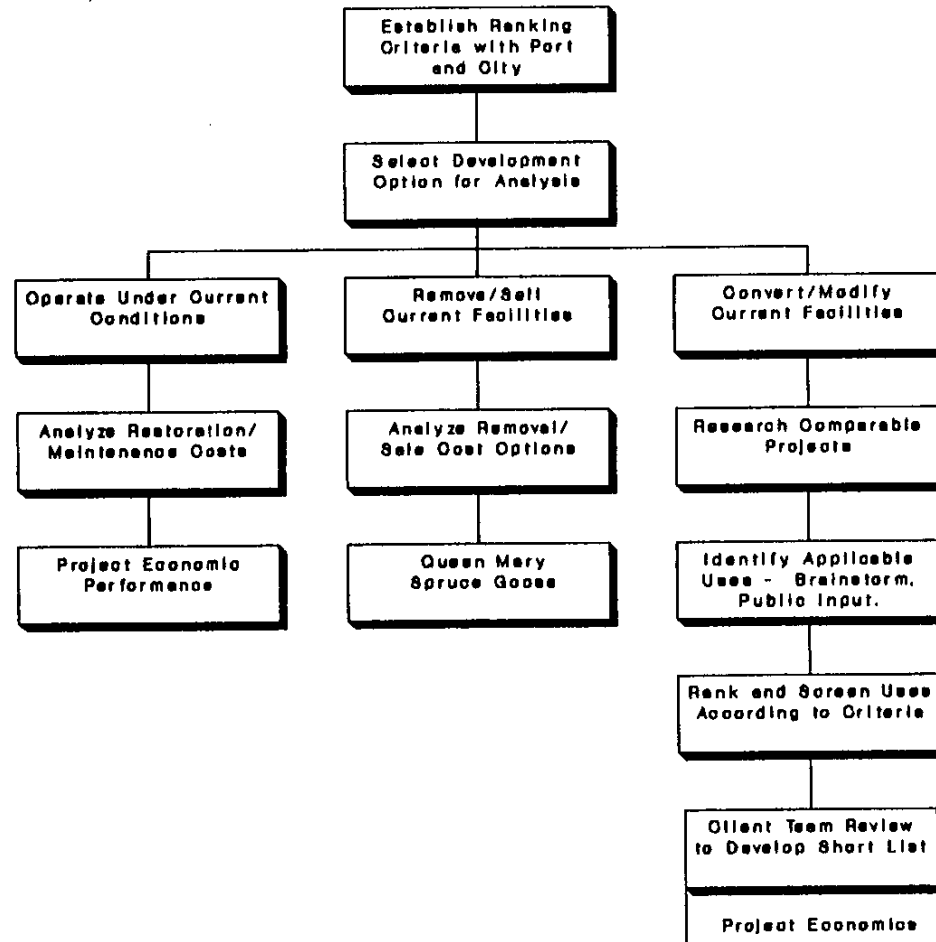
**PREPARED BY
ECONOMICS RESEARCH ASSOCIATES
IN ASSOCIATION WITH
KOTIN, REGAN & MOUCHLY**

JUNE 1992

ERA PROJECT NO. 10518

10990 Wilshire Boulevard, Suite 1600, Los Angeles, California 90024
(310) 477-9585 Telex: 857661 (ECON RES LA) Fax: (310) 478-1950

METHODOLOGY



Source: Economics Research Associates

Screening Criteria

1. Physical Compatibility with the Space Available on the Ship/in the Dome
2. Market Demand for the Use
3. Operating Income Potential
4. Revenue Potential to the City/Port
5. Development Cost and Space Modifications Requirement
6. Compliance with State Tidelands and Other Regulatory Guidelines
7. Overall Rating by Consultant Team
8. Public Acceptance of the Use

—
Source: Economics Research Associates

Short List

1. An entertainment center combining restaurants, retail, and themed entertainment venues
2. A card club/casino
3. A timeshare development
4. A Maritime Museum combined with an aquarium onshore
5. Base Case -- operate under current conditions (assuming the hotel is open and the Spruce Goose stays)
6. Partial Use -- mothball the lower decks and retain a limited tour, restaurants, and retail, on the Promenade, Sun, and Sports decks
7. Mothball -- mothball the entire ship but retain it as an icon
8. Disposition -- dispose of the ship by sinking, selling, or scrapping.

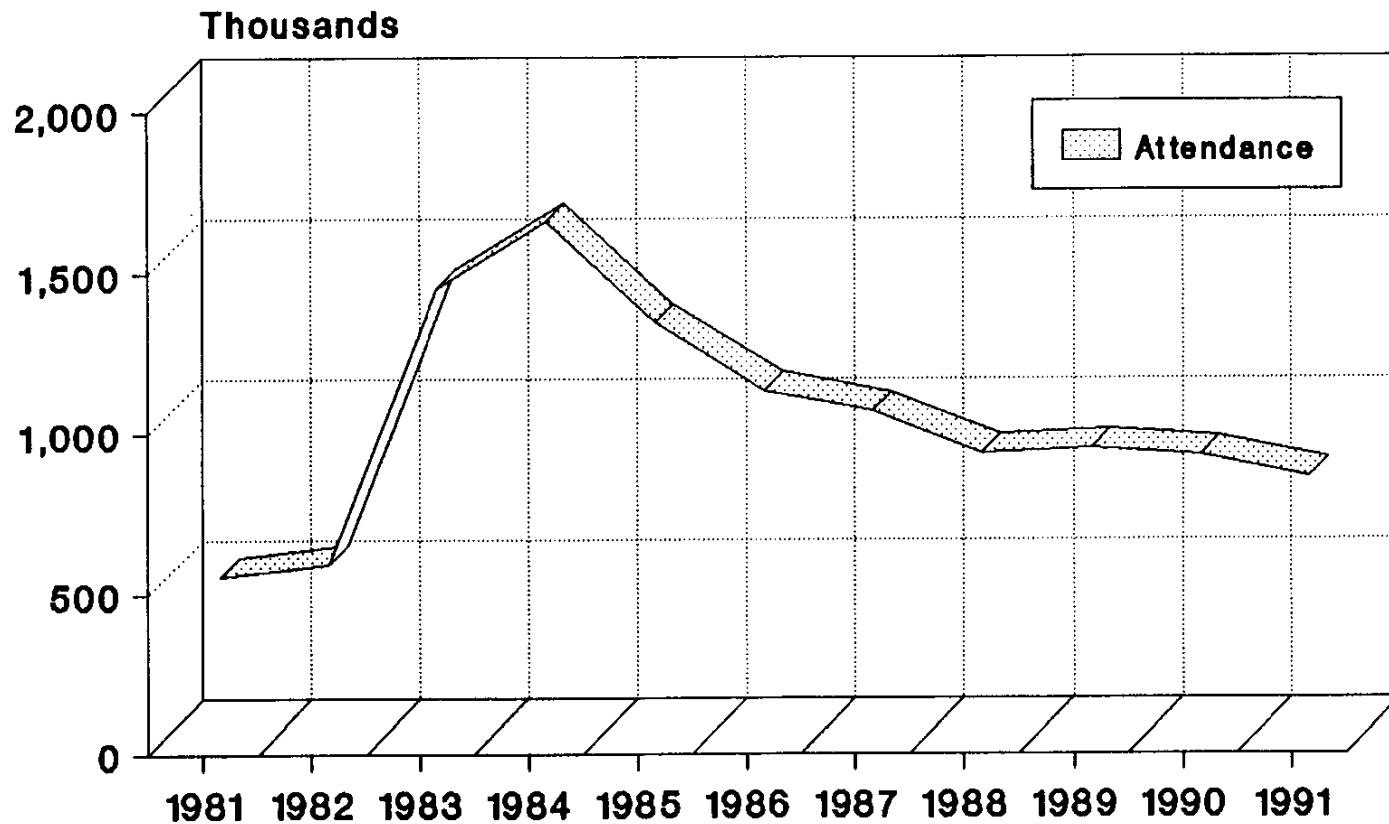
Source: Economics Research Associates

Short List

1. Entertainment Center	Infeasible
2. Entertainment Center/ Card Club	Feasible
3. Timeshare Development	Infeasible
4. Maritime Museum/Aquarium	Infeasible
5. Base Case	Infeasible
6. Partial Use	Infeasible
7. Mothball	Feasible
8. Disposition	Feasible

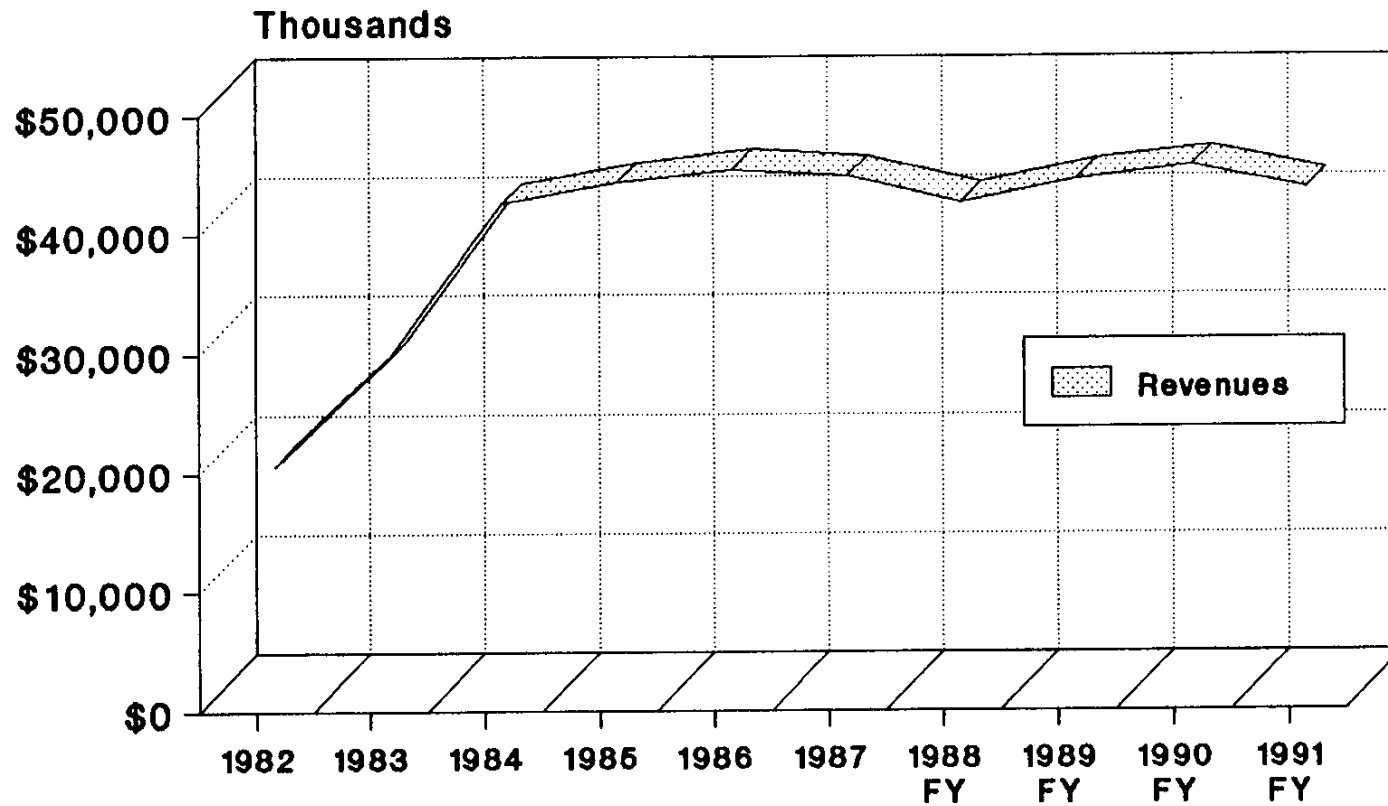
Source: Economics Research Associates

Queen Mary/Spruce Goose Historical Attendance



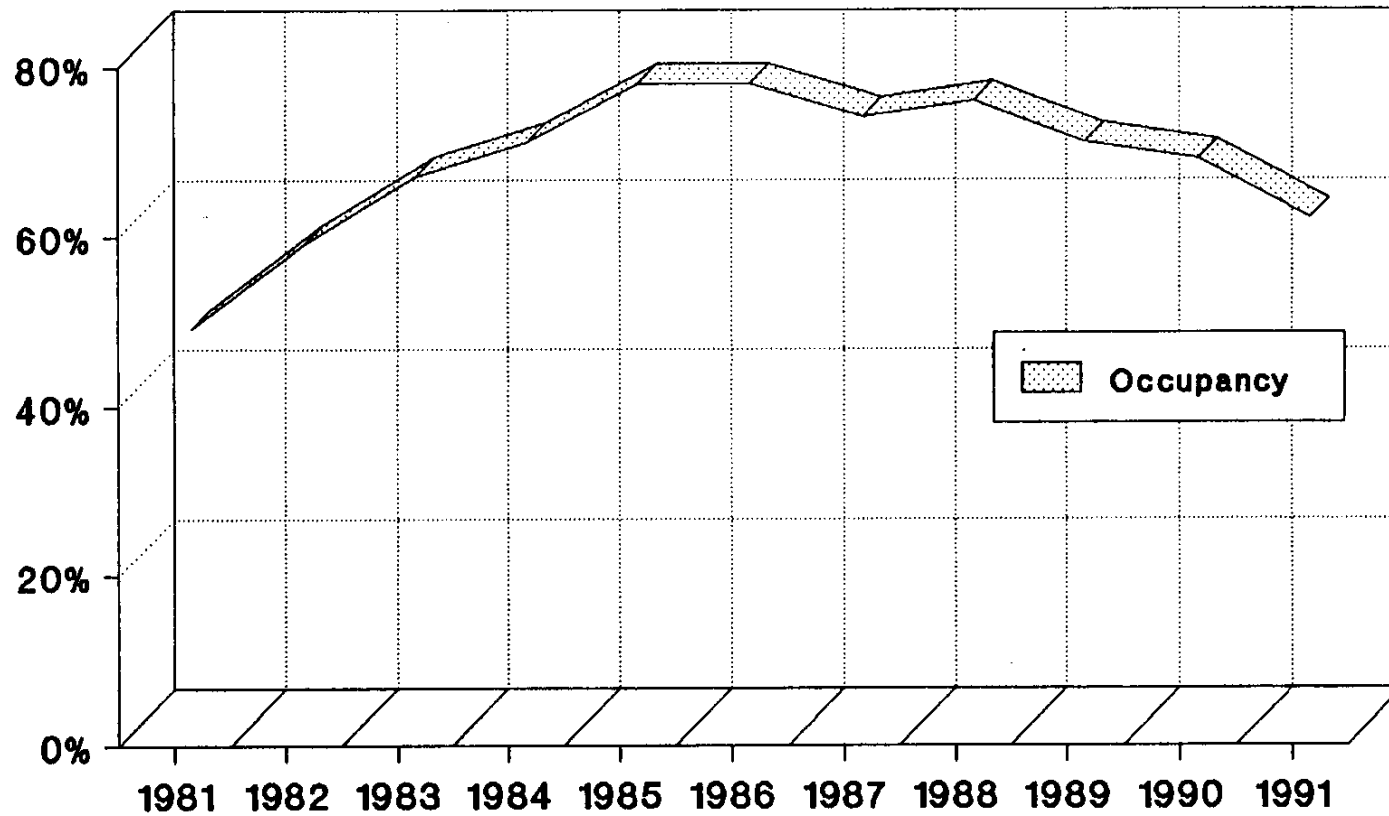
Source: Walt Disney Company,
Port of Long Beach & ERA

Queen Mary/Spruce Goose Historical Revenues



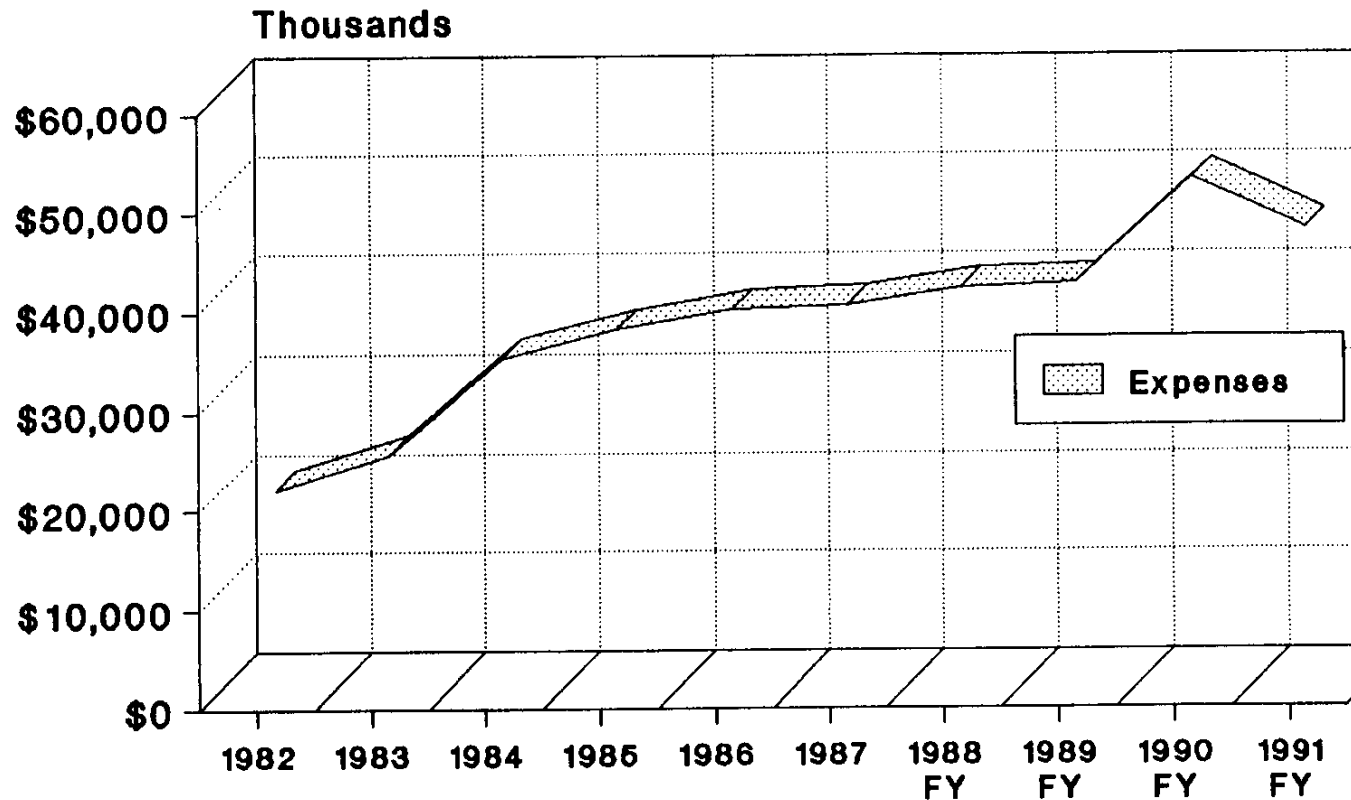
Source: Walt Disney Company,
Port of Long Beach & ERA

Queen Mary Historical Occupancy



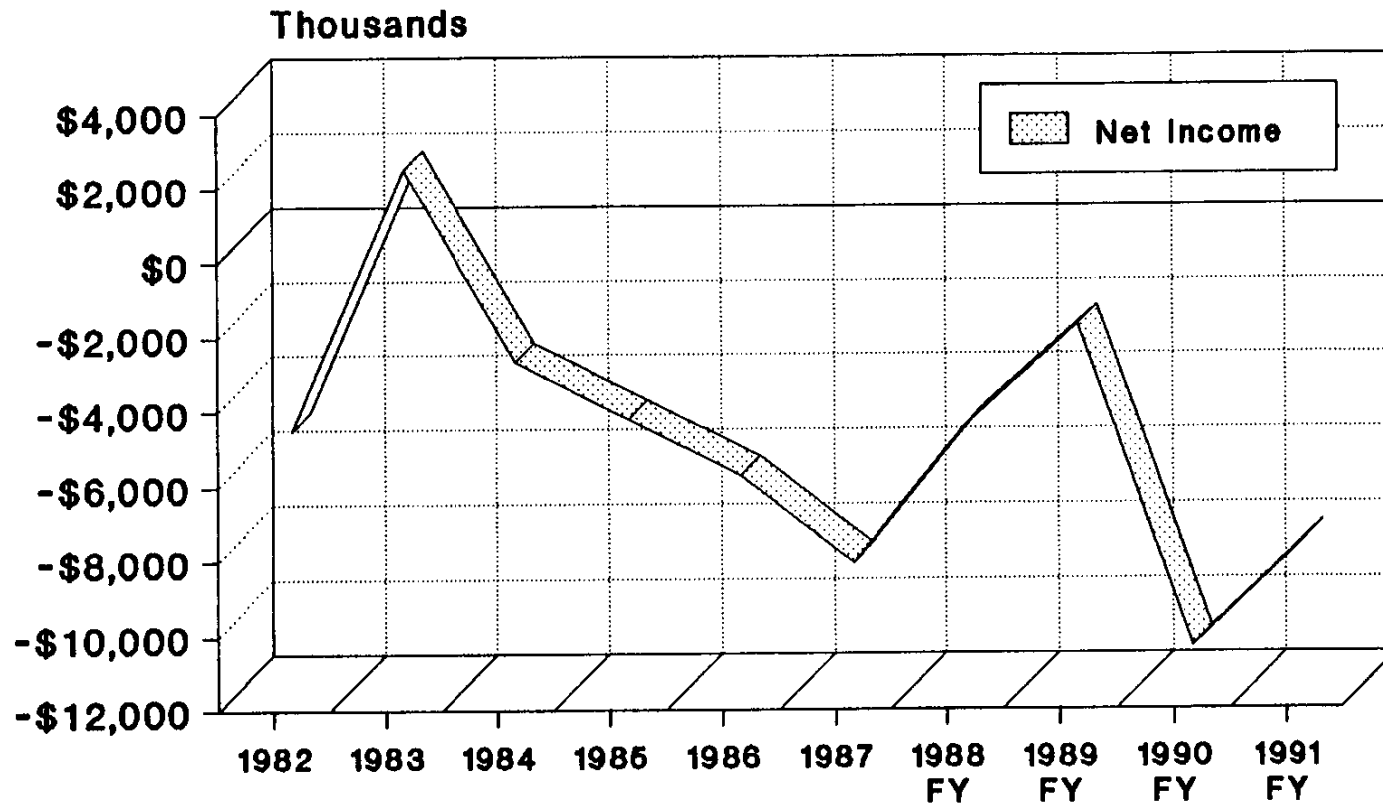
Source: Walt Disney Company, Pannell
Kerr Forster, Port of Long Beach, & ERA

Queen Mary/Spruce Goose Historical Operating Expenses



Source: Walt Disney Company,
Port of Long Beach & ERA

Queen Mary/Spruce Goose Historical Net Operating Income

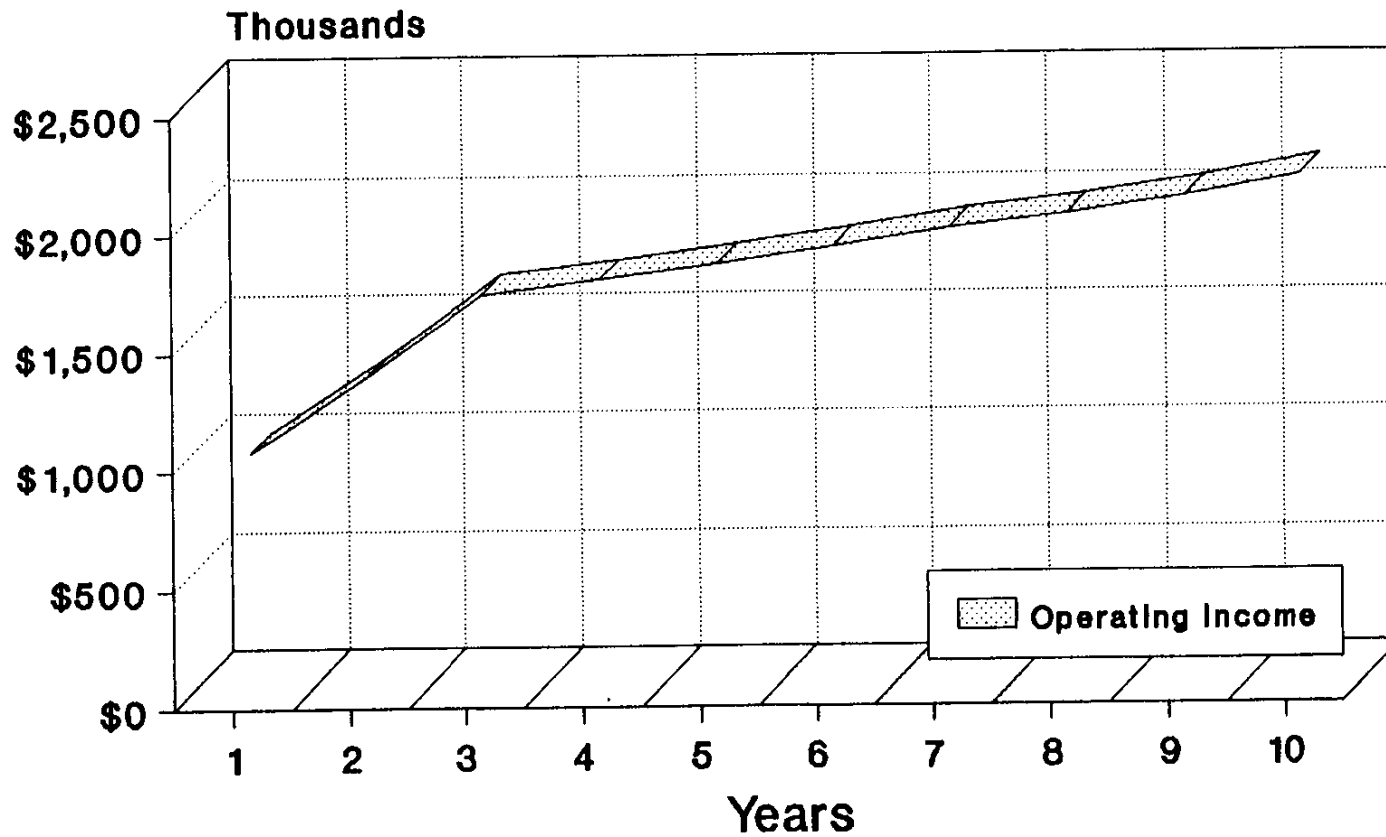


Source: Walt Disney Company,
Port of Long Beach & ERA

OPTION 1 - ENTERTAINMENT CENTER

Projected Income

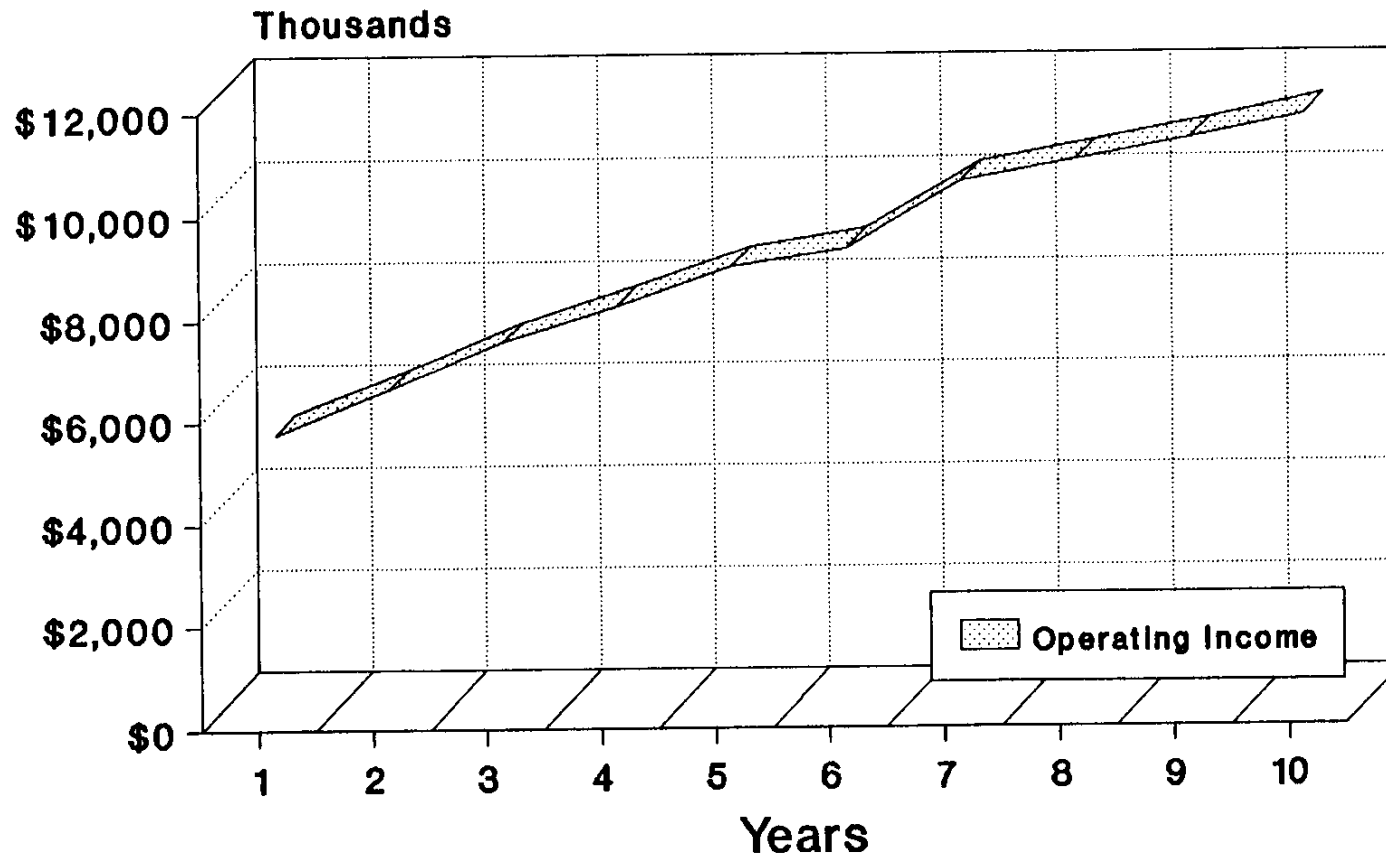
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Source: Economics Research Associates

OPTION 2 - ENT. CENTER / CARD CLUB

Projected Income (000)

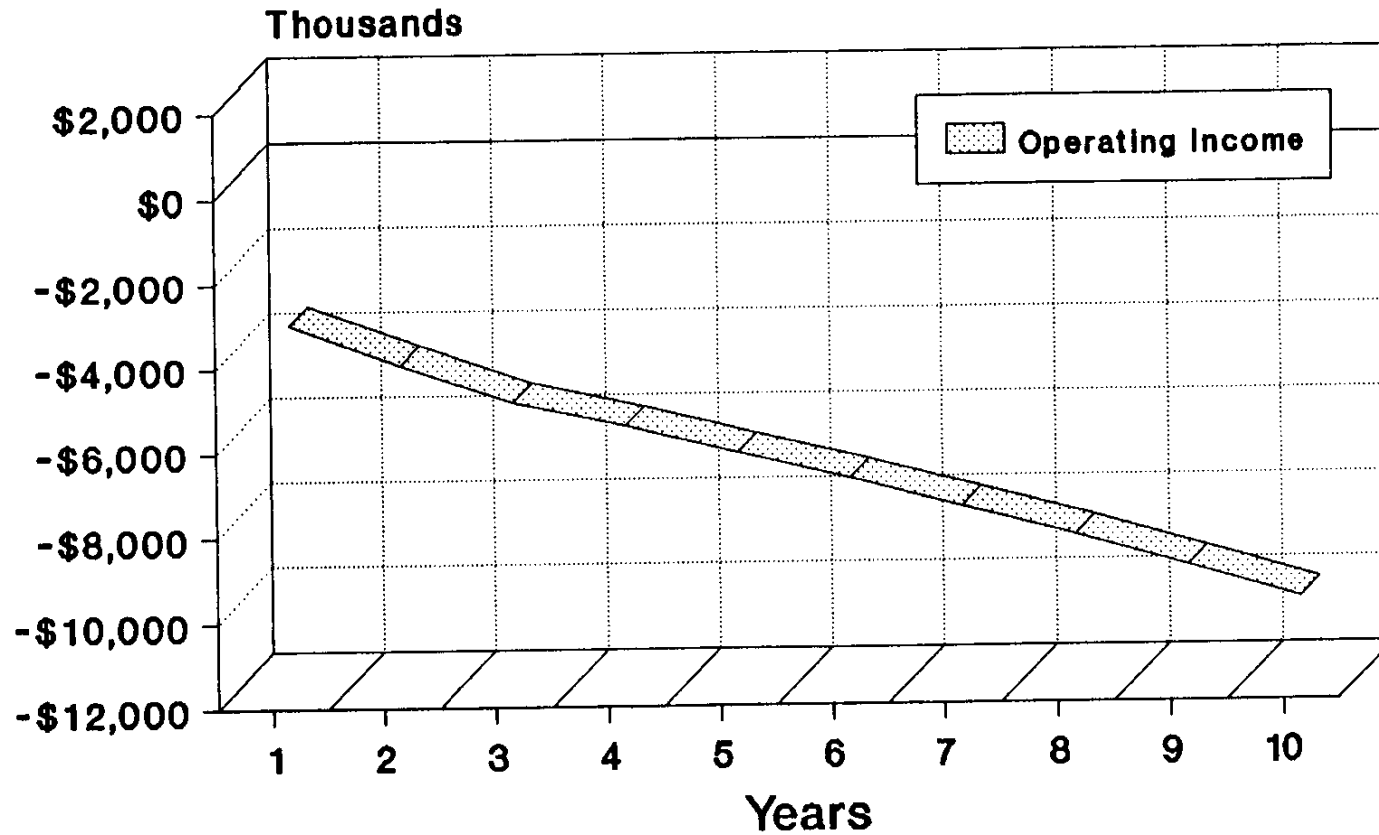


Source: Economics Research Associates

OPTION 5 - CURRENT OPERATIONS

Projected Income

(000)

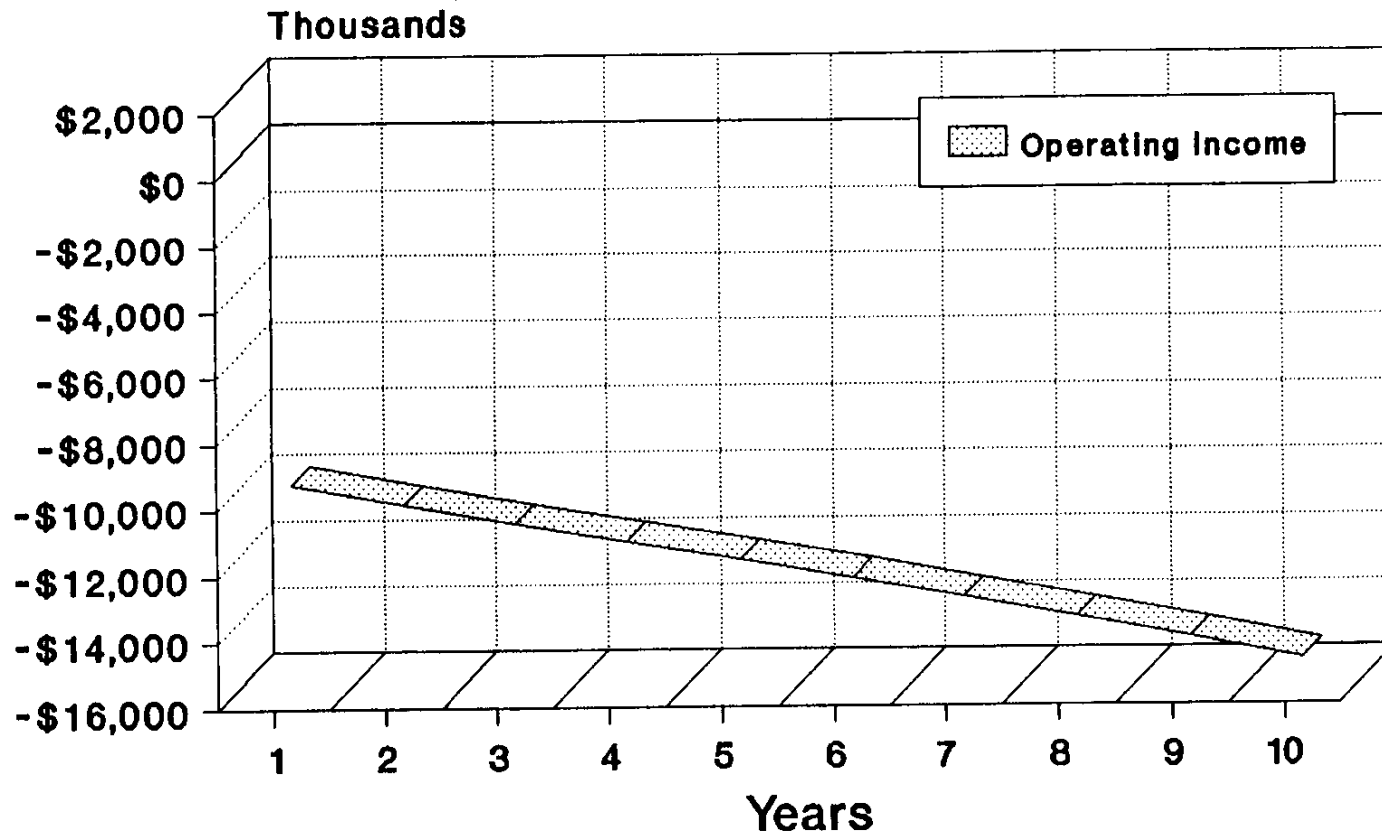


Source: Economics Research Associates

OPTION 6 - PARTIAL OPERATIONS

Projected Income

(000)



Source: Economics Research Associates

Stabilized Pro Forma 1992\$ (in 000's)

	<u>Option 1</u>	<u>Option 2</u>
N.O.I. - 1996	\$ 1,800	\$ 7,100
Less: Land Lease Pmts	<u>\$ 2,300</u>	<u>\$ 2,300</u>
Net Inc. Before Debt	(\$ 500)	\$ 4,800
Supportable Debt	\$ -0-	\$22,000
Required Equity	\$32,900	\$11,000
Pre-Financing IRR	(3.2%)	(21.3%)
Required Front-End to Generate ROI	\$23K to \$24K	N.M.

—
Source: ERA & KRM

Non Operating / Disposition Options

OPTIONS

COSTS

1. Mothball	- \$1.4 million
2. Sink	- \$5.0 million
3. Scrap	- \$8.0 million
4. Sell	- \$4.0 million

Source: Economics Research Associates

Stabilized Pro Forma 1992\$

(in 000's)

	<u>Base Case "As Is"</u>
Net Operating Income - 1996	(\$ 5,000)
Less: Land Lease Payments	<u>\$ 2,300</u>
Net Income Before Debt Service	(\$ 7,300)
Supportable Debt	\$ -0-
Required Equity	\$27,000
Pre-Financing IRR	Not Measurable
Required Front-End Subsidy to Generate Return on Investment	Not Measurable

Source: ERA & KRM

Economic Impact in Long Beach

(Stabilized Year - 1992\$)

Base Case "As Is"

EXPENDITURE IMPACTS (000's)

- Direct Spending @ Queen Mary	\$39,600
- Induced Spending in L.B.	\$ 1,000
- Indirect Economic Activity	<u>\$ 9,500</u>
Total	\$50,100

EMPLOYMENT IMPACTS

- Direct Jobs at Queen Mary	985
- Induced Jobs in L.B.	25
- Indirect Jobs	<u>104</u>
Total	1,114

Fiscal Impact in Long Beach

(Stabilized Year - 1992\$)

Base Case "As Is"

FISCAL IMPACTS (000'S)

- Direct Revenues from Queen Mary	\$ 1,000
- Induced Revenues in L.B.	\$ 10
- Indirect Reveues	<u>\$ 50</u>
Total	\$ 1,060

Source: ERA & KRM

Economic Impact in Long Beach

(Stabilized Year - 1992\$)

	<u>Option 1</u>	<u>Option 2</u>
EXP IMPACTS (000'S)		
- Direct Spending	\$29,400	\$46,800
- Induced Spending	\$ 4,400	\$ 4,400
- Indirect Activity	<u>\$ 7,400</u>	<u>\$11,300</u>
Total	\$41,200	\$62,500
 EMPLOYMENT IMPACTS		
- Direct Jobs	403	603
- Induced Jobs	115	115
- Indirect Jobs	<u>80</u>	<u>123</u>
Total	598	841

Source: ERA & KRM

Economic Impacts in Long Beach

(Stabilized Year - 1992\$)

	<u>Option 1</u>	<u>Option 2</u>
FIS. IMPACTS (000's)		
- Direct Revenues	\$ 480	\$ 510
- Induced Revenues	\$ 310	\$ 310
- Indirect Revenues	<u>\$ 40</u>	<u>\$ 60</u>
Total	\$ 830	\$ 880

Source: ERA & KRM

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