

Historic Leasing in the National Park System: Assessing Challenges and Building on Successes

Bob Kempkes
Chief Executive Member
Quapaw Baths, LLC

Chairman Bishop,

Thank you for bringing Washington D.C. to Hot Springs, AR. My name is Bob Kempkes and I am an architect by trade and also a partner in Quapaw Baths, LLC. As the name implies our group leases and operates the Quapaw Bathhouse in Hot Springs National Park. The Quapaw was the first leased bathhouse to reopen to the public. During that leasing process and subsequent business operation we learned a great deal and hope our testimony today can help other entrepreneurs around the country to invest in our National Parks and the communities they inhabit.

In May 2005 our group, Quapaw Baths, LLC, submitted a Proposal to the National Park Service to lease the Quapaw Bathhouse in Hot Springs National Park, AR. Our goal was to provide low cost access to the Hot Springs thermal water to individuals and groups in a modern facility in a National Landmark Building. Our Proposal was accepted at the Regional Level of the NPS and we began due diligence which included securing the necessary financing and reviewing the sample lease for any items requiring negotiation.

One of the major challenges with leasing from the NPS is that they retain ownership of the improvements to the building leaving a lender with minimal collateral which when coupled with an unproven, start-up business significantly increases the risk exposure. The required project equity can also be challenging but the NPS was able to work with us to provide a long-term lease of fifty-five years that allowed us to take advantage of the Federal Historic Rehabilitation Tax Credits which at the time were twenty-five percent of the qualified rehabilitation expenses. These tax credits were syndicated to an investment group which provided capital to meet the equity requirement of the financing package. The NPS was also able to receive permission to provide the lender and investor an estoppel agreement which in case of default by the borrower would allow them, with NPS approval, to bring in a new operator.

One of the big unknowns when we were talking to lenders was determining the value of the lease. Since no one had leased a Bathhouse and because the lease rate had not been determined it was difficult to assign a value to the lease for appraisal purposes. Eventually the NPS determined that the fair market (in 2007) rent should be \$9.50 per square foot per year. Noting that the lessee was making a considerable investment in the Bathhouse it was determined that the rent would be \$1.00 per square foot per year. The difference between fair market rent and the NPS rent gave the lease a value and provided us with a reasonable annual

rate of return of approximately 7.5% on our overall investment of \$2.5 million dollars. Another NPS incentive for the developer was the construction term rent of \$1.00 per year for 3 years. This allowed us to get the building renovated and open for business while operating essentially rent free. This enabled us to get the business stabilized faster and provided an additional level of comfort for the lender.

After working through the financing challenges, we executed a lease with the NPS in April of 2007 during the NPS celebration of the 175 year anniversary of the Hot Springs Reservation.

One of the major advantages of the leasing program for the NPS are the maintenance requirements in the lease. The lessee is required to fund a maintenance reserve account with 2% of the gross revenues. This fund has no cap and if the lessee leaves the fund balance becomes the property of the NPS. The NPS must approve any expenditures from the account. A Reserve Account is a typical requirement by a lender but being held by the Lessor it provides the NPS with the ability to stay proactive on the condition of its building. Major maintenance items are typically things that occur every 5 years or longer. We received a grace period to start depositing to the fund of 2 years of business operation which was another aid to the business start-up. Since 2010 we have spent approximately \$200,000 on major maintenance items and maintain a six figure balance in the fund. We are also required to perform routine maintenance, which includes painting the exterior of the building on a 5 year schedule, as defined in our Preservation Maintenance Plan and as noted in any NPS inspections. This plan includes correcting any deficiencies in accordance with the Secretary of Interiors Standard for Rehabilitation which ensures proper preservation of an historic structure. We have spent over \$170,000 on routine maintenance since opening the business. As the lessee we have never had any issues with the NPS over routine or major maintenance issues. We both understand our responsibilities in caring for a public treasure and take that very seriously.

Quapaw Baths and Spa employs 46 team members with an annual payroll of \$1.4 million. We are currently in the eleventh year of our lease and are extremely satisfied with our working relationship with the NPS. Our interaction has always been more like a working partnership than the standard Landlord – Tenant agreement we are involved with on the private side of Central Ave. The NPS' efforts to lease, renovate and bring back to life the long vacant bathhouses has been a catalyst for increased downtown tourism as well as a source of pride for our community and our visitors.