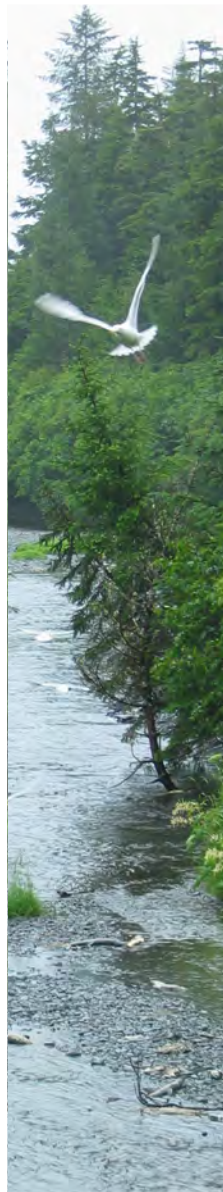


CHENEGA BAY

LODGING PROJECT

Feasibility Study and Business Plan

December 2007



A plan developed by Chenega Heritage, Inc. with assistance from Agnew::Beck Consulting. This plan was produced in part with Mini-Grant Assistance funds made available through the Department of Commerce, Community and Economic Development and the Denali Commission.



INTRODUCTION

Purpose of this Report

The community of Chenega Bay is considering developing a Bed & Breakfast or another form of lodging in their community. This report reviews lodging alternatives, and then evaluates the feasibility of the particular style and scale of lodging identified as most feasible and beneficial for Chenega Bay. Considerations in this evaluation include the character of attractions in the area, access to Chenega Bay, expected demand for lodging by business and tourist travelers, construction costs, and operation costs and revenues. The option that is most feasible is the one that can best serve the needs of the marketplace while also fitting well with community goals. In addition to generating sufficient revenue to cover costs and eventually make a profit, these community goals include compatibility with Chenega Bay life, and creating local jobs and business opportunities for residents and shareholders



Summary of Conclusions

Market Opportunity

Chenega Bay's Prince William Sound location creates a compelling opportunity to develop lodging and related visitor services. The community is far enough from established tourist destinations to offer a "wild Alaska" character, and offers ready access to great fishing, scenery, kayaking, wildlife viewing, glaciers, hiking, and other sought-after experiences. At the same time, Chenega is close enough to Anchorage and the rest of Southcentral Alaska to be readily accessible, by air, private boat, and the Alaska Marine Highway system. In addition, there are few competing lodging operations in the whole of Prince William Sound. Areas like Kachemak Bay already support several dozen successful waterfront lodging operations, suggesting that demand would be strong if comparable facilities were available in Prince William Sound. This set of characteristics suggests there is real demand for lodging in the Chenega Bay area, and the likelihood this demand will grow over time.

A Conditional Conclusion – "Feasible If..."

At present, Chenega does not have lodging for travelers, other than a few rooms available for rent on an unpredictable basis, or for certain service providers. The conclusion of this report is that a lodging operation would be feasible after 5 years of operation *if* the full set of conditions outlined below can be met, and *if* "feasible" is defined consistent with community goals, that is, the project will create local economic opportunities and cover operating costs, but not be judged strictly as a for-profit business venture. While achievable, these are both big "ifs". Ultimately the lodge project needs to be seen as the tip of the iceberg – just one part of an integrated program of

capital investment, training, facility improvements, “beautification”, marketing, upgrades to utilities, and business formation – in short, a series of big, but positive, changes in Chenega.

Project Goals: Criteria for Evaluating Success

Defining how to judge the “feasibility” of this project is a key first step in this process. In reaching a conclusion about the most viable lodging option for Chenega Bay village we have used the set of goals that emerged from discussions with Chenega community residents and Chenega staff. These are outlined below. The overriding theme of these goals is the recognition that success requires more than maximizing profit; success requires a lodging project that can be supported and sustained over the long term, both in terms of financial performance *and* community support. Specific project goals include:

- Create jobs and business opportunities in Chenega Bay for local residents and Chenega Corporation shareholders; create opportunities for residents to gain business skills and experience
- Attract more full time residents to Chenega Bay, to help create a stronger, more vital community.
- Plan the lodging project to be a good neighbor to Chenega Bay resident and a project that is widely seen as a positive addition to community life.
- Plan the lodging project and associated tourism development to protect environmental quality and subsistence activities.
- Develop lodging and tourism development plans in consultation with community residents

While maximizing the “bottom line” is clearly one important goal, equally important is an approach that creates maximum local benefits and minimum disruption in the community. This consideration tempers the scale and rate of the growth of the facility. For example, as is discussed in Chapter 4, as the size of the lodging operation grows, operations costs are spread over a broader revenue base, and the facility becomes more profitable. But the recommended option (Option 1) already will bring 1200 plus visitors per summer to the community, and require 2-3 new sport fishing charter operations to serve these visitors. That scale of development is judged to be as much as can occur without going against the third goal above. If the lodge sponsors only seek a maximum return on their investment, there are certainly options with greater prospects for profit and less risk than investing in lodging in Chenega Bay.

Recommended Approach

The lodging option that best meets project goals would be a set of one and two bedroom cabins. Option One, described below, has capacity to serve 14-24 guests; a manager’s cabin that also serves as a dining facility; and a design and site that allows this operation to expand over time. This approach would let the facility serve the existing business traveler market and begin to build capacity to serve travelers interested in fishing, wildlife viewing and other local recreational opportunities. The details of Option One are outlined below:

- 3 one-bedroom cabins, approximately 484 square feet, with limited kitchen facilities, bathroom, a living room with a fold out couch – sleeps 2 to 4 people

- 2 two-bedroom cabins, approximately 560 square feet, with a kitchen, bathroom, a living room with a fold out couch - sleeps 4 to 6 people
- 1 bedroom manager's cabin, with full kitchen, dining area for up to 14 people, laundry room, tool and equipment room

A second alternative is also identified. Option Two has three cabins, without a manager's cabin, with only limited food service, and with less staffing, marketing and other expenses. This latter alternative costs less to construct and operate, and produces more revenue for the investment, but generates fewer economic opportunities for the community. The community, Chenega Heritage and Chenega Corporation need to weigh these alternatives, and decide which comes closest to meeting their goals.

Neither of the two options return enough revenues to be feasible under traditional private sector investment criteria.

Conditions for Success

Successful development of Option One or Two will not be possible without meeting the challenges outlined below. Both options require improving local recreation offerings, selecting a great site, building the right kind of cabins, hiring the right manager, and all the other conditions specified below. This is particularly true with the more aggressive Option One, but ultimately most of these conditions are needed for Option Two to be viable.

One particularly important assumption is that the lodge operations will not be required to pay back 100% of the initial construction and start up costs. In Option 1 this cost is approximately \$1,000,000. The financial analysis presumes \$12,000 a year is plowed back into paying off this initial investment. This totals \$360,000 over thirty years, enough to cover a portion of start up costs. Option 2 assumes \$15,000 per year goes towards paying off the initial construction, producing \$450,000 in 30 years, which matches the start-up and construction costs of this more modest option. The analysis presumes at least a portion of the initial start-up costs will come from a source that does not need to be paid back through project operations.

Specific conditions for success are listed below; Chapter 4 gives more details.

- **Right site** – a superior site, with great views out over the water, the feel of a wilderness setting, easy access to community amenities, and the capacity to grow to a substantially larger facility.
- **Right character of facility** – cabins that are simple and not too costly to build, but at the same time provide a clean, comfortable, attractive place to stay.
- **Access to good food** – convenient, satisfying means for visitors to have a good breakfast, lunch and dinner, preferably including local seafood. The recommended lodging option recommends offering cabins with kitchens as well the option to purchase meals. A skilled cook is essential.
- **Right set of recreational activities** – the primary draw for the site will be sport fishing; secondary attractions will be kayaking, wildlife viewing, sightseeing, hiking, hunting and enjoyable ways to learn about Chenega village life, history and cultural traditions. At least 2 sport fishing charter operations as well as other activities – which are not available in the community today – need to be in place prior to opening the facility.

Over time, a key to success will be phased improvement of Chenega’s “development sites,” beginning with tent platforms or small cabins. Improvements and use of these sites can give Chenega a key competitive advantage over other waterfront lodging, fishing and kayaking destinations in Alaska.

- **Good marketing** – the right system of information to promote the facility, including a solid website and a prompt, reliable and professional system for making reservations and getting answers to questions about the facility and its attractions.
- **Right partnerships** – including linkages to Chenega Corporation hotels, and to other travel partners in larger communities, both for marketing and provision of activities.
- **Good management and staffing** – to ensure that the facility provides a consistently high quality of service, and to guide the ongoing operation of the facility. This may require working with a management entity from outside the community, and providing training to local staff.
- **Right financial incentives** – to be successful, this project will require the owner/operator put in long hours of work, at modest pay. The defining feature of successful tourism ventures is a highly motivated, very committed manager. Owners commonly work 7 days a week for an entire summer season, and are on call nearly 24 hours a day. Owners work this hard knowing that this effort will ultimately be rewarded – 5 or 10 years later – with a viable, valuable business. Given that the project will likely be owned and operated by different people, the compensation package will have to be structured to provide a comparable level of financial incentives.
- **Construction Costs** – As mentioned above, in the recommended alternative, the financial feasibility assessment assumes the lodge can cover operating expenses, and a portion of construction costs
- **Community Compatibility** – The overall set of facilities, users, access, demands on utilities, jobs created etc. must fit harmoniously with Chenega Bay community life.

Phased Development

Phased development of this facility is a good strategy for a number of reasons. At present, Chenega Bay is not an established tourism destination. While the area has many strengths the community’s attractions are not developed, nor is the area known to the traveling public. Starting at a modest level provides time for Chenega residents to gain the skills and experience needed to operate the businesses visitors expect. This may require multi-year training programs that parallel the planning and development of the lodge, including training in starting and operating fishing charters, kayak rentals and guide services, day wildlife and glacier tours, craft production and sales and other visitor-related businesses. This facility can create opportunities for local youth interested in learning guiding skills, business administration, and customer service skills. The size of the facility can expand as these capabilities grow.

In addition to the need to develop activities based in the village, another unique potential draw is Chenega Corporation’s set of development parcels, located in strategic areas around southwest Prince William Sound. These parcels could be used as sites for cabins or tent platforms, and serve as destinations for guided or independent activities such as “hut to hut” kayaking, fishing and hunting, all tied to the hub lodging facility in Chenega Bay.

Phased development also allows the facility time to establish itself without saddling the developing entity with huge, risky up-front costs, and allows time for the community to adjust to a visitor presence. Ultimately the community benefits of developing a lodging operation are substantial, but these benefits must also be balanced against the community's desires to maintain the peaceful character of their community. A phased approach allows time to find this balance.

Financial Performance and Sensitivity Analysis

The financial performance of the two alternatives is summarized below in Table 1. As noted above, neither option generates the level of profit necessary to support a typical private investment.

It should be noted that the financial assumptions behind this analysis are conservative. A bolder and more aggressive approach could readily show this project generating larger profits. We have aimed to be cautious and to err on the side of conservative estimates of revenues, and generous estimates of project costs.

Table 1. Financial Performance of Options

OPTION 1 - 5 CABINS, MANAGER'S CABIN, FOOD SERVICE					
	year 1	year 2	year 3	year 4	year 5
Total Staff Costs	\$ 65,350	\$ 65,350	\$ 65,350	\$ 65,350	\$ 65,350
Total Non-Staff Costs	\$ 30,048	\$ 25,048	\$ 25,048	\$ 25,048	\$ 25,048
Payoff Construction Costs	\$ 12,000	\$ 12,000	\$ 12,000	\$ 12,000	\$ 12,000
TOTAL OPERATIONS COSTS	\$ 107,398	\$ 102,398	\$ 102,398	\$ 102,398	\$ 102,398
Revenues					
Summer	\$ 59,413	\$ 65,354	\$ 71,295	\$ 77,236	\$ 83,178
Non-Summer	\$ 11,139	\$ 11,139	\$ 22,278	\$ 22,278	\$ 22,278
TOTAL REVENUES	\$ 70,551	\$ 76,493	\$ 93,573	\$ 99,514	\$ 105,455
NET REVENUES (LOSS)	\$ (36,847)	\$ (25,905)	\$ (8,825)	\$ (2,884)	\$ 3,057
Total visitors (year round)	1,090	1,176	1,495	1,580	1,666
Money to cover start up operations	\$ 71,404				
Construction cost (6 cabins)	\$ 995,500				
OPTION 2 - BASIC OPERATION: 3 CABINS, LIMITED FOOD, LIMITED SERVICE					
	year 1	year 2	year 3	year 4	year 5
Total Staff Costs	\$ 26,990	\$ 26,990	\$ 26,990	\$ 26,990	\$ 26,990
Total Non-Staff Costs	\$ 13,129	\$ 12,129	\$ 12,129	\$ 12,129	\$ 12,129
Payoff Construction Costs	\$ 15,000	\$ 15,000	\$ 15,000	\$ 15,000	\$ 15,000
TOTAL OPERATIONS COSTS	\$ 55,119	\$ 54,119	\$ 54,119	\$ 54,119	\$ 54,119
Revenues					
Summer	\$ 28,389	\$ 31,228	\$ 34,067	\$ 36,906	\$ 39,745
Non-Summer	\$ 9,825	\$ 9,825	\$ 14,738	\$ 19,651	\$ 19,651
TOTAL REVENUES	\$ 38,215	\$ 41,054	\$ 48,805	\$ 56,557	\$ 59,396
NET REVENUES (LOSS)	\$ (16,904)	\$ (13,065)	\$ (5,313)	\$ 2,438	\$ 5,277
Total visitors (year round)	567	604	740	877	914
Money to cover start up operations	\$ 27,566				
Construction cost (3 cabins)	\$ 433,100				

Before drawing final conclusions regarding these options it is important to review the impact of small modifications in different elements of the financial analysis. The analysis is sensitive to quite minor changes in these assumptions. Several key assumptions, and the impact of changing these assumptions for Option 1 on year 5 performance, are outlined below:

- The base case for Option 1 assumes 5 rentable units: 3 one bedroom units and 2 two bedroom units. If one additional unit is added, and the staff is asked to work a little harder (that is, staff pay doesn't change), the bottom line in year 5 jumps from \$3,057 to \$21,607. While increasing the size of the facility to this size will ultimately be desirable, we judged that the community would not be ready by year 5 to provide the level of charter fishing and other services needed for this expansion. Going from 5 to 6 rooms increases the average summer months from 343 to 411 visitors. In our view the community will already be stretched thin to handle the level of visitation associated with 5 rentable rooms.
- The base case assumption uses \$2.50/square foot for annual costs for utilities and routine maintenance. This figure is based on the assumption that 2 to 3 of the five cabins in Option 1 would be closed down during non-summer months, significantly reducing operation costs, which average about \$5.00/square foot in the region on an annual basis. If this number is brought up to \$5.00/SF the bottom line in year 5 falls to an annual deficit of \$5,427.
- The base case assumption presumes a summer occupancy rate of 70% in year 5. Increase the average summer occupancy to 80% and profits rise to \$14,940; drop to 60% and the operation runs a \$9,000 annual deficit.

The Bottom Line Regarding the Bottom Line

Overall, the financial performance of both options is weak. Option 1 does not come close to covering the initial investment cost; and Option 2 does so only if it is assumed construction costs are loaned interest-free or come from a grant.

Despite this limitation, both of the options are judged worthy of serious consideration by Chenega Heritage, the Chenega Corporation and the community. If a means is found to finance initial construction and start-up costs, these projects are able to cover their operations and even begin turning a profit. Over time, as the facility earns a favorable reputation, profits are likely to continue to grow. This would lead to increasing occupancies, higher room rates, and the option to accelerate the rate of repayment of the initial investment. It is worth pointing out that the rule of thumb for small fishing lodges in Alaska is that typically it takes 5 years to generate a client base and enough of a reputation to begin turning a profit.

One strategy to increase the profitability of a Chenega lodging project was considered but not pursued. Most fishing lodges make their money more on the fishing component of the experience than the accommodations. This project deliberately leaves to the community the opportunity to offer a range of profitable day activities, including charter boat fishing, guided kayaking, cultural tours, etc. If this lodging project was solely focused on profit, those activities would be incorporated into its overall financial operation, and would have an important, positive impact on the bottom line.

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