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Memo

To: Mammoth Lakes Town Council and Planning Commission
From: Owen Maloy
Subject: Town Profit and Loss with a Limited Market
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A simple analysis using Town financial data shows that the Town cannot afford to build more resort housing units if the visitor market is limited. This means that the highest priority is determining the actual size of the market, not the impact of peak visitation (people at one time).

Any economic entity, profit or non-profit, must take in more than it spends or go bankrupt. No competently-managed business plans an expansion without an accurate idea of the market size. Stories of firms that got into trouble by overexpansion abound. Two of the latest were the overexpansions of Starbucks and Krispy Kreme. I have been concerned by the lack of any credible demand analysis in Town economic projections. For this reason, I looked at the question of how many housing units the Town can afford to build if the Town's income is limited by the size of the market.

This analysis is simple, requiring only a few numbers from the Town's Comprehensive Financial Report. All we need to do is compare general-fund income and expense for various numbers of housing units, taking a nominal unit as having 4 pillows. The number of pillows determines peak visitation in winter. The information was put into a spreadsheet, plotting income, expense, and the difference (net income) against the number of units. The figures below show the results.

Expense – Town expenses in FY 2004-5 were \$24.3M. There were slightly less than 10,000 housing units, including MMSA and USFS housing. All units cost the Town money to support with various services such as police and snow clearance. If we take the common supposition that the Town is almost entirely in the tourism business, then it is fair to include all Town expenses as expenses of the tourism business. The expense per unit is about \$2500 per year.

All units are counted, not only those that produce transient occupancy tax (TOT) income. Non-rental units house workers, managers, and residents who do pay sales and property taxes. These units represent necessary overhead for the tourism business, and produce some income as well.

Income – In the same year, the Town had \$26.4M in income, including \$9.6M in TOT. Substantial amounts were derived from services, licenses and fees, and other sources.

Income has at least two components. One, like TOT and sales taxes, depends on visitation. This component was \$14.56M in FY2005. Another component depends on the number of housing units, such as property taxes and property transfer fees, and was \$11.87M in the same fiscal year.. We can expect the income to grow with the number of units provided to house visitors and the workers who serve them, until the maximum visitation is reached. After that, there is no increase in visitation income as the number of units increases. The vacancy rate increases instead. The property-related component of income continues to grow as more units are added.

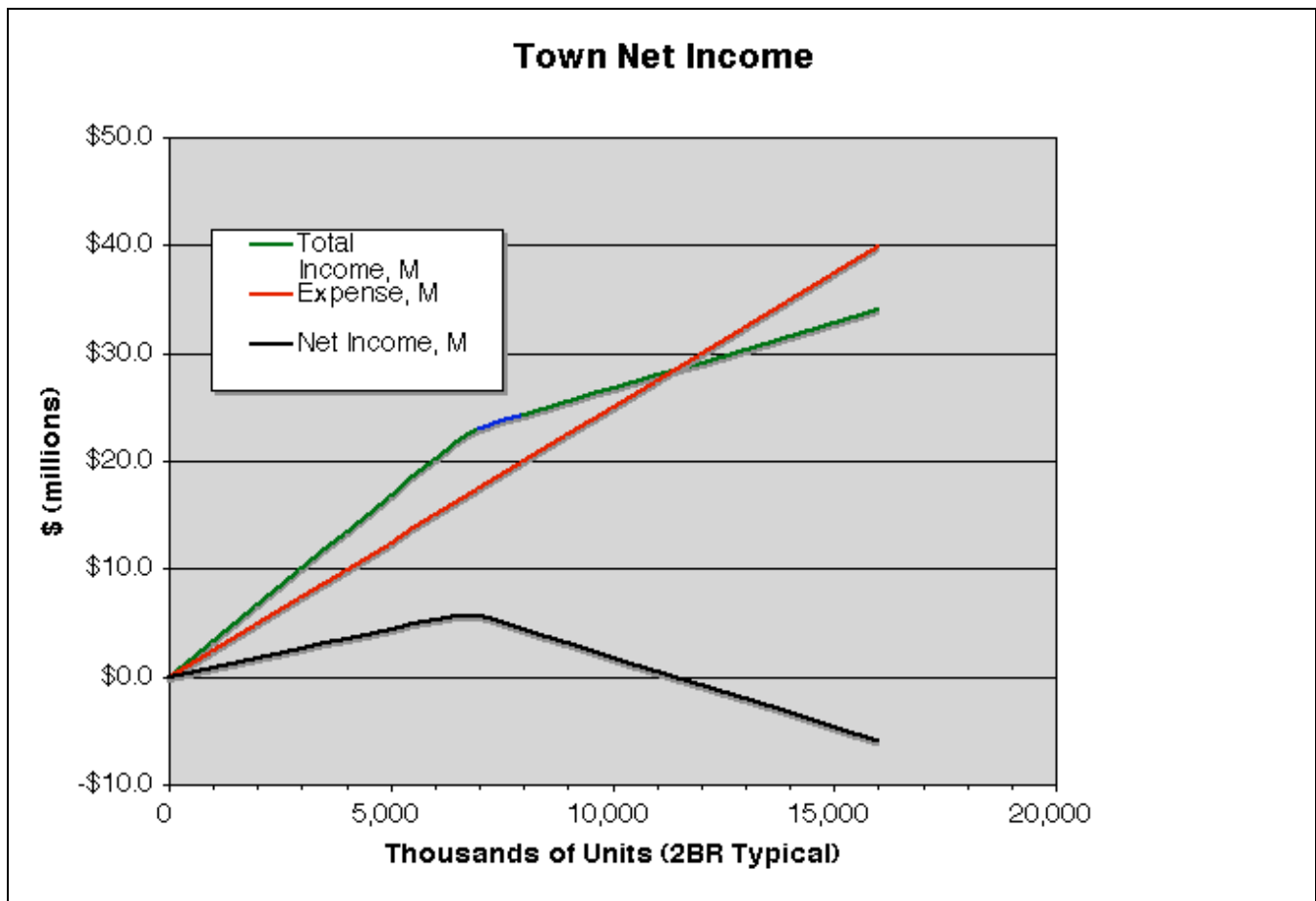
Market Size – The number of pillows available for visitor use determines peak visitation. At present, this number is about 24,000 to 27,000 visitors on a peak holiday weekend. As a first approximation we assume that the average income is proportional to the total number of pillows or units, up to the point of market saturation.

More housing units are needed in Mammoth only if **peak** visitation increases substantially, but the Town and the lodging business will lose money if units are built only to serve peaks. Only skiing produces peak demand for of housing units, including worker housing. There is little reason to expect any substantial increase. Mammoth Mountain's capacity is limited to, preferably, 18,000 skiers at one time for reasons of quality and safety. Because of past overcrowding, issuance of new inexpensive season passes (Gold Cards) has been discontinued. While the mountain experienced 1.5 million skier-days recently, that was also true over 20 years ago.

There is no substantial evidence that peak visitation can ever be much bigger. Skiing in general is declining, and MMSA capacity is limited. Tax income can be increased only by increasing visitor-days per week, but that number is already close to the typical value for destination resorts.

Net Income – We now have all we need to estimate net income ((income less expense (or profit and loss) as a function of the number of units provided. Net income was \$2.1M in FY2005. One of the features of such analyses is that there is a value of investment which produces maximum net income. For no investment there is no return; for too much investment there can be a loss. We expect that the Town will do worse by providing housing for the maximum crowd, when such housing is occupied only rarely.

The first figure below shows the result for a peak visitation of 27,000: 18,000 skiers and 9,000 non-skiers (the latter number seems high). The figure is a plot of expenses, income, and net income as a function of the number of housing units provided. As more units are provided, income increases until all visitors are housed. Then TOT, sales taxes, and other sales-dependent income stop growing, but property-related income as well as expenses continue to increase as more units are built. The Town’s net income begins to drop at about 7,500 units, 2300 less than the 9800 we have now, and goes negative at about 11,400 units. We assumed that annual TOT and sales taxes are proportional to peak visitation (or total pillows). The values below the maximum show the trend but are not relevant to the conclusion that net income declines after the market saturates. The Town’s share of property taxes is not enough to pay the bills. While one can refine the details of this analysis, the conclusions will not change materially. It is, after all, an analysis of the bottom line. Profit = income – expense!

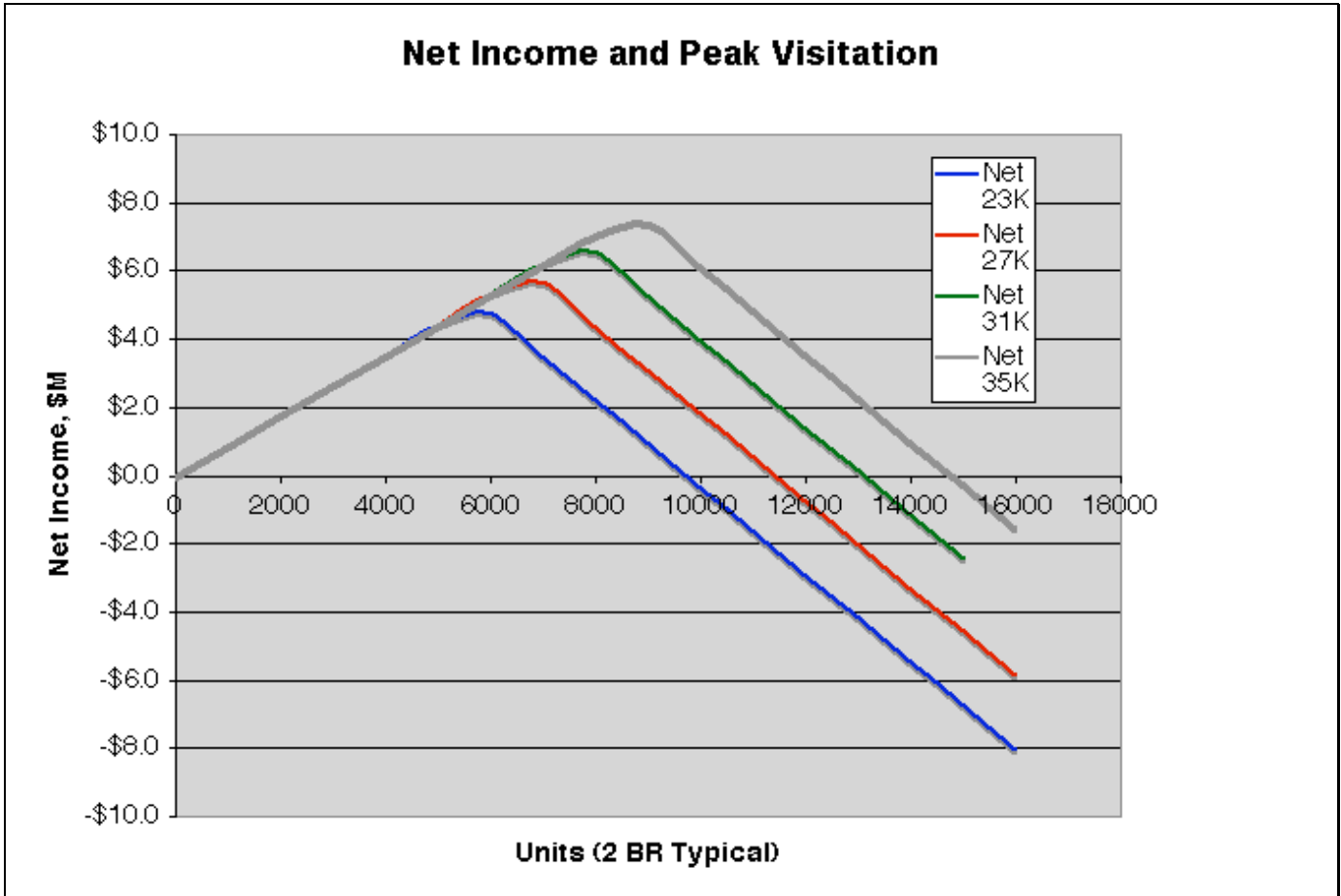


*Income, Expenses and Net Income for 27K Visitors Maximum.
The Town is already overbuilt and net income is declining.*

The income, expense, and net income shown above depend only on a few numbers, almost all taken from the FY 2005 comprehensive report: total expense, and the sales and property-related income. TOT, sales tax, business licenses (license fees depend on total saels), and Town services were considered to be sales related; all other categories were considered to be property related. A more refined allocation would not make enough difference to change the conclusion.

The net income curve shows that the Town is overbuilt now, and certainly cannot afford to build as many as 16,000 units, which would produce an annual loss of \$6.9M.

Other Values for Peak Visitation – The figure below shows the results for a range of values for peak visitation. This figure shows that adding 6,000 units, as some people have proposed, would put the Town into bankruptcy.



*Net Income for Various Values of Peak Visitation
Even with 35K visitors at one time, the maximum is below the present 10,000 units.*

Conclusions - Financial feasibility, not a large number of people at one time, is the dominant consideration. The Town will be broke long before it has to deal with 60,000 people unless the ski business miraculously doubles, which nobody expects and is physically impossible without a new and large mountain somewhere. There are more units than are needed for the best financial return. Supporting these unneeded units increases Town costs and the need for workers and worker housing, merely to serve holiday peaks. Reduced occupancy (vacant units) reduces rental profits, driving renters out of business.

It appears that the Town is spending too much money. By cutting expenses, the Town’s resort housing business (not the lodging business, but the Town’s taxation business) will be more stable. Operation near the net income peak provides more margin for error. The Town’s present 8% margin could easily be wiped out by a few bad seasons.

Recommendations
Without a Proven Average Market Increase:

- **Replace old units one-for-one. Do not build additional units on vacant land.**
- **Do not build more affordable housing than is needed now. Vacant units cost money.**
- **Convert existing units for affordable housing (no new units).**
- **Reduce marketing expenses: Transfer tourism marketing to private enterprise.**
- **Reduce developer support expenses. More development will reduce net income.**