

January 5, 2020

The Local Government Commission
North Carolina Department of State Treasurer
Attention: Dale R. Folwell, CPA, Chairman
3200 Atlantic Avenue
Raleigh, North Carolina 27604

Bald Head Island Transportation Authority (the “Authority”)
Application for Approval of Bald Head Island Transportation Authority Transportation
System Revenue Bond Findings (“Application”)

Dear Treasurer Folwell:

I am the Chair of the Bald Head Island Transportation Authority (the “Authority”), and am submitting information to the North Carolina Local Government Commission (the “LGC”) regarding the process undertaken by the Authority with respect to the proposed issuance of its Transportation System Revenue Bonds (the “Bonds”) in order to finance the acquisition of the ferry and ground transportation assets that provide service to Bald Head Island, North Carolina (the “Island”) including, but not limited to, (i) the transportation of passengers via ferry to and from the Island and Southport, North Carolina; (ii) the on-island tram transportation of ferry passengers; (iii) the vehicle parking operation at Deep Point Marina in Southport, North Carolina, and (iv) the tug and freight barge operation which carries supplies and equipment to and from the Island (the “System”) from Bald Head Island Transportation, Inc., a North Carolina corporation (“BHIT”), and Bald Head Island Limited, LLC, a Texas limited liability company (“BHIL”, and together with BHIL, collectively referred to herein as “Seller”). In particular, we wish to respond to the letter regarding the Bonds and the acquisition of assets submitted to the LGC by the Village Council of the Village of Bald Head Island (the “Village”) on December 15, 2020. The Authority has submitted an application for approval of the issuance of the Bonds to the LGC, and is requesting the LGC to consider such approval at its meeting on February 2, 2021.

Background. The Authority was formed in 2017 pursuant to Session Law 2017 – 120 (codified at N.C. General Statutes Chapter 160A, Article 29) (the “Act”), and resolutions passed unanimously by the Village Council of the Village, the Board of Commissioners of Brunswick County, and the Board of Aldermen of the City of Southport. Pursuant to the Act, the Village has three voting Trustees on the Authority – the Mayor and Mayor Pro Tem, ex officio, and one additional member appointed by the Village Council. The Village has more representation on the Authority than any other governmental unit.

The Village Council has been informed about, and involved in, the formation of the Authority and its statutory mandate to purchase the System from the Sellers since before the Act was passed. As shown from the attached chronology, numerous hearings and information

sessions were held for representatives of the Village and the City of Southport, as well as for residents and businesses on the Island. The Authority has held regular monthly meetings since November 2017, all held in accordance with the Open Meetings Laws. Village representatives on the Board of Trustees attended the meetings, including both open and closed sessions. Negotiations of the purchase price for the System were extensive, and were handled in closed session pursuant to N.C. General Statutes § 143 – 318.11(5).

Diligence. The Authority Board has spent much of the last three years doing diligence with respect to the System. The Authority first requested the Sellers to provide all of the information that they had developed regarding the System, which included reports prepared by third party consultants for the Seller. The Authority then commissioned the following third party reports:

- Vessel Survey by KOPCO Marine Services
- Marina Infrastructure Due Diligence Report by Moffatt & Nichol
- Real Estate Appraisals of the real property and improvements by Worsley Real Estate Company
- Environmental Reports by S&ME
- System Valuations by HMS Global, a full-service marine management company

As a result of all of those reports, the Authority determined that the assets of the System had a value of approximately \$50,900,000, and negotiated a purchase price with the Seller of \$47,750,000. The Authority also hired Mercator International LLC (“Mercator”) to prepare a feasibility study to determine the ability of the future anticipated cash flow of the System to support the issuance of bonds to finance the acquisition of the System, and then to pay operating, capital and debt service costs going forward.

UBS Financial Services Inc., which was hired by the Authority as senior manager in January 2020 after a RFP process and has been closely involved in the diligence process since then, has stated that the amount of diligence undertaken by the Authority in this transaction is extraordinary in their experience, relative to similar revenue bond issuances. All of this information was presented to the three major rating agencies in the indicative rating evaluations provided in connection with the proposed Bonds, which also represents a much higher level of independent, pre-marketing feedback than usual. A copy of the Credit Presentation submitted to each of the Rating Agencies is attached; the list of the diligence conducted is included on page 34. Despite COVID-19 related capacity restrictions beginning in March 2020, changes in domestic travel patterns have driven a quick rebound in ticket sales this year, with revenues recovering to their three year average.

Bond Feasibility Study. The Village representatives have raised several concerns about the diligence that was done and the feasibility studies going forward. They raised particular concerns about cash reserves and capital improvements that are included in the feasibility studies.

The Bond Feasibility Study (“Feasibility Study”) prepared by Mercator is an independent study that is typically required for similar types of revenue bond issues, supported by other third party studies. Mercator is one of the most experienced independent marine feasibility consultants in the world, executing over 300 similar engagements since 2009, including a report for the South Carolina State Ports Authority Series 2019 bond issue. The Feasibility Study provides extensive stress modeling to demonstrate financial performance under multiple demand scenarios, including median/low/high growth scenarios and median/low scenarios factoring in a housing recession. In all scenarios, the feasibility consultant has assumed fares that increase at the rate of inflation, and included key capital expenditures, such as vessel replacements and major repairs to the ferry and barge landings. The Feasibility Study includes both routine capital expenditures, extrapolated from historic requirements, ongoing facility maintenance projects based on engineering consultant recommendations, and ferry replacements based on estimated remaining life. Projected 30-year capital expenditures total \$44 million (including dredging costs), with an estimated additional \$22 million in average annual unrestricted cash under the low growth scenario to meet additional unanticipated capital needs. Projects that address capacity, such as parking lot expansion, are programmed according to expected demand. (Credit Presentation, page 51). Like many revenue bond credits, we note the need for and ability to pay for many of these capital expenditures is closely linked to the volume of usage, with the ability to pay for many of these needs with cash if the System performs better than expected and the ability to defer some needs if the System underperforms.

The General Indenture pursuant to which the Bonds will be issued also anticipates capital needs. It requires the Authority to build up a restricted reserve from revenues to support a rolling five year capital improvement plan, essentially creating a restricted savings account, giving the Authority an additional tool to fund future capital expenditures with cash on hand in addition to unrestricted funds. It contemplates additional indebtedness (which can be in the form of additional bonds or installment financing) of up to \$250,000 in the aggregate for general capital improvements, and up to \$5,000,000 in the aggregate for ferry replacement. The operating and maintenance reserve fund, funded initially from bond proceeds and thereafter from revenues in an amount equal to 25% of each year’s budget, is available for capital expenditures and maintenance costs in excess of those budgeted and provides an additional restricted reserve to address any unforeseen events.

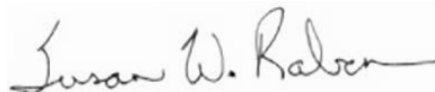
The Feasibility Study assumes rate increases over time at a level commensurate with expected inflation. The first ferry rate increase for Class I General Tickets, from \$23 to \$27 (17.4%) planned for July, 2021, will be the first rate increase for ferry tickets since 2011. Inflation as measured by the CPI for that same period was 18.7%. We note that most businesses on the Island pay the ferry fare for their employees as a cost of doing business on the Island. The cost of the barge and ferry transportation for contractors is passed along to the homeowners who are constructing homes on the Island. To be conservative, the Feasibility Study does not assume any operating efficiencies resulting from the ownership of the System by the Authority, including consolidation into a vertically integrated system, the ability to purchase fuel forward, the ability to align ferry schedules with passenger demand and the introduction of electronic ticketing and reservation systems. The efficiencies achieved from these improvements could

mitigate the need for additional rate increases, but are not included in the assumptions underlying the Feasibility Study.

Public Assets. The most compelling argument for the transfer of the System from the Sellers to the Authority is to move this essential transportation asset from the private sector, operating with a profit motive and no local input, to the public sector, which will actually permit the public to have input in its operations. As currently held, while ferry and tram rates cannot be changed without North Carolina Utility Commission approval, the rates for the use of the barge (which brings all freight to the Island) and the parking are not regulated. The acquisition of the assets of the System by the Authority consolidates ferry, barge, tram and parking services for the Island under a single public entity, providing long-term, reliable and safe transportation for passengers and freight to and from the Island while ensuring public ownership and local management of this essential infrastructure. The transition from a privately owned transportation system to a publicly owned system addresses the Island's critical need for long-term governance and stewardship of ferry service and related logistics operations, while allowing seamless integration and interoperability between the various aspects of the transportation operation. Putting the System in the hands of the Authority ensures the efficiency, viability and stability of the System, which serves as the critical link between three local government units.

We have been working with Local Government Commission staff for more than two years on this transaction, and have followed guidance from the staff regarding fare increases, reductions in purchase price and elimination of seller financing, all of which have made for a stronger credit profile. We look forward to having the opportunity to meet with you to discuss any of this further, and to answer any other questions you may have about the Authority, the acquisition or the System.

Very truly yours,



Susan Rabon
Chair, Bald Head Island Transportation Authority

cc: Sharon Edmundson, Deputy Treasurer
Tim Romocki, Director, Debt Management
Mayor J. Andrew Sayre, Village of Bald Head Island
Michael Brown, Mayor Pro Tempore, Village of Bald Head Island
Scott Gardner, Councilor, Village of Bald Head Island
Emily Hill, Councilor, Village of Bald Head Island
Peter Quinn, Councilor, Village of Bald Head Island
K. Christopher McCall, Village Manager, Village of Bald Head Island
Chad Paul, CEO, Bald Head Island Limited, LLC