The Honorable Beth A. Wood, CPA
North Carolina State Auditor
20601 Mail Service Center
Raleigh, NC 27669-0600

Dear Ms. Woods:

We are writing on behalf of Bald Head Island (BHI) property owners to request that your office conduct a financial audit of procedures that the Bald Head Island Transportation Authority (BHITA) followed in developing its proposal to acquire the Bald Head Island transportation system (System) from Bald Head Limited (Limited). We are concerned that the proposed $47.7M acquisition price is excessive. If implemented, along with a $56.M revenue bond issue needed to finance the acquisition, the BHI economy will be harmed, unnecessarily, along with individual BHI property owners, hundreds of workers who ride the ferry and depend on the Island for their livelihood, as well as thousands of tourists and vacationers that visit BHI annually.

In an April 23, 2021 letter, the Village of Bald Head Island (Village) formally requested that the NC Local Government Commission (LGC) delay consideration of the BHITA's revenue bond application until apparent problems with BHITA's valuation of the System are addressed. The Village also recently voted unanimously to acquire the System from Limited and operate it going forward. If BHITA's current bond application is approved by the LCG "as is," we intend to urge the Village to ask an appropriate state court to stop BHITA from proceeding with its revenue bond issue until the entire matter has been adjudicated. We regret that circumstances have brought us to this point, but for reasons highlighted below, we feel we have no other choice.

Background

In 1983, Bald Head Island was purchased out of bankruptcy by George P. Mitchell, a Texas billionaire. Mr. Mitchell's BHI properties, including the BHI transportation System, were organized under the ownership of Limited which was wholly owned by the Mitchell Family, and after the death of Mr. Mitchell in 2013, by the Mitchell family trust. In 2015, following a boating accident involving the BHI ferry, Limited opted to sell the System.

Limited had difficulty finding a suitable commercial buyer reportedly because the System is a local monopoly and has long been regulated by the NC Utilities Commission. As an alternative, Limited conceived and helped write what became the Ferry Transportation Authority Act (Act) which was enacted by the NC legislature in 2017. The Act created the BHITA, along with an 11-member Board of Trustees that would be appointed by the Governor, the legislature, various state agencies, and effected local government entities. Of the 11 Board members, only three, including the Village Mayor and Mayor *Pro Tem*, were required to be BHI residents or property owners.

The Act authorized, but did not require, the BHITA to appraise and purchase the BHI transportation System from Limited "at or below" its appraised market value, and to finance the purchase through the issuance of non-recourse revenue bonds. Importantly, the Act also: 1) <u>deregulated</u> the System once BHITA acquired it from Limited, and 2) purposefully avoided appropriating <u>any</u> state funds that the

BHITA would need to appraise the value of Limited's transportation assets, and develop an extensive revenue bond application to the LGC.

Problems with BHITA's Valuation of Limited's Transportation System

There are three fundamental problems with procedures that the BHITA followed in arriving at its \$47.75M acquisition price for Limited's transportation System, and its subsequent \$56M revenue bond application. First, because the Act provided BHITA with <u>no</u> state funds, BHITA was forced to rely on Limited, the seller, to select and pay various consultants that BHITA would use in carrying out its statutory mandate. Second, in the course of appraising the market value of the System, BHITA failed to account for, or evaluate, the System's <u>prior financial performance</u> (e.g., for the years 2013-2018), apparently at Limited's insistence. Third, "negotiations" between Limited and the BHITA over the \$47.75M acquisition price were done completely behind closed doors by a Board-appointed subcommittee with absolutely <u>no</u> public review or input from any BHI stakeholder, including the three designated members of the BHITA Board that actually own property on BHI, all of whom were purposefully excluded from the negotiating subcommittee.

Regrettably, all three of the aforementioned problems clearly encumber two real estate appraisals that BHITA heavily relied on in valuing the System. Both were done for BHITA by the Worsley Real Estate Company. Like all of BHITA's consultants, the Worsley appraisals were paid for by Limited. As it turned out, Worsley's appraisals of real estate parcels at the ferry terminals on BHI and at the Deep Point landing (on the mainland in Southport) came to \$42,395,000 and Deep Point. As such, they formed the basis (i.e., 88 percent) of BHITA's proposed \$47.75M purchase price for Limited's transportation assets. While both appraisals were completed in April 2019, they not released to the public until mid-February 2021.

Once released to the public, Worsley's appraisals immediately raised two key concerns among BHI stakeholders that BHITA has yet to address or explain. First, the Worsley reports valued real estate parcels at the Deep Point and BHI ferry terminal sites that BHITA would acquire from Limited at more than <u>twice</u> what the Brunswick County tax assessor estimates those same parcels are worth -- \$42,395,000 versus \$17,734,810. There is no explanation of this difference in the Worsley reports; only a brief reference that the difference exists. This is surprising and concerning since under state law, the Brunswick County property tax assessor is required appraise a commercial property for tax purposes at its fair market value.

A second concern with the Worsley appraisals is that they are based on only one of three approaches or methods that are commonly used to estimate values of commercial real estate. The three-method practice is routinely used in appraising commercial properties in order to reduce the risk that any one method might produce inaccurate valuations. Worsley used only the Cost Approach. This too is unusual since the Income Approach is generally regarded to be the most accurate of the three methods when appraising income producing properties. <u>Worsley's appraisal reports state further that the Income Approach was not used on explicit instructions from BHITA's Business Valuation Consultant</u>. That consultant also was paid by Limited.

We do not know why the Income Approach was purposefully excluded from the Worsley appraisals. We do know, however, that had Worsley been permitted to use the Income Approach he would have been required to review prior-year financial statements for the System, and explicitly factor those data into his appraisal of the Deep Point and BHI ferry terminal parcels. We also know that these prior-year financial statements exist because they were provided to members of the BHITA Board of Trustees, but only on the condition that each board member sign a binding non-disclosure agreement (NDA). For all practical purposes, the Board's decision to sign the NDAs precluded the use of prior-year financial operating results in determining the fair market value of Limited's transportation System.

We also know that Limited continues to make every effort to keep the System's prior-year financial performance data completely under wraps, and that BHITA has acquiesced in keeping these data proprietary and out of its valuation process. In our view, this is very problematic precisely because including the data would have resulted in a significantly lower valuation than $47.75M. Why?

Very simply because Section 160A-686(b) of the Act provides that once the transportation System has been acquired by BHITA, it will no longer be regulated by the Utilities Commission. Instead, BHITA will have unilateral discretion to set rates. The BHITA *Bond Feasibility Study* done by the Mercator consulting group (also funded by Limited) subsequently determined that if BHITA paid Limited $47.75M for the System, it would need to raise to raise ferry, barge and parking rates by 20 percent or so this year in order to generate enough cashflow to continue operating the System while servicing the proposed $56M revenue bond issue going forward. Absent the legislation, there is no reason to believe that the Utility Commission would have allowed BHI ferry rates to immediately increase at all, much less by 20 percent.

Looking at the Mercator study a little differently, one could conclude that Limited's transportation assets might be worth the $47.75M "negotiated" price but only if BHITA raised rates by 20 percent or so once the System is deregulated. Again, deregulation will occur under the terms of the Act that Limited, by its own admission, had a major hand in writing. Conversely, had Worsley appraised the value of the System using the Income Approach -- based on prior-year financial results when the System was regulated – its cash flow estimates and appraised market value would have been considerably lower than the $47.75M the BHITA eventually agreed to pay Limited.

In effect then, by agreeing to the $47.75M purchase price, BHITA is proposing to give Limited, and by extension the Mitchell family estate, the lion's share of the increase in the System's value that results from deregulation. We believe it would be far better if the purchaser of the System were to retain any such increase in market value and use it to pay for much needed System improvements, or mitigate the need for future rate increases. Should the Village succeed in acquiring the System, we and certainly many other BHI property owners will urge the Village Council to do just that.

Finally, it is noteworthy that, had prior-year financial data been explicitly factored into BHITA's valuation of Limited's transportation assets along with Mercator's *Bond Feasibility Study*, as the historical data should have been, BHITA's proposed revenue bond issue also would be significantly reduced. A smaller bond issue, in turn, would moderate risk to the state and NC taxpayers that BHITA could end up defaulting on its revenue bonds due to unforeseen shortfalls in the System's revenues and/or increases in its operating expenses or capital requirements that could result, for instance, from damage caused by an unusually strong hurricane.

Under moderately favorable revenue and cost projections (e.g., no costly storms) developed in the Mercator study, BHITA's non-recourse revenue bonds would tentatively be rated at BBB- or slightly above junk. As you are aware, a BBB- rating is considerably below the ratings of general obligation bonds that the LGC typically approves and subsequently sells to investors on behalf of local government entities in North Carolina. As such, were BHITA to default on its bonds due, in part, to BHITA's excessive valuation of the System in the first place, that default could have the unintended effect of raising the cost of debt that other NC local government entities, including the Village, will need to raise in the future. A default also would very likely leave the state, and NC taxpayers responsible for paying off BHITA revenue bond holders.

The Need for an Independent State Audit

We are bringing this matter to your attention because the figures and circumstances cited above underscore a potentially very serious conflict of interest in the manner in which BHITA has relied on Limited's resources in valuing Limited's transportation System. Again, we do not know why the BHITA agreed to a $47.75M acquisition price because no member of the Board that owns property on BHI, including the Village Mayor and Mayor *pro tem*, were appointed to the Board subcommittee that negotiated the acquisition price with Limited.

We do know, however, that these negotiations were done completely behind closed doors with absolutely no meaningful public input from interested stakeholders, certainly including BHI property owners. The Worsley appraisals were completed in April 2019 but were not made public until mid-February 2021. This was only a few days before the BHITA was forced to hold a public hearing on February 17 at which the Board Chair attempted to explain the proposed acquisition price and the $56M revenue bond application that had already been submitted to the LGC.

Had the Worsley appraisals been released shortly after they were completed in 2019, as they should have been, public input very likely would have <u>helped</u> the BHITA negotiate a more reasonable acquisition price with Limited. The same is true of the System's prior-year financial data. Making these data publicly available, rather than requiring BHITA Board members to see the data only after signing a binding NDA would not have harmed anyone other than Limited. But its release, no doubt, would have rendered BHITA's valuation of the System more transparent and a good deal more reasonable.

How many more mistakes BHITA may have made in dealing with Limited and various consultants that Limited hired on BHITA's behalf is unclear. It is unclear because the entire valuation process that BHITA followed remains cloaked in secrecy. In our view, this is unwise, unnecessary and very much at odds with good governance. Thus, we are urging you to undertake an independent financial audit of the entire valuation process before the LGC formally considers BHITA's revenue bond application. For all of the reasons cited above, we believe that an independent audit is clearly needed and will very much serve the best interests of the state, NC taxpayers and certainly those that depend on the transportation System to travel to and from Bald Head Island.

Respectfully yours,

Robert T. Blau, CFA
5 Starrush Trail, Bald Head Island

J. Paul Carey
611 Currituck Way, Bald Head Island

cc: Honorable Dale R. Folwell, CPA, NC State Treasurer and Chair, Local Government Commission
Timothy Romocki, Director, Debt Management, NC Department of State Treasurer
Susan Rabon, Chair, Bald Head Island Transportation Authority
J. Andrew Sayre, Mayor, Village of Bald Head Island