Bald Head Island Transportation Authority

QUESTIONS AND ANSWERS

On February 17, 2021, the Board of Trustees (the "Board") of the Bald Head Island Transportation Authority (the "Authority") held an information session and public hearing about the proposed acquisition of the Bald Head Island Ferry Transportation System (as further described below, the "System"), and the issuance of revenue bonds to finance that purchase. The presentation made at that meeting is attached as *Exhibit A* and is referred to herein as the "BHITA Presentation". The Authority received a number of questions and comments about the acquisition and the financing, in various formats, including letters delivered to the North Carolina Local Government Commission (the "LGC"), written comments received at BHITAcomments@villagebhi.org, and oral comments delivered at the hearing. A complete list of those questions is attached as *Exhibit B*. Many of the questions overlap, and are focused on topics relating to both the acquisition of the System, including valuation and price, and the operation of the System going forward. The Authority's responses are grouped by topic.

The Authority was formed by act of the North Carolina General Assembly enacted in 2017, Session Law 2017-120, codified as Article 29 of Chapter 160A of the North Carolina General Assembly (the "Act"). The System is currently owned and operated by Bald Head Transportation, Inc. (Ferry, Tram and Marine Maintenance) ("BHI Transportation"), and Bald Head Island Limited, LLC (Parking and Tug and Freight Barge) ("Limited," and collectively with BHI Transportation, the "Seller"). The Seller has been operating the System on a calendar fiscal year basis; the most recent fiscal year ended December 31, 2020.

The System consists of a number of components: Ferry Service, On-Island Tram Service, and Marine Maintenance ("Ferry Operation"), the Mainland Parking at the Deep Point Terminal ("Parking Operation"), and the Tug and Freight Barge ("Barge Operation," and collectively with the Ferry Operations and the Parking Operation, the "System"). The Authority will operate the System on the fiscal year required for all public bodies in North Carolina (July 1 – June 30). All references in the Q&A to "FY" are to the Authority's fiscal year going forward.

In April of 2020 the Authority engaged Mercator International LLC, a nationally recognized consultant in the transportation sector ("Mercator") to prepare an independent feasibility analysis for the planned bond issuance (the "Feasibility Study"). 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. See *Exhibit C* for a near final draft of the Feasibility Study. Based on information provided in the Feasibility Study, Davenport & Company, the Authority's financial advisor ("Davenport") developed a financial model that projected cash flow and debt service coverage over the life of the proposed bonds (the "Financial Model").

APPRAISALS AND VALUE OF THE SYSTEM

A number of questions were raised as to how the Authority arrived at the purchase price of $47,750,000 for the System. The Authority negotiated the purchase price with the Seller over the course of several years, and included consideration of a number of factors in that process. The following outlines the Authority's approach.

The three components of the System

The three major components of the System vary in regulatory oversight and the nature of their competitive market.

- The Ferry Operation is regulated by the North Carolina Utilities Commission ("NCUC"), which regulates the fares based on the allowed returns on the owner's investment. Under any for-profit owner, the ferry and tram service would remain a regulated utility. It is anticipated that a new private owner, or the Seller if it remained the owner, would file a rate case to increase fares, which have not increased since 2011.

- The Barge Operation relies on barge landings on Bald Head Island (the "Island") and the mainland. Any purchaser of the Barge Operation would also own and control the barge landings, thus maintaining monopoly pricing power. Any competitor would be required to permit and build new barge landings on the mainland and the Island; that substantial barrier to entry effectively means that the owner of the Barge Operation will continue to have an effective monopoly. Thus, any new owner with a profit motive could price the Barge Operation to maximize profit without the threat of competition.

- The Parking Operation at Deep Point immediately adjacent to the ferry is convenient for users. There are no existing commercial parking facilities anywhere nearby, nor is there existing transportation from potential off-site parking to Deep Point. While entry of a competitor is theoretically possible, it is unlikely. Any private owner of the Parking Operation has latitude to raise rates substantially to maximize profits without regard to overall system impact.

Seller estimates of enterprise value

Before the Seller and the Authority began negotiations for the purchase of the System, the Seller had commissioned an enterprise valuation that used a weighted average cost of capital to discount enterprise cash flows for each of the three components of the System, incorporating expected capital expenditures on vessels, major capital repairs and improvements, tram replacements, and parking expansions that were similar to those assumed by the Authority in developing its cash flow projections. Assumed growth rates were similar to the Authority's Median Growth scenario (See "Feasibility Study," below). Rates and fees were assumed to rise with inflation.

The enterprise values derived from the discounted cash flow analyses were $38.2 million for the Parking Operation, $14 million for the Barge Operation, and $3.6 million for the Ferry Operation. An alternative analysis was also presented that used a traditional real estate capitalization analysis for the Parking Operation. Assuming an EBITDA of $3.6 million, the Parking Operation valuation alone rose from $38.2 million to $51 million. The total valuation of the System was estimated to be $55.8 million using discounted cash flows, and increased to $68.6 million if the alternate valuation method were used for the Parking Operation. These enterprise values would have been even higher if the study had taken into consideration a purchaser's ability to increase the unregulated parking and barge rates faster than inflation.

The Seller's enterprise valuation was a starting point for negotiations *from the Seller's perspective*. It is important to note that while the Authority is charged with purchasing the System, the Seller is under no obligation to sell the System to the Authority and could sell components separately to alternative buyers.

Independent Appraisal of Asset Value

The Act requires an appraisal that sets a cap on the purchase price. The Authority hired independent appraisers to determine the market value of the assets of the transportation system.

The Authority sought out consultants who could provide an independent valuation of the various assets involved in the System. The consultants were well recognized in the industry as having expertise in their field. Those appraisals are listed below and have been posted.

a. Vessel Survey Reports – KOPCO Marine Services, Inc. *See Exhibit D*.
b. Marina Infrastructure Due Diligence Report (Deep Point Terminal and Bald Head Island Terminal) – Moffatt & Nichol. *See Exhibit E*.
c. Real Estate Appraisals (Deep Point Terminal and Bald Head Island Terminal) – Earl Worsley. *See Exhibit F*.
d. Environmental Reports (Deep Point Terminal and Bald Head Island Terminal) – S&ME. *See Exhibit G*.

These appraisals are based on comparable sales of land and vessels and on the depreciated replacement value of buildings, equipment, and vehicles. The value of the furniture, fixtures, equipment, which includes docks, piers and bulkheads, is a discounted book value figure. Information technology and intellectual property are also valued at discounted book value.

The Authority's independent appraisals thus set an upper limit of the purchase price at $50.9 million. The Authority's modeling efforts and negotiating positions started well below that figure, just as Seller's negotiating position began at their estimate of enterprise value.

The Role of the Feasibility and Affordability Analyses in Establishing and Justifying the Purchase Price

The Authority's expectation was that any transaction price considered during negotiations would be evaluated for feasibility and affordability under a variety of economic scenarios, and given a set of assumptions that would protect the public's interest in efficient and affordable ferry and barge access to the Island for of the System's users – residents, second home owners, renters, employees, and businesses, whether based on the Island or on the mainland. The assumptions used in the Feasibility Study and the Financial Model are discussed further under Feasibility Study and Financial Model below.

The Authority's feasibility and affordability testing also suggests that the negotiated purchase price reflects a reasonable enterprise value for the System as it would be operated by the Authority, using reasonably consumer-friendly assumptions about fares and conservative assumptions about growth. This purchase price is below the appraised value, and below the enterprise value of the separate components of the System if each component were sold to a private party that could price services to maximize profit.

Earnings Multiples (EBITDA)

In the course of due diligence and negotiation, the Authority did examine the transaction price as a multiple of earnings (specifically EBITDA). This rough measure is often suggested as a metric to estimate the enterprise value of an enterprise. One comment suggests that the purchase price of the System reflects a value of roughly 12 times EBITDA, as compared to a multiple of 4 to 6 claimed to be typical for transactions of this type. The Authority does not believe that this analysis provides an accurate measurement of the value of the System.

Note that projected EBITDA for fiscal year 2022 (July 1, 2021 – June 30, 2022), the first full year of operation by the Authority, is expected to be about $5.6 million, not $4 million, which yields an EBITDA multiple closer to 8.5.

EBITDA multiples vary not only with the size of the transaction but also with the industry involved. While a multiple of 4-6 may be appropriate for a business in a competitive market, the Underwriter notes that EBITDA multiples seen in transportation infrastructure acquisitions are commonly above 10. In addition, a focus only on EBITDA multiples deals only with net revenue, not with the capital requirements of the business, and do not provide an accurate estimate of the fair market value of businesses when the relevant market is either a regulated market (the Ferry Operation) or an unregulated hyperlocal market in which the business has a degree of monopoly pricing power (the Barge Operation and Parking Operation). The Authority believes that its detailed cash flow analyses, including all capital expenditures and debt payments, using conservative economic and growth assumptions, provides a better and more comprehensive metric to assess the reasonableness and affordability of the negotiated purchase price.

FUTURE CAPITAL EXPENDITURES

A number of comments and questions related to the current condition of the assets of the System, including the ferries, trams, baggage handling system and docks, as operated by the Seller. The Authority reviewed the condition of all of the assets in assessing the System. The Feasibility Study and Financial Model includes many capital expenditures. The costs for, and timing of, these capital improvements are laid out in the Feasibility Study and Financial Model. The Authority expects to incorporate those schedules and costs into its work plans and budgets going forward.

The capital plan that is an element of the Feasibility Study was developed to include capital to address the known desired improvements to the facilities, equipment and operations, including the following:

- A new ticketing and reservation system - $250,000 in FY 2022
- Adding 167 parking stalls at the entrance to the main lot (areas 6W and 6E in Figure 10 of the Feasibility Study) - $347,000 in FY 2022
- Replacement of the ferry San Souci - $4.6 million over FY 23-24
- Regular, perpetual replacement of the tram trucks and tram trailers (typically four trams/year), including $707,000 to replace all 24 tram trucks between now and FY28; $371,000 to replace half of the trailer fleet between now and FY28. The balance of trailers to be replaced during FY29-32. $280,000 to expand the Truck and tram fleet when ferry passenger volume reaches 400,000/yr.
- Developing additional parking stalls as needed: $2.5 million over the period 2026-2040 period to increase total stalls from 1955 to 2625
- Rebuilding of the passenger dock at the Island - $1,065,000 in FY27/28
- Acquiring property for additional parking at Deep Point: $ 1.2 million in 2037-2040
- Replacement of the freight barge in FY29-30
- Regular, engine overhaul or replacement on manufacturer's recommended schedules (based on hours of operation), including $1.05 million between FY21 and FY30
- The Authority's share of annual maintenance dredging and periodic major dredging at Deep Point and the Island

The Authority's pro-rata portion of costs relating to the Deep Point marina bulkhead (42%) and pro-rata share of costs relating to the Bald Head Island marina bulkhead (23%) are included in operating costs going forward.

The baggage system at Deep Point is operable and does not require capital investment. If the Authority decides that operation of the system is advisable, it can be activated and used.

The capital expenditure plan does not currently contemplate offsite parking.

Concerns were raised about the current Dock A at the Island terminal being unusable at the highest tides. The Seller has stated that Dock A is only impacted by exceptionally high (lunar) tides (i.e. when high tide is 6 feet or higher). Looking at the NOAA Tide Predictions for Bald Head Island for 2021, it is anticipated that there will only be 15 times when high tide will exceed 5.5 feet (2 in June, in early evening, and none in July, August and September), and only 6 of those are expected to occur during the primary hours the ferry is running. In addition, there are likely to be a few additional high tides that are lower than 5.5 feet, but where wind and wave action could push water onto Dock A. While a nuisance, the water on Dock A is not having a significant impact on operations. There will be an opportunity to address this issue when the Passenger Dock at the Island is rebuilt in 2027/2028. This work was recommended in 2019 by Moffat and Nichol to be undertaken within 10 years, and money for this project is included in the capital spending plan.

At the time of the Mercator engagement in 2020, all vessels had recently been examined and evaluated by BHITA's surveyor (KOPCO Marine Services, Inc.), were documented and inspected by the U.S. Coast Guard, and were continuing to operate in regular service. Mercator also reviewed maintenance and operational records to confirm that vessels were being maintained in good condition and that acceptable maintenance protocols were in place and that these procedures were being followed. The Feasibility Study and Financial Model both include assumed indebtedness to purchase a new ferry (purchase price of approximately $4.5 million) and that debt service was included in the cash flows included in the Financial Model and are considered when testing loan covenants and reserve requirements. All other capital expenditures are funded by the forecasted cash flows from operations.

Certain improvements and maintenance expenditures associated with the System were undertaken by Seller during the time that the Authority and Seller were negotiating the sale of the System, including, re-dredging of spoils basins, bulkhead repairs, scheduled maintenance and tram replacements, new parking system software, and general parking lot expansion.

FEASIBILITY STUDY AND FINANCIAL MODEL

In developing the Feasibility Study, Mercator found that ferry traffic is highly correlated with the size of the Island's housing stock, and by the number of housing units added to the housing stock (i.e. those for which construction was completed in a year). These are the inputs that drive the Mercator forecast model, and as shown in its report, they predict very well the volume of ferry and barge traffic. Mercator examines both a median (expected) growth scenario ("Median Growth") and a Low Growth scenario ("Low Growth"); the Low Growth scenario formed the basis of the analysis by the rating agency Standard & Poors (" S&P") and is reflected in the Financial Projections. As shown on page 12 of the BHITA presentation, under the Low Growth scenario, new home construction is held at 10/year through 2036, while under the Median Growth scenario this number continues along the recent trajectory, beginning at 18/year in 2021 and slowly rising to 25/year by 2030.

Based on the Low Growth scenario, passenger ferry ticket sales are forecasted to grow at a compound annual growth rate ("CAGR") of about 1.1% in the near term declining to 0.9% over the long term, while barge tickets are forecasted to grow at slightly higher rates of 1.8% and 1.4% over the near- and long-term. In that scenario, Ferry Operation system capacity is not reached before 2050, parking expansion will be undertaken in FY 2022 to increase capacity to about 500,000 vehicle days per year, and Barge traffic is lower due to reduced construction activity. Peak barge traffic seen in 2019 is not reached again until 2049.

These assumptions produce EBITDA of $5.0 million in FY22, followed by about $4.5 million per year until 2027.

The Feasibility Study also assumes no change in the schedule of service, and no reduction in service.

The Authority did not engage Mercator to perform a discounted cash flow analysis part of the Feasibility Study.

Residential Units. The assumptions used to develop the Low Growth and Median Growth scenario were derived from historical information and information provided by Bald Head Association (the "Association") and the Village of Bald Head Island (the "Village"). There are still a substantial number of residential building sites available on the Island, including 749 within the Bald Head Association. These numbers do not include any lots in Middle Island and or in the developer PUD known as "SF-22". In addition, Mercator understood that a 12 unit condominium development is planned for Edward Teach Extension. Taken together, the available information indicates the ability to add more than 749 residential units. It is not, however, a requirement that this many residential units be constructed in order to support the BHITA acquisition of the ferry, parking and barge system.

In the Low Growth scenario, the pace of housing unit additions is forecast to be only 323 units being added between now and 2050, well below the potential 749+ units referenced above. In the Median Growth scenario, ferry passenger traffic reaches the Ferry Operation capacity limit of 535,000 round trip passengers in 2045, at which time the number of new housing units added would amount to 649, still below the 749+ potential.

Housing prices are not themselves directly part of the demand equation for the ferry and barge. However, rising prices are a clear and unambiguous indication of increased demand, from which it may be logically inferred that more housing units will be constructed during a period of rising prices.

Based on the foregoing, Mercator and the Authority concluded that the expected level of residential unit additions is reasonable in the Median Growth scenario and very conservative in the Low Growth scenario.

Mercator noted that in the first 6 months of FY 2021, 12 new residential housing construction permits were issued, reflecting an annual rate of 24 new units, which is 30% higher than the 18 new units that are expected in the Median Growth model for FY 2021. If the rate of additions in the early years outpaces the expected growth used in the models, this will increase ferry (and barge and parking) demand in each subsequent year.

In addition to developing the Median Growth and Low Growth scenarios, the Mercator financial model was run for stress-case scenarios that include a multi-year housing market recession starting in 2022. These scenarios were all provided to the rating agency to inform its analysis of the bond offering.

Assumptions as to Usage. In the Low Growth scenario, passenger traffic is expected to increase at a Compound Annual Growth Rate (CAGR) of 1.1% over the next 10 years from, and just 0.9% between 2022 and 2050. In the Median Growth scenario, Ferry traffic is expected to increase at a CAGR of 2.1% over the next 10 years (2022 to 2032), and 1.5% over the full analysis period (to 2050).

These growth rates are not high when compared to historical figures. During the eight years from 2011 through 2019, ferry traffic grew at 4.5%. For the entire 19-year period from 2000 through 2019, which includes the period of the Great Recession which had a devastating impact on real estate activity, traffic grew at a CAGR of 1.91%. These comparisons demonstrate that the 1.1% growth expected in the Low Growth scenario is conservative, and that the 2.1% growth expected in the Median Growth Case is reasonable compared to historic actual growth.

As a point of clarification, the volume model does not start with an assumed number of riders and then add a compounding growth to that figure. Rather, it computes the expected number of passengers based on long-term behavior of the System, which has been demonstrated to be closely related to the number of housing units in place and the number of housing units being added.

For example, 2019 (the most recent peak traffic year, in which 357,200 passengers were carried to and from the island) was a particularly strong year, with passenger volume that was higher than the model would have predicted. Because the model is based on the underlying long-term statistical relationship with housing, and is not based on any particular year, it does not simply project forward from that peak year.

Instead, according to the Mercator forecast model, in the Median Growth case the level of passenger traffic carried in 2019 will not be exceeded until FY 2024 (July 2023-June 2024). In the Low growth volume case, the 2019 level of passenger traffic is not exceeded until FY 2033. Growth in the Median Growth case is about 2.1% per year, and in the Low Growth case only about 1.1% per year, which reflect realistic and conservative expectations.

<u>Revenues</u>. Mercator also had access to an extensive and broad range of historical traffic, revenue, operational and financial reports of the Seller, including audited financial statements. This historical data was used to construct the forward looking cost and revenue models.

As illustrated in Figures 16 and 17 of the Feasibility Study, the forecast model predicts both ferry ticket and barge ticket volumes. Parking demand is derivative of ferry traffic ridership, and so future parking volumes are forecasted on the basis of the historic ratio between ferry tickets and parking vehicle days, which made the development of a separate regression analysis of parking demand unnecessary.

<u>Operating Costs.</u> The feasibility model projects future operating costs in two broad categories: variable costs, which are those costs that depend on the volume of traffic and the number of barge and ferry sailings that will be undertaken, and fixed costs, which are not dependent on volume. Using this approach to the modeling of costs, and accounting for the need to add ferry and barge voyages to accommodate additional volume over time, a cost projection was produced which accounts for inflation, changes in volume, and changes in the cost structure itself. Cost structure changes include the savings of $1.253 million per year that is currently being paid by BHI Transportation to Limited for the lease of terminal facilities. These lease payments will be eliminated in the acquisition, since the Authority will own the terminal facilities.

<u>Peak Demand</u>. The financial model was constructed on an annual basis. Peak demand was considered in order to estimate how many additional voyages would be required to accommodate peak period requirements (i.e. how often additional voyages would need to be operated to augment the base schedule), and to determine the ultimate capacity of the system. However, Mercator and the Authority understood that it would be unreasonable to set the capacity of the system on the basis of across-the-board peak utilization (for example, 8100 voyages/year x 150 passengers = capacity of 1.2 million passengers/year), and this was not part of the Feasibility Study. The details of the capacity analysis are explained in the Mercator Report.

Dolly and tram requirements are driven by the number of sailings per hour and the number of passengers per sailing. The system already accommodates full ferries sailing twice per hour. Additional trams and dollies are added when ferry sailings are increased above 2 per hour.

During peak ferry operations, 15 trams would normally be operating, providing a capacity of 15 x 12=180 passengers per hour, which is 60% of ferry capacity (150/sailing x 2 sailings/hour = 300 per hour). Not all ferry riders are entitled to a tram ride. Over the last four years, the year-round average fraction of ferry riders that use a ticket that includes a tram ride (Class I, Class II and Class VII tickets) has been about 51%, while during the April to September summer period the ratio has been about 56-57%.

The percentage of passengers with tram tickets who use the tram was consistently about 50% during the recent 4-year period (2017-2020). In each year, the high season utilization has been no more than about 1% higher than the full year utilization figures.

In the tram capacity analysis, Mercator took the conservative assumption that all 150 passengers on a given ferry voyage would be entitled to a tram ride and demonstrated the capacity to accommodate 55% of those passengers on a tram, which is more than the historical average of 50-51% of passengers who request a tram side.

As with airports, rail systems, and other transportation infrastructure, it may be that at certain maximum-peak holiday periods demand exceeds capacity. This is true for many transportation systems and does not mean that a system should be expanded. The Authority will consider capacity requirements in the future and make adjustments as may be necessary.

Parking capacity will be added in the first year of the Authority's operation of the System, and again in subsequent years as needed.

Revenue Accounting. The Seller maintains "deferred revenue" accounts for advanced sales of tickets and parking passes. These accounts reflect the amount of revenue collected for parking and ferry services not yet delivered. The purchase agreement calls for this revenue money, which has been collected for tickets and passes not yet used, will be transferred to the Authority upon closing. As of 12/31/2020, the (as-yet unaudited) deferred revenue amounted to $86,861 for ferry tickets and passes, and $246,000 for parking.

Parking. Parking space requirements (as measured in car-days/year) were modeled as a multiple of ferry passengers, using the historic ratio of ferry passengers to vehicle parking days. If it turns out that additional parking capacity is required beyond what has been included in the capital plan, it will almost certainly be due to the fact that parking lot vehicle-days have increased beyond what has been forecast, or because ferry traffic has increased faster than expected. If either of these things occur, parking revenue will have increased above what has been forecast. With extra parking revenue in hand, it should be an easy decision to accelerate the timeline for parking lot improvements.

Mercator concluded that it would be necessary for parking to be developed as traffic increased, and included in the capital plan the resources needed for the addition of 167 stalls to be added in the first year of operations. Further development of Authority-owned land (land to be included within the transaction) would meet the parking needs through about 2041 (503,000 ferry passengers). Costs for this parking lot development are included in the plan.

In addition to developing land that is to be included in the initial transaction, the Authority will have an option to purchase and develop additional land (an area somewhat larger than Area #2 as shown in the Feasibility Study Figure 10), which will support parking for another 24,000 passengers (sufficient to serve a total of 527,000 passengers, and just shy of the 535,000-passenger system maximum).

At that level of passenger traffic and corresponding parking demand, (which is expected, in the Median Growth case, to be reached in about 2044), the Authority will have several choices:

(a) buy additional land at Deep Point (Area #3 shown in Figure 10 of the Mercator Report) to add as many as 300 additional stalls, which would take parking capacity well-beyond the expected maximum ferry system traffic level of 535,000. This is the solution that is assumed in the feasibility analysis.

(b) increase parking density during peak periods (using a valet system, for example),
(c) buy off-site land and operate shuttles, or
(d) encourage alternate means of arriving at Deep Point to reduce the number of cars that need to be parked.

With regard to option (d) above, it is understood that although guests generally come from a significant distance and will likely continue to travel by private car, over half of ferry riders are contractors or employees who come and go every day from nearby communities. Only a small fraction of these daily drivers would need to change their mode of arrival to have a meaningful difference. Although the success of the system will not depend on it, it is not unreasonable to think that some alternative local transport system could be implemented over the next 20 years.

The Authority will therefore have several means at its disposal to address future needs for expanded parking, with only one of them involving a change in rider behavior. In any case, it will be many years before the parking expansion options at Deep Point (that rely upon the current parking model) will be exhausted.

Financial Model. Building off of the Feasibility Study, the Authority's Financial Advisor developed a comprehensive forward-looking financial model to provide additional perspective on the financial performance of the Authority based on industry accepted cash-flow modeling methodologies. The financial modeling included the operating projections derived from the feasibility work, including capital investment and projected rate increases. It also incorporated debt assumptions consistent with municipal debt conventions and with guidance/input from the Authority's Underwriter and LGC staff. Key financial ratios and metrics are included in the financial forecasting consistent with required covenants, as prescribed in the Authority's bond documents.

The financial modeling assisted the Authority through its asset purchase negotiations and provided the Board with perspective related to the overall affordability and viability of the proposed Authority operations. Additionally, the financial modeling was utilized in the rating agency discussions.

Going forward, the Authority will be able to maintain and update the financial models, which can be used as a resource in developing the Authority's annual budget, its capital improvement plan and as a long-term planning tool.

OPERATIONS GOING FORWARD

Many questions and comments were raised about the operations of the System going forward. The Authority looks forward to being in a position to address operational improvements once it has a source of revenue and a budget that will allow it to hire staff, put in place processes and procedures for input from riders, have control the system, and implement change as it determines to be in the best interests of the users of the System.

At the outset, the Authority will work closely with Bald Head Island Transportation, Inc., the Operator under the Operations and Transition Services Agreement ("OTSA"), to keep the System running and to transition the operations to the Authority in an orderly fashion. The Authority will have control over the budget of the System and all capital expenditures.

The Authority also expects to consider and/or implement a number of the comments it has received.

- Create a “citizens advisory group” or put in place a similar mechanism to obtain input from residents of the Island and other users of the System in order to receive input on various aspects of the operation of the System

- Consider changes to policies that might alleviate the bottleneck during peak season, such as limits on the amount of luggage

- Continued focus on the experience of riding the Ferry

- Continue to work with local governments on COVID restrictions and making the experience as positive as possible notwithstanding those restrictions

- Consider development of and deployment of advanced electronic ticketing systems

- Consider buying fuel forward to lock in the cost of fuel and have better budget control of that variable cost

- Consider an independent study to address any employee issues arising from the transition from a private entity to a public one

- Work with the Village to address vehicular ingress and egress constrained by existing buildings and dune structures

- Consider engaging a professional land planner to conduct a land use study to include all parcels within the area with participation of all stakeholders, including the Village

- As with all coastal areas, consider effects of climate change, both sea level rise and changes in storm frequency and/or intensity as part of long-term planning

<u>Governance</u>. The Trustees are all appointed by governmental bodies; the Board itself does not select new members. The Board may consider recommending candidates to the various appointing bodies for consideration, although it cannot require that those members be appointed. Note that the statute requires three members appointed by, or ex officio) from, the Village, and a fourth appointed by North Carolina Department of Transportation must live in the service area of the System.

<u>Oversight</u>. The structure and involvement of the Board will aid in the successful launch of the new ownership. While it is true that the North Carolina Utilities Commission (“NCUC”) will no longer oversee rates, the elimination of the separation between the regulated ferry and tram system and the unregulated parking and barge system will allow the Authority to create a more integrated system. It also will allow the Authority additional flexibility in setting schedules. For example, during COVID, the Authority would have been able to add additional voyages to compensate for the reduced number of passengers permitted per voyage.

<u>Management</u>. Because the Authority has no revenue until it begins operating the System, the Board thought it prudent to retain the current management on an interim basis while recruiting and hiring a CEO and other permanent members of the management team. That recruitment effort will begin shortly after the Authority takes over the System. The new team will be expected to work closely with the Operator and to understand the assumptions and expectations included in the Feasibility Report. All of the costs of operating the System going forward, derived from the audited financial statements of the System in the past, are included in the Financial Model and will form the basis of the budget for the Authority’s operations.

The OTSA between the Authority and the Operator, which is an exhibit to the Asset Purchase Agreement, has been posted to the Village and the Association web pages and is attached as *Exhibit H*. As set forth in the OTSA, BHITA will approve the budget of operating the System and will approve all expenditures in excess of the budget. The funds of the System will be held by the Authority. All revenues of the System will be deposited daily with the bond trustee, and will be delivered to the Authority on a monthly basis to pay budgeted expenses. The Authority will provide those funds to the Operator to pay costs. The Authority has a part time Finance Director who will initially oversee day-to-day spending by the BHITA, based on the budget.

CODE OF ETHICS

A question was raised as to whether the Authority would publish and commit to enforcing a Code of Ethical Business Conduct applicable to the Trustees, management and employees of the Authority operating the System.

The Board of the Authority and any employees hired by the Authority are bound by the conflict of interest rules that prohibit public officials and employees from receiving personal benefit as a result of their position. For example, N.C.G.S. § 138-5 places statutory limits on the compensation of appointed public officials, and N.C.G.S. § 14-234 prohibits any public officer or state employee from deriving a direct financial benefit from contracts that they are involved in making or administrating. In addition to these statutory conflict of interest rules, many public bodies adopt their own specific Code of Ethics. The Authority may consider supplementing the existing state regulations with their own specific guidelines after the acquisition of the System.

ASSET PURCHASE AGREEMENT

The Asset Purchase Agreement has been negotiated through multiple drafts. The most recent draft is available on the Village and Association web pages.

Intellectual Property. The Asset Purchase Agreement provides for the transfer to the Authority by the Seller of several website addresses associated with the System, a Facebook social media page associated with the System, software programs associated with the System and the unregistered tradename "Bald Head Island Transportation" at closing.

Deep Point Marina. The property shown as Tract 2 on the map attached as *Exhibit I* (the "Deep Point Map"), which includes the current parking and several parking expansion areas, the ferry terminal, maintenance and warehouse buildings, barge area and spoil area, as well as the property shown as Marina Channel Basin on the Deep Point Map, which includes the ferry marina basin and marina entrance channel, will be transferred to the Authority at closing, and the Authority will enter into a cost sharing agreement with the owner of the rest of the property shown on the Deep Point Map at closing whereby the Authority will pay 42% of the marina maintenance, dredging and spoil expenses of the Deep Point Marina and the owner of the rest of the property shown on the Deep Point Map will pay 58% of such expenses going forward. This document will be perpetual in duration and will be recorded in the Brunswick County Registry at closing.

Bald Head Island Marina. The property shown as Parcel A on the map attached as *Exhibit J* (the "Bald Head Island Map"), which includes the ferry terminal, tram loading and parking area and the barge landing and barge landing access area, will be transferred to the Authority at closing. The Bald Head Island Marina and related spoil area are owned, maintained and operated by the Bald Head Island Marina Association, whose members currently consist of the Bald Head Island Yacht Club (as a 50% member), BHI Transportation (as a 23% member), the Village of Bald Head (as a 22% member) and Limited (as a 5% member) under an agreement which is perpetual in duration and is recorded in the Brunswick County

Registry and which governs the ownership and maintenance of the Bald Head Island Marina and related spoil area and the sharing of such expenses on a membership percentage basis, and the Authority will be substituted for BHI Transportation as a 23% member of the Bald Head Island Marina Association at closing.

Income taxes. Seller will be responsible for any taxes assessed for the results of the operations before the acquisition of the System, even if those taxes are due after the closing of the transaction.

Financial audit. The Authority has received and reviewed five years' of audited financial statements on the operations of the System.

Payment of Purchase Price. The purchase price will be paid directly by the Authority to the Seller. None of the purchase price will be paid by the Authority to any other person or entity.

Franchise Fee. Following the acquisition of the System by the Authority, it will be exempt from property taxes by Brunswick County, the City of Southport and the Village. However, the Authority will enter into an agreement with those entities to pay a franchise fee in lieu of taxes to entitle it to continue to receive services such as fire protection, police protection and other emergency response services. Those fees are built into the operating costs in the Financial Model, and are the same amounts as the property taxes paid in the past.

BOND ISSUANCE

Rating. S&P is the only rating agency that provided a public rating for the proposed Bonds. The BBB- credit rating from S&P makes the Authority the highest rated unsubsidized ferry operation in the world. While the S&P rating notes the Authority's "moderate debt burden" as a key credit strength, a limiting factor on the Authority's rating and any monopolistic infrastructure asset is its relatively narrow revenue base. The Authority's stable credit outlook means the rating is not likely to change for the next two years; however, the S&P report notes that the rating could be raised if "activity is sustained at higher levels than we expect [which was the Low Growth case], resulting in debt service coverage or debt-to-net revenues increasing at levels we believe are sustainable."

Financing Alternatives. From a financing perspective, a public municipal bond offering gives the Authority the broadest possible distribution at the lowest possible cost of capital, with repayment spread over 30 years. This combination will reduce the fare burden on users relative to other financing options, including private equity capital, which would likely cost multiples in excess of the municipal bond option, with the addition of a profit motive that siphons cash away from the System.

The next borrowing anticipated by the Authority is for the acquisition of a new ferry in 2023-24. That financing is permitted under the bond documents, and could be done as privately placed debt and/or a lease purchase arrangement. The financial modeling assumes the Authority will be paying debt service on a 10-year municipal bond issuance to finance the vessel.

Effect on other Municipal Debt. The Authority's revenue bonds are payable solely from the revenues of the System. No taxpayer dollars are involved in the repayment of the debt or the operation of the System. The Authority's debt is non-recourse to any governmental unit with taxing power, and secured only by System net revenues. The Authority's debt does not overlap with any existing or future general obligation bonds issued by the Village, the City of Southport or Brunswick County and should not be considered in any credit rating assessment of those entities.

NEXT STEPS

The Authority will continue to work with the staff of the LGC to request consideration of the bond issuance at the April 13, 2021 meeting. It will continue to refine and update the offering documents, with the hope of a sale of the Bonds in late April and a closing in May. Thereafter, the Authority will begin the process of hiring a CEO and operating the System as a publicly owned ferry transportation system.

The Authority wishes to express its appreciation to the Village of Bald Head Island (including in particular Carin Faulkner, its Public Information Officer), Bald Head Association (including in particular, Carrie Moffett, Executive Director) and Bald Head Island Club (including in particular, Nick Mott, IT specialist) for their assistance in hosting the information session and public hearing, providing a forum for questions, and a place on their web pages for the Authority to post information.