

BALD HEAD ISLAND TRANSPORTATION AUTHORITY
RESPONSES TO QUESTIONS REGARDING THE BHITA
ACQUISITION OF THE BHI FERRY SYSTEM (JULY 6, 2021)

Bald Head Island Transportation Authority (the “Authority”) is providing answers to the list of questions delivered to the Authority by the staff of the North Carolina Local Government Commission (the “LGC”) on Monday, June 14, 2021 that were designated either “1” (must be answered) or “2” (Nice to know). Because so many questions have been raised by the public, the Village and the LGC about the real property appraisals prepared by Earl Worsley (the “Worsley Appraisals”) in determining the value of the real property portion of the Ferry Transportation System (the “System”), the Authority has ordered a new appraisal of the Deep Point Ferry Terminal property and the Bald Head Island Terminal property. Greg Becker with Newmark Valuation Services in Florida, a nationwide appraisal firm with demonstrated experience with marina property, is performing the appraisal. In selecting the new appraiser, the Board of Trustees of the Authority first reviewed the credentials of three commercial appraisers who had no connections with either the Village of Bald Head Island or the sellers of the System, and narrowed the choice to two appraisers, both from outside North Carolina, who were found to have the most relevant experience. A subgroup of the trustees (consisting of two residents of Bald Head Island and two other trustees), then interviewed the two appraisers and unanimously selected Mr. Becker of Newmark. The Authority specifically requested Mr. Becker to apply all three standard approaches to the appraisal, including the income approach. Under the contract, the Authority expects to receive the appraisal on or about July 15 (the “New Appraisal”). The New Appraisal will be presented to the Authority and the public in an open meeting and Mr. Becker will be available to answer questions. It will also be provided to the LGC.

Since there will be a new appraisal, the Authority has not attempted to provide answers to all of the questions about the Worsley Appraisals, but instead, has simply referenced the fact that there will be a New Appraisal.

1. Why is there such a great disparity between the appraised value of the Deep Point Ferry Terminal Operation (Deep Point) and the Bald Head Island Ferry Operation (Bald Head) and the Tax Value of the same properties?

ANSWER: While we do not know what values the New Appraisal will provide, we note that the methodology used for an appraisal for property tax purposes (which is a mass appraisal) and an appraisal for purposes of determining the purchase price of a single piece of property are different, which often results in a different value in the appraisal as opposed to the assessment. Brunswick County’s methodology in providing assessed values for real property in the County in the most recent valuation year (2019) is outlined in the Brunswick County 2019 Real Property Appraisal Manual (the “Brunswick Manual”), which in turn relies heavily on the standards for mass appraisal found in Standard 6 of the 2019 Uniform Standards of Professional Appraisal Practice (“USPAP”). As stated in the Brunswick Manual, “market value for assessment purposes is generally determined through the application of mass appraisal techniques. Mass appraisal is the process of valuing a group of properties as of a given date using common data, standardized methods, and statistical testing. To determine a parcel’s value, assessing officers must rely upon valuation equations, tables, and schedules developed through mathematical analysis of market data.” Brunswick County accomplishes this by using computer models to run statistical tests on data collected about the properties. Mass appraisal aims to produce uniform, low-cost valuations of property, not to provide individualized valuations of unique properties.

In contrast, an appraisal of a particular piece of property for purposes of determining a fair sale price of property is done in accordance with Standard 1 of the 2020-21 USPAP. An appraiser

weighs the specific characteristics of a particular piece of property based on standard methodology to determine the market value. While both the mass appraisal and the individual appraisal use the three recognized approaches—the cost approach, the sales comparison approach, and the income approach – an individual property appraisal performed under Standard 1 uses information that is very specific to the property in question, whereas the mass appraisal must use general market data. The Brunswick Manual notes that “the cost approach is most applicable to industrial and special use properties for which market and/or income data is scarce or nonexistent.” Both the Brunswick Manual and the USPAP acknowledge that “[i]t is implicit in mass appraisal that, even when properly specified and calibrated mass appraisal models are used, some individual value estimates will not meet standards of reasonableness, consistency, and accuracy” (Brunswick Manual, p. 10). For these reasons, it is general practice in real estate transactions for buyers and lenders to obtain individual appraisals of the property rather than rely on the mass appraisal for purposes of ad valorem tax assessment.

As shown in the chart included under question 2 below, there are several significant differences between the appraised value and the assessed values, which account for the differences in overall value. For example, the values assigned to the buildings (using only cost less depreciation) are markedly different (\$9,262,950 in the appraisal versus \$1,788,990 in the tax assessment). The numbers in the appraisal are much closer to the actual cost less depreciation on the books of the current owner of those buildings. Similarly, the number assigned by the assessor to site improvements, including bulkheads, docks and piers (\$1,101,210) is significantly less than the amount shown in the appraised value (\$10,009,583). Again, the appraised values are more in line with the actual cost of those improvements (see chart below). It is not clear why the assessor assigned such low values to the buildings and site improvements.

[Remainder of page intentionally left blank]

2. For each building/site improvement, how does Worsley’s appraisal valuation compare to the book value, depreciated based on useful life of the assets?

ANSWER: The following is a list of the buildings at Deep Point and at the Bald Head Island Terminal, including cost and depreciated value in 2020, which information was provided by the Seller, and the values on a building by building basis from the Worsley appraisals in 2019. The assessed value was derived from the 2021 tax bills, which were based on the values determined in the 2019 assessment.

Asset Description	Seller's Cost	Seller's Book Value**	Worsley Appraised Value*	Brunswick County Assessed value
DP Maintenance Building	\$ 775,836	\$ 464,081	\$ 375,196	
DP Main Ferry Terminal Building	\$ 8,261,654	\$ 5,152,506	\$ 7,408,260	
DP IT Server Room Building	\$ 88,051	\$ 66,508	\$ 41,138	
DP Warehouse/shipping and receiving	\$ 1,271,645	\$ 775,258	\$ 425,840	
Parking Booths	\$ 67,372	\$ 11,351	\$ 12,516	
Deep Point - All Buildings	\$ 10,464,558	\$ 6,469,704	\$ 8,262,950	\$ 2,060,640
DP Bulkheads, docks piers	\$ 3,025,310	\$ 349,650	\$ 2,338,750	
DP Site Improvements	\$ 4,364,988	\$ 1,410,535	\$ 7,670,833	
DP Site Improvements including Bulkheads, Docks and Piers	\$ 7,390,298	\$ 1,760,185	\$ 10,009,583	\$ 1,101,210
Deep Point - Land	\$ 299,022	\$ 299,022	\$ 10,520,000	\$ 7,101,380
Deep Point Total	\$ 18,153,878	\$ 8,528,911	\$ 28,792,533	\$ 10,263,230
Bald Head Island Docks, Piers and Bulkheads	\$ 1,887,676	\$ 226,998	\$ 687,500	
Bald Head Island Site Improvements	\$ 423,199	\$ 163,467	\$ 150,625	\$ 39,870
BH Island Site Improvements including Bulkheads, Docks and Piers	\$ 2,310,875	\$ 390,465	\$ 838,125	\$ 39,870
Land			\$ 3,730,000	\$ 3,500,340
Bald Head Island Terminal	\$ 175,383	\$ 48,085	\$ 234,208	\$ 170,420
BH Island Terminal Total	\$ 2,486,258	\$ 438,550	\$ 4,802,333	\$ 3,710,630

Notes: *The Appraised value column uses cost less assumed depreciation as shown in the Worsley appraisals, and does not include the 10% for indirect costs or 15% for developer’s profit that Worsley included in his overall cost model.

**The book value column reflects cost less depreciation, including accelerated depreciation on some assets, as permitted under applicable accounting treatment. The placed in service dates for various assets that make up these categories date back as far as the late 1980s.

*** The Bald Head Island Terminal numbers (Cost and Book) do not include a value for land.

3. While the methodology is said to be in accordance with appraisal standards, I need more evidence, independent and objective, to be convinced these values used in the appraisal are justified, especially given the qualifying statement on the Limiting Conditions page of the report stating that all opinions, estimates, data and statistics furnished by others are assumed to be correct.

ANSWER: See New Appraisal.

4. Deep Point - How is it that entrepreneurial incentive applies in “this” deal? (Referring to deal in Question 53).

ANSWER: See New Appraisal.

5. Analysis of comparable market data: 5% annual upward adjustment was used, stated to be based on historical data. What historical data? Because it is also stated the 5% is “somewhat” judgmental.

ANSWER: See New Appraisal.

6. Analysis of comparable market data: Comparable 1 & 4 properties received a 10% upward adjustment due to inferior locations but no background on why the locations are inferior. So why this percentage and where is the justification for these 2 Comparables?

ANSWER: See New Appraisal.

7. Analysis of comparable market data: I understand the adjustment upward for utilities for comparable 1 but nothing indicates this is justified for 2, 3, 5. So what is the justification?

ANSWER: See New Appraisal.

8. Analysis of comparable market data: I don't understand why the 5% upward adjustment for Comparables 2, 4 and 5 for zoning. There is nothing to justify this zoning. What is the justification for this?

ANSWER: See New Appraisal.

9. This is not a question but it does need to be done –in the next appraisal the Income Approach, for which data was gathered but not used to assist in the appraisal of Deep Point and Bald Head, should be utilized.

ANSWER: The Authority requested that the Income Approach be included in the New Appraisal.

10. In the Chair's letter to the Local Government Commission dated March 4, 2021, page 35 in the LGC packet, but page 2 of the “Bald Head Island Transportation Authority, Questions and Answers”, the Authority dismisses the transaction price as a multiple of earnings (EBITDA). The current purchase price of the System reflects a value of roughly 12 times EBITDA (Earnings Before Interest, Taxes, Depreciation & Amortization) when a multiple of 4 to 6 is said to be typical for transactions of this type. The Authority refers to this metric as a “rough” measure when nothing in the appraisal world indicates there is anything “rough” about it. Certainly, there are pros and cons but nothing “rough” that would cause the Authority not to consider the metric. How is it that the Authority “dismisses” this metric without any real, valid reasons for doing so? Most of the argument that “is” given is based on “Projected” EBITDA for FY 2022.

ANSWER: There is no standardized approach to valuation to this type of asset, as governmental acquisitions of privately held infrastructure assets are very rare. Furthermore, the Authority is operating under a statute that requires it to acquire assets rather than a business. EBITDA is a measure of profits that also takes into account variable tax rates and depreciation policies. Because the Authority is not a for-profit entity, and will not pay taxes or depreciate assets for tax purposes, the Authority did not focus on EBITDA as a valuation tool for either value or feasibility. As noted below in question 19, since the Authority will be operating as a public entity rather than a private enterprise, its financial analysis and financial projections are all based on operating cash flows rather than net income and do not factor in non-cash revenue or expenditure items that could overstate financial performance. Rather than using a simple projection of the seller's historical net

income to estimate Authority financial performance, the Authority worked with a feasibility consultant to develop cash flow models as part of its due diligence of the transaction. In developing these models the sellers' historical audited financials were reviewed and analyzed to inform future projections of operating cash flow.

11. What is the current tax value of the land and improvements at Deep Point and at Bald Head Island?

ANSWER: Tax values based on 2021 Tax Bills

Deep Point terminal property (52 acres), all buildings and site improvements, plus submerged channel basin,	\$10,263,230
Island Terminal (5.89 acres) (land and improvements)	<u>3,710,630</u>
Total	\$13,973,860

12. When was the assessment done?

ANSWER: 2019

13. Is the fee appraisal a "Going-Concern Value"? If yes, have the intangibles, goodwill been appraised separately? By statute intangibles are exempt for property tax. So the county assessor could only appraise the tangible property (land, ferry, equipment). Whereas the fee appraiser may be valuing the entire ferry system as a business and maybe including intangible assets (such as workforce, contracts with vendors, trademarks, goodwill, etc.) in their appraisal that by definition could not be included in the county's assessment.

ANSWER: The real estate appraiser was asked to perform an appraisal of the real estate that would be transferred to the Authority as part of the Ferry Transportation System, based on the language in the Authority's authorizing statute that requires it to purchase the assets used and useful in the operation of the System at or below their appraised value. The appraiser was not asked to conduct an enterprise or "going-concern" valuation. See also the answer to Question 19, below.

14. What are the dates of the appraisal (or what is the date the appraisal is based?) The county's land value will be based on their last reappraisal which was January 1, 2019 and their personal property will be based on January 1 of the date of the appraisal (which I am assuming is January 1, 2020). What is the date of the fee appraisal? If January 1, 2020 – then we could assume the land values would have changed some (not to that extreme) but it is possible we are not comparing apples to apples.

ANSWER: The Worsley Appraisal was completed in 2019; the New Appraisal will be dated July, 2021.

15. Do both appraisals clearly identify what they are appraising? Does the fee appraisal say it is appraising the tangible assets only, or the ferry system as a business? We know the county can only appraise the tangible assets.

ANSWER: The New Appraisal will be an appraisal of the market value of the fee ownership of

the real property located at the Deep Point terminal and the Bald Head Island terminal.

16. What is the purpose/use of the appraisals? The county's appraisal is for property tax purposes, but there are all kinds of reasons to hire a fee appraisal. The purpose is normally listed early in the fee appraisal. But based on why the appraisal was conducted could explain the variance in values. But to compare the two, they really should be based on the same purpose.

ANSWER: As noted in question 15, the New Appraisal will be an appraisal of the market value of the fee ownership of the real property located at the Deep Point terminal and the Bald Head Island terminal.

The Brunswick Manual states that the 2019 revaluation is a mass appraisal performed pursuant to USPAP Standard 6 for ad valorem property tax purposes.

17. What information did both sides have to conduct their appraisals? The county is following their schedule of values for the appraisal of the land, and likely using cost figures reported by the taxpayer to determine the ferry value and any other personal property. But did the fee appraiser have additional information provided to them that the county didn't? Were there major renovations to the ferry that were not provided to the county assessor? Example – airplane values typically drop as they get older. However, if you added certain engine kits to them or replaced the engines with new ones, you could have the values increase. Any major overhaul should have been reported to the county over the years; have there been any and were they reported?

ANSWER: As noted in response to question 1 above, the Brunswick Manual indicates that the information used by Brunswick County in a mass appraisal is based on general market information. The appraiser undertaking the fee appraisal has access to specific information about these parcels of property, including actual revenue generated in the past and expected revenue for the future, cost of repairs, third party studies as to needed capital expenditures, etc.

18. Please provide a new appraisal without limitations set on it.

ANSWER: See New Appraisal.

19. Has a quality of earnings assessment been conducted as is typical for transactions of this size and nature and has it been disclosed?

ANSWER: We understand that a quality of earnings report is often prepared for private acquisitions to determine the underlying nature of a private company's net income for a specific time frame and the associated cash flow attained during that same period. In particular, the quality of earnings report provides details on the expected operating cash flow of the private enterprise in comparison to the net income which can be skewed by large non-cash/balance sheet items or other nonrecurring revenue sources.

Given that the Authority will be operating as a public entity rather than a private enterprise, its financial analysis and financial projections are all based on operating cash flows rather than net income and do not factor in non-cash revenue or expenditure items that could overstate financial performance. Rather than using a simple projection of the seller's historical net income to estimate Authority financial performance, the Authority worked with a feasibility consultant to develop cash flow models as part of its due diligence of the transaction. In developing these models the sellers' historical audited financials were reviewed and analyzed to inform future projections of operating

cash flow. The revenue projections included in the feasibility study were derived from five different projections of ridership, parking usage and barge usage (system demand) in varying economic/development scenarios. These annual revenue calculations were based on the projected system demand and assumed rates while future operating expenditures were informed by the historical results and adjusted to reflect the Authority's anticipated operations. As discussed in its response to other questions herein, capital expenditures were also included in the analysis of the Authority's cash flow.

The results of this cash flow model were utilized to develop a cash flow pro forma projecting the Authority's debt service coverage and reserve balances. The feasibility report and cash flow pro forma projections are publicly available and have been submitted to the LGC.

20. Is there sufficient community support, including by the regular users of the Transportation System, for the Project/financing? LGC Guidelines, Section 7) ("Community Support for the project is important, especially for non-voted debt. Lack of community support may be evidenced by comments at meetings of the governing body or public hearings, correspondence, newspaper articles, etc.").

ANSWER: As the LGC is aware, both Brunswick County and the City of Southport have passed resolutions in favor of the proposed transaction under which the Authority will own the ferry transportation system. There have been a number of public hearings and public comment forums, including social media postings, both in favor of and against the transaction. Recently, there have been several communications to the LGC in favor of the Authority's transaction, including an email from Mr. and Mrs. Edward Johnston on June 27, 2021, an email from Mrs. Elizabeth Robinson on June 28, 2021, and a letter to the LGC dated June 28, 2021, sent by Dr. Elizabeth Stephens and signed by more than 100 property owners and residents of Bald Head Island.

On June 11, 2021, the Board of Directors of the Bald Head Association (representing all of the property owners on the Island) provided an open forum for representatives of the Authority, the Village and the Sellers to make presentations and respond to questions from the Association Board. Following that meeting, the Association has circulated to its membership a survey regarding the transaction, asking for responses by July 1, 2021; the results of that survey will be provided to the LGC as soon as they is available.

21. Do the proposed transaction and financing adequately account for the condition of the assets and improvements necessary to operate the System through the maturity date of the financing?

ANSWER: The proposed transaction, related documentation and the cash flow projections include capital expenditures necessary to operate the System going forward. The feasibility study, which provides the basis for the cash flow analysis, uses historical traffic and financial data provided by BHI Limited and the audited financial statements, to develop a forecast of volume, rates, operating expenses, and capital expenditures by line of business: (i) passenger ferry and on-island tram, (ii) parking, and (iii) tug and freight barge. Costs included in the financial model are based on continuing to operate the ferry and barge system in its present form. If the Authority makes changes in those operations, it would adjust the capital and operating budgets accordingly to address those issues.

Operating expenses were forecast based on historic actual costs, carried forward to include and reflect (a) the specific operating circumstances of the Authority and the terms of the transaction, (b) adjustments for inflation and (c) increases to costs related to increased volumes and additional

sailings that result from increasing volumes. Capital expenditures were forecast considering (a) the requirements to expand capacity to handle growing volumes with a level of service comparable to historical service levels, (b) the need to replace existing assets at the end of their assumed useful life, (c) on-going “sustaining” or “maintenance” capital expenditures in line with historical spending, and (d) required additional maintenance and life-extension work identified by inspections carried out by engineers retained by the sellers and the Authority. Capital expenditure assumptions included the following:

- (i) replacement of each of the four ferry vessels when each vessel reaches the end of its expected useful life. Mercator, the Authority’s feasibility consultant, has assumed replacement of ferries with catamaran type ferries (similar to the Ranger and Patriot) at defined intervals based on an approximate useful life of 45 years, with a current (2020) cost of approximately \$4.5 million per unit, escalated by inflation;
- (ii) capital expenditure forecast includes costs for major programmed spending such as engine overhauls for vessels;
- (iii) replacement of tram trucks at defined intervals under an assumed useful life of about seven years, which is consistent with the historical trend;
- (iv) replacement of the un-powered passenger trailers after 20+ years;
- (v) new ferry ticket system;
- (vi) the addition of 167 parking stalls at the northwest corner of the campus that will be done no later than 2024, followed by additional stalls as demand dictates;
- (vii) all of the repair and replacement work identified by Moffat & Nichol as being required within the next 10 years, including bulkhead and dock repairs, a ferry landing replacement, periodic barge ramp replacements, and recommended inspections; and
- (viii) additional “sustaining” capital expenditure amounts that are consistent with the average historical capital expenditures incurred over recent years, and increased going forward for inflation.

22. Are the financial projections consistent with past performance, including the audited three (3) year financial statements?

ANSWER: The financial model was constructed using the 2019 actual results as the base for the model, with forecasts informed by the cost trends shown in the historical financial statements going back five (5) years. Adjustments were made to specific costs that are known to be changing as a result of the new ownership and management structure.

23. Did the Mercator cash flow projections take into account:

- c) the revamping of the baggage delivery system.

ANSWER: Revamping of the baggage handling system at Deep Point Terminal was not included in the Mercator capital or operating costs. As has been explained by the current operator of the ferry system, and witnessed periodically by others, from a mechanical perspective the baggage

handling system operates properly, receives routine maintenance and is not in need of capital investment. Using the system, however, requires an increase in staffing, which the present operator has chosen not to do for cost economy reasons. Should the Authority reach a different conclusion with respect to the benefits of using the baggage handling system, the Authority would be free to do so.

24. The value of the land used for the first comparable for Deep Point is a “listing”. The difference in the price per acre versus the most recent (2016) sale is a 45% increase. Why is the adjustment 10%? What backs up that judgement call?

ANSWER: See New Appraisal.

25. Why don't the Village and the Authority agree on an appraiser AND split the cost of the Appraisal?

ANSWER: The Authority has selected the new appraiser with input from a subgroup of Trustees that included the Trustee appointed by the Village and another Trustee who lives in the Village. The Mayor and Mayor Pro Tem (who are also Trustees) declined to participate in the process, although they voted with the rest of the Trustees to approve the choice of appraiser recommended by the subgroup.

26. What is the Authority's plan for holding a meeting where “all” questions are answered openly and thoroughly?

ANSWER: Once the New Appraisal is completed, the appraiser has agreed to meet with the Trustees of the Authority in open session, where members of the public will be invited to attend, to present the appraisal and answer questions.