

June 8, 2021

Memorandum to BHI Village Council

Re: Bald Head Island Transportation Authority

We are writing to urge the Village Council, as the only active voice representing BHI taxpayers and stakeholders, to redouble its efforts in opposing the BHI Transportation Authority's (BHITA) current plan to acquire the BHI ferry system for \$47.75M, and pay for it through a \$56.1M revenue bond issue. As things currently stand, in the next 60 days or so, BHITA will likely conduct a second appraisal of the ferry system, revise its proposed purchase price and bond issue downward by a modest amount, and resubmit its bond application to the NC Local Government Commission (LGC). Absent a concerted effort by the Village to scrap anything approaching BHITA's current proposed deal with Limited, the LGC may have no choice but to approve the bond application.

The consequences of the latter scenario are dire and not well understood by most BHI property owners. If implemented, BHITA's current \$56.1M bond application would require annual debt service payments totaling \$111M over the next 30 years. BHI property owners would bear nearly all of these costs directly or indirectly. Similarly, because BHITA's bond proceeds would be used almost entirely to pay Limited \$47.75M along with various fees associated with issuing the debt, BHI property owners would get nothing in return for incurring the cost of BHITA's debt. Indeed, it would be as if the Village decided to raise local property taxes by an additional \$111M over the next 30 years -- an average \$3.7M per year beginning in 2022, or nearly 25 percent of the Village's current annual budget -- and donated all of those added tax receipts to Brunswick County, or some other removed third party, no strings attached.

The Problem

The problem with BHITA is twofold. First, the BHITA Board "negotiated" a purchase price with Limited that is excessively high, which resulted in a revenue bond application that is far larger, and riskier, than it needs to be. This resulted from the fact that because BHITA had no state funding to carry out its statutory responsibilities, Limited, the seller, paid for all professional consultants that BHITA, the buyer, relied on to appraise the ferry system and develop its bond application. Compounding the problem, it appears that at least some of the consultants working on BHITA's behalf only get paid if and when the transaction closes. Moreover, some of these consultant fees, particularly those incurred in developing the bond application, will ultimately depend on the size of the issue. Thus, BHITA's valuation process is rife with very serious conflicts of interests that have given rise to: 1) a proposed acquisition price that is well above anything that might reasonably be construed as a fair market value, and 2) a revenue bond application that subjects BHI, as well as the state, to unreasonable costs and unnecessary credit risk.

We know that BHITA's \$47.75M offer price for the ferry system is well above its fair market value for two reasons. First, in this instance, that value (by definition) is supposed to reflect the price that a willing buyer -- other than BHITA -- would agree to pay for the ferry system as a whole (or some combination of its ferry, barge, and parking operations) were Limited to put those assets on the open market and agree to accept that buyer's offer price. Without getting into a lot of financial detail about what a third party (e.g., another commercial operator) might pay for the system, or any one of its three components, it is virtually certain that no entity (other than BHITA) would willingly borrow \$56.1M in order to pay Limited \$47.75M.

A debt load of \$56.1M, after all, is five times the ferry system's 2019 total operating revenues and roughly 15 times its 2019 earnings before interest, taxes, and depreciation (EBITDA). In a normal commercial setting, a debt-to-EBITDA ratio of less than 3 is considered reasonable for privately owned businesses and their creditors. Ratios above 3 or certainly 4 are "red flags" when it comes to judging a business' credit worthiness, but the ratio here is five times what is routinely considered reasonable or safe.

Again, BHITA's proposed acquisition price and bond issue "work" only because under the terms of the Ferry Transportation Authority Act (that Limited helped write), BHITA would have complete discretion to raise rates for the ferry, parking and barge services to whatever levels BHITA would need to service its debt. BHITA can and would do this because the ferry system is a local monopoly which the Act expressly deregulates once it is acquired by BHITA. Importantly, the Act also effectively eliminates any recourse that BHI property owners have to contest BHITA decisions that could unreasonably harm BHI.

Another buyer would not have this discretion. Ferry rates would remain regulated by the NC Utilities Commission. And while the system's parking and barge operations are not regulated, a potential commercial buyer (and its bankers) would need to assess the likelihood that the Village could persuade the state to regulate the entire ferry system if barge and parking rates became that much more excessive and subject to monopoly pricing abuse.

The second problem with BHITA has to do with the fact that its current Board of Trustees is largely oblivious (or hostile) to the interest of BHI stakeholders, including the Village. One practical way of dealing with this going forward is to ensure that BHITA's current proposed deal is scrapped. If that happens, many if not most of the current Board members will likely resign or not be reappointed. Once that occurs, the Village should be able to use its case for revamping BHITA's current proposed deal with Limited as a primary rationale for revamping the make-up of the BHITA Board or, if need be, modifying the terms of the Act in ways that make it more responsive to BHI's transportation needs.

Next Steps

Undoing BHITA's acquisition price and bond application will not be easy. Nor should the Village assume that the LGC will scrap the BHITA's proposed deal on its own motion. The LGC's job primarily comes down to examining whether an amount of debt that a local government entity (e.g., BHITA) proposes to borrow for a given project is "adequate and reasonable" and whether that entity can "reasonably afford" to repay that debt. As such, if the Village expects to get the LGC's help in persuading BHITA to substantially reduce its proposed purchase price and bond issue, it will need to focus on why the current offer price is far too high and why the bond issue is unreasonably large and risky.

There are at least three tasks that the Village should undertake immediately to help make that case.

- 1. Hire a Business Valuation Consultant to Critique BHITA's Appraisals and Assist the Village in Formally Making an Offer to Acquire the Ferry System.*

At its May 29 meeting, the BHITA Board announced that it would conduct a second appraisal of the ferry system, in part, to address concerns that the Village and others raised with the LGC about the Worsley appraisal reports. Apparently, BHITA hopes to complete its new appraisal within the next 30 days which implies it will not differ significantly from the Worsley appraisals. Instead, BHITA's new appraisal will very likely be set up to address specific concerns raised by the LGC while keeping the appraised value of

the Deep Point and BHI ferry terminal sites as close to Worsley's valuation as possible. While this could lower BHITA's proposed purchase price and bond issue modestly, the Village needs to assume that any reductions will be small, and only what BHITA and Limited believe BHITA will need to make in order to get LGC approval of its bond application.

A reputable business valuation expert could potentially force significantly larger reductions in BHITA's offer price by refocusing the valuation/appraisal process on the fair market value of Limited's ferry terminals as opposed to their reproduction cost (net of depreciation), or how much income the system generates by virtue of its unregulated parking and barge monopolies. Drawing on his/her critique of BHITA's appraisals, the valuation consultant also should be asked to develop an offer price for the entire system that the Village should submit to Limited in writing as soon as possible. Again, doing so should help refocus BHITA's appraisal/valuation process away from: a) how much debt BHITA could potentially raise to pay Limited to b) what a potential buyer – other than BHITA – might be willing to pay for the system if future ferry, barge and parking rate increases were mitigated by regulation or the threat of regulation. The LGC should understand this, and hopefully be sympathetic to the Village's case, particularly if it were well documented.

- 2. Instruct the Village's Legal Counsel to Figure Out the Best Way of Requesting that the NC Utilities Commission Subject Limited's Parking and Barge Operations to the Same Type of Rate-of-Return Regulation that Currently Governs the BHI Ferry.*

Once submitted and publicized, this request should help refocus BHITA's valuation process and potentially soften Limited's resistance to accepting a lower offer price whether it be from BHITA or the Village.

- 3. File a Freedom of Information Act (FOIA) Request Asking that BHITA Immediately Disclose All Written Communications Between Individual Members of Its Board of Trustees, Any Employee of Limited, and Any Consultant Working on BHITA's Behalf Since BHITA's Inception.*

Far too little attention has been focused on very serious conflicts of interests between Limited and various consultants that Limited paid and BHITA relied on to establish its proposed acquisition price as well as its bond application, including all exhibits and underlying studies. The request should note that because BHITA has no state funding it has no budget through which consultants would normally be paid. Particular attention should focus on communications between individual BHITA Board members, Limited, Mercator International, the Worsley Real Estate Company and any consultant that BHITA is currently considering to conduct its second appraisal. The FOIA request also should note that Limited hired Mercator in 2017 to estimate the enterprise value of the ferry system which Mercator placed at \$55.8M. Mercator's valuation report was made available to the BHITA Board and shared with Worsley which completed its appraisal in 2019. In 2020, Mercator was hired by BHITA, but paid by Limited to, prepare its *Bond Feasibility Study* that BHITA relied on as the foundation for its proposed \$47.75M purchase price as well as its \$56.1M bond application. The request should be as pointed and well documented as possible.

Finally, we believe it is imperative that the Village be more vocal in expressing concerns, publicly, about the potential harm to BHI that will result from BHITA paying far more than it needs to for the ferry system, and why the BHITA's valuation process has been as closed and as orchestrated as it obviously

has been. On this issue, the Village Council is uniquely positioned to speak for residents and non-residents alike and we urge you to do just that.

Concerned BHI Property Owners:

Robert and Jane Blau

Joe and Judy Brawner

Paul and Lori Carey

Gerald and Joan Maggio

Robert and Mary Taylor

Robert and Beth Iseman

Frank and Karen Klaine

Robert and Robbie Nixon

Mimi and Larry Leonard

Dr. Mark and Tonia Smith

Richard and Mary Fines

James and Teresa Bourdan

Brent and Cindy Belch

Joe and Mary Beth Snee

William Morton

Cathy Segal

Steven and Sharon McCoy

Jeff and Mary Kay Hull

James and Sherry Roese

Dr. Gene and Joyce Douglas

Michael and Sherry Becker

Louis and Gretchen Meyer

Lee and Ellis Gutshall

Robert and Gail Liesegang

Robert B Liesegang Jr

Deborah Wildgoose

Doug and Wyndie Eberle
William and Mary Michaels
Scott and Mary Mears
Robert and Merry Vaughan
Dr. Allie Smith
Watts and Betsy Carr
Ann Elder
Ryland and Kelly Pruett
Wayne and Joyce Lambert
Buddy and Betty Lawrence
John and Marilyn Dimling
Paul and Debbie Brooks
Dan and Betty Boyce
Doug and Missy Anderson
Julie Showalter
Lee and Prudy Weaver
David and Loan Guilkey
Robert and Suzanne Price
Scot and Sandra Yancy
Rick and Joyce Nelson
Claude Pope III
Dennis and Kay Carwile
Phil Ross
Michael and Carol Caufield
James and Kathleen Koch