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Bald Head Island Transportation Authority, North Carolina; Transit

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Credit Profile

US\$46.755 mil transp sys rev bnds ser 2021A due 08/01/2051

Long Term Rating BBB-/Stable New

US\$3.185 mil transp sys rev bnds (taxable) ser 2021B due 08/01/2031

Long Term Rating BBB-/Stable New

Rating Action

S&P Global Ratings assigned its 'BBB-' long-term rating to the Bald Head Island Transportation Authority, N.C.'s estimated \$46.8 million series 2021A tax-exempt transportation system revenue bonds and estimated \$3.2 million series 2021B taxable transportation system revenue bonds, using its "Global Not-For-Profit Transportation Infrastructure Enterprises" criteria, published Nov. 2, 2020. The outlook is stable.

The bonds are secured by system net revenues, which include all revenues, income, proceeds, tolls, rents, proceeds of ticket sales, parking revenue, lease money, returns, and charges derived from the system less operating and maintenance (O&M) expenses. The system is composed of four services: ferry transit, on-island tram transportation, parking at Deep Point Terminal, and barge (tug and freight) operations. The ferry system consists of four vessels and transports passengers from the Deep Point Terminal in Southport, N.C. (mainland) to Bald Head Island, a residential and resort barrier island community four nautical miles off the coast of mainland North Carolina.

We view the bond provisions as credit neutral. The rate covenant requires net revenues to provide at least 1.3x debt service coverage (DSC), per the indenture, on senior-lien debt and 1.05x DSC on senior- and subordinate-lien debt. An additional bonds test is also in effect based on a historical test the same as the rate covenant and 1.45x of projected net revenues on senior bonds. Furthermore, there is an O&M reserve requirement at 25% of fiscal 2022 O&M expenses as projected by the feasibility report, revised each year based on budgeted O&M for the following year; and a capital improvement fund requirement at 20% of the five-year capital improvement plan (CIP) for the system with a minimum balance of \$500,000. A cash-funded debt service reserve provides additional liquidity for bondholders.

The proposed series 2021A&B bond proceeds will be used to finance the acquisition of the system from Bald Head Island Ltd. and Bald Head Island Transportation; fund a debt service reserve, O&M reserve, and \$1 million in working capital; pay capitalized interest; and pay costs of issuance.

Post issuance, the authority will have approximately \$49.94 million in senior-lien debt outstanding. However, our financial risk profile assessment also considers an expected \$4.6 million in additional subordinate-lien debt for a ferry vessel replacement in fiscal 2023 in our evaluation of financial performance, debt and liabilities capacity, and liquidity and financial flexibility.

Credit overview

The rating reflects our opinion of the authority's adequate enterprise risk and financial risk profiles. The stable outlook reflects our view that the authority's activity levels have generally recovered to pre-pandemic levels, although we note lingering and ongoing risks related to COVID-19 remain. For more information, see "Updated Activity Estimates For U.S. Transportation Infrastructure Show Public Transit And Airport Operators Still Face A Long Recovery," (published Jan. 13, 2021, on RatingsDirect).

Our enterprise risk profile incorporates the authority's role as a marginal provider of a relatively discretionary transit service to a single-location narrow market with comparatively low activity levels (359,000 in ridership in fiscal 2019) coupled with demand and future growth prospects that we view as somewhat limited, constrained by residential housing buildout, and susceptible to different economic conditions and weather-related events, despite its monopolistic competitive position and generally favorable historical demand trends. Our financial risk profile reflects our expectation that DSC (S&P Global Ratings-calculated) will be generally maintained within a range of 1.1x-1.25, tempered by exposure to revenue fluctuations due to weather-related events, periods of economic weakness, and a generally limited and highly correlated revenue stream with revenue growth largely dependent on housing development on the island. Furthermore, we consider debt and liabilities capacity as strong given a moderate debt burden and manageable CIP with no additional near-term debt needs following the \$4.6 million in subordinate-lien debt in 2023, along with vulnerable liquidity and financial flexibility. Our financial risk profile also considered the authority's expected fare-rate increases across service lines, housing development based on a "low" housing growth scenario outlined in the financial forecast, and plans to draw down a portion of unrestricted reserves to fund a portion of the CIP.

Activity levels have generally recovered from severe declines experienced beginning in March 2020 due to the effects of the COVID-19 pandemic. April and May 2020 activity declined 82% and 47%, respectively, compared with 2019 levels, but gradually recovered with September-December 2020 outperforming 2019 levels, up an average of 8%. However, overall ferry ridership declined 18.7% in 2020 to about 292,000 from 359,000 in 2019 due to the effects of COVID-19. Despite the recovery in ridership activity, we believe volume risk remains depending on the duration and severity of outbreaks; local requirements for shelter-in-place or social distancing; shifting consumer preferences and behavior; economic fallout; and the availability, effectiveness, and adoption rate of a vaccine.

Key credit weaknesses, in our view, are the authority's:

- Role as a marginal provider of relatively discretionary transit service to a single location and narrow market with comparatively low activity levels;
- Exposure to revenue fluctuations due to weather-related events, periods of economic weakness, and a generally limited and highly correlated revenue stream;
- Demand and future growth prospects that we view as somewhat limited, constrained by residential housing buildout, and susceptible to different economic conditions; and
- Exposure to longer-term climate-related risks that could result in more frequent and more severe weather events.

Key credit strengths, in our opinion, are:

- Autonomous rate-setting flexibility with the ability to increase fares across service lines (ferry, parking, and barge);
- Generally favorable historical demand trends prior to the pandemic and a monopolist competitive position; and
- Moderate debt burden following the proposed series 2021A&B bonds and subordinate-lien debt for the ferry vessel replacement in 2023, with no additional near-term debt needs and a manageable CIP.

Environmental, social, and governance factors

We analyzed the authority's ESG risks relative to its market position, management and governance, and financial performance, and determined that environmental risks are above the sector standard. Similar to other transportation infrastructure providers, the authority is exposed to health and safety social risks that could present financial pressures in the near term from the COVID-19 outbreak, particularly if activity deteriorates and remain at weakened levels. Longer term, we believe the environmental risks for the authority are elevated based on the coastal location of system assets at Deep Point Terminal and Bald Head Island exposing it to severe weather-related events including hurricanes and sea level rise. We note system vessels are stored at an inland shipyard during severe weather events and much of the housing stock is elevated and designed to mitigate effects associated with hurricane storm surges. Finally, while small in scale, the authority's governance risks are in line with those of other transit providers, in our opinion.

Stable Outlook

Downside scenario

We could lower the rating if DSC or debt-to-net revenues are consistently and materially lower than our expectations.

Upside scenario

We could raise the rating if activity is sustained at higher levels than we expect, resulting in DSC or debt-to-net revenues increasing at levels we believe are sustainable.

Credit Opinion

Enterprise Risk Profile

Our assessment of the authority's enterprise risk profile considered its service area economic fundamentals, industry risk, market position, and management and governance.

Economic fundamentals

Our assessment of the authority's service area economic fundamentals reflect the Wilmington, N.C. metropolitan statistical area's economic activity as measured by estimated GDP per capita of \$50,325, modest population (estimated at 300,000), estimated population growth of 3.3% comparable with the national average, and unemployment comparable with the national average despite a recent spike due to the effects of COVID-19. However, we note that more than 50% of Bald Head Island property owners are from North Carolina, providing a somewhat broader reach given the island's status as a popular vacation destination for second homeowners within the mid-Atlantic region.

The authority is located in Brunswick County at the mouth of the Cape Fear River, approximately 25 miles south of

Wilmington. The authority provides transit from Southport to the Village of Bald Head Island, with demand primary driven by year-round residents, vacation homeowners, employees, and contractors from construction activity on the island. Popular attractions include beaches, historic sites, private clubs, dining, shopping, and outdoor activities. Wealth and income levels among the population on Bald Head Island are robust with median household incomes around \$102,000 in 2019 and a median home value listing price of about \$1.25 million in 2020.

Market position

Our assessment of the authority's vulnerable market position considered its role as a marginal provider of a relatively discretionary transit service to a single-location narrow market with comparatively low activity levels coupled with demand and future growth prospects that we view as somewhat limited, constrained by residential housing buildout, and susceptible to different economic conditions and weather-related events, despite its monopolistic competitive position and generally favorable demand trends.

The system is composed of four services including ferry transit, on-island tram transportation, parking at Deep Point Terminal, and barge (tug and freight) operations. The ferry system consists of four vessels and transports passengers from the Deep Point Terminal in Southport, N.C. (mainland) to Bald Head Island, a residential and resort barrier island community, which we view as a small, affluent and narrow market with limited geographic reach. A one-way trip is about four nautical miles and crosses the Cape Fear River, requiring about 30 minutes, including loading and unloading. The barge system includes two vessels for cargo and freight. The parking system is composed of 1,955 parking spaces including a premium lot (396 spaces), general parking (1,021), contractor parking (366 spaces), and employee parking (172 spaces). Activity levels and revenues across system service lines are highly correlated. Overall, we consider service more discretionary given the system generally serves passengers with vacation homes on Bald Head Island, or employees and contractors.

The island has approximately 1,300 private residences, and about 250 year-round residents with the remainder second residences or vacation homes. We consider exposure to weather-related events, including hurricanes and sea-level rise as elevated given the coastal location. However, design standards on the island require elevated housing (stilts) to mitigate the effects of storm surge from hurricanes, which we view as prudent. Nevertheless, longer-term climate-related risks could result in more frequent and more severe weather events along with sea-level rise, leading to reduced desirability, lower property values, and erosion in ferry ridership.

We view activity trends as generally favorable leading up to the pandemic with a sufficient base level of system demand, supported by the authority's monopolistic business position. Ferry ridership increased significantly to about 359,000 in 2019 from 263,000 in 2012, an increase of 36.5%, with growth primarily driven by residential housing buildout on the island averaging about 14 residential units per year. Although activity levels have been generally stable to improving, the authority is exposed to periods of economic weakening as experienced following the effects of the Great Recession, when ferry ridership declined to about 263,000 in 2012 from 354,000 in 2007, or 25.7%, exacerbated by weaker housing development averaging less than seven units. Ridership recovered to pre-recession levels by 2019. In addition, the system is exposed to weather-related events given its coastal location, including hurricanes, as evidenced in fiscal 2018 when ferry ridership declined about 7.4% because of Hurricane Florence. Overall, we expect future system demand will remain highly correlated with residential housing development, with 800-1,000 developable building sites remaining on the island, although we consider demand susceptible to volatility due to weather-related

events and changing economic conditions.

Monthly activity levels have generally recovered from severe declines experienced at the on-set of the pandemic despite lingering COVID-19 North Carolina state government-imposed capacity restrictions on vessels limiting up to 75 passengers (150 maximum capacity). For example, September monthly ridership increased 24.2% compared with 2019 levels. November was comparable with 2019 levels, and December was up 9.6%; however, ferry ridership remained depressed from March through August with peak declines of about 82% and 47% in April and May, respectively. Overall, ferry ridership declined 18.7% in 2020 to about 292,000 from 359,000 in 2019, due to the effects of COVID-19.

In fiscal 2019, system revenues totaled \$9.6 million with 59% from ferry, 27% from parking, and 14% from barge revenues, an increase of 0.5% from \$9.5 million in 2018. We note there is significant seasonality. Activity levels peak in the summer months, with June-August accounting for 37% of ferry ridership in 2019, followed by spring and fall, and are lowest during winter. In 2019, ferry and parking utilization were 29% and 61%, respectively, but increased to 38% and 96% from June-August. We expect overall system revenues will rise commensurately with expected housing development on the island and planned rate increases across service lines.

We consider the rate-setting flexibility as adequate, given the authority has autonomous flexibility to adjust fares across system (ferry, parking, and barge) with no external approvals required. Ferry tickets cost \$23 for a round-trip general fare; daily parking costs \$11 from June-August (peak season) or \$9 from September-May; and barge tickets cost \$55 (per six foot of storage length). Expected near-term fare increases, which we view as reasonable given the above-average income levels of residents, include an increase in ferry tickets to \$27 from \$23 in July 2021, a 21% increase in parking rates beginning in fiscal 2022, and a 9% increase in barge tickets to \$60 from \$55 beginning in fiscal 2022. Such proposed rate increases are consistent with an expectation that fares will increase in line with inflation.

Management and governance

We consider management and governance adequate, reflecting our view of the authority's strategic positioning; risk management and financial management; and organizational effectiveness. We consider the governance structure credit neutral.

The authority maintains no formal or informal policies outside of its indenture; however, we expect financial and operational goals to be established in the near term once operations and ownership are transitioned from the private operator. Financial policies, per the indenture, include a rate covenant of 1.3x for senior bonds, and 1.05x for subordinate bonds. The ABT is 1.45x on historical and pro forma projections. Furthermore, there is an O&M reserve requirement funded at 25% of fiscal 2022 O&M expenses as projected in the feasibility report. We view the authority's rate-setting flexibility as adequate, with rates for system assets independently set by the authority with no external approvals required. The authority maintains adequate insurance coverage for system assets, and business interruption coverage approximately equivalent to fiscal 2022 projected net revenues.

Under the proposed new structure, the authority will operate the system as a combined, non-regulated system providing enhanced flexibility for operational efficiency. In addition, there will be financial oversight from the North Carolina Local Government Commission, which can assume financial oversight of the authority if a debt service payment is expected to be insufficient.

Financial Risk Profile

Our assessment of the authority's financial risk profile considers its financial performance, debt and liabilities capacity, and liquidity and financial flexibility. Our financial risk profile assessment considers the authority's pro forma figures that reflect the effects of the series 2021A&B bonds, an additional estimated \$4.6 million in subordinate-lien debt for ferry vessel replacement in 2023 followed by no near-term additional debt needs, and plans to draw down a portion of unrestricted reserves to fund a portion of the CIP.

The pro forma figures we evaluated are based on a financial forecast that was prepared in connection with the series 2021A&B bonds, assuming a "low" housing growth scenario averaging 0.75% per year (0.2% from 2022-2025, 0.8% from 2025-2030, then 0.9% thereafter to 2050), which we consider reasonable compared with the 10-year average historical housing growth of about 1% on Bald Head Island. The forecast also includes proposed fare-rate increases (parking, barge, and ferry) and additional subordinate-lien debt needs of \$4.6 million in fiscal 2023 for ferry vessel replacement. Our pro forma figures consider fiscal 2024 amounts when senior- and subordinate-lien debt begin fully amortizing and following a modest drawdown of unrestricted reserves to fund the CIP. Our financial profile assessment also considered the authority's financial policies, which we consider credit neutral.

Financial performance

We assess the authority's financial performance as vulnerable, reflecting our expectation that it will generally maintain DSC (S&P Global Ratings-calculated) within a range of 1.1x-1.25x, incorporating the effects of the proposed series 2021A&B bonds and additional subordinate-lien debt in fiscal 2023. Tempering this is the authority's exposure to revenue fluctuations due to weather-related events, periods of economic weakness, and a generally limited and highly correlated revenue stream with revenue growth largely dependent on housing development. We expect DSC, per our calculations, of about 1.24x in fiscal 2024 once debt begins fully amortizing, including the effects of the proposed series 2021A&B bonds and additional subordinate-lien debt in fiscal 2023. Our debt service calculation evaluates coverage on an all-in basis assuming net system revenues from parking, barge, and ferry revenues less O&M, divided by total debt service requirements (senior and subordinate bonds).

Debt and liabilities

We consider the authority's debt and liabilities capacity as strong, with debt-to-net revenues expected to generally remain within a range of 10x-15x, per our calculations, including the effects of the proposed series 2021A&B bonds and an additional \$4.6 million in subordinate-lien debt to fund the CIP for ferry vessel replacement in fiscal 2023. Following the series 2021A&B bonds and additional subordinate-lien debt in 2023, the authority will have approximately \$54.5 million of debt with debt service requirements level around \$3.7 million once debt begins fully amortizing from fiscal years 2023 to 2033, then declining to level debt service of about \$3.3 million through the final maturity in 2051. There are no near-term additional debt needs following the subordinate-lien debt in 2023.

We consider the authority's five-year CIP plan as relatively modest and manageable given only \$4.6 million in subordinate-lien debt needs in fiscal 2023 for replacement of the Sans Souci ferry vessel. The ferry vessel Adventure has a remaining useful life of about 13-17 years, and ferry vessels Patriot and Ranger are relatively new with a remaining expected useful life of at least 30 years.

Liquidity and financial flexibility

We assess liquidity and financial flexibility as vulnerable, based on our expectation that the authority will maintain unrestricted reserves generally within a range of 60-120 days' cash on hand, after payment of estimated capital expenditures with cash on hand, and about 4% of debt outstanding following the series 2021A&B and additional subordinate-lien debt. Although unrestricted reserves are expected to be modestly higher from fiscal years 2021 to 2023, we expect a portion will be drawn down to fund some of the authority's CIP. Consequently, pro forma unrestricted reserves are estimated at about \$2.3 million in fiscal 2024, including \$1 million in working capital (funded at closing) and a buildup of about \$1.3 million surplus reserves after payment of estimated capital expenditures with cash on hand, equal to 119 days' cash on hand and 4% of total debt (senior and subordinate).

Related Research

- Through The ESG Lens 2.0: A Deeper Dive Into U.S. Public Finance Credit Factors, April 28, 2020

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