Financial Analysis of Proposals to Redevelop the Port of Ketchikan Cruise Terminal Berths I, II, III and IV

For the City of Ketchikan

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INTRODUCTION

Piper Sandler & Co. has been engaged to review the proposals received from Survey Point Holdings ("SPH") and Global Ports Hold/Conrac Solutions proposing to do business as Ketchikan Port Solutions, LLC ("KPS") to redevelop and operate the cruise terminal facilities in downtown Ketchikan including terminal berths I, II, III and IV. The scope of our engagement includes review of proposals received and development of a financial model to objectively analyze the economic benefits of each proposal. In addition, we were asked to consult with the City's bond counsel regarding the restrictions related to the proposers' ideas for addressing the outstanding Alaska Municipal Bond Bank, 2016 Series Four Bonds (the "2016 Bonds") as well as existing lease obligations with the Ketchikan Dock Company. We were not engaged to diligence the qualifications of either of the proponents in terms of their development experience or their ability to operate the leased assets, nor have we provided any assessment of the respective management team qualifications for either proponent. We have not interviewed either respondent, therefore statements in our report related to project development and operations are based solely on the information provided in the proposals received from SPH and KPS and responses received from each of the parties to the City's clarifying questions. Opinions of Piper Sandler & Co. unrelated to the financial proposals are either derived from these same sources or from our experience more broadly in the public private sector.

EXECUTIVE SUMMARY

At its most basic level, evaluation of a public private partnership comes down to weighing the economic value to the public partner against the risk transference to the private partner. Generally, the greater the risk retained, the more the financial upside should be to the public participant. The two shortlisted proposals received by SPH and KPS are in stark contrast to each other in terms of economic upside and risk transference. The SPH proposal has the potential to deliver significantly more financial benefit to the City, however their proposal and responses to questions posed by the City indicate that nearly all the economic benefit comes with some level of operating risk to the City. SPH is not proposing any upfront payments to the City. With the potential exception of the Berth IV lease payments, all of the economic benefit to the City will come from passenger fees and terminal operations.

In comparison, the KPS proposal offered the City an upfront payment of $40 million which over a 20-year lease term is on average approximately equivalent to $3.30 in passenger tariff. This upfront payment was revised to $10 million ($15 million of the 30-year lease term) in the "best and final" offer with the balance paid in equal amounts $5 million per year over the next 6 years. Additionally, KPS is proposing a minimum annual guaranty ("MAG") of passenger fees of $400,000 growing at CPI. This MAG represents a very small percentage of passenger revenue proposed by SPH but over a 20-year lease term it is on average 75% of passenger tariff revenue proposed by KPS which means that the City is exposed to the first 25% of passenger volume risk but then is insulated from any further declines in passenger volume qualified only by the risk that KPS honors the terms of lease.

An additional consideration for the SPH proposal, and to a lesser degree the KPS proposal, are passenger fee structures proposed. SPH proposes to maintain the existing $7 passenger fee and KPS proposes to increase the passenger fee to $9 and adjust the fee upward over time. SPH, however, proposes an additional $10 per passenger fee "as operator". The decision rendered by the U.S. District Court of Alaska in the case of Cruise Lines International Association Alaska v. the City and Borough of Juneau establishes the passenger fees charged by ports are limited by the Tonnage Clause of the U.S. Constitution. Specifically, the decision set out that passenger fees can only be spent on projects that directly benefit the cruise vessels. While each proposal could be challenged under the Tonnage Clause, the SPH $10 fee appears to be much more likely to be successfully challenged as it has the appearance of inuring to the benefit of the private operator and not a capital expense benefiting the cruise lines.

These are the primary differences that we see between the two short listed proposals. We provide more detail of the specifics of each proposal in the respective proposal review sections that follow.

REVIEW OF SPH MATERIALS SUBMITTED

In general, we found the SPH proposal to be vague in several key areas, specifically the proposed equity contribution, the proposed facility capital improvements, and future capital investments. These are important elements of the City's request for proposal. In particular, an understanding of SPH's financial commitment to the leased assets is critical to fully understanding the ongoing operational success of the terminals and SPH's ability to execute on needed infrastructure improvements including cathodic protection updates and berth improvement required to accommodate neo-panamax ships. Further, SPH indicates that additional compensation for berth expansion would be needed (Section 6.7.1.v and response to City question No. 12). Overall, we feel that the proposal requires the City to have a great deal of trust in the ability of the two parties to work out the complicated business details of the concession.

In their proposal, SPH proposed to establish an escrow to address the 2016 Bond debt service payments to the par redemption date in 2026 at which point the bonds would be called. This structure was suggested In lieu of an upfront payment, however in their response to the City's clarifying questions it appears that they will address the bond payments over time from terminal operating revenue. If the latter is accurate, City retains operating risk on this component of their financial proposal because the Bonds remain the City's legal obligation and payment will likely rely on some form of annual (or semiannual) concession fee. It is important to note that this is no different than the KPS strategy for addressing the 2016 Bonds and based on conversations with the City's outside tax counsel, will likely have private use implications for the 2016 Bonds.

We would want to consult further with the City's tax counsel, but it may be possible to utilize an upfront payment from the lessee equivalent to the required cost of a defeasance escrow for the 2016 to eliminate the City's debt service obligation. This would eliminate any subordination issues for private activity bonds issued to fund a portion of the project but would either require additional equity capital from the proponent and/or a higher leverage factor on the project. This approach would be applicable to either the SPH or KPS proposals.

SPH is also proposing an annual concession payment initially equal to $500,000 and escalating at CPI. This is something that KPS is not proposing but also relies on the future operating success of the terminals. Throughout their proposal, SPH references restrictions on City fees derived from passenger fees or vessel charges. Our analysis does not attempt to adjust the value of revenue streams to account for these restrictions. We are simply focused on the present value of the revenue streams to the City. Related to the proposed concession payment of $500,000, SPH indicates that these fees would not be restricted since they will come from upland business activities which if accurate may have additional value to the City.

With regard to the City's Berth IV lease obligation, SPH has proposed a suspension of the lease so long as SPH is operating berths I-IV pursuant to the concession agreement. While this is financially the same as the KPS proposal, we believe that it has a slightly different risk profile in that a release would not be reliant on future operations of the assets. This is our understanding of how the release would work but should be confirmed with SPH. The details of the release are important to understand since the City will want to retain control of Berth IV in the potential event that SPH is in violation of the terms of the concession agreement.

In summary, SPH has proposed an initial per passenger charge of $17 per passenger escalating at approximately 2.34% annually to 22.75 in 2040 and $26.95 in 2050. Of this amount, $7 per passenger would be due to the City. Based on the spreadsheet data provided in SPH's proposal, the amount of the passenger tariff paid to the City would remain constant at $7 throughout the term of the lease. SPH is additionally proposing a $500,000 annual lease payment escalating approximately 1.48% annually. These are financial elements of SPH's proposal that differentiate it from the KPS proposal.

SPH's financial projections for Berth I-IV operations show an operating margin of 26.5% in 2021 growing to 43.8% in 2040 and grows to 53.0% in the 30-year term scenario. It is impossible to determine SPH's return on equity capital from their submittal as we were not given their proposed equity contribution. For the 20-year term, debt capital funding shows $42.045 million in proceeds with principal payments beginning in 2032. The amount of debt capital funding under the 30-year term is higher by roughly $10.4 million to $52.439 million.

REVIEW OF KPS MATERIALS SUBMITTED

In contrast to the SPH proposal, the KPS proposal was very detailed with regard to the capital improvements to be implemented immediately which would include improvements to Berth III and cathodic protection of Berths I-III as well as the timing of those improvements. Like SPH, KPS's proposal indicates that the expansion of Berth I, would be dependent upon the Ward Cove development but their plan for execution of that expansion is clearly laid out. Similarly, their capital structure including equity contribution and debt funding are also clearly summarized in their proposal. Our general assessment of the KPS proposal is that it is well organized and clearly addresses the business points covered in the City's RFP.

The KPS proposal identifies sources and uses of funds. Specifically they plan to commit $69.209 million to the project under the terms of a 20-year lease. Of this amount, $50.726 million would come from private activity bond proceeds and the balance would be equity capital. This money would be used to make an upfront payment to the City of $40 million and pay for project construction expenses. The balance of the funds would cover transaction fees, capitalized interest during construction and a small amount of working capital ($1 million).

For the 30-year proposal the uses of funds increase by approximately the amount needed to cover the increased upfront concession payment to the City of $5 million (up to $45 million from $40 million), however they reduce the amount of bond funding in this scenario and make up the difference with an increased equity contribution.

KPS indicates that the leverage factors for the project would be 73.3% and 59.6% for the 20- and 30-year options respectively. These are reasonable leverage factors for a project of this nature but they fail to account for the leverage added by the 2016 Bonds. If we include that debt, the leverage factors increase to 107% for the 20-year option and 91% for the 30-year option. This is potentially problematic and raises questions about the investment of KPS's private activity bond funding plan despite assurances from KPS that their debt will follow "general investment grade guidelines." Nevertheless, the situation with the 2016 Bonds is the same for SPH. Ultimately both parties will need to effectively address the 2016 Bonds which may require additional upfront equity to address tax law issues and any project leverage factor concerns.

With regard to Berth IV lease payments, like the 2016 Bond payments, these payments would necessarily need to be senior to any private activity bond debt service payments in the KPS structure. While the economic result to the City is the same as the SPH proposal, the project cash flows are different. This is because under the SPH proposal, the Berth IV lease payments would come from net income and would not be an operating expense. To be clear, SPH will generate enough revenue to compensate Ketchikan Dock Company for Berth IV, but it will come at the bottom of the expense waterfall after any private activity bond payments. As far as the City is concerned the cash flow benefit is the same, and we've assumed identical Berth IV lease payments for SPH and KPS in our analysis of the financial benefit to the City. However, in the KPS structure Berth IV lease payment will be an operating expense further adding to the obligations that are senior to any private activity bonds. It is also important to note that the current Berth IV lease agreement with Ketchikan Dock Company expires in 2038 and continued control of this facility will be a factor in lease negotiations with KPS.

KPS is not proposing an annual concession lease payment. Payments to the City after financial close will solely come from passenger fees. In our analysis of the economic benefit to the City, only the passenger fee revenue and the upfront concession payment differ from the SPH proposal. Under the 20-year option, KPS's proposed passenger fee is initially $9.00 escalating to $17.67 in 2040 and $20.51 in 2050. The passenger fee increases more rapidly initially then stabilizes at an assumed rate of inflation of 1.5% annually beginning in 2030 under both scenarios. Of this amount the City would be paid $0.50 under the 20-year option and $1.25 for a 30-year lease. This is obviously one of the major differences between the two proponents.

KPS's financial projections for Berth I-IV operations indicate an operating margin of 25.9% in 2021 growing to 65.3% in 2040 and grows to 75.9% in the 30-year term scenario.

COMPARATIVE FINANCIAL BENEFIT TO THE CITY

To develop the comparative financial analysis we have utilized the lower of the two passenger traffic projections provided by the respondents which is the SPH passenger traffic projection and applied those uniformly to the financial models submitted by the short listed proponents.

Related to the proposed payments to the City, our understanding is that both respondents will commit to covering the remaining debt service payments on the 2016 Bonds to the call date and will also cover the redemption of the 2016 Bonds on the call date. While we believe that this may have to come in the form of an upfront concession payment to the City to avoid tax law issues related to private use of facilities funded with tax-exempt bonds, the financial benefit to the City under either proposal is assumed to be equal.

Further, it is our understanding that both respondents either release the City from its lease payment obligations at Beth IV (SPH) or cover those payments through operating revenue generated from fees due to the concessionaire (KPS). As noted, while there may be different risk profiles between the SPH and the KPS approach to addressing the Berth IV lease payments, from a financial modeling perspective both the SPH approach and the KPS approach will have the same financial implications to the City and therefore not a factor in determining the financial benefit to the City. The differential financial value to the City is derived from any upfront payment to the City, the passenger tariff/charge allocated to the City (with the Tonnage Clause issue noted previously), any additional annual concession lease payments and importantly the relative financial strength of the proponent.

The following is a summary comparison of the key operating and financial metrics for each proposal and to status quo projections prepared by the City.

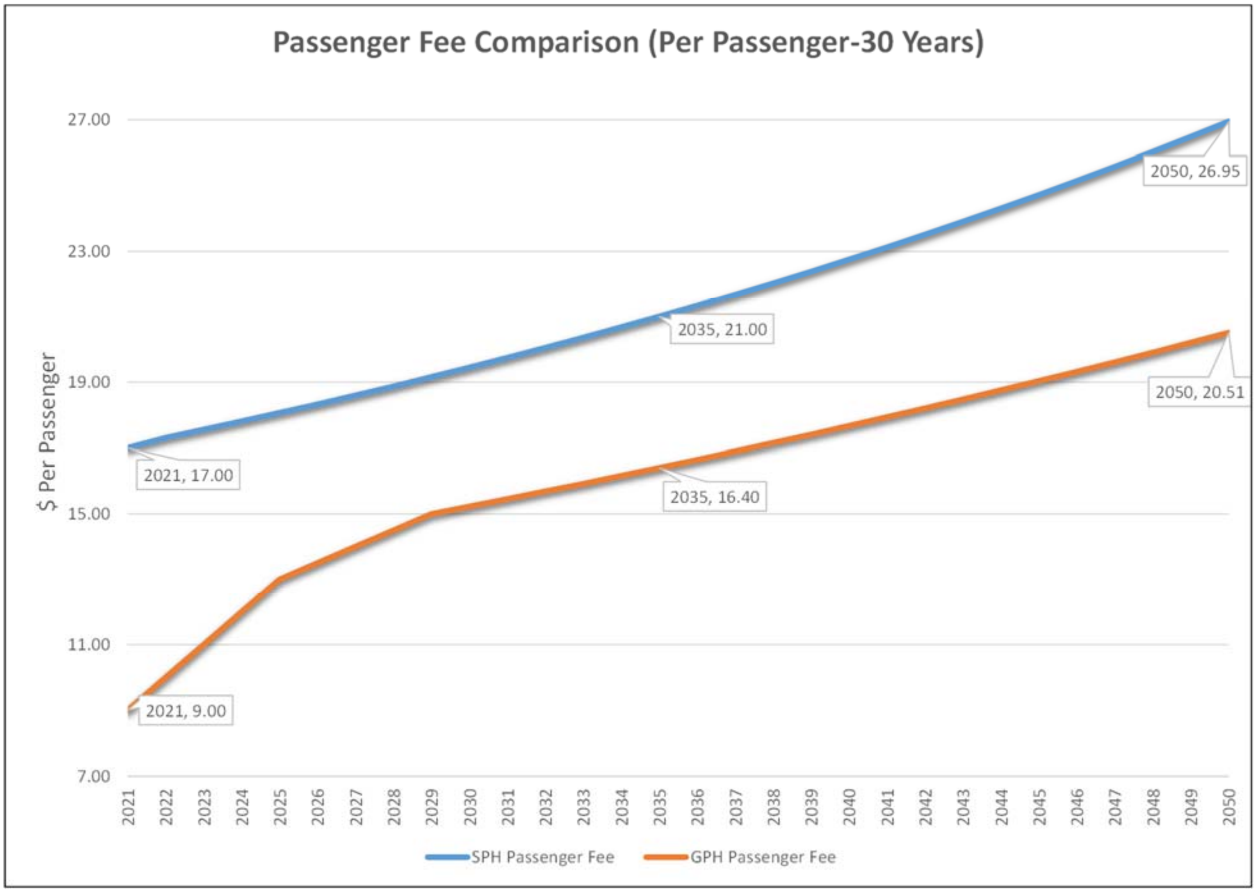
Ketchikan Berth I-IV Project Proposal Comparison

	20 Year Lease			30 Year Lease		
	SPH	**KPS**	**Status Quo***	**SPH**	**KPS**	**Status Quo***
Total # of Passengers	21,302,462	21,302,462	21,302,462	33,999,385	33,999,385	33,999,385
Total Passenger Fee Income	$ 421,897,247	$ 314,491,298	$ 314,591,363	$ 739,713,994	$ 558,647,198	$ 558,690,458
NPV Total Passenger Fee Income	230,589,120	167,440,361	167,479,740	302,419,298	222,677,745	222,704,466
Projected Cash Flow to Ketchikan						
Consession Payments	$ 11,561,834	$ 40,000,000	$ -	$ 18,769,341	$ 39,586,622	$ -
Net Passenger Fees/Dockage to KET	149,953,231	12,375,366	223,857,891	239,271,694	53,858,530	472,787,598
2016 Bond Payments	33,519,750	33,519,750	-	33,519,750	33,519,750	-
Berth IV Lease Payment	54,132,076	54,132,076	-	85,252,406	85,252,406	-
Total Cash Flow to Ketichikan	$ 249,166,891	$ 140,027,192	$ 223,857,891	$ 376,813,191	$ 212,217,308	$ 472,787,598
NPV of Total Cash Flow to Ketchikan @ 6%	$ 142,966,751	$ 93,500,041	$ 105,155,167	$ 172,073,498	$ 120,948,537	$ 161,237,409

*Data provided by the City of Ketchikan. Net passenger fees/dockage fees for Ketchikan status quo are after forecasted capital expense.

CONCLUSIONS

From a monetary perspective, assuming passenger counts return to pre-pandemic numbers, the SPH proposal is superior but results in the City retaining more facility operating and revenue risk relative to the KPS proposal which offers upfront revenue (although less than originally proposed) and a minimum annual passenger guaranty. When comparing the two proposals, it is important that the City factor in the amount of the passenger fee being proposed by SPH in light of the competing facilities at Ward Cove. SPH is proposing a substantially higher passenger fee and also proposing to pay the City a substantially greater portion of the passenger fee when compared to KPS. A lower passenger count, driven by high fees on City controlled facilities and competition from Ward Cove, would move the SPH proposal closer to the KPS proposal. Further as it relates to the KPS proposal, it is possible that the lower proposed passenger fee will drive more throughput which would improve the value to the City relative to the SPH proposal. While the passenger fee to the City would be established by the concession agreement, viability of the overall project could be at risk if the passenger fee is set too high.



Taking a step back from the financial details of both proposals, Piper Sandler suggests that the City review its goals for this P3 process. From our perspective, the benefits of working with the private sector in a concession type arrangement are risk transfer from the City to the private partner and expertise offered by the private partner that is not a core or inherent at the City. Expertise and risk transference includes the areas of facility operation, project development, project construction, and marketing/sales. We believe that, in addition to the monetary elements of the proposals, the City should also consider these factors when making its partner selection. These factors could translate to lower cost or improved operating revenue which could be shared with the City. However, bottom line revenue to the City is unlikely to be improved from the status quo due to a variety of factors including revenue sharing and cost of private sector debt and equity capital.

If the City is bottom line focused and can tolerate the business risk associated with cruise ship terminal operations, then continuing to operate the Berth I-IV facilities as you have historically should result in the best return to City, assuming passenger counts normalize and remain stable into the future. If the projections from either of the proponents indicate that this is not the case, then the City needs to closely examine and question the assumptions behind those projections.

Looking at our calculations of return to the City based on materials submitted by both proponents and comparing those to status quo projections provided by the City, the KPS proposal to the City indicates what we would expect. Return to the City is approximately 11.5% lower than the City's status quo estimate over the 20-year term and approximately 25% lower over the 30-year term. The opposite is true with the SPH proposal. Return to the City over the 20-year term is actually 35% higher over the 20-year term and 7% higher over 30 years.

In conclusion, we believe that both proponents are well qualified to execute the project improvements and operate the cruise terminals in Ketchikan. We found the KPS proposal to be more specific in terms of how they would accomplish these responsibilities than the SPH proposal. On paper, the SPH proposal provides the best return to the City, however we question the viability of more than doubling the current passenger charge with new facilities coming online at Ward Cove and have concerns about the impacts to the City should a $17 plus passenger fee prove to be unacceptable to the market.

If it's helpful, we would be pleased to meet with City representatives to discuss our observations and answer questions.