1 Relevant Information is being withheld from the public and the Legislature

The first question that should come to everyone's mind in trying to decide whether the granting of an SDO to Tucker's Point Resorts ("TPR") is good or bad for the people of Bermuda is this—"What are the facts?"

Unfortunately, TPR has refused to disclose the relevant facts to the public. In particular, they have refused to provide the public with
(i) a copy of their financial statements;
(ii) a copy of the most recent valuation of their principal assets (the hotel and golf course);
(iii) a list of all shareholders and creditors (so we can see whom we are being asked to help);
(iv) a list of all loans, the amount presently outstanding and the rate of interest payable;
(v) a copy of all environmental reports on the SDO lands; and
(vi) the estimated costs of building the 78 houses/condos and the 70 hotel rooms, the source and terms of funding, and the expected sale prices and net profit.

BEST asked the Minster of the Environment for the above information, but the Minister refused, saying (through his Permanent Secretary) that the information was not his to provide. This is particularly disconcerting because, while TPR does not owe a fiduciary duty to the people of Bermuda, the Minister does. He could have simply told TPR to disclose the information to the public or else government will not grant the SDO. But he did not.

Not only did the Minister not disclose the relevant information to the public, he even declined to disclose the information to the Members of the House of Assembly, including those of his own party. It is difficult to understand how a Member of the House can be asked to vote on an SDO that greatly decreases the economic interest of the Bermuda people in a large parcel of environmentally protected land (see item 6 below) without first being provided with all relevant information. That is not good governance.

We can only hope that our Senators are not treated with similar disrespect and that they instead be given access to all information needed to make an informed decision that is in the best interest of the people of Bermuda.

2. What information do we have?

The refusal by TPR and the Minister to make the above information available has led to much unnecessary confusion and speculation by the Bermuda public in their attempt to determine what is best for Bermuda. However, from limited information provided by Ed Trippe in a meeting with BEST and from information contained in a letter dated 15 November 2010 from Mr. Trippe to his shareholders (which we received from a concerned third party) we have pieced together the following information:

(i) TPR owes $250 million to its lenders, but it is trying to convince the holders of $100 million of that debt to convert their debt-holding into preferred shares. The $100 million debt has a rate of interest of 12% and if converted, the preferred shares would have the right to a 12% accrued dividend. We don't know the rate of interest on the other $150 million.
(ii) Ed Trippe told BEST that the estimated value of the TPR hotel as of last year was $60 million and the golf course was $30 million (i.e., total assets have an estimated market value of $90 million as of last year);
(iii) For the first eight months of 2010, TPR was losing money at the rate of $1.66 million a month. That information was contained in the 15 November 2010 letter to shareholders. We have no reason to believe that loss rate has improved over the winter months, and suspect that with lower winter occupancy rates, it has probably worsened;
(iv) The 2009 financial statements of Bermuda Properties Limited (whose subsidiary owns TPR) were completed in July 2010, but as of 15 November 2010 neither the Board of Directors nor the auditors had signed off on the audited statements for the stated reason that TPR's lenders had

still not approved and signed the amendment to the loan agreement extending the due date for the loan, which was due to expire on 31 December 2010. In other words, unless the loan agreement has been amended and the term extended, TPR is in default on its senior loan agreement to the tune of $150 million. The subordinated debt loan agreement likely has a cross-default clause and so TPR may be in default of that $100 million loan agreement as well;

(v) TPR has received two prior SDOs, which were meant, among other things, to make TPR economically viable;

(vi) If TPR does not obtain the SDO to build more houses, condos and hotel rooms, its lenders will likely place the company in receivership.

From this information we can deduce the following:

Even though TPR has already received two prior SDOs that were intended to make it economically viable, it appears that it is again insolvent with negative net worth of at least $160 million and losses growing larger by approximately $1.66 million every month. In other words, it is a failed business.

Even with the most optimistic projections, the profit from building these new homes can only make a small dent in TPR's massive debt outstanding, and so TPR's bankruptcy would appear inevitable. The only thing that the granting of the SDO will do is delay TPR's bankruptcy, probably by a year or two. That being the case, it makes little sense to even consider granting an SDO, particularly when you consider the economic and environmental harm that will flow from such act.

3. The granting of the SDO will hurt tourism and the TPR workers

TPR and government have argued that the granting of the SDO will help tourism. The opposite is true.

Right now TPR has to pay a very large amount of interest on its outstanding debt (12% on $100 million of its subordinated debt and some unknown rate on the senior debt of $150 million). If we estimate the unknown rate of interest on the $150 million to be around the market rate of 7 %, then TPR is paying $22.5 million a year in interest on its $250 million total debt (12% of $100 million + 7% of $150 million = $22.5 million). In order to cover that huge interest payment as well as its operating expense, TPR has chosen to charge very high room rates (reportedly, when the hotel first opened they charged a minimum of $750/night but according to the 15 November 2010 letter to shareholders they now average $465/night).

Unfortunately, as TPR has learned all too well, very high room rates result in very few tourists. (TPR reported to its shareholders that it had a 35.9% occupancy rate in 2009 but was hoping to achieve a 58% rate in 2010.) But if the SDO is not granted and TPR were to go into receivership, we would ultimately have a more financially sound hotel and see more tourists. Here's why.

The bank would put a receiver manager in place (as was recently done for Newstead/Belmont) and the receiver manager would run the hotel while the bank searched for someone to buy the hotel. (It should be noted that the receiver manager would continue to keep the hotel operating during this period because it is much easier to sell a hotel that is operating than one that is dormant, particularly a new luxury hotel like TPR. Current staff will be needed to ensure the smooth continuation of operations.)

A potential purchaser would know that international golf course resorts have significantly fallen in value since last year, so let's make the reasonable assumption that he could negotiate a purchase price of, say $70 million and could obtain a loan at the going rate of interest of 7%—which by the way is much lower than the 12% TPR has to pay its unsecured lenders because of their higher exposure of loss if TPR goes bankrupt. The new purchaser would have annual interest payments of only $4.9 million (7% of $70 million), which means the new purchaser would be able to run the hotel for $17.6 million less each year than TPR can[1]. That allows the new owner the ability to charge significantly lower room rates and still generate a profit. And lower room rates mean more tourists for Bermuda. Further, higher profits for the owners of the hotel would give hotel workers both greater job security and greater negotiating power when negotiating wages.

So if we want to help tourism and the workers at TPR, then we should do the exact opposite of what TPR and its lenders have asked government to do—we should cancel the SDO and allow the market to function exactly as it is intended to function: allow new buyers to purchase the hotel on terms that make the hotel more economically viable, and provide the Bermuda tourism market with a renewed vitality that will both help our economy and increase job security.

4. The granting of the SDO to build more houses/condos will hurt Bermudian homeowners and the Bermuda Economy

TPR has argued that they will be creating construction jobs by building these 78 houses and condos. This is true. But such economic gain will be offset by the economic harm it will also cause.

By granting an SDO that facilitates the addition of another 78 homes to the supply of houses for sale in a falling real estate market, government will cause house prices to fall even further, which means that not only will the houses built by TPR attract a lower price than similar houses presently on the market, but it also means that this increase in the supply of housing will likely cause a large number of other houses in Bermuda to fall in value.

This means two things: (i) the sale of the 78 houses/condos TPR proposes to build will generate significantly less profit than that generated by the first group of houses built and sold by TPR over the last four years, making the chances of TPR avoiding ultimate bankruptcy that much more remote; and (ii) the addition of 78 new houses/condos to the supply of houses available in the market will hurt many Bermudians who are presently trying to sell their homes or merely hoping to keep their house prices above their mortgage debt so that the bank won't force them into foreclosure.

Bermudians thinking of selling their house or having trouble making their mortgage payments, need to be warned that the granting of this SDO will directly hurt them. And landlords struggling to find tenants should also be warned that the granting of this SDO will make it that much harder for them to find tenants and will lower the rents they will ultimately receive from tenants, which may result in even more foreclosures for struggling Bermudians.

In fact, just the announcement by government that it has granted the SDO in principle will have likely hurt property values because knowing that 78 more houses and condos are coming on the market will cause prospective buyers to rethink their price point. Bermuda prices have always commanded a higher price because buyers know that the amount of land available for development is limited. By granting the SDO in principle, government has now changed the facts underlying that assumption. The approval of the SDO by the Senate will further cause prospective buyers to rethink their price point downward and the actual building of these homes will further solidify downward pressures on market prices. Buyers are not fools. Every move by government that brings the supply of 78 houses closer to an already falling market will adversely affect house prices.

Further, while it is likely that most of these houses and some of these condos will be bought by non-Bermudians, these 78 houses and condos will also be available to Bermudians and will be part of the supply of houses for sale in Bermuda. To argue, as proponents of the SDO have done, that these expensive houses won't affect the price of less expensive homes in Bermuda is as flawed as the argument of years ago that the increase in rents for high-end houses wouldn't increase rents for middle and lower end housing. This is nonsense. Rents throughout the market went sky high. Likewise housing prices in a falling market will feel the negative reverberations throughout all levels of the market if these 78 houses are added to supply.

5. Selling houses to absentee foreigners is a bad tourism model

One of the biggest reasons for turning down TPR's request for an SDO to build more houses and condos is that the entire plan is based on a failed tourism model that once worked for Bermuda but now adds little value.

Ninety years ago, the Bermuda government made the very controversial decision to launch high-end tourism by confiscating the property of mostly black Bermudians and building a brand new community for the wealthy elite of America. While the economic harm to the displaced Bermudians is irrefutable, so is the economic success of the project. Some of America's most wealthy citizens bought homes in Tucker's Town where they lived throughout the fall and winter months each year, greatly adding to Bermuda's economy for many decades.

Unfortunately, with the invention of air conditioning that made many other warm destinations more attractive and with the great efficiencies in air travel, these wealthy Americans no long spend five or six months each year in Bermuda. Instead, many of the houses in Tucker's Town and now in Tucker's Point are empty for all but a couple weeks a year, adding very little to the Bermuda economy. When you consider the limited amount of land in Bermuda and the little value that this type of pseudo-tourism adds to our economy, it becomes clear that an SDO to build more of these houses will only add to an already inefficient and wasteful use of Bermuda's land.

Bermuda doesn't need more empty houses. Bermuda needs a cost-efficient hotel that attracts more tourists, which is exactly what we will get if we say no to the SDO and allow new owners to breathe new life into Bermuda tourism.

6. The Bermuda people are being asked to swallow TPR's Debt

From the limited information we have received, it would appear that TPR is insolvent and its lenders are on the verge of putting it in receivership, so TPR desperately needs to restructure its asset/debt ratio (i.e., increase its assets or decrease its debt) else it will be put out of business.

Plain and simple, this is a debt restructuring, and in every debt restructuring someone has to take a hit. If the SDO is not granted, it will be TPR's shareholders and lenders that will take the loss. If the SDO is granted, TPR's shareholders and lenders will have shifted that loss to the Bermuda people. Here's how.

The lands that are the subject matter of the SDO are presently zoned Woodland Reserve, Nature Reserve, Coastal Reserve, Recreation, and Cave-Protection areas. Such zoning limits the use of those lands and, in so doing, further delineates the interests that TPR holds in the lands and the interests that the Crown (i.e., the Bermuda public) has in the lands.

Right now the value of the interest TPR has in the lands is quite low. It can allow its hotel guests to walk on the lands and enjoy the views, but it cannot develop the lands or build on them. Conversely, the interests of the Bermuda people in the lands, as protected under present zoning laws, is relatively high compared to other lands in Bermuda that are developed. This interest allows the Bermuda people the right to enjoy the view of rolling hills of untouched Bermuda wilderness, to use that beautiful vista as a means of attracting more tourists to our island to help our economy, to enjoy the increased number of migratory birds that are attracted to woodlands—the list of benefits is long.

The granting of the SDO to facilitate development on these lands will significantly decrease the value of the land to the people of Bermuda so that TPR can significantly increase the value of its interest. TPR will then use the increased profits from the use of that land to pay down part of its debt. In other words, the SDO causes the people of Bermuda to lose so that TPR can gain.

The folly of this whole SDO issue is that even with that economic gain, TPR will likely still go bankrupt because its debts are so huge that the gain from developing the property will only postpone the inevitable. Which begs the question: Why should the people of Bermuda be asked to economically suffer in so many different ways just so that TPR can buy an extra year or two before going bankrupt?

[1] It should be noted that in this example the purchaser is assumed to have financed the $70 million purchase price with 100% financing. It is much more likely that the purchaser will use equity financing (i.e., selling shares in its company to raise money) for a large portion (say 30%) of the purchase price. This means that the purchaser's interest payments would be roughly 30% lower than in the example ($3.43 million total interest) making the hotel $18.57 million more profitable each year in the new owner's hands.