SPECIAL FEATURE

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Private sector takes a fresh look at potential of US ports

Barry Parker

In March, at a time when reports of slower trade growth continued to mount, details of two fresh US port privatisations - one agreed upon and one at the proposal stage - were emerging. Barry Parker reports

The Port of Oakland, across from San Francisco, has announced a 50-year concession deal for a handful of berths in its Outer Harbor, with a company owned jointly by Ports America ¡- an entity owned by private equity player Highstar Capital - and Mediterranean Shipping Co (MSC). RBC Capital Markets acted as financial adviser to the port on the transaction.

Shortly after the announcement of the Oakland deal, the Port of Virginia, a state entity operating four terminals in the Norfolk area, received an unsol¡icited proposal for a 60-year concession from CenterPoint Properties, an industrial real estate company with a portfolio that includes several inter-modal distribution centres under construction. A major investor in CenterPoint is the California Public Employees Retirement System (Calpers), the largest pension fund in the United States, managing assets of USD173.6 billion as of 31 January.

Mega-deals

The long-term nature of maritime terminal cashflows has enticed financial investors in recent years. From the investor side, a reason for renewed interest in the sector may be that prices of assets have come down to earth. During 2006 and 2007, a time of heightened interest in the ports sector, deals were done at prices reported to be in the range of 15 to 20 times annual cashflow.

Mega-deals from those years included Ontario Teachers Pension Plan splashing out USD2.4 billion to take out Orient Overseas International Ltd's (OOIL's) concessions in four North American terminals, and the Goldman Sachs-led Admiral Group spending a reported GBP2.8 billion (USD4.1 billion) in the privatisation of Associated British Ports.

In another high-profile deal during that timeframe, a Highstar Capital fund acquired what became the nu¡cleus of Ports America from P&O Ports. While a deal price was not ann¡ounced, the transaction - in the wake of political opposition to DP World's acquisition of the US business of P&O Ports - was estimated to be worth between USD700 million and USD1 billion. Yet another deal involved a unit within Deutsche Bank's RReef Alternative Investments funds acquiring privately held Maher Terminals for an undisclosed amount.

Now, however, the economic cycle has reminded buyers and sellers that growth is not continuous. On the contrary, trade throughput has been substantially down in 2008 and 2009.

Analysts are quick to point out that trade growth, as measured in 20 ft-equivalent units (teus) moving through terminals, rises - or falls - more rapidly than overall gross domestic product (GDP) growth. With likely declines in the 2009 GDP, flows of container boxes have slumped dramatically.

One forecaster, Piers, a service supplying data on inter¡national trade, said that imports into the Pacific Rim ports from the US fell by 8 per cent overall in 2008, compared to the watershed year of 2007.

In the fourth quarter of 2008 (4Q08), teu movements were down 10.9 per cent from 4Q07. The Inter-modal Association of North America (IANA), which measures container imports destined for railcar shipment inland or across the country, measured an 11.1 per cent decline in 4Q08 compared with 4Q07.

Yet another forecaster, IHS Global Insight, which works with a leading retailer trade group, reported 18 consecutive months of declining teu imports into US ports; its prognostication for the first half of 2009 was an 11.8 per cent drop versus already weakened 2008 figures. With the weakened economy and slowed trade, port authorities - and other potential sellers or lessors - have sought to squeeze cash out of their operations.

PPPTA mechanism

The CenterPoint proposal falls within the purview of the Commonwealth of Virginia's Public-Private Partnership Transportation Act (PPPTA) of 1995, which was revised in 2005. The legislation provides the framework behind well-known transport infrastructure projects such as the Pocahontas Parkway south of Richmond, where Australia's Transurban Group has been a partner since 2006 under a 99-year concession. Another well-known project, the Dulles Greenway to the west of Washington, DC, built under an earlier highway act, is now operated by Macquarie Group companies under a concession stretching through to 2056.

Under the PPPTA's mechanism, if an unsolicited proposal such as CenterPoint's passes muster with the commonwealth's department of transportation, the commonwealth will then request competing proposals after posting the original proposal online. Local media reports suggest that the overall procurement process could take between 12 and 18 months. J R Steele, a lawyer in the firm of Akerman Senterfitt in Vienna, Virginia, tells Jane's: "The 'unsolicited' aspect of the CenterPoint proposal is not all that unusual in the context of public-private partnerships [PPPs] in Virginia." He adds: "Under Virginia law solicited and unsolicited proposals are evaluated in exactly the same manner."

Virginia Hot Lanes

Steele, whose practice combines both infrastructure and construction issues, explains that another widely followed highway project, called Virginia Hot Lanes, on a high-volume portion of the Beltway around Washington, DC, which will feature a toll road with congestion-based pricing, emanated from an unsolicited proposal from a Flour Corporation-Transurban Group consortium. That project, with an estimated USD1 billion price tag, is expected to open in 2013. Steele explains that, under PPPTA bidding rules, an unsolicited submitter has the opportunity to amend its proposal during the competitive bidding period, thus minimising the risks of being the first mover.

Chicago-based Joseph Seliga, a partner in the law firm of Mayer Brown's state and local government practice and a member of the team that advised the principals in the privatised Chicago Skyway and Indiana Toll Road projects, and who is providing legal counsel to CenterPoint, tells Jane's: "Virginia's public-private transportation act was adopted in 1995, making it among the first PPP statutes in the country. It sets forth a comprehensive set of procedures related to PPP transportation projects, not only in the port sector but in the highway, mass transit, airport, parking and other transportation sectors."

Amplifying Steele's comments, Sel¡iga adds: "Virginia's statute permits the commonwealth to initiate its own PPP projects and accept unsolicited proposals, as in the case of the CenterPoint project."

Beyond the financial benefits to Virginia, one aspect of CenterPoint's value proposition is the company's experience at the junctures of different transport modes. Seliga tells Jane's: "The Virginia statute differs from those in other states in several respects. For one, it is among the most expansive PPP statutes in the country in that it permits PPPs across transportation sectors and so without the need for additional legislation for any specific project. In addition, the process that the statute requires is more elaborate than that in many other states."

After pointing out that Virginia has been one of the country's leading states for PPP projects (mainly in the highway sector), Seliga says: "The CenterPoint proposal is the first major port project under the statute."

Ahead of the game

In contrast to the CenterPoint deal, which is in its early stages, the Oakland transaction has now been agreed. "Work on the Port of Oakland's Outer Harbor concession project was under way for many months" before the port's request for proposals (RFP) was issued in May 2008, according to Eric Richards, a partner in the project development and finance practice at law firm O'Melveny and Myers. The firm previously represented OOIL in its negotiations with the Canadian pension fund.

One for all

In a 2008 American Association of Port Authorities (AAPA) presentation, co-authored with David Alexander, the Oakland port's attorney, Richards identified a number of objectives for the Oakland project that can be broadly applied to port privatisation in general. Richards' list of objectives included modification of traditional port business practices to align with an evolving industry; encouraging optimal development and usage of port terminal areas; and raising cash to enable ports to reinvest in rail and other critical supporting infrastructure.

In Richards' opinion, privatisation would put Oakland in a position "to benefit economically in anticipated traffic growth over the life of the concession".

In Oakland the new concessionaire, dubbed Ports America Outer Harbor Terminal LLC (PAOH), is set to begin operations at five container berths at the beginning of 2010 under a 50-year concession, after an existing agreement with APM Terminals, negotiated in the late 1980s, expires. Information made available by the Port of Oakland reveals that the 50-year deal involves five existing berths, with options on an adjacent two berths along the waterfront. Bidders shortlisted in mid-2008 were Ports America, which joined up with the MSC entity in January 2009; APM Terminals; Hutchinson Ports Development; the RReef-Maher Terminals entity; and a joint venture comprising shipping companies Hyundai Merchant Marine, K-Line and Yang Ming Marine Transport.

'Apples to oranges'

Although the nature of the proposals is confidential, there is a hint that disparate solutions were advanced by the bidders. The Richards/Alexander AAPA presentation describes as one of the project's challenges the fact that the bids represent "apples to oranges" proposals.

The business elements of the Oakland deal are straightforward: the concessionaire, PAOH, will make an upfront payment of USD60 million - part of which will be used to defease existing revenue bonds used to finance previous improvements at the terminal - plus an annual rental that escalates from USD19.5 million in the first year. The Ports America/MSC joint venture guarantees a minimum cargo volume of 250,000 teu over the first 15 years of the agreement, and must pay USD40 per teu in the event of a shortfall. A profit share, of sorts, called a consumer price index (CPI)-adjusted 'super profit' fee, kicks in after 10 years if annual throughput exceeds 1.6 million teu.

Ports America indicates that plans for the first phase include an investment of USD150 million; the joint venture has the 'right of first offer' on developing one of the five berths; and it estimates investments aggregating more than USD500 million over the 50-year project timeframe. The nearby investment will also likely include container cranes, several of which the port acknowledges are obsolete and needing replacement.

Art and craft

Richards, interviewed along with his colleague Christine Tam, who also worked on the deal, explains to Jane's how the art of crafting concession agreements has advanced since 2006-07. At that time, negotiations became protracted in several deals involving facilities at the Port Auth¡ority of New York & New Jersey (PANYNJ). In these deals, questions arose around the exact parameters for transferring a concession.

According to Richards: "Our agreement describes it more expressly than New York. The port must give consent to a transfer, which consent may be withheld if there is an adverse financial impact to the port or other reasonable grounds." He adds: "We don't contemplate that the port would charge a large sum just for the ability of a concessionaire to have a successor."

However, at the same time, the deal's structure does not encourage a 'quick flip', which was one of the worries of PANYNJ officials confronting the influx of financial investors three years ago. Tam says: "There is language in the contract that the port would share in the profits if the concession interest were to be flipped within five years." Richards adds: "We discussed this very subject with each of the bidders and we identified very specific terms under which the lease could be assigned." He summarises: "It's somewhere between 'can be assigned' and 'can't be assigned'."

Changed business model

The Richards/Alexander AAPA presentation alluded to changes in Oakland's business model. The port's formal board meeting agenda, in which the deal was approved, states explicitly: "The proposed concession agreement transfers the vast majority of main¡tenance and repair responsibilities to the concessionaire."

Richards comments: "The port was committed to exploring changes in its business model; it had been a pro¡active landlord. Now it is committed to shifting responsibilities to the private sector."

Noting that the agreement with APM Terminals, the outgoing concessionaire, spanned 20 years, Jane's asks Richards about the rationale for a 50-year tenor. Richards replies: "The private sector needs more time to recover its investments if they are assuming those risks." He explains that a combination of financial and operational considerations went into the decision: "We debated everything from 20 years out to 66 years - the maximum allowed under Oakland's city charter."

Richards continues: "You can imagine how an operator would view a 10-year deal, given the current downturn. The solution we came up with gives the private sector operator an opportunity to impose their long-term view on the asset. At the same time, we think that our client [the port] can get a better price when that long-term view is brought in." Summing up, he says: "Quite simply, the more typical 10 to 15 years just isn't enough."

The port's board minutes indicate that a USD20 million bid bond must be posted by the winning bidder. Tam adds: "There is no minimum credit rating required by the concessionaire during the term of the agreement, but the deal requires that they have a letter of credit posted."

California is at the forefront of the environmental movement; the Oakland deal carves out specific responsibilities for the government but potential concessionaires were well aware that they would be subject to current and subsequent regulations. The O'Melveny and Myers lawyers stress the importance of emission reductions. Richards says: "This was an important consideration in evaluating the proposals. We are delighted that the Ports America consortium had a terrific plan on that front."

He adds: "The Port of Oakland maintains the right to set environmental policies that will affect the berths. Extensive reviews are under way and further environmental plans are forthcoming. All tenants are subject to it. The port places great importance on exercising its responsibilities to the community."

Richards points out that the concession agreement also includes language precluding the port from creating regulations aimed solely at the new terminal operator.

US East Coast activity

On the US East Coast, the broader picture sees a half-dozen ports along the Atlantic coast vying for huge inflows of containers as mega-containerships transit directly between Asia and that part of the US due to a widened Panama Canal. The PPPTA legislative mechanism, which calls for the CenterPoint proposal to be posted for other potential bidders to examine, offers a unique opportunity to study the document. The proposal encompasses operation of four existing facilities, where current operator Virginia International Terminals (VIT) would become a CenterPoint subsidiary, and the USD1.3 billion development of a fifth

facility on 600 acres (2.5 km2) at Craney Island in Portsmouth, Virginia. Ultimate ownership of the ports would remain with the Commonwealth of Virginia.

CenterPoint's proposal boasts of the company's "expertise in large-scale inter-modal infrastructure and companion distribution parks". It adds: "The ability to package port service with distribution facilities and inland rail service would differentiate the port from its competitors."

This expertise in developing distribution centres for industrial and retail interests would be invaluable as a key component in the competition to attract vessel calls in the burgeoning East Coast trades.

The business side of the proposal features a USD500 million upfront payment to the Virginia Port Authority (VPA), an agency of the commonwealth; yearly concession payments based on port throughputs; and at least USD1 billion of capital expenditure and investments - in addition to the massive development project at Craney Island - that CenterPoint would make over a 60-year concession term. The upfront payment works back to an 11.1-times multiple of 2008 EBITDA and a 13.8-times multiple of the existing terminals' anticipated EBITDA in 2009.

Share of the profits

Annual payments from the concessionaire to the VPA include a profit-sharing component in which the agency could earn a 30 per cent share in annual profits, based on a sliding scale. All told, CenterPoint puts the present value of its proposal at between USD2.2 billion and USD2.3 billion, based on the value of the existing terminals.

Virginia would realise USD962 million in net present value (NPV) from the return of the transportation trust fund, accounting for distribution of retained cash and repayment of debt; payments made to the VPA from the trust fund would be suspended.

The two deals could be contrasted from multiple angles, one of which is the shipping company tie-in. On the East Coast, CenterPoint Properties - perhaps referring to the newly opened USD450 million deep-draught Maersk-linked APM Terminal in Portsmouth, Virginia, just south of its proposed Craney Island development - stresses in its pitch: "Importantly, because CenterPoint is not aligned with any steamship line, its participation in the port's management ensures a level playing field among existing and prospective customers."

The Oakland situation differs. Tam states: "One of the goals was to inc¡rease inter-modal cargo throughput." But she is quick to add: "They are a terminal operator, so there is no type of exclusive arrangement with one carrier. But the shipping company tie-in is important; it gives insights into what is happening in the marketplace."

Welcome stimulus

The timing of the renewed interest in maritime PPPs coincides with the Obama administration's stimulus bill, also known as the American Recovery and Reinvestment Act. Richards says that the Oakland deal, although in the planning stages for nearly two years prior to passage of the stimulus bill, "was driven by some of the same policy objectives that have led President Obama to encourage further investment in infrastructure, including PPPs - namely, the need for further development of US infrastructure to support our national economy and the expertise and financial resources that private sector participants can bring to infrastructure development and management".

Seliga also provides the broader context for the PPP trend, especially in recessionary times. "There is an increasing need for governments to find new and innovative ways to fund transportation improvements. The need to expand and rebuild our infrastructure continues to grow - and traditional funding sources such as gasoline taxes have not kept up with the demand." Difficulty in drawing money from constituents also imposes a constraint. Seliga adds: "The app¡etite of public officials and constituents for increased taxes is limited."

Deals between the private sector and governments will likely become more commonplace. Steele states: "I am of the opinion that the infrastructure industry is set to see a further expansion of the use of PPPs in America. States and local governments have a unique opportunity to leverage the stimulus funding by partnering with private entities through the use of PPPs."

After pointing to specific sections in the stimulus bill that explicitly identify the ability of state and local governments to distribute funds to PPPs, Steele says: "In addition, states and local governments have the ability to use the federal funds to improve associated or key infrastructure in their states to attract private entities into proposing PPPs."

Describing Virginia's PPPTA as one of the US' better state schemes, with an emphasis on "being friendly to private businesses trying to solve difficult infrastructure problems", he adds: "It is not hard to see private entities preferring to partner with states that are serious about improving rail, roads, waterways and bridges that serve the states' major ports."

Seliga stresses the importance of private investment that "provides a new source of funding for developing new infrastructure, and investment in existing infrastructure". He continues: "In Indiana, for example, Governor Mitch Daniels used the USD3.8 billion that Indiana received for the lease on the Indiana Toll Road to invest in the state's 10-year transportation plan, making Indiana the only state in the country with a fully funded transportation plan."

Perhaps similar financial dynamics might play out on the US East Coast. Seliga adds: "Similarly, the CenterPoint proposal would enable Virginia to free up funds that it can otherwise use for transportation purposes."

Retiring Port of Oakland debt

In the Port of Oakland transaction, part of the USD60 million upfront payment to the port will be used to defease several series of outstanding tax-exempt revenue bonds that were issued to finance port improvements in 2000 and 2002.

Peter Wong, Oakland-based managing director of municipal bond underwriter and financial adviser Siebert Brandford Shank & Co LLC (SBSC) - one of two co-financial advisers working with RBC Capital Markets, the port's financial adviser on the Outer Harbor deal - says that "with a change of ownership under long-term concessions, the federal tax code [Section 147, dealing with restrictions on private activity bonds] requires the redemption of associated debt as soon as legally permitted under the relevant bond documents".

He states that any potential PPP project in the US would need to be carefully vetted by a bond issuer's tax counsel if there were any tax-exempt bonds outstanding.

Wong says that bond defeasances (where money is set aside in an escrow account to repay maturing obligations, which are then decoupled from revenues that had been previously pledged for debt service) also played a role in two high-profile non-maritime transactions: Chicago Skyway and Chicago Midway Airport. He explains the tax code-driven rationale for defeasance: "The assets will no longer be considered governmental purpose projects."

The Port of Oakland already had experience with bond defeasance in June 2008, motivated by raising its debt coverage ratio, in which revenues are compared with requirements for servicing debt. In the 2008 defeasance, funds raised through a taxable commercial paper issue were escrowed and subsequently used to service interest and pay off principal on some USD11 million of tax-free bonds due later in the year. USD10 million of bonds, also due in late 2008, had been defeased during mid-2007. The mechanics were described in Port of Oakland's 2008 accounts as follows: "Sufficient funds were deposited with the trustee and invested in state and local government series [SLGS] securities to pay both interest and principal on their respective due dates."

Minutes of a June 2008 meeting of the port's board detailed improvements in the debt coverage ratio expected for the 2009 fiscal year versus 2008: for senior lien bonds, an improvement from 1.61 times to 1.89

times is contemplated; for intermediate lien bonds, the measure was estimated to move from 1.16 times to 1.31 times with the defeasance.

According to Wong: "For the Port of Oakland, the [Ports America] transaction had no impact on its credit rating." As for the impact of PPP deals on ratings, he says it is impossible to generalise.

However, Wong cautions that Fitch Ratings and Moody's Investors Service have released reports suggesting that their analyses would consider the use of the sale proceeds. He further warns: "If, for example, a city is selling assets for the sole purpose of fixing short-term budget deficits with minimal regards to long-term implications, then such transactions may be viewed negatively."

Even before the PPP-related defeasance occurs, Oakland, like other maritime facilities, has seen its ratings lowered because of generally weak cargo flows, and not because of wanton asset sales. In early March, Fitch lowered its rating on USD948 million of senior consolidated revenue bonds (under various indentures) to A+ from AA-; the USD499 million of intermediate lien revenue bonds outstanding were notched down to A from their previous A+ rating. Fitch's announcement of the downgrade details a 6 per cent drop in Oakland's teu flows in 2008, compared with 2007.

Practical suggestions for structuring PPPs

Owing to the ongoing process in Virginia, the interview with Joseph Seliga, Chicago-based partner in law firm Mayer Brown's state and local government practice, skirts the specifics of CenterPoint's plans, other than what has been publicly revealed. But Seliga's work across the broad spectrum of transport and other infrastructure projects has given him a perspective on the outside environment for, and the components of, successful transactions. "Generally, all transportation modes are suitable for private investment, although the forms of investment may differ, depending on the mode," he says. Seliga provides an example from mass transit (for example, a bus or light rail system): "In this sector, projects usually rely on some sort of public subsidy. This makes full privatisation, where the private sector takes the entire financing risk, less likely. In that case, you are likely to see private investment coupled with public subsidy, allowing public dollars to be stretched further and used for more projects."

As for differences in PPP deals, Seliga says: "Maritime projects pose a number of differences from toll roads. [With the latter] there may be competing routes, but usually there are only a handful of ways of getting to two locations efficiently." The maritime situation, he says, is far more competitive, adding: "Ports in the East Coast compete against one another for traffic, as do ports along the Gulf Coast or on the West Coast."

Seliga explains that customers differ as well: "A toll road serves public and commercial traffic on a general basis. Ports typically have contractual relationships with shipping lines. In the port sector there is also a much more accepted history of private involvement in ports - with private operators on container terminals, for example."

He offers practical suggestions for structuring transactions in the port sector, identifying nearly a dozen US terminals or ports with potential for PPP transactions (including Oakland and Virginia). "A long-term port transaction requires more of a partnership between the port and the private operator, similar to what is being proposed by CenterPoint in Virginia. With a toll road, it is possible for the government to turn over the operations under a long-term lease with detailed operating requirements and then leave the private sector partner alone to operate the road; the government would step in if a problem were to develop.

"Long-term concessions in the port sector are likely to involve a more active ongoing relationship between port authorities and private sector partners, in which the private sector improves operating efficiencies at the port with the help of the port authority. This creates benefits for both parties over the long term."

Transaction overview

SUMMARY OF PORT VALUATION

Valuation component	PV (USD millions)	Total payments (USD millions)
Upfront cash concession payment	$500	$500
NPV of revenue from Transportation Trust Fund (USD35 million growing at 2.0%)	$962	$3,992
Annual payment to Virginia Port Authority	$219	$987
Annual payment to host communities	$128	$615
Commonwealth share of future profits	$60 - $191	$440 - $1,312
Forecast capex funded by CenterPoint	$344	$1018
Valuation for existing terminals	$2,213 - $2,344	$7,552 - $8,424
Add: Anticipated funding - Craney Island Terminal	$1,300	$1,300
Grand total valuation	$3,513 - $3,644	$8,852 - $9,724

PROFIT-SHARING: INCENTIVE PAYMENTS SYSTEM

CenterPoint's cumulative equity IRR	Virginia Port Authority- share of profits
13.0% - 16.0 %	5.0%
16.0% - 20.0 %	10.0%
20.0% - 30.0%	20.0%
> 30.0%	30.0%

VALUATION ANALYSIS METRICS

Value provided	USD millions	2008 EBIthA multiple	2009 EBIthA multiple (est.)
Cash concession payment	$500	11.1 x	13.8 x
Cash payment + NPV of trust fund	$1,462	32.4 x	40.5 x
Total capital for existing facilities	$2,213	49.0 x	61.2 x

(source: CenterPoint Properties)