Selected Issues in Port Container Leasing

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Topics

In the context of container terminal leases:

1. Pricing and rent structure.
2. Risk.
3. Change in tenant ownership.

Pricing and Rent

- Understand what drives your port.
- A public port is **not** a private sector business—profit motive is not the main driver for business decisions.

Pricing and Rent

- “Triple Bottom Line” is an example of non-market factors public bodies use to score an investment decision:
  - Monetary return;
  - Jobs created;
  - Environmental benefits.

Pricing and Rent

Other examples of factors that might affect a business decision:

- Keep the unions happy;
- Keep the mayor/governor happy;
- Civic pride.

Pricing and Rent

Ports are not always driven by profit motive—
Get used to it.

Ports in Washington state were created to wrest control of the waterfront back from the railroads.

The public good (as defined by elected officials) has been a driver for port business decisions since the beginning.

Pricing and Rent

What is the market?

Container terminals are not your typical real estate development.

Comparable industrial land appraisals are a starting point to determine rent.

Pricing and Rent

However, the container terminal market is limited and so the local market is not determinative of what kind of rent you can get.

Pricing and Rent

Typical approach to figuring out what rent should be:

- Comparable rents.
- Port investment size.
- Rate of return over term of lease.

Pricing and Rent

The rise of the “ultra-large container ships” (“ULCS”) has meant that ports are faced with competition to adapt their existing facilities to be able to handle these ships.

Pricing and Rent

ULCS require the following kinds of improvements:

- Larger container cranes;
- Stronger aprons to support the cranes;
- Additional electrical capacity to power the cranes;
- Additional gates;
- Container yard improvements to handle large volumes of containers;
- Outside-the-gate improvements.

Pricing and Rent

Fundamental question for ports:

- Is the goal to get a particular rate of return (business decision)?
- Or is it to achieve the other non-business objectives?
- If the latter, how low are you willing to go?

Pricing and Rent

Type of rent:

- Per-acre rent.
- Volume based rent.

Pricing and Rent

Per acre rent

How does it escalate?

- Consumer Price Index or other government index.
- Periodic market-rate adjustment.

Pricing and Rent

Advantages of per-acre rent:

- Cash flow is easy to predict;
- Rent is unaffected by how the MTO's business is doing;
- The tenant pays the same if it moves 5 million containers or only 1.

Pricing and Rent

Volume-based rent

- Usually has a minimum guarantee.
- It’s great when business is good.
- Can be tiered in a way to encourage more volume.

Pricing and Rent

Disadvantages of volume-based rent:

- Cash flow hard to predict year-to-year.
- Shortfalls can be subject to re-negotiation.
- Volumes can be manipulated by shifting of cargo between terminals (if the MTO is tied to a carrier that is in an alliance that serves other terminals within the same port).

Risk

Very broad topic—Selected issues

General push-pull – who shoulders the risk: the port or the MTO?

Risk

Investment risk by port

Assuming port is making a large investment in the development, how does the port mitigate its risk?

Risk

Mitigating the port's financial risk:

- Get a guarantor.
- However, this may be unrealistic since the MTO is likely to form a shell entity (LLC) that will shield the parent.
- One compromise: Get a guarantee that dissipates over time.

Risk

Mitigating port financial risk (cont.):

- Get a larger rent security.
- Warning– under US bankruptcy laws, the most landlord creditor can recover from lease security is the greater of one year's rent or 15% of the remaining rent (not to exceed 3 years). 11 USC §502(b)(6)(A)

Risk

Mitigating port financial risk (cont.):

- If the MTO invests in the terminal, get it to invest in infrastructure that can be used by other tenants.
- Avoid investments that are portable (container cranes, yard equipment).

Risk

Mitigating port financial risk (cont.):

- The port can find a way to provide (and charge for) services outside the gate.
- Port of Tacoma operates an intermodal rail facility that collects fees for handling containers moving by rail.
- But this is expensive to operate and revenues suffer if business is bad.

Risk

Mitigating port financial risk (cont.):

- Bankruptcy (MTO's)– Not many good options to mitigate risk.
- Get a guarantor (see previous discussion).
- Might have to trade off on rent to get one.

Risks

Environmental risks

- Existing contamination risk is something that can be calculated and negotiated.
- What's harder is new environmental liability created by day-to-day operations.

Risks

Environmental risks (cont.):

- Stormwater run-off is a big issue in the PNW.
- It's a Clean Water Act issue and it can pose a huge cost and exposure.

Risks

Stormwater risks (cont.)

- Key issue: Who holds the stormwater permit?
- Who installs the stormwater system?
- Who operates it?
- If the tenant has all of these responsibilities, the port needs to stay as far away as possible from involvement and oversight.

Change in Ownership

As lessor, always try and have a strong Assignment and Sublease clause in the lease.

Try not to settle for language that consent will not be unreasonably withheld—you end up in arguments over whether or not you're being reasonable.

Change in Ownership

Additionally, any consent to assignment should keep the assignor on the hook.

Potential flaw– the assignor is a shell entity with few assets and is therefore judgment proof.

Change in Ownership

Other ideas:

- Get a performance guarantee from a viable parent (very hard to get).
- Negotiate a higher lease security (although remember the limitations on bankruptcy discussed above).

Change in Ownership

One wrinkle:

- What if the tenant entity remains the same but the parent ownership changes?
- It would be nice to get that kind of leverage because it opens the door to getting additional protections.
- However, this will be difficult to obtain in a lease.

Questions?