**AAPA Maritime Economic**

**Development Committee**

(MEDC)

**Real Estate Best Practices Group**

Lease Structure Group

Whitepaper (Draft)

**Sub-Group Team Members:**

• Jay Stewart Port of Tacoma

• Kathryn McDermott Port of Los Angeles

• Steve Hagar Port of Everett

• Spencer Stewart (Private Consultant)

**Purpose**

The objective of the Leasing Best Practices Project is to create a compendium of current Port policies, practices and lease provisions as a reference for AAPA members. Oversight and guidance of the project was provided by the Lease Structure Subgroup. Two methods were used to collect research for this project. The initial research reviewed leasing practices of multiple U.S. west coast ports. Specific provisions were then complied into a living database that will be posted online for AAPA members to use as a reference guide. Next, a survey questionnaire was created to assess current leasing policies, practices and terms used by AAPA members. The survey was provided to Maritime Economic Development Committee member Ports. Seven Ports responded initially and the survey results are summarized below and attached as reference. This summary of survey responses and the reference table of sample lease policies and provisions will be posted online for AAPA members.

The following three (3) areas were the focus of the group’s research.

1. Leasing Policies
2. Leasing Practices
3. Leasing Guidelines
4. Special Provisions and Performance Incentives

**Summary of Port Responses**

**Leasing Policies**

If we were to codify the primary theme given to us by respondents to our survey, it would be the need for increased flexibility in reacting to market conditions in setting lease terms in a timely manner, while attempting to adhere to written policies of each respective port. If the policy is too restrictive, the port may lose a worthy tenant and income. If the appeal process to be given the authority to modify lease terms is too slow, the port may lose a worthy tenant and income.

Leasing Policies typically are established by a port governing body and can vary greatly depending on the scope and size of the port. Larger ports tend to have more extensive and well-defined guidelines while the smaller ports may have more general and limited guidelines. Policies guidelines can cover a wide range of topics including standards for term must be approved by the Board. Echoing the market-accountable nimbleness of private landlords, all ports surveyed agreed that circumstances may justify deviating from an established leasing policy and in such instances the governing board should review the needs of the tenant and rule if a deviation should be allowed.

The Lease Term establishes the period of time tenant may utilize Port property. The Lease Term will vary depending on the port, the property location, the type of use (marine terminal, industrial and commercial) and the improvements to be constructed. . The survey showed that the lease terms for marine terminals ranged from 1-50 years depending on the port. The average period for a land lease to industrial and commercial tenants is five years for the initial term with a five-year extension option. Some of the ports surveyed do not offer a lease extension to all tenants.

The need for flexibility in setting lease terms as codified in policy statements was a common refrain by nearly all surveyed ports. For example, one surveyed port told us they could amend their leasing policies only with approval from their tenant association, while allowing stakeholders to offer input if they feel it is necessary. In another case a port’s governing board has delegated signature authority for lease agreements less than a year in duration, while leases with terms over a year lease extension to all tenants. Almost all ports surveyed suggested that the guideline lease terms and extensions could be changed if there is a long-term economic benefit to the surrounding area. One port surveyed signed a forty-year lease with a marine terminal operator based on the sizeable investment the tenant would contribute to the harbor improvements - estimated at $500 million.

While most ports understood the need for consistency in setting lease terms, the need for flexibility in finalizing the business terms of a lease was paramount.

**Leasing Practices**

Leasing Procedures govern the process to be followed when a port generates a new lease or renews or extends a lease. Lease terms are the business and legal provisions contained in the lease. Procedures can influence lease terms; both procedures and terms will vary greatly from port to port. Factors such as competing market properties and environment, location of the premises, type of use (industrial, commercial or maritime), tenant or offsite improvements, business volumes and length of the lease will all have an effect on lease terms.

For those ports we surveyed, we found that lease rates are typically determined by appraisal with an annual adjusted of approximately 2-4%, most often pegged to a particular Consumer Price Index (CPI). Most ports surveyed review their CPI annually and adjust their tenants rent accordingly. Typically, port lease agreements provide that rent will not be lower than the previous year’s rent, should CPI actually drop. Most of the ports surveyed include the month in which the rent increased will be determined and the month that the increase will go into effect. Some additional terms commonly found in our surveyed port’s leases include:

* Annual Escalation based on CPI
* Security deposits based on the strength of the lease
* Lease agreements longer than 10 years may have reappraisal provisions.
* Adjusting for new equipment and improvements
* Valuation based on ROI and/or NPV of the lease (discounted cash flow analysis)

In addition to annual rent bumps as a result of pre-negotiated stepped rent increases or due to CPI adjustments (see above), some leases held rents flat for the term of the lease using a variety of rate setting methodologies. One port uses tariff based rental and flat rental components. The tariffs are updated on a regular basis depending on research of other ports tariffs. The flat rental components are outlined in their leasing policy. Other examples of rate setting methodologies include:

* The rate can be determined by the amount of land used by the tenant
* An agreed upon price per unit of throughput produced by the customer
* A negotiated monthly rental payment that is not based on acreage or throughput, but on some other unique metric.

A basic tenant of real estate is that land is treated separately from improvements upon that land. Typically, land value is often established through a review of comparable sales of industrial land, land values used by other West Coast ports, market conditions, and other factors such as the age and condition of the property. When improvements and equipment are new, valuation is determined by a return on investment calculation using the actual cost of construction and a rate of return as defined by the Port's Leasing Guidelines. When improvements are not new, the basis of valuation will be determined by looking at industry accepted replacement costs for similar construction and then applying an appropriate depreciation factor. The field of real estate appraisal has undergone significant shifts since 2007, and depending on the size of the lease transaction and associated risk, ports might consider hiring an independent appraiser to best evaluate the parcel/lease in question, in order to best maximize the port’s resources and income stream on behalf of its stakeholders.

**Guidelines**

The surveys revealed that not all cargo classifications have sufficient margins to pay the same rates. In addition we observed that standard lease provisions pertaining to rent, payment structure, and term, some ports include provisions to prevent one tenant within a given classification (eg. breakbulk) from having a competitive advantage or disadvantage from the other tenants. Other factors, such as Port or tenant investment, assets being leased, rate of return guidelines, or other factors specific to a particular tenant or agreement should be considered.

One of the ports surveyed recommended that ports establish inclusive guidelines to determine rental rates. The port’s Guideline Rent calculation values the range of assets covered by the lease including: 1) land, submerged land, or water, 2) capital improvements such as buildings, wharves, paving, lighting, rail facilities, or water, and 3) equipment such as cranes and ship loaders. That port utilizes all methods available to establish a basis for determining Guideline Rent which may include engaging third-party appraisers or consultants to review competing ports, adjacent markets, and adjust values and rates due to age and condition of the property, allowing for CPI or Fair Market Value adjustments over time.

**Special Provisions and Performance Incentives**

The port can also employ standard (or special) provisions in all leases and should decide if these provisions are negotiable. Examples from the ports surveyed are:

* Living Wage Policy compliance
* Non-discrimination
* Small Local Business Utilization Policy compliance
* the Maritime Aviation Project Labor Agreement
* which applies to various “construction” activities broadly defined in the Agreement
* Tidelands Trust compliant use
* Surrender and Holding Over
* Taxes and Assessments
* Utilities
* Title to Improvements
* Dredging
* Crane Insurance
* Damage and Destruction
* Indemnification and Liability Insurance
* Toxic Materials (and related items)
* Annoying and Injurious Conduct; Defaults and Remedies
* Security and Protection of Premises
* Waivers; Right to Inspect Premises
* Visitors
* Estoppel Certificates
* Force Majeure
* Eminent Domain
* Waiver of Claims
* Extension of time
* Sections and Subsections
* Successor; Time of Essence
* Notice; Other Agreements
* Applicable Law and Venue
* Covenant Against Contingent Fees
* Third Party Rights; Definitions
* Warranty of Signatories
* Agreement in Multiple Copies
* Partnership considerations

In general nearly all surveyed ports agreed with the idea of a standard lease template as a starting place for all tenant negotiations on the port. The value of this approach is obvious, not only in time saved in recreating the wheel, but in maintaining a standards-based approach to lease terms. Some common themes in legal terms were regularly mentioned in our surveys, including:

Dispute Resolution: Standard dispute resolution language in the lease template to help resolve disputes and avoid litigation.

Performance Requirements: The surveys revealed that it can be beneficial for ports to establish performance requirements for the tenant port’s leasing policies. The specific kinds of provisions that should be included in the leasing policies should be agreed upon on by the board members to maintain continuity in the lease agreements. Some examples of provisions include; a requirement that commercial tenants be in compliance with a recreation dockage policy if it is approved in the future, marina maintenance audits required every 5 years and the requirement for the tenant to make the improvements identified in the survey.

Air Pollution Incentives: Most ports also include requirements or incentives for tenants to reduce air pollution emissions through identified responsibilities. These include obligations for vessels to use shore side power, reduce vessel speed, use of low emission yard equipment, purchase green commodities and installation of solar panels. Any failure to comply with these requirements is a default of the lease. To prevent loss of a tenant by default, one port has included a provision to financially penalize tenants who are not in compliance.

Environmental contamination: This can be costly both for the tenant and the port if compliance responsibilities are not clearly defined in the leasing policy and the lease. Most of the ports surveyed have detailed language in their leasing policies (and/or leases?) that hold the tenant responsible for environmental compliance and remediation of tenant-caused contamination. This also holds the tenant responsible for securing all required permits and regulatory approvals. One of the ports reported they have made exceptions to this rule citing an example that when it signed major fifty-year lease, the port agreed to split the costs of remediating environmental contamination with the tenant 50/50. Most of the ports surveyed also take responsibility for any pre-existing conditions unless they are agreed upon in the policy or codified in the lease.

Business Incentives: Most ports reported they do not employ standard provisions for incentivizing business or performance; however, the ports did point out certain provisions by their nature help to incentivize business or performance. For example, several respondents permit tenants to reinvest in their leasehold improvements in exchange for a favorable lease provision such as an extended lease term at a more favorable rate, free rent, or changing income calculations (i.e. Charging a lower per-TEU rate for cargo volumes above the minimum annual guarantee or reducing the per-TEU rate if certain performance standards are met). One port stated they incentivize business by allowing registered VSA, partners to take advantage of negotiated leaseholder rates as opposed to full tariff rates. They also offer Tariff incentives for container terminal lines with more than 100,000 tons of cargo throughput as well as for the introduction of new services for cruise tenants. MAGs are reached; incremental revenue is ceded to the cruise lines, meaning their per-passenger margins scale up immediately once minimum commitments are reached

Another incentive that can be offered to new tenants is a Minimum Annual Agreement (MAA). In the lease agreement the tenant and port specific a MAA revenue the port expects to receive, once passenger/revenue Minimum Annual Agreements are reached, after which all incremental revenue is ceded to the tenant. This is often done in the case of cruise lines, and allows their per-passenger margins scale up immediately once minimum commitments are reached.

Trucking Considerations: The survey showed most ports currently do not provide facilities for the truckers serving port terminals and businesses. Such services might include restrooms, customer services centers, dedicated truck queuing areas, virtual container and transload yards. Most ports surveyed do not require their terminal operators to provide facilities for the truckers within their terminal. One port surveyed did state that their one terminal operator is responsible for providing trucker facilities.

A number of ports surveyed also stated while it is not a requirement to provide facilities for truckers most of them provide staging areas for the tenants to use. Some of the amenities that are provided by the various ports are: Portable and physical restroom facilities, queuing lanes, break areas and fax machines. Some ports provides a customer service center that is funded by the port and is operated by a port contractor, the main reason for the service center is to ensure that the truckers are in compliance with their secure truck program.

Afterword: This Leasing Best Practices project is envisioned to be an evolving, expandable resource that incorporates new information, ideas and techniques from all AAPA members. A copy of the survey provided to the MEDC by the Member ports are attached below. Next an online reference guide will be developed and a link to the guide will be provided in this document. The reference guide will include a table of port responses and a table of leasing policies, examples and updates from AAPA members and new and/or special provisions that have been introduced.