aegir
Port Property Advisers
Drewry
Maritime Advisors

American Association of Port Authorities
Property & Terminal Lease Workshop
Houston, The Republic of Texas
21 September 2016

Port waterfront commercial, development & other real estate minefields ©

Franc J Pigna CRE FRICS CMC, Managing Director

Port Property Advisors | Maritime Research | Maritime Advisors | Supply Chain Advisors | Maritime Equity Research

www.aegirports.com

To be determined?

- Changing industry dynamics is and will continue to impact the port authority business model.

  What will be the impact on port property and how it is employed?

- Current state of 'port property' vis-à-vis port authorities.

  How should these challenges reflect on port property leases?

- It is increasingly critical that port property leases reflect key financial and control issues for the port.

  How should this be addressed in the lease?

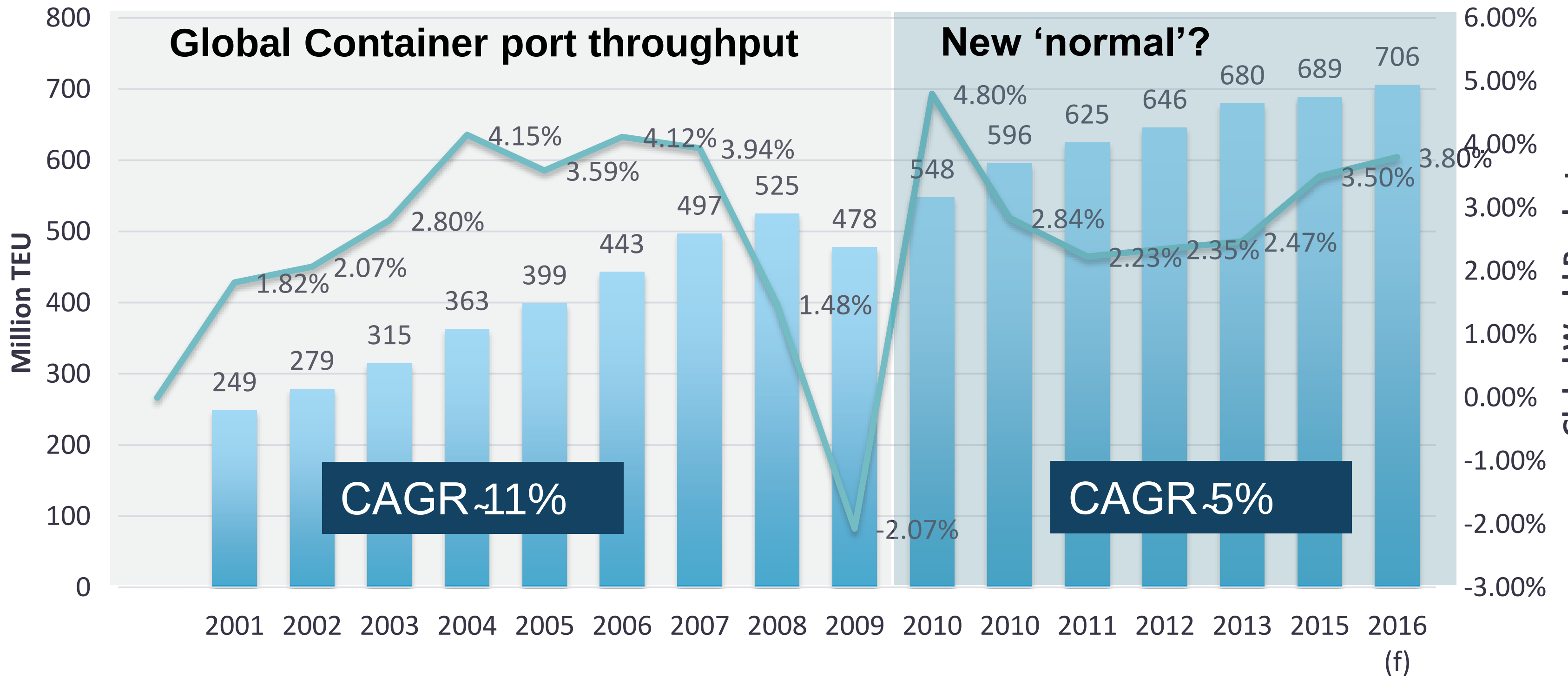
Subjects to be covered:

- Another 'New Normal' - again
- Challenges impacting ports – changing and increasing
- State of Port Property
- The leasing 'minefield'
- Conclusions/takeaways

Another 'New Normal' – again!

Demand growth – will this accelerate diversification of revenue streams at ports?

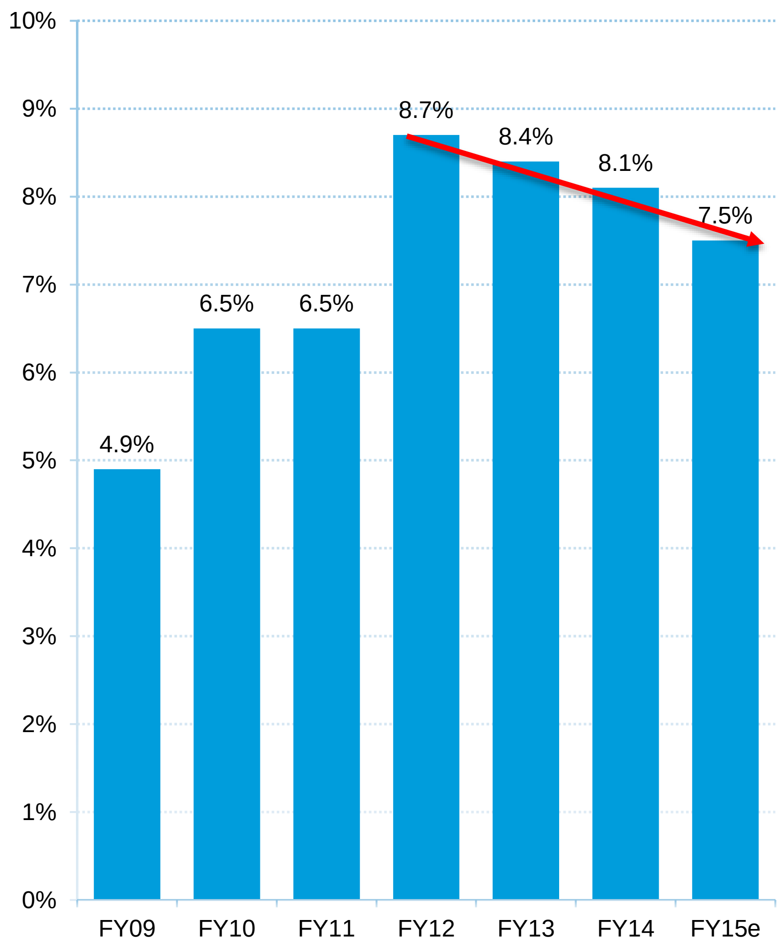
Double digit growth (~11%pa) before Great Recession (2008/09); since then, single digit (~5%pa) – lowest growth rates ever in the industry (apart from 2009). But there is the China Factor.



Source: Drewry Maritime Research/Aegir Port Property Advisers

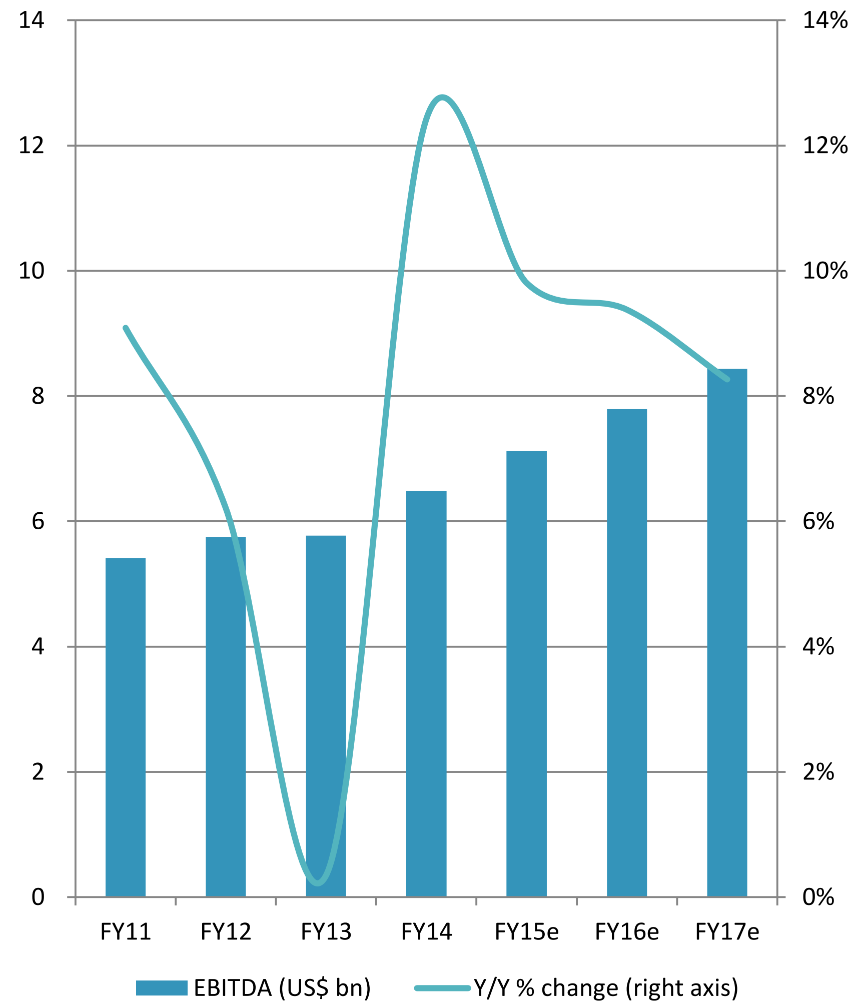
Entering a market of lower returns

Drewry Port Index: Return on Equity



Source: Bloomberg, Drewry Maritime Equity Research. Note: Drewry Port Index is a market-weighted index, comprising 11 listed terminal operators Drewry Maritime Research covers globally. The ROE estimates of respective companies are weighted accordingly.

Drewry Port Index: EBITDA growth estimates



Source: Bloomberg, Drewry Maritime Equity Research

Are we entering a period of markedly less port and terminal profitability? More concession demands from port clients, what role will port property play?

- Container terminal and port investments:
  - historically highly profitable /resilient with
  - high barriers to entry/limited competition.
- While not immune to market volatility, global economic shifts, ports' sector proved resilient – even in '09.
- Typical EBITDA margins for global container terminal operators remained in 20-45% range a year.
- But, industry entering new, 'mature phase', resulting in lower profitability, more challenging environment.
- Ports will need diversified revenue sources to maintain capital funding requirements - property will be key.

Changing environment for port and terminal operators

	Container port demand	Containership sizes	Shipping lines	Competition	Returns
10-15 years ago	Strong demand growth	Limited growth in ship size	Smaller shipping lines and alliances	Competition for acquiring port assets	Generally high returns
Today	Weaker demand growth	Huge growth in ship size (raising terminal opex and capex)	Much bigger shipping lines and alliances	Greater international competition for acquiring port assets	Lower returns?

Source: Drewry Maritime Research

Challenges impacting port properties – changing and increasing

Impact on ports resulting from larger ships – major peaks; requiring more infrastructure, longer periods of underutilisation, lower revenues

Before

3,000 boxes

MONDAY

3,000 boxes

THURSDAY

After

6,000 boxes

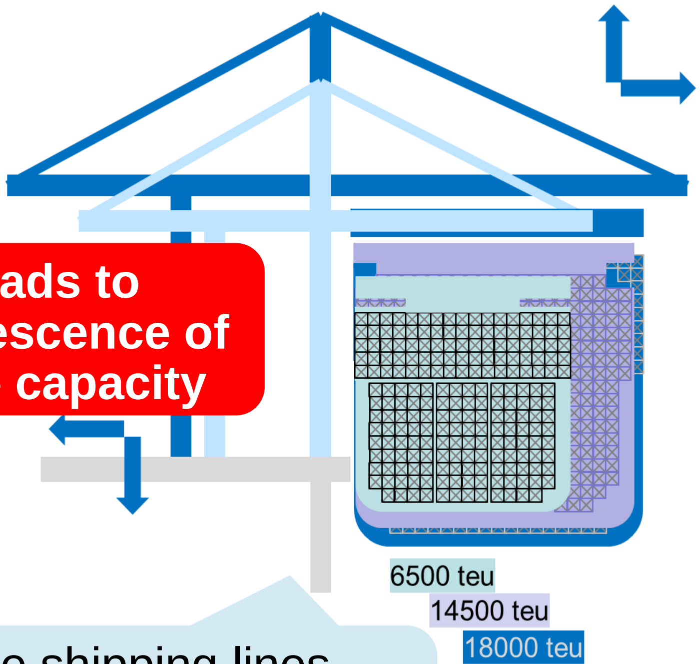
MONDAY

…and what if the ships are off-schedule too?

Bigger ships requires more investment in equipment, infrastructure, systems and more and more efficient use of real estate; who pays for this?

- Larger (and more) cranes
- Longer berths
- Deeper berths
- Deeper approach channels
- Greater air draft
- Higher crane and berth productivity
- And a yard/landside operation and inland links capable of coping……

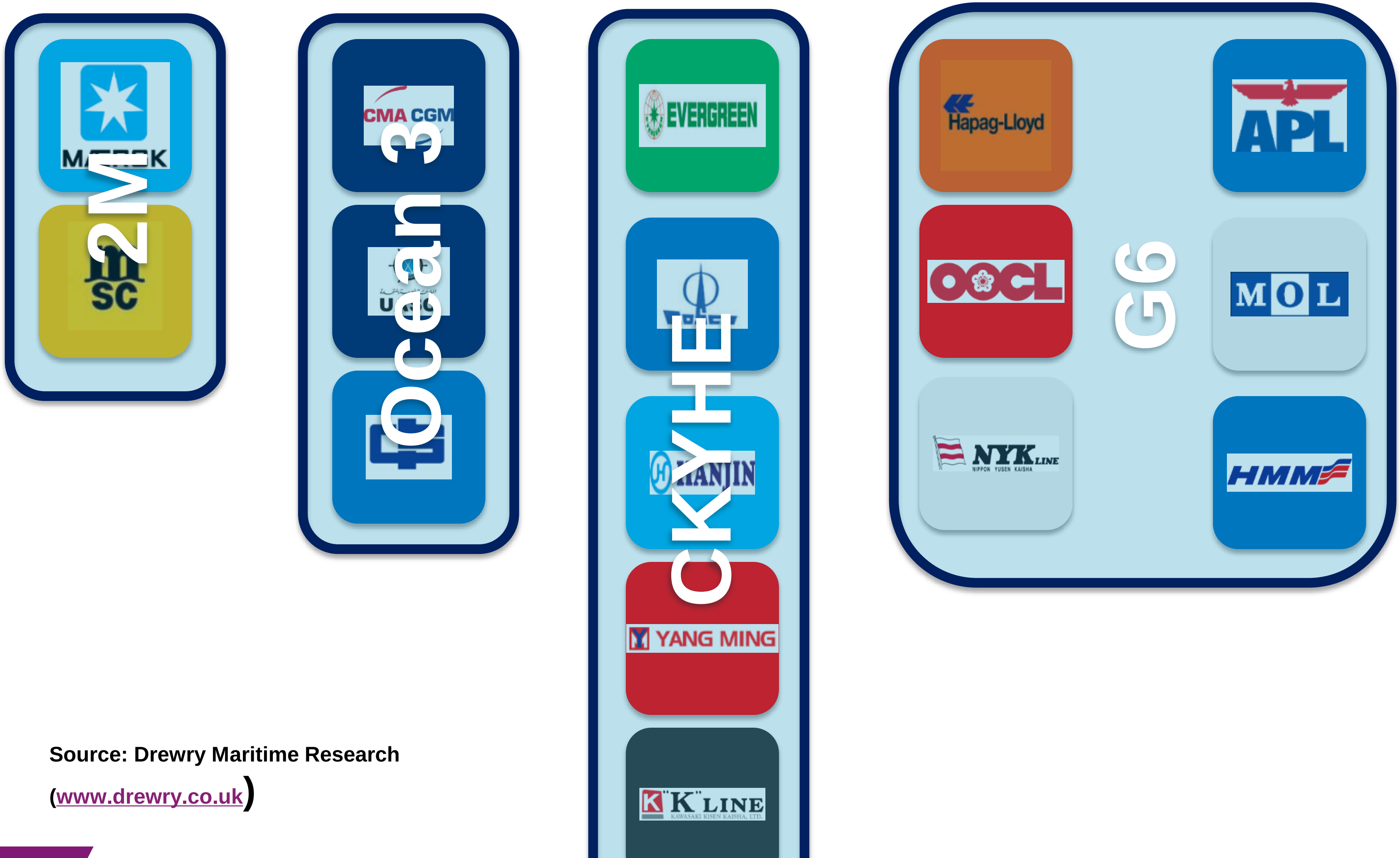
Leads to obsolescence of some capacity



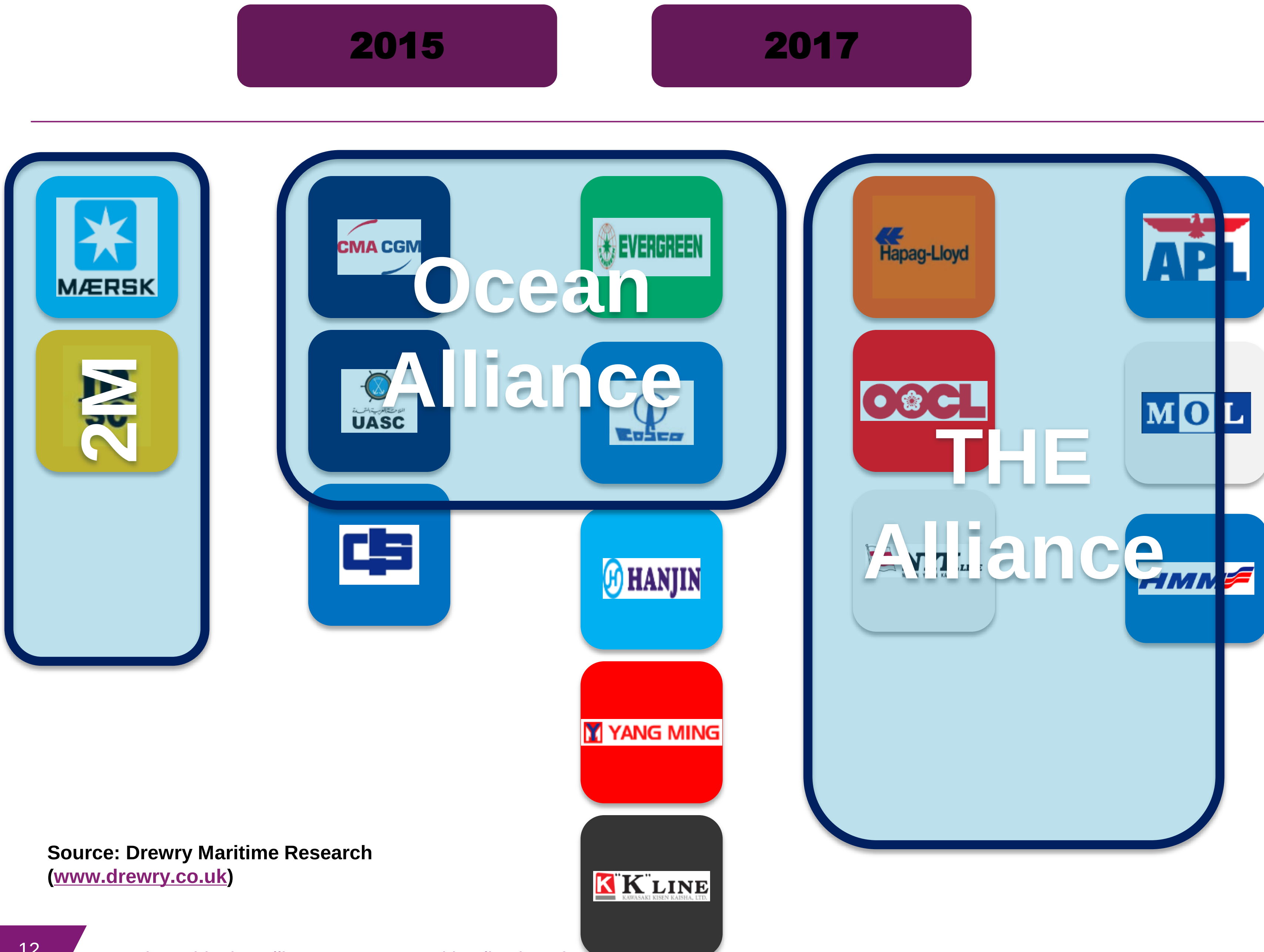
Are shipping lines prepared to pay for these enhanced requirements?

Alliances Consolidating

2015 | **2017**



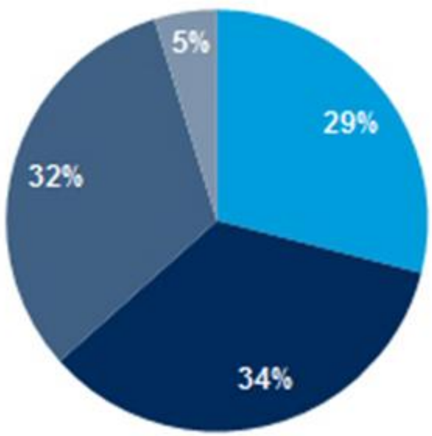
Source: Drewry Maritime Research (www.drewry.co.uk)



Source: Drewry Maritime Research (www.drewry.co.uk)

Shipping capacity by alliances in 2017 – consolidation of power: more changes to come; even after changes, alliances aren't stable forever.

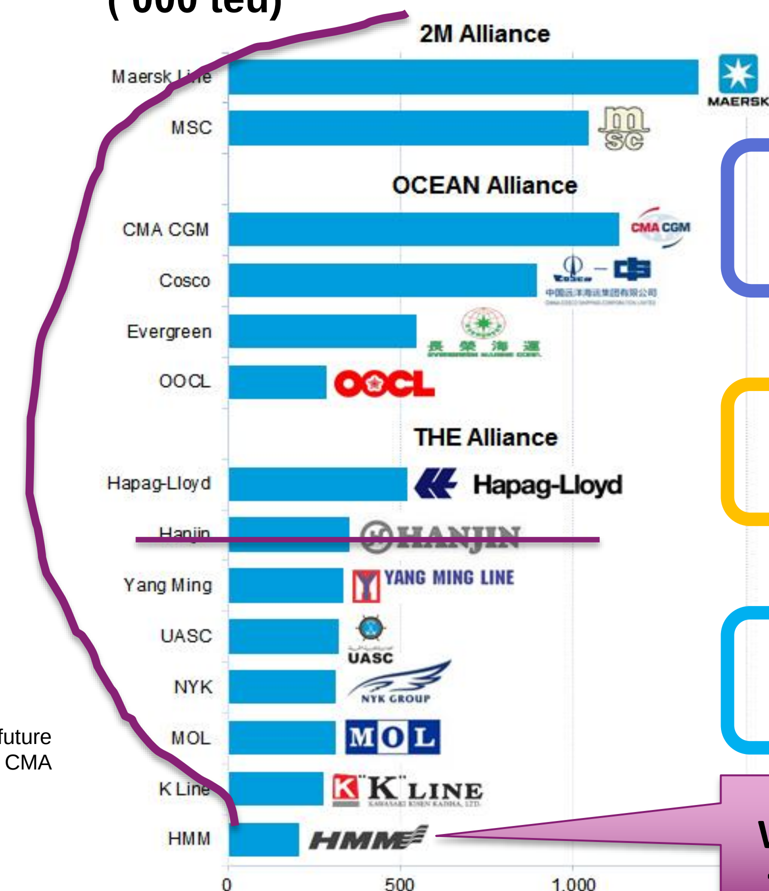
Nominal East-West ship capacity shares of three mega-alliances, April 2016



Note: Based on deployed capacity in April 2016 and does not include future deliveries;THE Alliance includes UASC and HMM; OCEAN Alliance includes CMA CGM takeover of APL and merger between Cosco and CSCL.

Source: Drewry Maritime Research (www.drewry.co.uk)

Breakdown of three mega-alliance nominal East-West capacity, April 2017 ('000 teu)



What comes after Hanjin?

Entry of IRISL (Iran)?

Merger of Japanese lines?

Will move to 2M Alliance

Obsolescence

Functional:

Economic:

Auckland, NZ

State of Port Property

Port Property Advisers

State of port property

AAPA research paper and overview on port property, challenges faced and issues for further research; Franc J Pigna, April 2013

- International survey conducted of six ports:
  - –US Gateway
  - –US Inland
  - –US Gulf
  - –European gateway
  - –Asian transhipment
  - –Latin American regional

State of port property

- Port's surveyed represented:
  - 34,176 acres/13,831 hectares
  - $6.835 billion in land value (at $200k/acre or $495k/ha)
  - 2,145,000 teu's
  - 750,000,000 MT

Aegir survey results

- **Shift to property rent revenue from MAG's** and throughput charges
- **Property side** of business needs to be **better understood**
- Terminal concessions **underlying land do not take into account**
- **No starting basis of value for property portfolio**
- **Leases do not reflect real financial performance** needs

Aegir survey results

- Traditional appraisers do not understand dynamics of port business, challenged in identifying ‘highest and best’ uses
- Want **accurate data on port property values** to better manage business
- **Economic development issues/requirements disconnects** them from real, competitive world

Aegir survey results

- No port **property asset management** in place
- Capitalisation rates and **financial performance thresholds not readily defined**
- **Property departments understaffed**; importance of **property little understood** outside of senior management
- **Underperforming** financially

Aegir survey results - lease issues

- **Balance between ‘fixed’ and ‘variable’ rents** (ie, property and throughput respectively)
- **Balance between fixed rent and MAG revenues** (pressure from rating agencies for ports)
- Issues surrounding **lease capitalisation** for companies from changing IASB/FASB regulations and resulting impact on leases
- **Shorter term** property usage from greater peaks
- **Leases do not reflect real financial performance needs**

The leasing ‘minefield’

Do or are your leases…

- **Benchmarked** against non port properties?
- Account for the **real value of port property**?
- Strategically structured to give port **maximum flexibility, financial protection**?
- Synchronised with operations to **produce revenue synergies**?
- Produce **real profits**?

What should your lease rate cover?

- Costs:
  - Cost of capital, risk?
  - Inflation?
  - Capital sinking fund for renovations, infrastructure recapture?
  - Repair & maintenance?
  - Operating, insurance costs eg, common area maintenance, security, electricity?
- Revenue:
  - Return on investment?
  - Return on equity?
  - Landlord profit?
  - Demand/supply balance?
  - Throughput charges?

  Without consideration of the above, are you making any money?

Lease issues

- **Realistic capital basis** (land value) – the starting point
- **Balance** between property and throughput based rent MAG (rating agencies?)
- **Terms & conditions**, adequate and proper rent reviews AND Port Authority control of its destiny
- **Meaningful lease rates**; 'financiable' leases
- Impact of **capitalised leases** (elimination of FAS 13) on tenants (lease versus buy issues by corporations)

Port property dynamics

- **Port Property Dynamic different than traditional real estate**: although there is a relationship between industrial real estate market dynamics to port property, the more direct relationship is with GDP, international trade, cargo throughput and velocity, specialised use and high barriers to entry.
- **Overarch, support main port business strategies**: port's core business mission must always be at the forefront when deploying port properties.
- **Long term impacts**: leasing decisions made today will impact the port decades into the future – be careful what you commit and who you lease to.
- **Key**: manage tenant/client needs with port's; maximise financial performance of the real asset.

Takeaways

Takeaways

1. Port authorities and operators will see slower throughput, revenue, EBITDA and ROE growth – property will become even more critical, strategic.
2. Larger ships will require more infrastructure and land to achieve faster cargo velocity; land use needs to be used more efficiently.
3. How will required infrastructure be paid for? Property portfolio to become increasingly important as a capital asset?
4. Larger, consolidated alliances = more powerful, from a negotiating standpoint.
5. Economic obsolescence is major port threat.
6. Port's industry readily acknowledges that their largest asset – property, is not being properly managed or leased.
7. The lease document is critical to achieve meaningful results.

Port Property Advisers

Since 2003, Aegir Port Property Advisers are the pioneer consultancy engineered to meet the unique property challenges faced by the ports and maritime industries. Aegir's focus is to enhance a port's competitive position and financial value through the more strategic use of its largest asset - property.

In the last decade Aegir has undertaken complex port property lease, asset management, valuation, development feasibility, management consultancy and strategy instructions in Europe, the Middle East, Africa, the Americas and Asia.

info@aegirports.com

www.aegirports.com

Helping you navigate the world of ports
by bridging the gap
between the port and property sectors.

Maritime Advisors

From our origins in 1970 London to a 21st century maritime and shipping consultancy, Drewry has established itself as one of the most widely used and respected sources of impartial market insight, industry analysis and advice. This in-depth understanding and objectivity provides our clients with the actionable advice and recommendations they need to achieve their ambitions and stay ahead of the market.

- Last 10 years - over 400 port assignments in 50 countries.
- Since 2010 - $20bn value in commercial and due diligence advice in port M&A and financing.
- Last 5 years - provided advice on vessel valuations on asset value of more than $180bn (combined).
- Last five years - advised on container shipping industry on investments totalling $6bn.

USA (Aegir)

299 Alhambra Circle
Suite 402
Coral Gables Florida
33134-5117 USA

T +1 888 517 9990

UK (Drewry)

15-17 Christopher Street
London
EC2A 2BS
United Kingdom

T +44 20 7538 0191

India (Drewry)

209 Vipul Square
Sushant Lok - 1
Gurgaon 122002
India

T +91 124 497 4979

Singapore (Drewry)

#13-02 Tower Fifteen
15 Hoe Chiang Road
Singapore 089316

T +65 6220 9890

China (Drewry)

Office 555, 4th floor
Standard Chartered Tower
201 Shi Ji Avenue
Pudong District, Shanghai
China, 200120

T +86 (0) 21 6182 6759

Port Property Advisors | Maritime Research | Maritime Advisors | Supply Chain Advisors | Maritime Equity Research