Managing Port Property as a Strategic Asset - Unleashing Opportunities

AAPA Port Property Management & Pricing Seminar

25 Oct 2006

Summary

- Role of port authorities
- Historical Perspectives
- Asset management
- Regionalisation
- Port life cycles
- Port land usage - strategies
- Underestimating value of port land
- Property industry dynamics & considerations
- Conclusions

Introduction

- Who is Franc Pigna?
- Goals to be accomplished:
  - Introduction to some property issues and thinking strategically
  - Get everyone involved to access wealth of experience and industry knowledge
  - Exchange of ideas and concepts
  - Identify critical areas to be further addressed
- Who are you?

No longer business as usual

Due to:

- Escalating property costs
- Land shortages
- Threatening economic obsolescence
- Security and ecological constraints
- Profitability & productivity demand
- Regionalisation

Port Property

Port Authorities (PA's) control significant strategically located waterfront **property**, which typically:

- Is the largest asset on their balance sheet
- Financially underperforms
- May operationally be underutilised
- Is viewed as an administrative function - not a strategic asset

Why PA's need to manage port properties professionally?

- Changing role: operators to asset managers
- Congestion pressures, supply chain compression, requirements of 'big' ships, regionalisation
- Land constrained ports must improve productivity and 'velocity' to remain 'economically' viable
- Better manage security, ecological, logistical and quality of life constraints
- Now profit centres - must maximise revenues & values to facilitate access to private capital to modernise & expand

To maximise profit and asset values PA's must:

- Develop 'asset management' skill sets
- Manage 'property' as a strategic asset
- Be financially disciplined with property to optimise land usage based on economic value eg, increasing velocity by moving distribution and warehousing to hinterlands, closer to intermodal access points

PA's property management challenges

- Overarch property objectives with port's overall business strategy and mission
- Asset management Procedures (EVA)
- Financial engineering to access available, lower cost, private capital and financial markets

EVA: Benefits from managing for value - refocus, reconfigure, re-engineer

Shareholders:
- Higher value
- Higher returns

Port:
- Enhanced viability
- Inward investment
- More competitive
- More profitable
- More valuable

Clients:
- Better service
- Better price
- Better productivity

Community:
- Sustainability
- Economic contribution
- Jobs

Asset Management

“The acquisition, administration, re-development, re-use and disposition of real property assets in such a manner that the owner’s business mission, goals and objectives are supported and achieved in the long run and add economic value.”

Effective asset management requires:

- Property **asset management plan**
- Operational **controls** to execute plan
- ‘M**arket driven**’ property decisions
- Ability negotiate and structure complex property decisions – **financial engineering**
- Benchmarking

Benchmarking: The Key to Performance

- ***Execute***: Crucial element to developing, executing and managing an effective asset management plan
- ***Measure:*** Required to attain any reasonable performance goals
- ***Collaborate:*** High level collection, dissemination and sharing of key data between major executive & managerial elements: Senior management, Finance, IT, Operations

Benchmarking Requires

- Aggregation of properties
- Lease administration
- Accurate market values for port properties (challenging as like kind comparables may be worldwide - not across the street), which are highly specialised

Financial Engineering

Facilitates releasing tied up equity in property for port modernisation & expansion.

Requires:

- 'Financiability' (ie, standardisation) of leases
- Proper structuring of leaseholds for tenants/PA to finance facilities eg, security, collateral, safeguards
- Disciplined asset and property management
- Benchmarking
- Economic Value Added decision making

Overarching port property objectives with the port's

Port property strategies need to:

- Support the port's core business
- Create synergies and competitive advantages with port operations
- Increase port's operational efficiency, address client needs
- Make most of existing logistical infrastructure and changes - regionalisation

Regionalisation

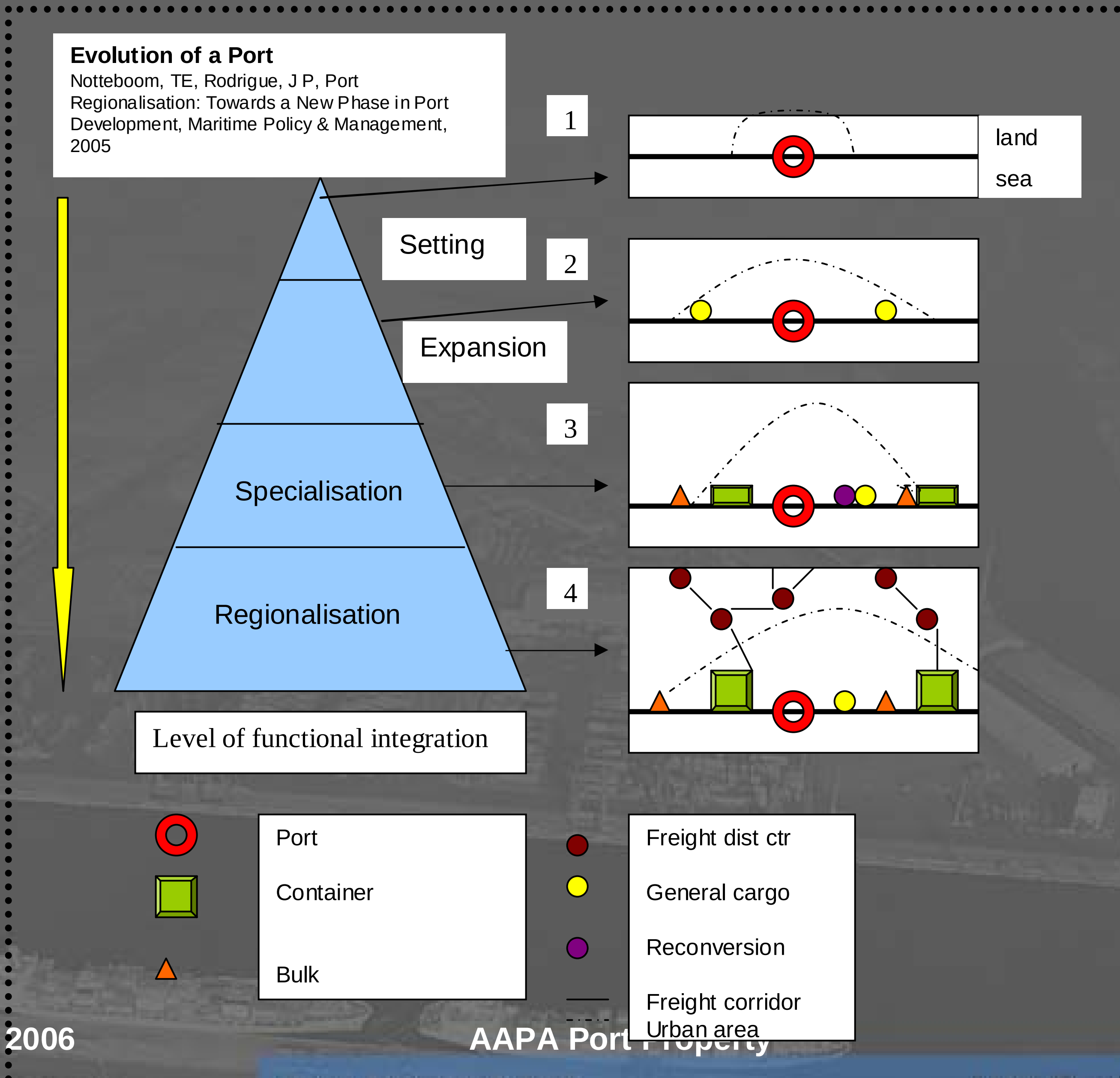
- Ports will integrate into new freight paradigm – major impact on land usage
- Inland distribution cost - now savings area
- Constraints (political, ecological, economic) will force hinterland expansion and access
- 3PL heavy users of real estate facilities

Regionalisation (cont.)

- Inland logistics considered most vital area to cut costs
- Corridors and inland terminals – cornerstones in port regionalisation
- Inland ports critical to in maintaining major seaport efficiency, attractiveness and competitive advantages (eg velocity/productivity)
- All of which is heavily dependent on strategic management of land usage

(excerpts from: Notteboom T E, Rodrigue J E, 2005 (revised), Port Regionalization: Towards a New Phase in port Development, Maritime Policy & Management

Regionalisation – heavily property based



Managing port land usage

- Emphasis on maximising value, revenues & meeting client needs but always ‘market driven’ eg the new ‘one’ container terminal
- Planning always requires careful strategic asset management and input from critical sr. executive, operations, clients & stakeholders:
  - Executive
  - Financial/IT
  - Operational
  - Corporate Responsibility

Potential impact of strategically used port properties

- Higher integration of hinterlands with quayside, increase port efficiency and viability
- More effectively meet port client needs to better retain and attract them
- Compress the supply chain, reduce costs
- Requires bridging best practices

Bridging dynamics between maritime, transportation & property industries

- To obtain maximum operating efficiencies
- Create major competitive advantages - developing special use facilities to attract clients
- Maximum property asset performance - enhance overall port value
- Release equity tied up in port lands for port modernization and expansion

Property market dynamics – take advantage of opportunities

- Supply & demand (industrial vacancy rates in port city markets) – time leases with cycles
- Yields & Capitalisation rates (ie, alternative investment product)
- Risk (what is the real risk in emerging market ports? Strength of covenant, dollar denominated rent, global trade)
- Inflation
- Cost of Capital

Lender/investor considerations

- Security, collateral, particularly of leaseholds
- 'Market Value' of collateral, is it assignable
- Political risk
- Standardisation of leases, are they assignable
- Lease models – what are they based on?

Key investment factors

- Vacancy rates
- Rental rate growth
- Barriers to entry
- Capitalisation rates for comparable and competitive properties
- Functional obsolescence, changing market demands
- Port Life cycle

Port Life Cycle

- Establishment, development, maturity, demise
- Functional obsolescence
- Economic obsolescence

Port's Functional Obsolescence

- Changing market dynamics
  – Local, feeder, transshipment ports
- Changing industry requirements
  – Ship size requiring deeper harbours & more land
  – Intermodal requirements and pressures
  – Expansion ie Regionalisation

Port's Economic Obsolescence

- Older ports strategically located, original growth catalyst for mature cities
- Real estate values have appreciated making port operations economically unviable
- Environmental constraints
- Example: London Docks – Canary Wharf

Opportunities, challenges, solutions – Strategic property management

Opportunities

- Maximise value of a port through increasing value of land banks
- Creation of new revenue streams
- Releasing tied up capital
  - Raising off balance sheet debt & equity through:
    - **PPP – Public Private Partnerships**
    - **L-T ground leases**
    - **Build-to-suits**

Opportunities

- Create competitive advantages through:
  - Integration of hinterlands with port operations to shorten supply chain – intermodal platform
  - Creative re-development of existing facilities (Greece)
  - Development of specific use, non-traditional port properties eg, strip & stuff, distribution, office

All of which are heavily property based

Challenges

- Position in port life cycle
- Arching of port objectives with port property strategies
- Expertise to develop and execute comprehensive real estate strategies
- Seemingly non-core business – selling concept to stakeholders

Solutions

- Integrating ‘best practices’: maritime & property
- Bridging dynamics - market intelligence, contacts & industry expertise from various industries
- Long term strategic thinking – prepare before a port is economically obsolete
- For example:

Port of Auckland & Tauranga NZ

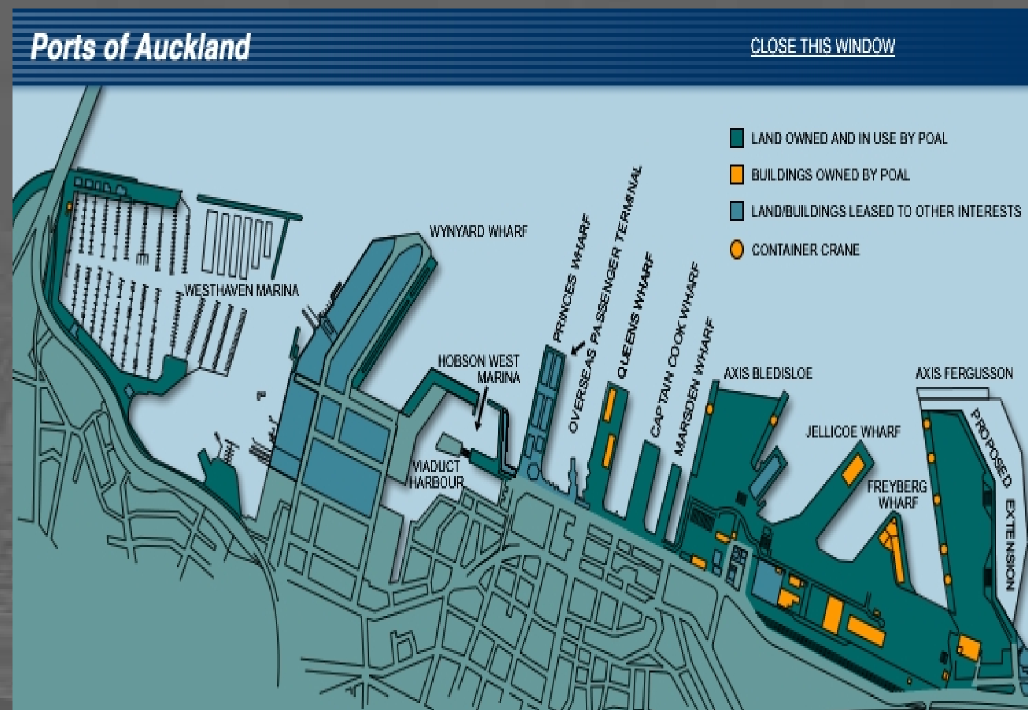
- New Zealand - Area of acute micro-competition
- Two ports, two different sets of challenges
  - Auckland: manage growth of port & city
  - Tauranga: expand port operations & compete with Auckland

Port of Auckland

- 1989 Port Development Plan
  - Meet market demands
  - Maximise existing & redeveloped facilities
  - Identify facilities no longer required by port for redevelopment
- Results
  - Doubled volume without expansion of wharf
  - Viaduct Harbour land sold & developed for people orientated use

Example of Effective Property Strategy

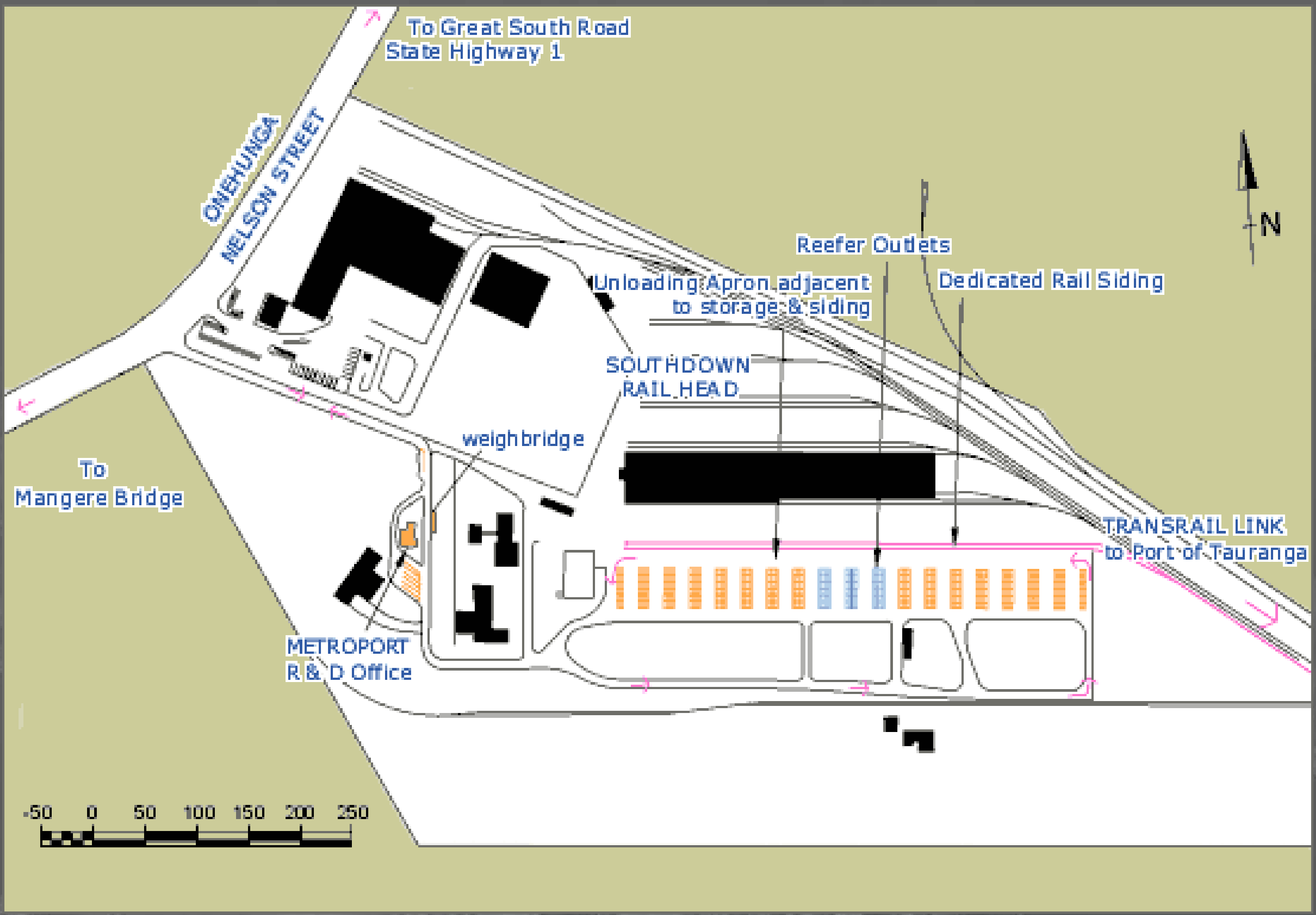
- Land shortages in resulting from port users - city needs (eg Auckland): is there a solution to economic obsolescence?
- City – port relationship: Sybaritic or parasitic?



Port of Tauranga

- Challenge
  - Need to expand port's reach & attractiveness to market
  - Compete with Port of Auckland by delivering Auckland's industrial zone to port clients
- Solution
  - Development of inland port (Metroport) taking advantage of existing rail links

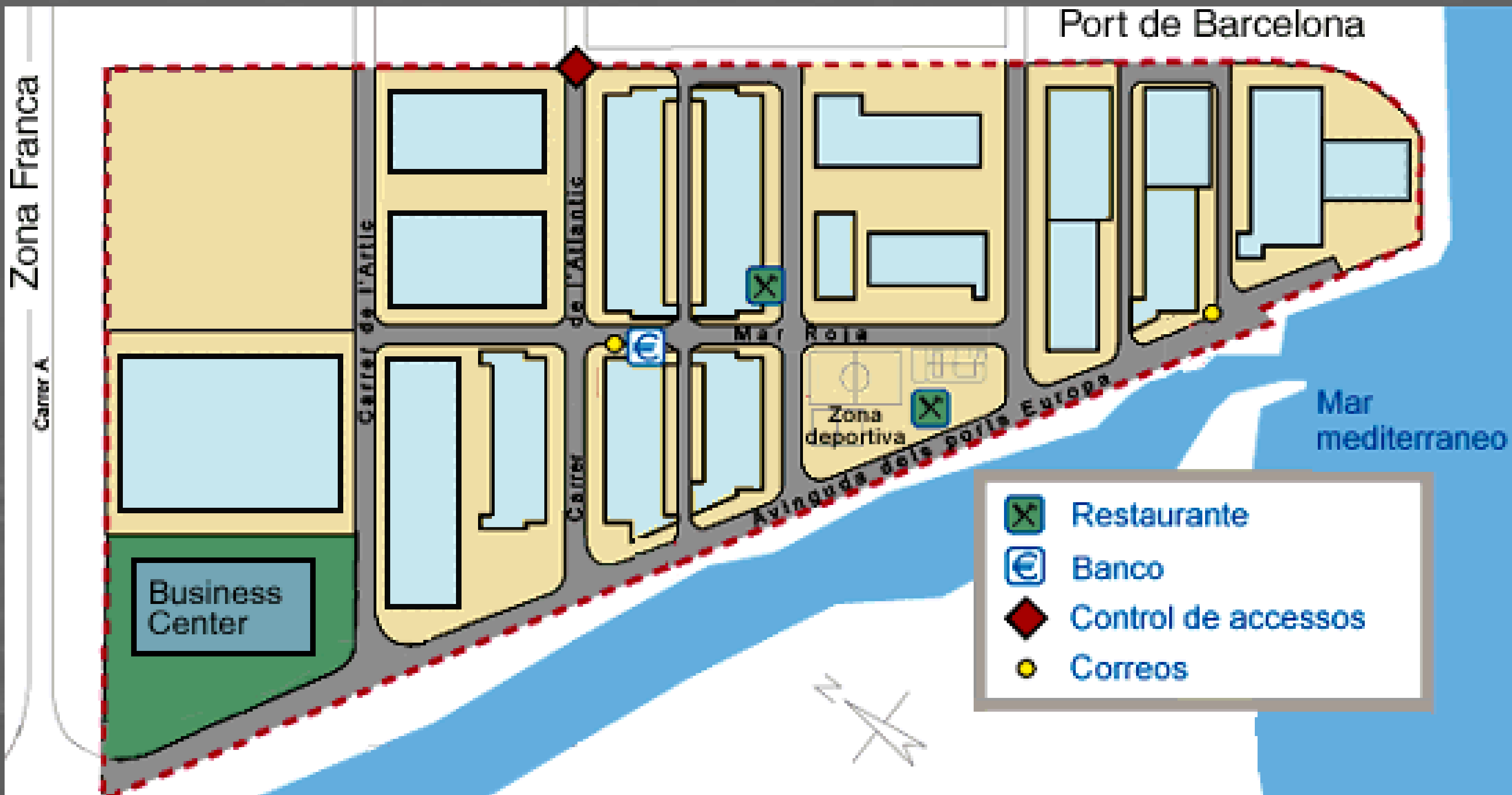
Metroport - Tauranga



Port of Barcelona ZAL

- Challenge
  - Differentiate and more effectively compete with port in Valencia & other regional ports
- Solution
  - Create intermodal & logistical platform offering client demanded real estate facilities
    - Warehouse & flex space
    - Sites for build-to-suit
  - Take advantage of strategic multi-modal location
  - Maximise use & value of land bank
- Resulting in major logistics centre in Southern Europe housing 50 companies

ZAL Site Plan



ZAL

Underestimating the Value of the Land

- PA's underestimate value of landholdings by structuring leases based on throughput, outdated 'rules of thumb' and uncorroborated benchmarks for property values and yield rates
- PA's lease properties as **incentives** rather than sound business practice – short sighted.
- PA's must understand the challenges and needs of private capital and financial markets so as not to undercut themselves, for example:

What is driving high port vauations?

ABP

Bid battles often resemble a bruising prize fight. Two developments yesterday following the 910p-a-share bid for Associated British Ports from a Goldman Sachs-led consortium suggest the final bell is close. First, 3i Group has bowed out from the rival bidding group. Second, ABP's shares closed 9p above the bid – not even enough to cover the new break-fee.

On any conventional measure, Goldman's consortium is overpaying. Arbuthnot Securities, though, highlights the option value of ABP's land. Of its 21 ports, just four account for the bulk of profits.

Compared with Goldman's earlier offer of 810p, the new bid offers an extra £307m. Say a quarter of ABP's 12,500 acres could be turned over for other uses. If ascribed to that option, the extra cash works out at under £100,000 an acre – cheap in the context of residential development. Of course, it is unclear how much of ABP's acreage is actually on the sea-bed. And building waterfront housing in, for instance, Ayr and rebranding it as the Scottish riviera may be a bit of a stretch.

For Goldman, however, there is a simpler consideration. ABP may not make big returns, but it is not terribly high risk either. It would also be the first UK purchase for Goldman's infrastructure fund at a time when good targets are scarce and the bank has missed out on other recent opportunities. Sometimes, winning is everything.

Google/Baidu

Google cannot direct search-junkies to democracy in China, but it has managed to make a profit there – at least for now. The US search engine cashed out its tiny stake in Baidu.com, a Chinese peer, making a 12-fold return on its $5m investment in the space of two years.

That was the easy money. By severing equity ties, Google is now signalling its readiness to go it alone in China, a market bigger on promise than profit. Baidu.com, which leads the domestic search market, made less than $6m last year, although admittedly that is expected to rise steeply.

Baidu is also a pretty formidable competitor. It has a particular stranglehold over the wealthier and more tech-savvy pockets of China, such as Beijing.

Yet it is far from complacent: it added 500 workers in the first quarter, most of whom joined Baidu's sales forces in the big cities. Nor is it the only competitor. In addition to China's Sohu.com, most of the international names are making inroads into China's search market.

That does not leave a huge amount for Google. According to iResearch, a Shanghai consultancy, the total pie of search revenues will be worth $450m this year, while online ad sales will add another $570m – a fraction of the US market. Google investors should not count on reaping another chunky profit from the world's second biggest internet market anytime soon.

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ABP Sale

Underestimating the value of land – not everyone is.

- Eg, GS acq of ABP UK
- By conv measures – GS overpaid
- But, ¼ ABP's 12.5K acres could be used for other purposes
- If so, £100k/acre was cheap by any measure
- Ports: stable and safe investments but with great upside if land holdings strategically managed

Valuation Challenges

- Valuations of port properties need to be benchmarked for like kind properties which are most probably not found ‘across the street’ but across the world
- Valuations need to concentrate on the specific economic use of both the port and the location of the subject property at the port, along with commensurate risk levels

What property rights can be valued

- Fee Simple -freehold
- Leased Fee Estate – leasehold
- Both can represent substantial equity

- At ports typically one sees leasehold interests as land continues to be owned in freehold by the port authority

What are the approaches used to value real property?

- Sales Comparison or Market
- Income
- Cost

Note: <u>Market Value</u> according to the Royal Institution of Chartered Surveyors: 'is the Valuer's opinion of the **best price which would have been obtained in the market on the date of valuation** (subject to the exclusion of any additional bid by a prospective purchaser with a special interest): **not a 'fair' price**, or an average price or the price which the vendor thinks ought to be achieved.'

Measures of Investment performance?

Capitalization Rate:	NOI/Price
Equity Div. Rate:	BTCF/Equity
Debt Coverage:	NOI/Mtg Pmt

Net Present Value
Internal Rate of Return
Modified IRR
Profitability Index
Cash Flow from Operations
Cash Flow from Resale

Reasons for investing in Port Properties?

- Stable low risk Income (higher yields with strong covenants)
- Appreciation (industry expanding)
- Upside ((alternative future uses)
- Diversification (appreciation and rents based on global trade not competitive properties)
- Preferential Tax

Value creation through income producing property, how?

- Direct Sale (leaseholds) to investors
- Build-to-suits
- Mortgage Backed Bonds
- Real Estate Investment Trusts
- Property Companies

On what basis do you value income property?

- On its ability to generate a cash flow
- The strength of the lease covenant
- Lease terms and conditions eg, rent reviews, pass throughs, etc

What should a lease at a port include sand reflect?

- Market factors: supply/demand?
- Financial factors: cost of capital?
- Opportunity costs?
- Operational costs?
- Throughput?

What's in a lease?

Gross Lease (expenses paid by lessor owner)

Net Lease (expenses paid by lessee tenant)

Term, options, rent reviews, expansion, cancellations

Ways of Releasing Equity

Direct Sale (leaseholds) to investors

Build-to-suits

Mortgage Backed Bonds

Real Estate Investment Trusts

Property Companies

Conclusions

Effective management of a port's real property holdings can:

- Maximise a port's value to its stakeholders
- Create additional revenue streams
- Better retain and attract clients through creative land use port lands and facilities to meet client need
- Release needed capital from tied up equity in land holdings
- Extend a port's economic life cycle by better integrating it into regional logistics chains

Aegir Port Property Advisers

Practical, market driven property solutions engineered to enhance ports' property values, revenues and competitive advantages while supporting their core business.

'Navigating the World of Port Properties – To Maximise the Value of Ports'

Thank You

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