Capital Project Funding
David Morrison, PE
Port of Tacoma & Northwest Seaport Alliance
Northwest Seaport Alliance Structure

King County Voters

Port of Seattle Commission

Executive Director
Stephen Metruck

CEO John Wolfe

Pierce County Voters

Port of Tacoma Commission

CEO John Wolfe
Agenda

- Funding Options
- Debt Types
- Tax Issues
- Accounting Changes
- Example portfolio
- Things to avoid
Funding Options

• Pay as you Go
• Debt
  • Corporate borrowing
  • Project specific
• OPM – Other People’s Money
  • PPP or PPPP
“Pay Go” or Pay as you Go

• Use existing cash to pay for construction of a project
  • Suited for projects with shorter lives and where cashflow is sufficient to cover project costs per year

• Advantages – no new debt, no interest expense, no limitations on use of funds compared to tax exempt bond proceeds and grants

• Disadvantages – lower liquidity, delayed project completion

• Example: Port of Tacoma is using Pay as you Go for a new $35M auto processing terminal
Pay as you Go Auto Terminal
Debt

• Promise future revenue to pay for cash borrowed to fund a project or projects
  • Suited for larger programs or where you need to complete quickly

• Advantages – Maintains cash/investments for liquidity, access to funds to build a project sooner, avoid construction cost escalation

• Disadvantages – debt payments, limits on use of bonds, impact to the Profit and Loss statement

• Example: Port of Tacoma issued approximately $100M in 2016 to fund the construction of a new wharf and 8 cranes
  • Total Cost $200M, split 50/50 with Port of Seattle as an Northwest Seaport Alliance project.
Debt Funded Projects
Debt Types

- **Tax backed debt**

- **Revenue backed debt:**
  - Port Net Operating Revenue Bonds
  - Port Asset Backed Debt
  - Port Special Purpose Facility Bonds, backed by lessee/concessionaire revenue and parent guarantee
  - Port Special Purpose Facility Bonds, backed by the net operating revenue of a single terminal concession, i.e. apart from the Port’s “System”

- The chosen debt security type is port and project specific, taking into consideration the unique operating and business characteristics of any given lease
Limitations on Bond Proceeds

• Different types of tax treatments for the holder of the bonds:
  • Tax payers who purchase your bonds may be subject to the Alternative Minimum Tax (AMT)

• Type of Bonds
  • Governmental = Non AMT:
    • Question to ask: “Is the property used in the trade or business of a private person?” If not assume governmental
    • Bond interest received never subject to Federal tax
  • Private Activity = AMT:
    • If the bonds are for a private “person”, the IRS has exemptions for Airports, Docks and Wharfs, water systems, sewer systems, etc.
    • Bond interest received may be taxable per AMT rules
  • Taxable Bonds
OPM: Other People’s Money

• Giving up control and future cash flows / profit by allowing someone else to pay for a project
  • Grants – Buy America requirements
  • Private Equity – Ownership, management and benefits of the project

• Advantages – Maintains cash/investments for liquidity, funds the project

• Disadvantages – lack of control, long term concessions. The Private company in the PPP (Private Public Partnership) demands a higher return than the port
Public Private Partnership

• USDOT’s definition of a public-private partnership is quite broad.
  • P3s are contractual agreements formed between a public agency and a private sector entity that allow for greater private sector participation in the delivery and financing of transportation projects.
  • There are many different P3 structures, and the degree to which the private sector assumes responsibility - including financial risk - differs from one application to another.
  • Additionally, different types of P3s lend themselves to the development of new facilities and others to the operation or expansion of existing assets.
P3 vs Debt

• **Bondholders are passive lenders**
  - Seek timely payment of principal and interest
  - Investment decisions are based on third-party evaluations and “done deals”
  - Rating agencies and credit enhancement are key

• **P3 investors are active business partners**
  - P3 investor wants to manage the project
  - Interested in profit, in equity return, in risk allocation and in regulation
  - P3 investor will perform their own technical due diligence
  - The project & the business structure creates the credit, which in turn
  - defines the financing options
Seaport Finance Alternatives

- Many US seaports issue non-recourse net operating revenue supported debt, typically on a “system” approach as opposed to a single project.
- Compared to P3 concession debt structures, public seaports have typically used very conservative debt practices.
- Many US seaports utilize a variety of tenant lease & use agreements by which private partners might construct, finance and/or operate facilities – the related revenues support various types of debt.
Debt Structures

• **Fixed vs Variable interest long term debt**
  - Fixed
    - once you issue, no further management required as long as you pay your debt service
  - Variable
    - Requires ongoing management
    - Lower interest cost in general, with periods of extreme anxiety possible

• **Short term financing**
  - Commercial Paper Program
  - Short term variable rates
Short Term Interest Rates

Spot Rates

Jan-07, Jan-08, Jan-09, Jan-10, Jan-11, Jan-12, Jan-13, Jan-14, Jan-15, Jan-16, Jan-17, Jan-18, Jan-19

SIFMA
70% of LIBOR
Tax Issues

• **Tracking good/bad use – map and data base**
  - Don’t get in trouble with the IRS for using tax exempt bond proceeds on “bad use”
    - Example: A Starbucks on a terminal funded by AMT bonds
    - Some allowance for “bad use” for bonds, but it is small.

• **Arbitrage – why your finance team wants accurate construction schedule**
  - If your port borrows to fund a project, it may be able to keep any interest earned if certain criteria are met
    - Issue tax exempt bonds at 3%
    - Invest funds in taxable investments at 4%. You can keep the extra interest if certain spend-down criteria are met.
Port of Tacoma Good Use / Bad Use Map
Accounting Changes

- **Changes to Capitalized Interest**
  - No longer add interest expense to your capital projects
    - Interest in not an asset because it does not possess service capacity
## Capitalized interest change

### With capitalize interest

$100M project and you borrowed at 5%. Assume it takes one year to build the project

- Asset has a 10 year life
- Capitalized cost = $105 million
- Annual Depreciation is 10.5

<table>
<thead>
<tr>
<th></th>
<th>year 1</th>
<th>year 2</th>
<th>year 3</th>
</tr>
</thead>
<tbody>
<tr>
<td>Revenue</td>
<td>$ 5.0</td>
<td>$ 35.0</td>
<td>$ 36.0</td>
</tr>
<tr>
<td>Expense</td>
<td>(2.0)</td>
<td>(5.0)</td>
<td>(6.0)</td>
</tr>
<tr>
<td>Income before Depreciation</td>
<td>$ 3.0</td>
<td>$ 30.0</td>
<td>$ 30.0</td>
</tr>
<tr>
<td>Depreciation</td>
<td>-</td>
<td>(10.5)</td>
<td>(10.5)</td>
</tr>
<tr>
<td>Income before Interest Expense</td>
<td>$ 3.0</td>
<td>$ 19.5</td>
<td>$ 19.5</td>
</tr>
<tr>
<td>Interest Expense</td>
<td>-</td>
<td>(5.0)</td>
<td>(5.0)</td>
</tr>
<tr>
<td>Net Income</td>
<td>$ 3.0</td>
<td>14.5</td>
<td>14.5</td>
</tr>
</tbody>
</table>

### Without capitalized interest

$100 M project funded by borrowing at 5%

- Asset has a 10 year life
- Capitalized cost = $100 million
- Annual Depreciation is 10

<table>
<thead>
<tr>
<th></th>
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<th>year 2</th>
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<tr>
<td>Revenue</td>
<td>$ 5.0</td>
<td>$ 35.0</td>
<td>$ 36.0</td>
</tr>
<tr>
<td>Expense</td>
<td>(2.0)</td>
<td>(5.0)</td>
<td>(6.0)</td>
</tr>
<tr>
<td>Income before Depreciation</td>
<td>3.0</td>
<td>30.0</td>
<td>30.0</td>
</tr>
<tr>
<td>Depreciation</td>
<td>0.0</td>
<td>(10.0)</td>
<td>(10.0)</td>
</tr>
<tr>
<td>Income before Interest Expense</td>
<td>3.0</td>
<td>20.0</td>
<td>20.0</td>
</tr>
<tr>
<td>Interest Expense</td>
<td>(5.0)</td>
<td>(5.0)</td>
<td>(5.0)</td>
</tr>
<tr>
<td>Net Income</td>
<td>(2.0)</td>
<td>15.0</td>
<td>15.0</td>
</tr>
</tbody>
</table>
## Port of Tacoma Debt Portfolio as of 12/1/2018

<table>
<thead>
<tr>
<th>Series</th>
<th>Outstanding Par</th>
<th>Call Date</th>
<th>Purpose</th>
<th>Interest Rate Mode</th>
<th>Coupon</th>
<th>All-In True Interest Cost</th>
<th>Final Maturity</th>
<th>Credit Enhancement</th>
<th>LOC/DP Expiration Date</th>
<th>Summary of Refunded Bonds</th>
<th>Additional Refunding Notes</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>GO Bonds, (Rated A2/AA-)</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
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</tr>
<tr>
<td>2016 LTGO</td>
<td>$ 24,893,000</td>
<td>Anytime</td>
<td>Refunding</td>
<td>Fixed Rate Direct Purchase</td>
<td>1.060% - 2.360%</td>
<td>1.9942%</td>
<td>12/1/2025</td>
<td>None</td>
<td>N.A.</td>
<td>- 2008A LTGD (2019-2025)</td>
<td></td>
</tr>
<tr>
<td>2016A LTGO</td>
<td>$ 106,155,000</td>
<td>12/1/2026</td>
<td>Refunding</td>
<td>Fixed Rate</td>
<td>3.000% - 5.000%</td>
<td>2.7047%</td>
<td>12/1/2033</td>
<td>None</td>
<td>N.A.</td>
<td>-2006 LTGD (2017-2033)</td>
<td>-2008A LTGD (2018, 2025-2038)</td>
</tr>
<tr>
<td>2017 LTGO (Taxable)</td>
<td>$ 19,410,000</td>
<td>12/1/2027</td>
<td>Refunding</td>
<td>Fixed Rate</td>
<td>2.500% - 3.400%</td>
<td>3.1775%</td>
<td>12/1/2038</td>
<td>None</td>
<td>N.A.</td>
<td>-2008B LTGD (AMT) (2018-2038)</td>
<td></td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>$ 150,458,000</td>
<td></td>
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</tr>
<tr>
<td><strong>SR. REV Bonds, (Rated A3/AA-)</strong></td>
<td></td>
<td></td>
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<td></td>
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<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2014A REV</td>
<td>$ 6,473,173</td>
<td>Anytime</td>
<td>Refunding</td>
<td>Fixed Rate Direct Purchase</td>
<td>2.500%</td>
<td>2.6430%</td>
<td>12/1/2021</td>
<td>None</td>
<td>N.A.</td>
<td>-2004A Rev (Term 2021)</td>
<td></td>
</tr>
<tr>
<td>2016A REV</td>
<td>$ 36,535,000</td>
<td>12/1/2026</td>
<td>Refunding</td>
<td>Fixed Rate</td>
<td>4.000% - 5.000%</td>
<td>2.5223%</td>
<td>12/1/2034</td>
<td>None</td>
<td>N.A.</td>
<td>-2006 Rev (2017-2034)</td>
<td>-2006 Rev refunded 2004A Rev</td>
</tr>
<tr>
<td>2016B REV (AMT)</td>
<td>$ 102,405,000</td>
<td>12/1/2026</td>
<td>New Money</td>
<td>Fixed Rate</td>
<td>2.000% - 5.000%</td>
<td>3.6417%</td>
<td>12/1/2043</td>
<td>None</td>
<td>N.A.</td>
<td>N.A.</td>
<td></td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>$ 173,868,173</td>
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</tr>
<tr>
<td><strong>SUB. REV Bonds, (Rated A1/AA-)</strong></td>
<td></td>
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<td></td>
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</tr>
<tr>
<td>2008B REV (Non-AMT)</td>
<td>$ 122,180,000</td>
<td>Anytime</td>
<td>New Money</td>
<td>Variable Direct Purchase</td>
<td>Variable Rate + Bank Fee</td>
<td>4.4792%</td>
<td>12/1/2044</td>
<td>None</td>
<td>Nov 1, 2019</td>
<td>N.A.</td>
<td></td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>$ 269,490,000</td>
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<tr>
<td><strong>SUB. CP</strong></td>
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<td></td>
</tr>
<tr>
<td>Commercial Paper</td>
<td>$ 25,000,000</td>
<td>Anytime</td>
<td>New Money</td>
<td>Variable</td>
<td>Variable Rate + Bank Fee</td>
<td>N/A</td>
<td>N/A</td>
<td>BotA LOC</td>
<td>April 2019</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>$ 618,816,173</td>
<td></td>
<td></td>
<td></td>
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<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

(1) The Port can issue up to $100 million Commercial Paper.
Things to Avoid

• Borrowing more than you need

• Borrowing sooner than you need

• Bad Use of bond funded projects that used Governmental or Private Activity Bonds
Port Planning and Investment Toolkit – *Funding Strategy Module*

- Developed through a cooperative agreement between the U.S. Department of Transportation, Maritime Administration and the American Association of Port Authorities

- Public Financial Management led Toolkit development, with oversight of Port Industry Volunteers
  - Port managers
  - Technical consultants
  - Legal consultants
  - Financiers
  - Industry association members
  - Academicians
Goal of the Toolkit Funding Strategy Module

• Funding strategy is a primary consideration of any capital investment decision

• Ports should evaluate and approach investment opportunities using an approach grounded in prudent due diligence and fundamental credit/investment evaluation

• It is important for ports to understand the full range of potential capital needs and financial solutions, and not be wed to just one potential solution

• The Toolkit offers a full range of funding solutions!

• The Toolkit can be used to lead a port through a logical and thorough step-by-step process to make sound investment decisions
Toolkit Components and Uses

- **Toolkit components include:**
  - Port Planning and Investment Toolkit - *Funding Strategy Module*
  - Funding Strategy Checklist
  - Sample Financial Model

- **Port industry professionals can use the Toolkit for any number of capital investment activities including, but not limited to:**
  - Long Term Capital Planning
  - Upgrading Capacity
  - Asset-Backed and Lease Financing
  - Weighing Traditional vs. Alternative Financing
  - Project Finance Structuring
  - Evaluation and Implementation of Public-Private Partnerships
  - Procuring Government Loans and Grants

The possible applications of the Toolkit are broad!
## Port Concession Transactions

<table>
<thead>
<tr>
<th>Transaction</th>
<th>JaxPort Mitsui</th>
<th>Oakland Ports America</th>
<th>Baltimore Ports America</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Operating Model</strong></td>
<td>Long Term Landlord</td>
<td>Passive Landlord</td>
<td>Passive Landlord</td>
</tr>
<tr>
<td><strong>Primary Mgmt Control</strong></td>
<td>Public-Private</td>
<td>Private</td>
<td>Private</td>
</tr>
<tr>
<td><strong>Typical Contracts &amp; Lease Agreement</strong></td>
<td>Single Tenant; Term Covers Debt</td>
<td>Single Tenant; 50-year Term to Cover Debt &amp; Equity Return</td>
<td>Single Tenant; 50-year Term to Cover Debt &amp; Equity Return</td>
</tr>
<tr>
<td><strong>Facilities Financed</strong></td>
<td>2 berth container terminal on 158 acres</td>
<td>5 berth container terminal on 202 acres</td>
<td>3 berths going to 4 berths container terminal on 201 acres</td>
</tr>
<tr>
<td><strong>Sources of Revenues and Security for Debt</strong></td>
<td>Corporate Rental, Minimum Guarantee &amp; Throughput Fees</td>
<td>Tariffs/Lease Revenue; Received by Private Concessionaire</td>
<td>Tariffs/Lease Revenue; Received by Private Concessionaire</td>
</tr>
<tr>
<td><strong>Type of Debt</strong></td>
<td>Special Purpose Conduit Bonds and JaxPort Revenue Bonds</td>
<td>Concessionaire Private Equity</td>
<td>PABS, Tax-Exempt Debt &amp; Private Equity</td>
</tr>
<tr>
<td><strong>Tax Status/ Term</strong></td>
<td>AMT Tax-Exempt Up to 33 years</td>
<td>Taxable 50 years</td>
<td>Tax-Exempt and AMT 50 years</td>
</tr>
<tr>
<td><strong>Primary Private Partners</strong></td>
<td>Shipping Company/ Terminal Operator/ Corporate Guarantor</td>
<td>Private Equity Concessionaire</td>
<td>Private Equity Concessionaire</td>
</tr>
</tbody>
</table>
## Value and Risk Sharing

<table>
<thead>
<tr>
<th>Transaction</th>
<th>JaxPort Mitsui</th>
<th>Oakland Ports America</th>
<th>Baltimore Ports America</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Upfront Capital</strong></td>
<td>$100M SPB + $95M PABs; PV of DS Rent $147M; Mitsui buys cranes $65M</td>
<td>$60M Equity</td>
<td>$140M Upfront Payment and $105 for Construction (Financed with $167M Tax-Exempt Debt; $82M PABS; $70M Equity)</td>
</tr>
<tr>
<td><strong>Revenue Sharing</strong></td>
<td>$7/container; Adjusted by CPI, capped at 5%</td>
<td>$19.5 million/year + $26.55/lift over 900,000</td>
<td>$3.2 million/year + $15/lift over 500,000</td>
</tr>
<tr>
<td><strong>Interest Rates</strong></td>
<td>JaxPort has Risk</td>
<td>N/A</td>
<td>Private has Risk</td>
</tr>
<tr>
<td><strong>Completion Costs</strong></td>
<td>Shared; Mitigated by Const Contract</td>
<td>N/A</td>
<td>Private Pays and has Risk; Mitigated by Const Contract and 95% Design</td>
</tr>
<tr>
<td><strong>Market Revenues</strong></td>
<td>Private has Risk</td>
<td>Private has Risk</td>
<td>Private has Risk; Partially Transferred to Debt</td>
</tr>
<tr>
<td><strong>O&amp;M Costs</strong></td>
<td>Private Pays and has Risk</td>
<td>Private Pays and has Risk</td>
<td>Private Pays and has Risk</td>
</tr>
<tr>
<td><strong>Technology Performance</strong></td>
<td>Private has Risk</td>
<td>Private has Risk</td>
<td>Private has Risk</td>
</tr>
<tr>
<td><strong>Long Term Capital</strong></td>
<td>Private Pays and has Risk</td>
<td>Private Pays and has Risk</td>
<td>Private Pays and has Risk</td>
</tr>
</tbody>
</table>