Managing Port Property as a Strategic Asset - Unleashing Opportunities

AAPA Port Property Management & Pricing Seminar
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

VALUE
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
- ‘Market 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

Evolution of a Port
Notteboom, TE, Rodrigue, J.P., Port Regionalisation: Towards a New Phase in Port Development, Maritime Policy & Management, 2005

Regionalisation – heavily property based

1. Setting
2. Expansion
3. Specialisation
4. Regionalisation

Level of functional integration

- Port
- Container
- Bulk

- Freight dist ctr
- General cargo
- Reconversion
- Freight corridor
- Urban area

Sea
Land
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
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

AAPA Port Property

www.aegirports.com

Aegir Port Property Advisers
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:
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: Market Value 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: \( \frac{\text{NOI}}{\text{Price}} \)
- Equity Div. Rate: \( \frac{\text{BTCF}}{\text{Equity}} \)
- Debt Coverage: \( \frac{\text{NOI}}{\text{Mtg Pmt}} \)

Other Metrics:
- 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 and 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’