

Innovation Briefs

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Ports Infrastructure — A New Frontier for Public-Private Ventures?

Until now, most of the debate about the need to expand public infrastructure has centered on highways—partly because growing congestion on the nation's highways has highlighted the need to increase road capacity, and partly because a highly publicized event – the collapse of the I-35 bridge in Minneapolis—has focused public attention on the need to reconstruct many of our aging roads and bridges.

A December 3-5 conference in Coral Gables, Florida, organized by Infocast, has thrown a spotlight on another class of infrastructure assets, namely ports and intermodal facilities. Judging by the large number of senior executives from port authorities, shipping concerns and the financial community taking part in the conference, the challenge of expanding port and intermodal infrastructure is resonating strongly with operators, shippers and investors alike. A keynote address by former Transportation Secretary Norman Mineta and the presence of senior officials from U.S. DOT underscored the importance which the public policy community attaches to the ports issue.

The conference took place against a background of forecasts that predict a veritable "tsunami" of maritime cargo swamping U.S. port facilities in the years ahead. In the past 5 years container trade in North America has increased at an annual rate of 6.8%. As a consequence of the rapidly expanding global trade, maritime cargo is predicted to soar by 50% by 2015, from 48 million TEUs in 2005 to 72 million in 2015. (TEU stands for "twenty-foot equivalent unit," a standard measure of container capacity). By 2020 North American ports and their associated intermodal systems will be severely congested, with demand exceeding current capacity by as much as 200% assuming current productivity and growth levels, predicts John Vickerman, a well-known and respected expert in the planning and design of port, intermodal and freight logistics facilities.

How should U.S. ports respond to this challenge? Some observers suggest that the capacity problem could be alleviated if port authorities placed operations on a 24/7 basis, as many foreign ports do. But there are good reasons why that would be impractical in the case of U.S. ports, claims Brooks Royster, former director of the Port of Baltimore. These constraints include local regulation and work rules limiting hours of operation, inadequate labor pool of longshoremen, and the need for some slack time to perform routine maintenance. Only Asian ports (notably Singapore and Hong Kong) exceed the productivity of our own ports, Royster contends, and then only because many of them are transshipment ports that do not have to move containers "through the gate" as is the case with destination ports like ours.

In rare cases, large private shippers will take care of their growing needs for cargo processing by constructing their own marine terminals. The Maersk Marine Terminal in Portsmouth, VA is the first such terminal in the U.S. to be independently constructed and privately financed by a major shipping line. But in the great majority of cases, major

improvements and expansion of physical port capacity and their intermodal connectors currently falls on the shoulders of local tax payers.

That notion, that local tax-supported bonds should finance port expansion, is sometimes being challenged, as shown by a debate in Houston over who should bear the cost of improvements to the Port of Houston. Harris County Commissioner Steve Radack contends the port authority should finance the \$550 million package of port improvements with revenue bonds supported by internally generated fees rather than rely on ad valorem or property tax-supported bonds. Nevertheless, a \$250 million tax-supported bond issue was approved by a 65 percent popular vote, Tom Kornegay, Executive Director of the Port of Houston Authority, told us.

In some cases, internal revenue bond financing might indeed be feasible. The Port of New Orleans, for example derives 90 percent of its revenue from dockage fees, wharfage fees and other user fees, says Gary La Grange, President and CEO of the Port of New Orleans. But, as discussion at the Port/Intermodal Summit has shown, port authorities are also searching for new sources of capital and for creative new approaches to finance major expansion and improvement of marine terminals and intermodal access facilities.

For example, container fees have been used in part to fund construction costs of the Alameda Corridor and "availability payments" will be used as the method of financing the Miami Port Tunnel (\$1.2 billion) and the Port of Savannah Connector. The last two intermodal connectors will be built in their entirety without any initial investment of public funds. Private concessionaires will invest in the projects upfront and assume construction and performance risks. The public authority will pay the concessionaires an annual fee (over 35 years in the case of the Miami tunnel), based on the condition and performance of the facility and its availability for public use. If maintenance, congestion levels, incident response or other stipulated performance measures are not met, the payments will be reduced.

A relatively new trend that may profoundly affect the future of port expansion is the growing interest of private equity markets in ports. To be sure, there has always been private ownership of discrete port facilities such as piers and warehouses. What is new is a recognition by institutional investors with long-term investment horizons that ports represent an attractive investment asset class. The growing scarcity of deep water port capacity and environmental obstacles to building brand new ports gives existing port facilities a large revaluation potential and more future pricing power — and thus makes them more attractive to private investors, speculates Robert Flanagan, Senior Vice President of First Southwest Company and former Secretary of Transportation in Maryland.

Recent examples of the heightened investor interest in port infrastructure include the purchase of the long term leases to the Port of Newark terminal by the AIG Global Investment Group; the acquisition by the investment division of Deutsche Bank of Maher Terminals, the company that runs operations at the Port of Elizabeth in New Jersey and the Port of Prince Rupert in British Columbia; and the purchase of the lease to operate a

terminal on Staten Island, N.Y. by the Ontario Teachers Pension Fund. In each case, the private equity investors may be expected to inject new capital to enhance their investment.

Announcements at the Summit meeting disclosed that even larger deals are in the offing. The Port of New Orleans is preparing a request for proposals (to be issued in 2008) inviting the private sector to participate in a two billion dollar program of facilities expansion including a new container terminal and a new cruise ship terminal, according to Gary La Grange. The Port of Portland, OR is considering entering into a long-term private concession agreement for its facilities, announced Bill Wyatt, Executive Director of the Port of Portland. Other ports seeking private partners to finance major capacity expansion include the Port of Oakland, the Port of Virginia and the Port of Corpus Christi.

The Coral Gables maritime summit could mark the beginning of a public-private dialogue on the financing of port and intermodal infrastructure similar to the debate, already in full swing, concerning the financing of highway infrastructure. The dialogue should include the federal government, suggested Secretary Norman Mineta in his keynote address. Its role should be to develop a comprehensive maritime policy and place maritime issues on the same level as surface transportation in the legislative reauthorization process. But Mineta hastened to add that he was not advocating a centrally controlled maritime system. Rather, he thinks state and local governments and port authorities should work together with industry stakeholders to develop the maritime infrastructure needed to adequately support the U.S. role in the global economy. This also means integrating the maritime system more closely into the surface transportation system in order to create seamless supply chains from shipper to end consumer, added Julie Nelson, Deputy Administrator of the Maritime Administration.

A limited role for the federal government and an expanded role for the private sector in the development of port infrastructure were two recurrent themes throughout the meeting. "Don't wait for us," urged David Horner, U.S. DOT's Principal Deputy Assistant Secretary for Transportation Policy. "Seek our input but develop local solutions because port capacity and access problems are too acute to await federal solutions." Jim Ray, Acting Deputy Administrator and Chief Counsel of the Federal Highway Administration noted that the private sector can play a constructive role not only by bringing capital to the table but also by providing "due diligence" analysis of the rationale for infrastructure investment. In the final analysis, conference speakers agreed, each port is unique and will have to devise its own investment strategy using a mix of public and private funding.

Will the port dialogue include foreign investors? Significant presence at the Summit meeting of representatives from foreign banks and financial institutions suggests that global capital markets, always in search of stable long term returns, are looking at U.S. ports with interest. A weak dollar has enhanced their buying power, as indicated by a rise of 38 percent in foreign acquisitions of U.S. assets in 2007 as compared to 2006, according to the Wall Street Journal. But the Dubai Ports World episode cast a deep shadow on foreign purchases of sensitive U.S. assets. DP World's 2006 attempt to assume

the operation of several U.S. ports met with heated rhetoric in Congress about the dangers of a foreign entity controlling "critical infrastructure." The political furor led to heightened scrutiny of foreign acquisitions by the interagency Committee on Foreign Investments (CFIUS). These developments could discourage many global funds from investing in U.S. assets. That, we think, would be unfortunate. As a major player in the global economy, and a debtor nation to boot, the U.S must not reject foreign investment on grounds of economic nationalism—unless it can be shown that foreign ownership of the asset in question raises true national security concerns.

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