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PORT FINANCING TRENDS

Ports seek diverse financing opportunities while employing technology for efficiency and transparency.

By Tom Gresham

In the past decade, the port industry has experienced a shift that has had a major impact on many ports' financing responsibilities. Previously, ocean carriers paid for many terminal infrastructure and port infrastructure projects, said John F. Reinhart, CEO and executive director of **The Port of Virginia**. However, as the ships began to grow larger and more expensive and as carriers formed new alliances with each other, the carriers "just couldn't afford the cost of infrastructure on their capital plans," he said. "So now a lot of that responsibility has fallen on the state ports authority or the terminal operators in the United States to come up with their own funding plans."

The result? Ports have become increasingly creative and sophisticated in their approach to financing their operations and capital improvements, said Reinhart. At the Port of Virginia, for instance, he said his organization pursues a mix of public and private funding support, ranging from grants and bonds to joint ventures with private developers and master equipment leasing.

"It all starts with a good master plan," Reinhart said. "And then you've got to look around and say, 'OK, what are all of our opportunities out there to make this happen?'"

Bonds and Private Investment

Cynthia Weed, a partner with the **K&L Gates** law firm, said changes in federal tax law lowering the value of tax exemption to banks has resulted in higher interest rates on bank loans and prompted some bond issuers to public bond offerings of either variable rate debt backed by letters of credit or fixed rate long-term debt as interest rates for investors other than banks remain low.

"I believe that more and more larger ports will be establishing short-term borrowing programs and utilize commercial paper formats for variable rate exposure and utilize long-term debt to take out (refinance) commercial paper," Weed said.

Weed said the difference between taxable and tax-exempt interest rates has diminished because of low interest rates and the elimination of the corporate alternative minimum tax.

"Issuers are issuing refunding bonds on a taxable rate because tax-exempt advance refundings are no longer possible, and ports as well as other issuers are going to utilize taxable options more often," Weed said.

The **Port of Tacoma**, for instance, converted a series of tax-exempt bonds to taxable bonds, said David Morrison, director of financial planning and treasury for the port. Morrison said a key positive characteristic of taxable bonds in contrast with tax-exempt bonds is that they do not carry the same restrictions on the use of property as tax-exempt bonds do. In particular, taxable bonds often can be used for funding projects such as warehouse, distribution, and office facilities, while the use of tax-exempt bonds for those projects is limited.

In light of the low interest rates, Weed said issuers are taking advantage of taxable bond issues to avoid those restrictions and pursue capital development. "This has encouraged capital investment," she said.

"When you have low borrowing, people are going to borrow for projects and go out and build things that they wouldn't have if that had not been the case," added Morrison.

Weed noted that one potential downside commentators have noted is that the increased prevalence of taxable financings could impair ongoing lobbying efforts to retain tax-exempt financing for municipal bonds.

In addition, Reinhart said low interest rates spur investment from retirement and infrastructure firms seeking better returns, and ports are being viewed by some as "a safe harbor" for a reasonable rate of return on an investment. The Port of Virginia completed a $320 million expansion of its Virginia International Gateway facility in Portsmouth in 2019. The gateway is owned by Alinda Capital Partners, a private infrastructure investment group, and Universities Superannuation Scheme Ltd., a pension fund based in the United Kingdom, and the port will operate the terminal through a leasing agreement that runs through 2065.

"They front-loaded the capital needed to develop that project, and now they will get a guaranteed return for many years," Reinhart said.

Public Investment

John McCarthy, commissioner with the Port of Tacoma, said he sees a major

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difference in port financing today with compared to when he first worked as a commissioner for the port from 1983 to 1992. In particular, the landscape for public funding reflects a greater appreciation for the interdependence of various modes of transportation in the supply chain and a willingness to fund projects that benefit multiple modes. For instance, McCarthy said public investment in major multiple interstate projects in the region will aid the delivery of goods to both the Port of Seattle and the Port of Tacoma, bringing consequential benefits to both ports.

"Back then, ports in general relied on cities, counties and states to do transportation projects and the ports focused their attention on terminals, docks and warehouses near the terminals," McCarthy said. "One of the big cultural changes that has occurred over that time is the interface and the interaction and the working together and joining together of the government to tie the transportation network to our facilities.

"So we're really happy to see that happening here because we're so interdependent. We used to each work in somewhat of a vacuum, but now there's much greater coordination to tie those projects into what we're doing."

Morrison and Reinhart said they have seen strong direct public funding support for their ports. Morrison pointed to Washington state investing in a $350 million international terminal at the Port of Seattle, among other efforts, while Reinhart highlighted the help of federal funds to pursue infrastructure improvements at an inland intermodal container transfer facility and a combination of state and federal help he anticipates for a $350 million dredging program designed to make the Port of Virginia the deepest port on the East Coast.

Insurance and Environmental Concerns

Morrison said the insurance market could present some challenges ahead.

"The international insurance market appears to be hardening, which means reduced capacity and increased rates and premiums," Morrison said. "Ports will want to be creative and work with their brokers to identify alternative coverage arrangements as expenses go up."

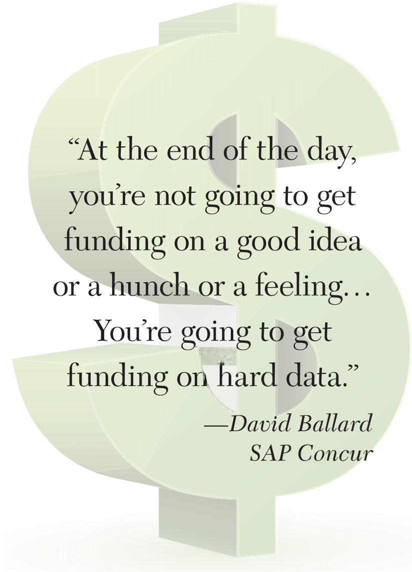
Morrison said earthquake insurance coverage remains an ongoing issue for West Coast ports – specifically the question of whether to purchase it or not. He said insurance coverage allows ports to get funding for repairs to "make sure you have business continuity," while going without coverage means waiting for FEMA assistance, "which will occur but maybe not immediately." The Port of Tacoma has opted to have the insurance coverage, Morrison said.

Reinhart said environmental concerns play a role in financial issues on multiple levels – from considering the environmental impact of projects to pursuing investments that make ports more sustainable, including "hardening our sites" to be prepared for sea level rise.

"We have long-term plans to want to become zero emissions and work to have clean energy all the way across our operations," Reinhart said. "So we're looking at what are the solar opportunities, what are the offshore wind opportunities? What can we do to electrify more of what we do? And so, yes, the trend for continued responsible action on behalf of the environment is in everybody's plan."

The Influence of Sophisticated Technology

David Ballard, senior vice president of public sector for **SAP Concur**, which provides an integrated spend management platform to ports, among other entities, said best-in-breed tech applications can help bring major efficiency gains to ports' finance operations. Like other industries, ports are turning to automation, digitization and consolidation of data to drive those efficiencies and improve transparency, such as eliminating leakage – spending that occurs without visibility. Ballard said the ability to better report a port's finances helps with earning more funding.



"At the end of the day, you're not going to get funding on a good idea or a hunch or a feeling… You're going to get funding on hard data."

—David Ballard
SAP Concur

"At the end of the day, you're not going to get funding on a good idea or a hunch or a feeling, right?" Ballard said. You're going to get funding on hard data."

Reinhart said the Port of Virginia has invested "a heck of a lot of capital" in technology.

"A lot of the efficiency gains come at a cost, but it's the responsible way to go so you can have predictive behaviors, so you can anticipate the flows, so you can eliminate reaction time, you can speed up the operation, you can eliminate waste," Reinhart said.

Reinhart said his organization is mining data to make better, more informed financial decisions and "to be a little more predictive in the way we direct our capital flows and direct our investments."

"It just makes you a more efficient organization," Reinhart said.

Ballard said the compliance piece of port financial operations remains critical, especially because of the "tremendous amount of pressure" that comes with accounting for the spending of state and federal funding.

"The pressure is on those folks to make sure that they're operating at their highest level of efficiency and that they are managing their budgets within the guidelines put on top of them," Ballard said. "And the thing that counts most important around that is accountability. Being sure that you're able to capture views of where that spend is happening."

Ballard said he believes the level of oversight on entities receiving taxpayer money has increased exponentially in recent years and will continue to build.

"We're seeing a lot of clients who have been really struggling in that area simply because they don't have tools in place to effectively collect that data, measure it and report out on it," Ballard said.

Reinhart said spending resources on data analytics and sophisticated technology tools for a port's financial systems helps build critical funding support. Extensive data, a transparent approach, and a detailed master plan combine to support ports in the eyes of potential funding sources, Reinhart said.

"You have to prove you can be a good steward of the capital you're entrusted with," Reinhart said. "So that's why transparency and showing information and showing master plans and living by those help you get access to the capital markets, whether it's state funding, federal funding or bond markets or venture capital funding. Those are critical and they show you have a mature understanding of your business. Everyone wants predictability. They don't want surprises." ●

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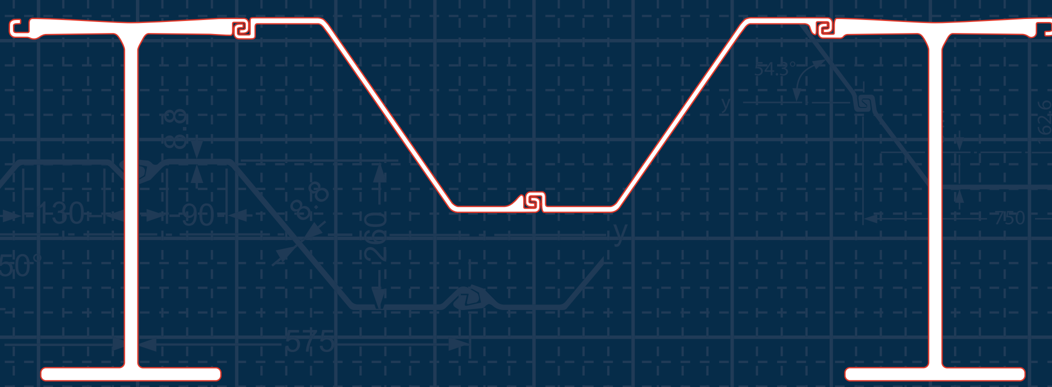

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