



**THE PORT  
OF LOS ANGELES**  
Executive Director's  
Report to the  
Board of Harbor Commissioners

**DATE: SEPTEMBER 12, 2014**

**FROM: REAL ESTATE**

**SUBJECT: ORDER NO. \_\_\_\_\_ – RESET COMPENSATION UNDER PERMIT NO. 827 WITH APM TERMINALS PACIFIC, LTD. AND RESOLUTION NO. \_\_\_\_\_ FOR THE SIXTH AMENDMENT TO PERMIT NO. 827**

**SUMMARY:**

Pursuant to the Charter of the City of Los Angeles (City Charter), Section 607(b) and the terms of Permit No. 827 (Permit), the Board of Harbor Commissioners (Board) is required to adjust the compensation for the Pier 400 container terminal facility for the period of August 1, 2012 to July 31, 2017 (Reset Period). Staff herein presents for consideration by the Board, its information regarding the fair market rent for the premises and its recommendation for approval of an increase in rates as negotiated by APM Terminals Pacific, Ltd. (APMT) and the staff of the City of Los Angeles Harbor Department (Harbor Department). Also included herein is the Sixth Amendment to the Permit, to amend the compensation provision of the Permit as necessary to effectuate the negotiated agreement. However, as required by the Permit, if the Board does not approve this recommendation, the Board should set this matter for a full public hearing to determine the appropriate rental adjustment all as more fully discussed below.

**RECOMMENDATION:**

Staff recommends that the Board of Harbor Commissioners:

1. Set the rental rates for the period of August 1, 2012 through July 31, 2017, by determining (a) all Twenty-foot Equivalent Unit (TEU) rates, (b) the Minimum Annual Guarantee (MAG), and (c) the Intermodal Rail Facility (IRF) Rate, as follows:
  - Increase the TEU Rate by 2 percent effective January 1, 2014, and escalate this rate by CPI-U (CPI, All Urban Consumers, Los Angeles-Orange-Riverside Counties) for the remainder of this five-year reset period of August 1, 2015 and August 1, 2016, with a floor of 0 percent and a cap of 3 percent; provided that until July 31, 2017, to the extent that percentage increases of TEU charges, the MAG and/or IRF Compensation occur in a compensation year through application of Section 3(c)(2) of the Permit, in the case of TEU changes, the compounded percentage increases of such charges resulting from CPI-U adjustments shall be deemed to constitute full increases of such TEU charges as required by application of Section 3(c)(2), if any;

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- Increase the MAG by 8 percent effective January 1, 2014; and
  - Maintain the current IRF Rate of \$49,768 per acre per year.
2. Adopt the matters set forth in this Board Letter and findings set forth herein, including the finding that while it is the policy of the Board that pricing for use of Harbor Department property shall be structured to enhance the Harbor Department's competitive position and advance the Port of Los Angeles (Port) as a positive place to do business while working to achieve minimum Rates Of Return (ROR) on land and on improvements consistent with Harbor Department financial management policies (current goal of 10 percent ROR target on land and 12 percent ROR target on improvements, blended rate of 10.92 percent), the Board finds that it is more commercially reasonable given the state of the market at this time to gradually move APMT towards achieving the Board's target rate of return by imposing a less than full market rent rate at this time with CPI-U increases for the TEU rates in each of the next two reset anniversary dates, leading to a ROR of 8.06 percent for this reset period;
  3. Authorize the Board Secretary to attest to the Order resetting rental compensation;
  4. Adopt Order No. \_\_\_\_\_, which Order effectuates the adjustments summarized above;
  5. Approve the Sixth Amendment to Permit No. 827 with APM Terminals;
  6. Direct the Board Secretary to transmit the Sixth Amendment to the City Council for approval pursuant to Section 606 of the City Charter;
  7. Authorize the Executive Director to execute and the Board Secretary to attest to the Sixth Amendment upon approval by the City Council; and
  8. Adopt Resolution No. \_\_\_\_\_, which constitutes this Board's approval of the Sixth Amendment.

**DISCUSSION:**

1. Overview – The analysis by staff based upon review of appraisals, rates charged to other container terminal tenants, and other relevant market data, indicates that the current fair market rent for the compensable portion of the premises leased to APMT under Permit No. 827, is approximately \$96.5 million per year. Under current rental rates, APMT will pay an average of approximately \$85.7 million per year in rent during the Reset Period, approximately 13 percent below the current estimated market rent. The current recommendation continues the gradual increase to the ultimate goal of obtaining full market value for the Premises. Staff believes that, given the initial low rate agreed to with APMT in 2000, the significant commercial challenges facing the industry

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at this time (i.e. mega-alliances and other shifting market trends), and the risk of cargo shifting from our primary facility to other alliance-related facilities not located in the harbor, a continuation of gradual increases is the most the market can bear at this time. Permit Section 3(h) requires the Board to readjust the components of rent: the Twenty-foot Equivalent Units (TEU) rates, which is the rental charge based on estimated cargo throughput, the MAG, which is the minimum amount of cargo throughput charges due, and the Intermodal Rail Facility (IRF) rates, which is the rent charged for the IRF acres, every five years<sup>1</sup>. At current levels, as demonstrated below and discussed in more detail in this Board Letter, APMT has the lowest rates at the Port, with the exception of a temporary rate for a tenant whose operation is impacted by construction.<sup>2</sup>

a) TEU rates:

APMT's current TEU rate (at the 5000 TEUs per acre throughput bracket<sup>3</sup>) is \$38.00. The average TEU rate for other Harbor Department container terminal tenants at the same throughput rate is \$42.15. Figure 1 on the next page shows the comparison between container terminal tenants at the 4,000 to 8,000 TEUs rate.

b) MAG Rate:

APMT's current MAG is \$145,751 per acre. The average MAG for other Harbor Department container terminal tenants is \$160,237 per acre; accordingly, APMT's rate is 9.04 percent lower.

c) IRF Rate:

APMT's current rent for the IRF is \$49,768 per acre per year, which is the second lowest IRF rate in the Harbor Department. The average IRF rent paid by the other Harbor Department container terminal tenants with IRF during 2013 is \$137,256 per acre per year; accordingly APMT's rate is 63.74 percent lower.

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<sup>1</sup> These rent components are more fully explained in the Discussion section on pages 5 through 7.

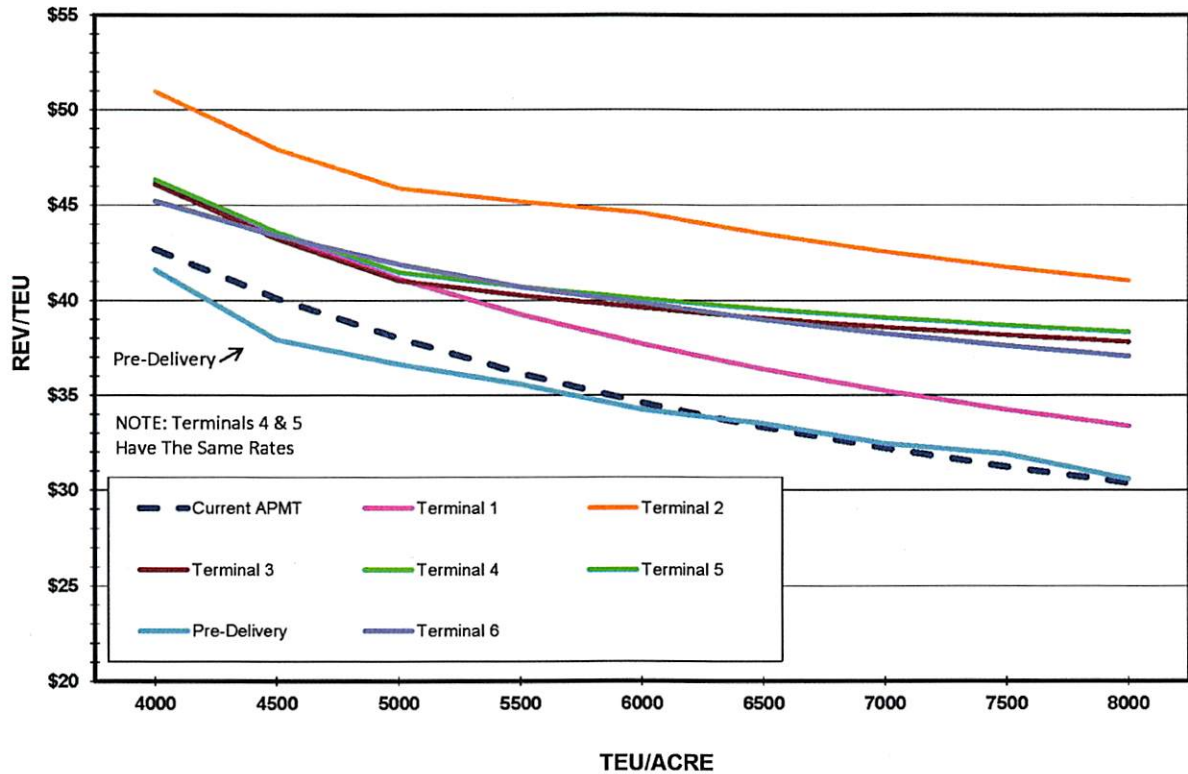
<sup>2</sup> Note that although APMT has the lowest rates, it generates the greatest revenues to the Harbor Department in part because it has the largest facility.

<sup>3</sup> The 5000 TEU bracket is utilized as a representative rate for comparison between the various container terminal tenants. For APMT, all TEUs are charged at the lowest rate APMT achieves on their TEU scale. Therefore, how APMT's rates compare to other container terminal tenants will depend on APMT's annual cargo throughput in any given year.

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Figure 1

POLA TEU RATE COMPARISON BY TENANT FOR 4,000 - 8,000 TEUS PER ACRE (Existing rates as of January 1, 2014)



As required by the Permit, staff commenced negotiation of new compensation rates with APMT for the Reset Period. These negotiations began in the Spring of 2012 and continued to September 2014. However, since the parties were unable to reach agreement on an acceptable reset of compensation by May 2013, the Board declared that negotiations were at an impasse and instructed staff to implement the rate reset dispute resolution process set forth in the Permit. Pursuant to that process, three separate property appraisals were commissioned to assess the fair market rental rate for the Premises. Nonetheless, staff continued negotiations during the reset process in an effort to reach an agreement which would obviate the need for protracted dispute resolution.

Based on review and analysis of the appraisals, the rates charged to other Harbor Department container terminal tenants, and other relevant market data, staff's opinion is that current rental rates charged to APMT for their occupancy and use of Pier 400 are below market and should be adjusted upward.

The following chart (Figure 2) shows a comparison between the current APMT rates, the recommended rates, and the average rates for all other container terminal tenants in the Port:

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Figure 2

Rent Component	Current APMT Rate	Recommended Rates	Average Port Terminal Tenant Rate
TEU rate at 5000 TEU bracket <sup>4</sup>	\$ 38.00	\$38.76 (effective Jan. 1, 2014 with 2.48% CPI-U increase on August 1, 2015 and August 1, 2016 = \$40.71) <sup>5</sup>	\$ 42.15
MAG (for Terminal Area acres only)	\$145,751/acre	\$157,411/acre (effective Jan. 1, 2014)	\$160,237/acre
IRF (for IRF acres only)	\$ 49,768/acre/year	\$49,768/acre/year (effective Jan. 1, 2014)	\$137,256/acre/year
Storage and Queuing Area	No charge	No change	n/a
Tariff Rates	Increase to Applicable Tariffs are due as part of APMT's Compensation	Applicable Tariff rates remain at current rates throughout the Reset Period	n/a

2. The Permit. On August 1, 2002, Maersk Pacific Limited (Maersk) became the Harbor Department's tenant at the Pier 400 container terminal facility (Berths 401 through 406). On June 14, 2010, the name of the tenant was changed from Maersk to APMT. Both Maersk and APMT are part of the A.P. Moller Maersk Group based in Copenhagen, Denmark.

APMT has the preeminent container facility at the Port and, arguably, on the U.S. West Coast. The facility is superior because it was "purpose built" as a state-of-the-art container terminal facility envisioned to handle the largest vessels in the trade as efficiently as possible. As a result, APMT enjoys benefits such as excellent backland to berth ratios, competitive on-dock rail access, outstanding berth depth and length, and no pre-existing contamination or other impediments. APMT also enjoys the premier location in the San Pedro Bay, excellent rail infrastructure access, and the most direct and efficient access to the regional road network. All of this leads to its capability to handle the greatest number of large capacity ships simultaneously within the San Pedro Bay port complex (six simultaneous ships versus an average of two berths at all other terminals).

The Permit has a 25-year term and three, five-year options to extend with a provision for compensation readjustments at each five-year anniversary of the Effective Date (hereinafter referred to as "readjustment" or "reset").

3. The Premises. The property covered by the Permit consists of approximately 512.36 acres of land and improvements (Premises), making it the largest container

<sup>4</sup> All the TEU rates with the recommended increase are shown in Transmittal 3.

<sup>5</sup> CPI-U rate based on a 10-year average.

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terminal at the Port. The entire Premises (Transmittal 1) consist of the following components:

- 441.74 acres for container terminal yard (Terminal Area)
- 40.84 acres for IRF
- 24.24 acres for storage tracks
- 5.54 acres for truck queuing

The Permit, as originally negotiated, provides the 29.78 acres of storage track and truck queuing area at no charge<sup>6</sup> and a low initial rental rate for the container terminal and IRF acreage in return for, among other things, relocating to Pier 400 from the Port of Long Beach.

The 441.74 acres of the Premises referred to in the Permit as the Terminal Area are subject to a rent structure based on the greater of a rate based on volume or a MAG, while the 40.84 acres of the Premises used for the IRF are subject to a fixed rental rate per acre, with all three components subject to five-year readjustments, all as more fully explained below.

In September 2010, APMT entered into a sublease agreement with California United Terminals (CUT) for a 91 acre portion of the Pier 400 facility's Terminal Area, including one berth. APMT handles CUT's shipping line customers' on dock rail container cargo, and, therefore, does not sublease any of the IRF to CUT. While the Harbor Department is not a party to the sublease, it can be reasonably assumed that this offsets a portion of the rent and other facility costs incurred by APMT in its occupancy and use of Pier 400.

4. **The Compensation.** As with all Harbor Department container terminal rental agreements, with the exception of Eagle Marine Services (EMS) at Pier 300, rent paid per year under the Permit on the Terminal Area is based on the number of TEUs per acre APMT handles, subject to a MAG, which is intended to ensure a minimum amount of revenue from the Terminal Area of the Premises.

**TEU charges.** TEU rates are assessed based on a sliding scale, whereby progressively lower rates are charged at progressively higher volume points. The purpose of the TEU rate scale is to provide a built-in incentive to increase volume. As the per acre volume increases during a compensation year, the TEU rate decreases. Under the Permit, rates change for every 100 TEU increments; for example, designated TEU rates for annual volumes of 4,000 to 4,099 per acre changes to a lower rate when the volumes increase to 4,100 to 4,199 per acre, and changes again at 4,200 to 4,299 per acre, etc. This rate differential is as little as \$0.10 per TEU to as much as \$1.32 per TEU between volume bands. In determining the TEU rates, only the 441.74 acre Terminal Area is considered;

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<sup>6</sup> These areas are not subject to the 5-year reset since the Permit does not include this acreage in the compensation formula. To charge any future rent for this area would require a Permit amendment.

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that is, the 40.84 acres of IRF and 29.78 acres of storage tracks and queuing areas are excluded from the TEU rate calculation. (Permit Section 3(d))<sup>7</sup>

For the last nine-year period, APMT has had the highest gross volume of all Harbor Department tenants. However, its per-acre throughput is among the lowest; presumably as a result of various factors which potentially could include the fact that APMT has the largest facility by acreage. For comparison purposes, at the throughput level of 5,000 TEUs per acre, APMT's current TEU rate is \$38.00.<sup>8</sup> The average TEU rate of other Harbor Department container terminal tenants at the 5,000 TEU level is \$42.15.

As shown in Figure 1 on page 4, APMT currently has the lowest TEU rate scale at the Port, with the temporary exception of one tenant that is impacted by construction. Once construction is completed, that tenant will have rates in line with the market and higher than APMT's current rates.

**Payment of a MAG.** The MAG is independent of TEU volume-based rates and is intended to provide the Harbor Department with minimum annual revenue for the Terminal Area, not the full market rent for the Premises. The MAG is based on the 441.74 Terminal Area acreage only. (Permit Section 3(e)(1))

The MAG was set in 2000 to recover slightly less than 75 percent of the targeted rate of return on the initial capital invested. Under past practice (and based on the then Harbor Department rate of return policy): "The minimum annual guarantee shall be equal to at least 75 percent of the required revenue. Required revenue is to be calculated by applying the Board's established rate of return to the fair market value of land and water, together with the replacement cost new, adjusted for utility loss .... *It must be recognized that the transition to market value may take some time and involve a number of interim steps, but market value is the ultimate goal.*" (Port of Los Angeles Rate of Return Policy and Procedure for Negotiating Major Port Land Use Agreements, Section II.2, page 6 (1987), *emphasis added.*) It should be noted, however, that for this particular Permit, the Board approved an initial MAG that was set at 71.46 percent of required revenue.<sup>9</sup>

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<sup>7</sup> All references to "TEUs per acre" and "MAG per acre" refer to the 441.74 Terminal Area acres only.

<sup>8</sup> APMT's actual performance over the last ten years averaged to 4,680 TEUs per acre corresponding to a rate of \$39.62 per TEU at APMT's 2012 rate schedule. The average TEU rate for the 4,680 TEU level of the other Harbor Department container terminal tenants is \$43.48.

<sup>9</sup> To determine "required revenue", the Harbor Department applies a fixed percentage increase to the expected revenue generated in each of the years of a permit; in this case, 25 years with a fixed increase of 1.94%. The discounted total (at the then current weighted average cost of capital of 6.5%) of projected MAG rental revenue plus IRF rental revenue over the 25 year life of the permit was divided by the discounted total of the required revenue. The result of that calculation (\$839,599,000/\$1,174,887,000) is 71.46%, slightly short of the 1987 policy level of at least 75%.

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APMT's current MAG is \$145,751 per acre per year. The average MAG for all other Harbor Department container terminal tenants is \$160,237 per acre.<sup>10</sup> An Amendment to the Permit was enacted in 2010 in an attempt to clarify the acreage against which the MAG is calculated. Although the Amendment incorrectly uses the term "Premises" it is clear that the purpose of the Amendment is to set the terminal area against which MAG is calculated and charged equal to 441.74 acres which are referred to elsewhere in the Permit as the Terminal Area. Regardless, and as previously discussed, the MAG does not represent the full fair market rent for all the compensable acreage.

**IRF charges.** Payment for use of rail and intermodal yards, the IRF charge, is in addition to the TEU charge and covers the use of on-dock rail and intermodal yards to expedite transportation of freight, thereby increasing the efficiency of delivering cargo. APMT's Premises contains the largest on-dock rail yard at the Port, with 12 loading tracks, each approximately 2,500 feet long with each track having the capability of handling eight 305-foot-long doublestack railcars (capacity of 96 railcars) and six adjacent storage tracks, each 6,400 feet long and each capable of handling twenty-one 305-foot-long doublestack railcars (capacity of 126 railcars). The cargo-handling efficiency provided by this high-volume, on-dock rail yard provides APMT and its customers with efficient intermodal connections. Thus, the IRF is an integral part of the Premises and APMT's operation.

APMT's current rent for the IRF is \$49,768 per acre per year, the second lowest at the Port. The average IRF rent of other Harbor Department container terminal tenants is \$137,256 per acre per year, APMT's IRF rent is approximately 64 percent less than the average rate.

Through a prior reset and Tariff rate increases for Merchandise Not Otherwise Specified (the "N.O.S" rate), APMT's current rates do reflect an incremental movement towards full market rent. In the first reset period, APMT did not receive a rate increase for the first four years of the reset period (August 1, 2007 through July 31, 2011) due to a negotiated reset agreement between the parties, but did receive a 7.5 percent increase for the last year of the period (August 1, 2011 through July 31, 2012). Moreover, the rate of increase is dependent on the rental rates at the time of the reset. If a tenant is already at or near market, their increase, if any, will be slight; the further the then current rent deviates from market rates, the greater the adjustment needed to achieve market rental rates.

From the inception of the Permit to August 2012, APMT's cumulative rate increases total 18.5 percent (including N.O.S. Tariff increases). For reference, over the same period from July 2002 to August 2012, the Consumer Price Index (CPI-U)<sup>11</sup> increased

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<sup>10</sup> Similarly, although rent is structured differently at the Port of Long Beach, the range of MAG at their facilities is \$150,000 to \$180,000 per acre per year.

<sup>11</sup> The CPI-U (the Consumer Price Index for all items, All Urban Consumers for the Los Angeles-Riverside-Orange County, California Area, 1982-84=100 as published by the U.S. Department of Labor, Bureau of Labor Statistics).

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by 30.2 percent. Additionally, the rate of return relative to this Permit to the Harbor Department is estimated at 7.44 percent over the period from August 1, 2012 through July 2, 2017, if no rate increase is applied, which is below the Board's current established target for return on investment of a blended rate on land and improvements of 10.92 percent. When the Permit was approved in 2002, the Board's targeted rate of return on both land and improvements was 12 percent.

**5. Resetting of Compensation**

a) **Five-Year Adjustment Requirement.** Pursuant to the City Charter, and included in the Permit, it is required that compensation be reset every five years.<sup>12</sup> Section 3(h) of the Permit states that compensation, including the TEU rates, IRF charges, and the MAG, "shall be readjusted every five years." This Permit section implements the rental adjustment requirement contained in Section 607(b) of the City Charter, which states: "Every franchise, concession, permit, license, or lease shall include a procedure to adjust the compensation periodically but in no case shall the period between adjustments exceed five years." This reset requirement is important to ensure that rents on long term permits are consistent with current market rental rates. APMT's prior rate increases and the recommended rate increase for the current reset period are still below staff's opinion of fair market rent; however, as stated in the Board's policy cited above, since the inception of the Permit, it has been understood that achieving full fair market "value may take some time and involve a number of interim steps". The current recommendation continues the gradual increase to the ultimate goal of obtaining full market value for the Premises. Staff believes that, given the initial low rate agreed to with APMT in 2000, the significant commercial challenges facing the industry at this time (i.e. mega-alliances and other shifting market trends), and the risk of cargo shifting from our primary facility to other alliance-related facilities not located in the harbor, a continuation of gradual increases is the most the market can bear at this time.

b) **Compensation Negotiations.** As previously stated, staff and APMT have been negotiating to arrive at a mutually agreed upon reset of APMT's compensation since the Spring of 2012. Staff attempted to reach an agreed upon figure that would make APMT's rental rates closer to the market, as demonstrated by the rental rates paid by the other Harbor Department container terminal tenants. As a result, the parties were unable to come to agreement prior to declaring an impasse in the negotiations.

The following Figure 3 sets forth a summary of the current compensation rates, the Harbor Department's last offer prior to reaching an impasse, and APMT's then counter proposal:

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While the CPI-U increased by 30.2%, the Consumer Price Index, West Urban areas, All Consumers, Not Seasonally Adjusted (Series ID CUUR0400SA0) increased by 26.3%. APMT's increases were below both indexes.

<sup>12</sup> See Permit Sections 3(d)(1), 3(e)(3), 3(f) and 3(h). Compensation, the rent due for this Permit, is defined in Section 3(a) of the Permit which states that "compensation" is the total aggregate amount Tenant is required to pay during each compensation year and defines compensation to include: (i) all TEU Charges, including the MAG; (ii) the charges for use of the IRF; (iii) applicable wharfage and dockage charges prescribed by Tariff and all other Tariff charges as set forth in the Permit; and, (iv) all other amounts due under the Permit.

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Figure 3

APMT Compensation Reset			
	APMT Current Rates	Harbor Department Offer February 6, 2013 <sup>13</sup>	APMT Counter Offer March 3, 2013
TEU Rate (based on a sliding scale)	\$38.00 at 5,000 TEU bracket <sup>14</sup>	At 5,000 TEUs: 4% increase eff. August 1, 2012 = \$39.52 4% increase eff. August 1, 2013 = \$41.10	No Increase
MAG	\$145,751/acre	4% increase eff. August 1, 2012 4% increase eff. August 1, 2013	4% increase eff. January 1, 2013 4% increase eff. January 1, 2014
IRF	\$49,768/acre	4% increase eff. August 1, 2012 4% increase eff. August 1, 2013	No Increase

c) Interim Rate Increase During Negotiations. The Permit allows for the Executive Director to impose an interim increase of up to 25 percent in the rental rates from the rate readjustment date to the Board's setting of new rates. Rather than increasing the compensation by the full 25 percent during the protracted negotiations, the then Executive Director sent APMT written notice that an increase of 8 percent, in line with the then pending rental rate increase offer that staff made to APMT would be effective May 1, 2013. However, based on three separate written requests from APMT, this interim 8 percent increase was deferred by the Executive Director until January 1, 2014. A fourth request was made in May 2014, five months after the 8 percent increase went into effect. APMT has refused to pay this amount and continues to pay rent at the rates currently in place during the entirety of this rate reset process.

d) Reset Dispute Process and Continued Negotiations. Under the terms of the Permit, if the parties reach an impasse during negotiations, the dispute resolution process outlined under Section 3(h) is implemented which includes an appraisal process and a public evidentiary hearing where the Board determines the appropriate rent adjustment and imposes that adjustment by Order of the Board.

In the spring of 2013, an impasse in negotiations had been reached and staff implemented the provisions of Section 3(h). Subsequently, three appraisers were selected:

- Norris Realty Advisors (Norris) – appointed by the Board on May 2, 2013
- CB Richard Ellis, Inc. (CBRE) – appointed by APMT
- Overland, Pacific & Cutler (OPC) – appointed by both Norris and CBRE

<sup>13</sup> This is a cumulative increase of 8.16 percent.

<sup>14</sup> This is one of 77 of the brackets in APMT's TEU rate and is used for comparison.

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All three appraisers were instructed to determine the fair market rental value of the Premises, taking into consideration “the uses permitted under the Permit and all of the terms, conditions and restrictions, including, but not limited to, the MAG, the throughput of TEUs per acre, the TEU rates or other comparable efficiency scale, the availability of comparable terminal facilities, and the compensation paid by comparable terminal operating tenants of the Port of Los Angeles.... [also taking] into consideration all of the factors and data relating to such value of comparable leaseholds under the laws of eminent domain of the State of California.” (Permit, Section 3(h)).

The opinion of the appraisers ranged from no rent increase to an increase in rent of over 10 percent. Staff’s evaluation of the appraisals led staff to the conclusion that only the Norris appraisal provided sufficient information to determine appropriate rental rates for the three components of rent. Staff calculated that those rates, based on Norris’ opinion of the value of the Premises of \$200,000 per acre per year, should be increased by 10.73 percent to achieve the target rent of \$200,000 per acre for the 482.58 compensable acres of the Premises (441.74 acres of Terminal Area and 40.84 acres of IRF)<sup>15</sup>. This conclusion led to additional negotiations, with several offers and counter-offers, which culminated with the current recommendation agreed to by APMT.

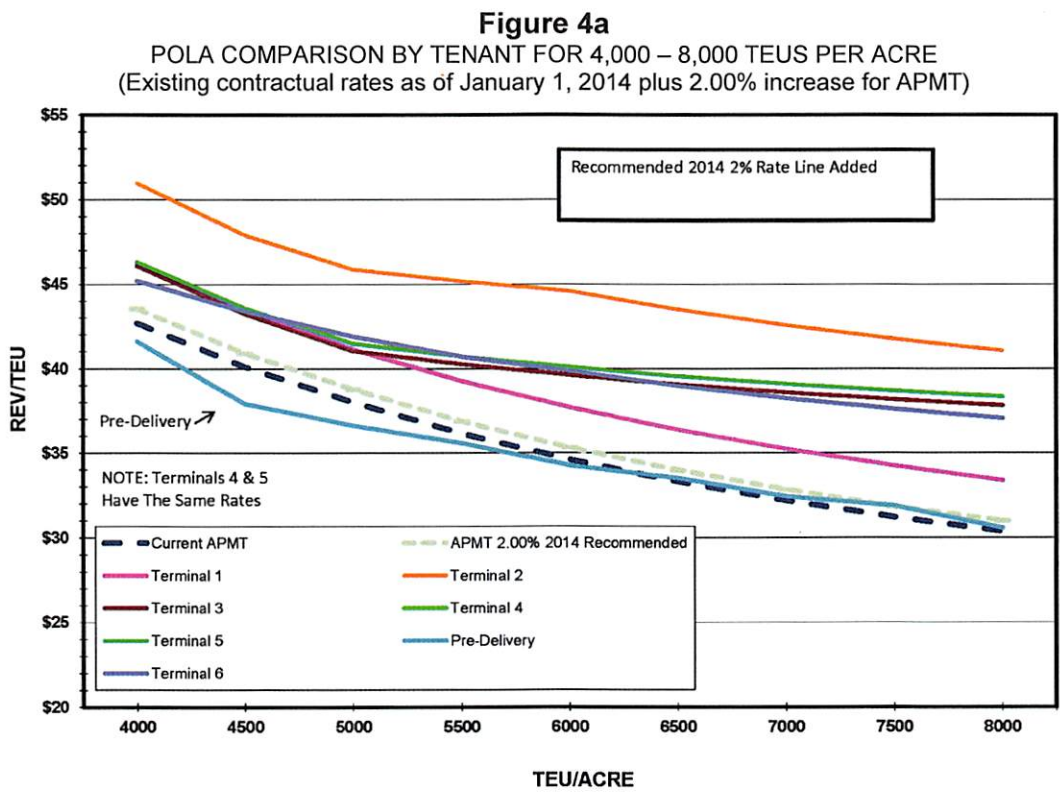
While the staff’s recommended reset rates are below the market rent established by the Norris appraisal, staff is recommending this incremental increase towards market rental rates in an effort to finalize negotiations, save additional time and costs for both parties, and work toward building stronger relations with a highly valued customer. Moreover, and as stated earlier, staff believes that the current market conditions will not bear an increase to full market value. Additionally, with the CPI-U increases in August 1, 2015 and August 1, 2016, the last two years of the reset period, the reset TEU rates will progress the rent towards the goal of receiving full market rent for the compensable portion of the Premises.

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<sup>15</sup> This calculation required staff to estimate the projected five year revenue under existing rates. The projected revenues were based a combination of (a) the actual TEU throughput volume for the first year of the readjustment period from August 01, 2012 through July 7, 2013, which was 2,050,823 TEUs, and (b) a projection of future volume, assuming an annual increase of 100,670 TEUs over the first year’s actual volume, to obtain a TEU estimate for each of the remaining years of the five-year reset period. The annual increase of 100,670 TEUs reflects the slope of a regression line run through actual Pier 400 performance over the 11 years from August 1, 2012 through July 31, 2013. If TEU and intermodal rates were increased by 10.73% and the five years of throughput were reevaluated at the increased levels, total Harbor Department revenue for the five-year period would exactly attain \$482.6 million. Note that because volume is assumed to grow, none of the five years generates exactly the market rent of \$96.5 million. Early years generate less, later years generate more. However, subsequent to this calculation actual volume numbers were received for the second year of the reset period which shows the actual increase in volume was only 84,449 TEUs. Assuming an average increase of 84,449 TEUs per year, rather than 100,670 TEUs, and using the same slope of regression methodology, in order to obtain \$200,000 per acre for the compensable acres, the rate increase would need to be higher for all three components of rent. Nonetheless, since previous discussions were based on the earlier assumptions, this report retains the 10.73% analysis for consistency. The actual rent received may be less or more than the estimate depending on the actual throughput for the five-year period.

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Figure 4a reflects the current TEU rates for the Harbor Department’s container terminal tenants and where APMT’s rates would be if the Board adopts a 2 percent increase in TEU rates as shown by the gray dashed line<sup>16</sup>. Assuming that the CPI-U is 2.48 percent (based on the last ten year average) in each of the next two years, AMPT’s TEU rates are shown in Figure 4b. Although these TEU rates and an 8 percent increase in the MAG and no increase in the IRF rates will leave APMT below the average rates of the other Port terminal tenants, staff has concluded that the agreed upon rate increase is appropriate given the state of the industry and the significant risk to the Port’s largest customer from a full move to market for the current Reset Period.

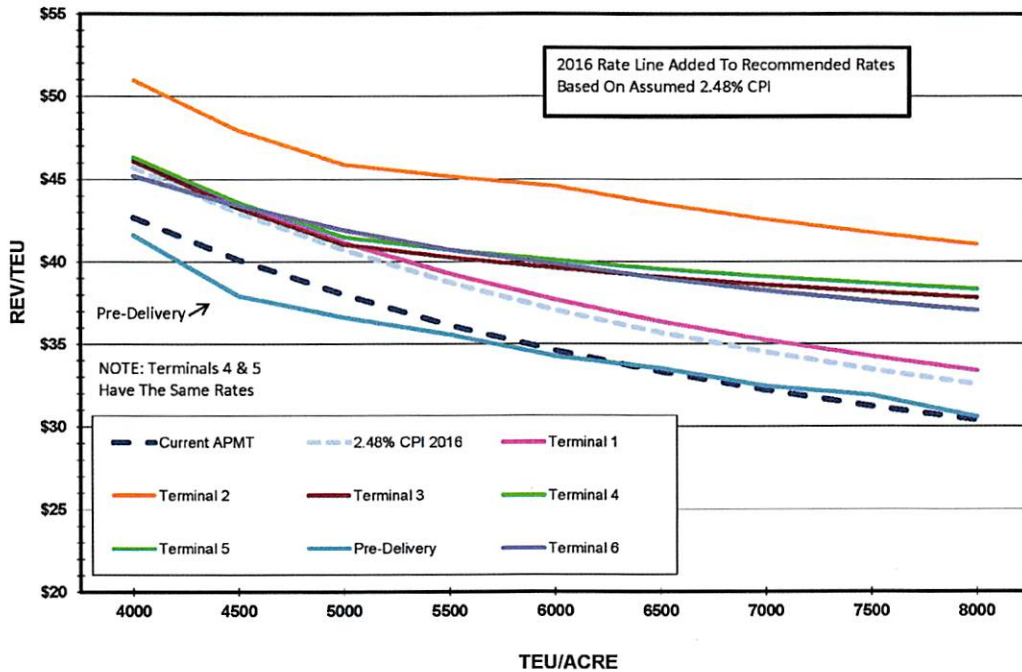


<sup>16</sup> Figure 4a only reflects the initial 2 percent increase in TEU rates effective January 1, 2014, and not the subsequent rates based on the CPI-U adjustments on August 1, 2015 and August 1, 2016. Assuming an historic average of approximately 2 percent CPI-U increases per year, the TEU rates would increase to approximately 6.12% over current rates after the second CPI-U adjustment.

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Figure 4b

POLA TEU RATE COMPARISON BY TENANT FOR 4,000 - 8,000 TEUS PER ACRE (Existing rates as of January 1, 2014)



e) Permit Amendment – The proposed Sixth Amendment to the Permit will address the change in the entity from APM Terminals Pacific, Ltd. to APM Terminals Pacific, LLC.

In addition, as part of the negotiated rates, APMT has agreed to the recommended increases to the TEU and MAG rates, including the imposition of the CPI-U adjustments to the TEU rates in 2015 and 2016, in return for assurances that no applicable Tariff rate increases, including but not limited to the N.O.S., would increase the compensation during the Reset Period. In order to maintain the current Tariff rates during the Reset Period, the Board and City Council must approve an amendment to Sections 3(a) and 3(c)(2) of the Permit as shown in Transmittal 2.

As noted earlier, Staff believes that this amendment is necessary to maintain the economic balance, and therefore feasibility, of the agreement reached with APMT. Staff recommends such approval in order to effectuate the agreed upon rate adjustment to APMT's compensation for the Permit.

6. Conclusion – The Harbor Department remains committed to its valuable and mutually beneficial long-term relationship with APMT at Pier 400, the largest single proprietary terminal on the U.S. West Coast. The current recommendation continues the gradual increase to the ultimate goal of obtaining full market value for the Premises.

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Staff believes that, given the initial low rate agreed to with APMT in 2000, the significant commercial challenges facing the industry at this time (i.e. mega-alliances and other shifting market trends), and the risk of cargo shifting from our primary facility to other alliance-related facilities not located in the harbor, a continuation of gradual increases is the most the market can bear at this time. It is in the best interest of both parties that they each continue to grow in a fiscally responsible and prudent manner. The Harbor Department's commitment to APMT is in no way diminished by obtaining rental rates that progressively move APMT to rates that are more in line with other container terminal tenants in the Port. At the same time, the reset agreement, including the TEU and MAG rate increases, and the commitment to raise the TEU rates by a CPI-U, justify the commitment to maintain all other existing Tariff charges at their current rates through the end of this Reset Period.

For all the reasons set forth above, staff believes that the negotiated rates are commercially reasonable given the current market conditions and are necessary to retain the customer and its substantial cargo volume and, therefore, recommends that the Board enact the Order resetting compensation for the five-year period from August 1, 2012 to July 31, 2017 per the following:

- Increase the TEU Rate by 2 percent effective January 1, 2014, and escalate this rate by CPI-U (CPI, All Urban Consumers, Los Angeles-Orange-Riverside Counties) at each August 1 for the remainder of this five-year reset period of August 1, 2015 and August 1, 2016, with a floor of 0 percent and a cap of 3 percent; provided that until July 31, 2017, to the extent that percentage increases of TEU charges, the MAG and/or IRF Compensation occur in a compensation year through application of Section 3(c)(2) of the Permit), in the case of TEU charges, the compounded percentage increases of such charges resulting from CPI-U Adjustments shall be deemed to constitute full increases of such TEU charges as required by application of Section 3(c)(2), if any; (Transmittal 3);
- Increase the MAG by 8 percent (Transmittal 3);
- Maintain the current IRF Rate of \$49,768 per acre per year (Transmittal 3); and
- Amend the Permit to maintain all applicable Tariff rates at their current rates for the remainder of the Reset Period and reflect the proposed name change of the entity.

If the Board does not accept staff's recommendation on rent adjustment as agreed to by APMT, the Board must either (i) instruct staff to continue negotiations and/or provide additional information to the Board or (ii) hold a public hearing to determine the appropriate rental rates. As stated in the Permit, at the public hearing (which, if necessary, staff would recommend holding at a subsequent meeting of the Board scheduled such that staff and APMT had adequate time to prepare presentations), "the [appraisals] and such other evidence of the fair compensation value of the premises as may be presented by Tenant or others shall be received and considered. Based upon

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such evidence, Board's adopted policy on rate of return and any other relevant factors, Board shall determine and make a determination of the fair compensation value of the premises and establish the same by order as the compensation to be paid by Tenant for the five-year period under consideration." (Permit, Section 3(h)). Staff will prepare and submit a Board Letter with the appraisals, staff's evaluation of the appraisals and other relevant facts for the Board's consideration at the public hearing.

**ENVIRONMENTAL ASSESSMENT:**

The proposed action is approval of an Order resetting compensation for APMT for the five-year period between August 1, 2012 and July 31, 2017. As an activity involving the modification of a rate for using existing municipal facilities involving negligible or no expansion of use, the Director of Environmental Management has determined that the proposed action is exempt from the requirements of the California Environmental Quality Act (CEQA) in accordance with Article II Class 2(f) of the Los Angeles City CEQA Guidelines.

**ECONOMIC BENEFITS:**

This Board action will have no direct employment effect.

**FINANCIAL IMPACT:**

The proposed APMT compensation reset will increase TEU rates by 2 percent, increase the MAG rate by 8 percent, and maintain the current IRF rate, with the TEU rate subsequently subject to a CPI-U annual increase capped at 3 percent effective August 1, 2015, and again at August 1, 2016. Assuming modest annual 84,449 TEU growth and 2.48 percent annual inflation, revenues generated by these rates will increase over the five-year reset period ending July 31, 2017. The estimated revenue increase over the reset period is \$12.5 million, while the estimated rate of return during the reset period is 8.06 percent, a rate that does not reach the return levels established under the Port's Real Estate Leasing Policy. Replacement of the previously imposed 8 percent rate increase imposed as result of Executive Director order and effective January 1, 2014 with the 2 percent increase proposed herein will result in a reduction to operating revenue of approximately \$5.6 million in this operating year. Additionally, until July 31, 2017, the Sixth Amendment prevents any Tariff No. 4 increases from being applied to APMT, including APMT TEU, IRF, MAG, pilotage, and space assignment charges. The dollar magnitude of this suspension is indeterminate.


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**CITY ATTORNEY:**

The Order (Transmittal 4) has been approved as to form and legality by the Office of the City Attorney.

**TRANSMITTALS:**

- 1. Site Map
- 2. Sixth Amendment
- 3. Chart of New Rental Rates
- 4. Order



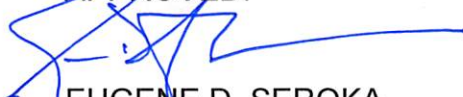
JACK C. HEDGE  
Director of Real Estate

FIS Approval:  (initials)  
CA Approval:  (initials)



DAVID L. MATHEWSON  
Interim Deputy Executive Director

**APPROVED:**



EUGENE D. SEROKA  
Executive Director

EDS:DM:JH:RG:ST:JS:pvt:mmm  
BL467raw APMT Order