Overview and History of Target Rates of Return at POLA

- Traditionally, a hurdle rate is used to assess whether the monetary return on a project measured as a percentage, given its risks and costs versus other projects, should be undertaken.
- The Harbor has established target rates of return.
- Codified in a board report from the Executive Director to the Board in January of 2006:
  - 12% for improvements
  - 10% for land
- Previously, the rate for both improvements and land was 12%.
- Such rates seek to sustain the economic well-being at the Port.
What Do Others Charge?

- Original rates set based on what other municipalities and Ports charged
  - POLB – 10% for Land, 12% for Improvements
  - Port Authority of NY & NJ – 7.5%
  - Port of Oakland – 10%
  - Port of Portland – 10%
  - Port of San Diego – 9%
  - Port of Seattle – 6.5% to 14.5%
  - Port of Tacoma – 10%
  - Southern CA Edison – 5-8%
  - Vancouver Port Authority – No standard
  - Watson Land Company – 10%
Possible Reasons Why There are Different Hurdle Rates

- Other sources of revenues to support the port
  - Taxes
  - Airports
  - Roadways
- Different costs
  - For maintenance
  - For infrastructure needs
Historically our cost to borrow has been approximately 6.0%.

- We have a stated policy of generating operating income in excess of our debt service by 2 times.

- Since our debt service is 6.0%, to achieve generating operating revenues that are twice the debt service or 2 X 6.0% or 12%.
As we apply the 12% hurdle to individual projects, the answer is sometimes “Yes” to certain projects but “No” in general.

So if we are not meeting the 12%, how have we “survived”?
- We have used our own cash that have been stored
- The returns we obtain from land

Our returns are diminishing to where costs of borrowing is higher than what we can generate from projects.
Looking at Overall Returns on our Invested Capital

- Using an arithmetic ratio: the Return On Invested Capital (ROIC)
- The ROIC helps an entity understand whether it is adding to its value or eroding it
  - The ROIC calculates whether the money an entity invests generates more than what it costs to borrow
    - The conclusions are
      - If the borrowing costs is more than what is generated from what has been invested, then the entity has reduced value
      - If the borrowing costs is less than what is generated in income, then the entity has increased value

In FY2007, POLA generated about 4.42% more in revenue than its cost to borrow
In FY2013, POLA generated about 0.37% less in revenue than its cost to borrow
High Before, Low Now Now

Return on Capital Assets
Weighted Average Cost of Capital
An Interesting Comparison

- The ROIC for POLA for FY2011-12 and FY2012-13 were 4.79% and 3.48%.
- The ROIC for APM Terminals were 15.2% for FY2012 and 13.5% for FY2013.

*From AP Moller-Maersk A/S 2013 Annual Report