



Executive Director's
Report to the
Board of Harbor Commissioners

DATE: FEBRUARY 9, 2017

FROM: CARGO & INDUSTRIAL REAL ESTATE

SUBJECT: RESOLUTION NO. _____ - APPROVE TENTH AMENDMENT TO PERMIT NO. 733 WITH EAGLE MARINE SERVICES, LTD.

SUMMARY:

Staff requests approval of the Tenth Amendment to Permit No. 733 (Permit) with Eagle Marine Services, LTD. (EMS). The Permit premises consist of 261.03 acres at Pier 300. In addition, EMS occupies 30.28 acres and 0.69 acres granted under a Space Assignment and Revocable Permits, respectively.

The Tenth Amendment will (a) incorporate the Space Assignment area into the Permit at a fixed annual rent plus annual Consumer Price Index (CPI) based adjustments, (b) reset compensation for the five-year period beginning January 1, 2017 through December 31, 2021, (c) increase the Minimum Annual Guarantee (MAG) per acre, (d) grant EMS two separate rights to request that City furnish real property for developing 41 existing acres adjacent to the Premises until December 31, 2025, as well as non existing additional future acreage to develop up to 35 acres after the 41 acres have been first requested, (e) incorporate the application of a General Rate Increase (GRI) to the Tariff No. 4, if any, at any time after January 1, 2020, and (f) release City of Los Angeles Harbor Department (Harbor Department) from the claim filed by EMS against the Harbor Department for the development of additional premises.

RECOMMENDATION:

It is recommended that the Board of Harbor Commissioners (Board):

1. Find that the proposed action is exempt from the requirements of the California Environmental Quality Act (CEQA) under Article II Section 2(i) of the Los Angeles City CEQA Guidelines as determined by the Director of Environmental Management;
2. Find that, while the Rate of Return does not meet the current Leasing Policy Section VIII Rates, Fees and Charges, by approving this Amendment the Rate of Return is expected to increase from its current level;

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3. Approve the Tenth Amendment to Permit No. 733 with Eagle Marine Services, LTD. with the finding that such Amendment is in the best interest of the City of Los Angeles;
4. Direct the Board Secretary to transmit the Tenth Amendment to Permit No. 733 to City Council for approval pursuant to Charter Section 606;
5. Authorize the Executive Director to execute and the Board Secretary to attest to the Tenth Amendment upon approval by City Council; and
6. Adopt Resolution No. _____.

DISCUSSION:

Background - The Permit between the Harbor Department and EMS, a wholly-owned subsidiary of American President Lines, Inc. (APL), became effective on September 10, 1993. In 1997, NOL, a Singapore-based shipping company, purchased APL and in June 2016, the Marseilles, France-based shipping company, CMA CGM S.A. (CMA CGM), acquired NOL and APL, thereby taking control of EMS in the acquisition. CMA CGM now controls strategic decision-making and capital investment, while EMS continues to be the Permit holder and operator of the facility. EMS occupies the area depicted as Current Premises in the drawing attached as Transmittal 1. In addition to the premises entitled under the Permit, the Harbor Department issued EMS a Space Assignment (Transmittal 2) to entitle EMS to use approximately 30 acres adjacent to the Permit premises as terminal backland.

At the Board meeting held on October 24, 2016, the Ninth Amendment to the Permit was approved which extended the term of the Permit by 16 years from June 2027 to September 2043. The extension was granted to facilitate EMS' ability to compete for cargo by giving them the opportunity to make longer-term commitments to shipping lines in order to secure their prospective business at the terminal.

As a result of the extension of the term and the resultant total estimated container volume throughput of 2.4 million TEUs per year, CMA CGM and the Harbor Department agreed to revisit the compensation provisions of the Permit in a future Amendment.

Current Compensation – The compensation structure currently in effect under the Permit has three major components, including a provision for an arithmetic adjustment to compensation every five years. The existing compensation structure is detailed below:

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- 1) Minimum Annual Guarantee (MAG): The MAG is the aggregate minimum annual payment of volume based charges per acre that EMS is obliged to make to the Harbor Department. A MAG payment is required if the total of these payments do not exceed the MAG amount. EMS' current MAG is \$153,454 per acre for a MAG revenue of \$40,056,098 per year.
- 2) Payment of TEU Rates: TEU rates are assessed on a sliding scaled based on per acre volume brackets. The higher the TEU volume per acre, the lower the applicable rate per TEU.
- 3) Compensation Reset Methodology: The Permit provides a set of procedures executed at five-year intervals to set compensation over the next five years. The methodology covers the resetting of MAG, TEU rates, and other wharfage and dockage tariff revenue generated.
- 4) Space Assignment Acres: EMS compensates the Harbor Department \$224,229.46 per month for the occupation of 30.28 acres on space assignment, totaling \$2.7 million annually.

Note: Under the current compensation schedule, EMS is not subject to any GRI to the Port of Los Angeles Tariff.

Proposed Changes to Compensation under Tenth Amendment – The goal of both parties was to ensure that the prospective container volume evaluated in the Addendum to the Final EIR dated October 17, 2016, 2.4 million TEUs per year would come to the Pier 300 facility and the Port of Los Angeles. Recognizing the existing market conditions in the San Pedro Bay, a revised compensation structure was negotiated based on a “gain share” basis detailed below:

Space Assignment Acres (30.28 acres) - The 30.28 acres of land will be included in the premises “as is where is” as of April 24, 2001, when the property was first occupied by EMS. A flat rental amount of \$3 million per year will be charged commencing on January 1, 2017, which will be increased by CPI, on an annual basis. The rent is reflective of the current market for similar property of like kind and a land value of approximately \$28 per square foot and a Rate of Return (ROR) of 10.21 percent per year. There is no cap on the amount of CPI applied and the amount paid can never go down. These 30.28 acres, while incorporated into the premises as covered by the Permit, are excluded from the MAG and TEU per acre volume calculation. These 30.28 acres are subject to a five-year compensation reset process as required by City Charter.

Compensation Acres (261.03 acres) - The TEU rate increase determined by the reset process for the reset period effective January 1, 2017, is replaced by a one-time CPI based increase on TEU rates. The amount of increase is expected to be approximately 1.7 percent applied to the TEU rate scale only. Thereafter, the arithmetic reset procedure called for in the Permit will be applicable on all future resets.

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MAG - MAG will be increased to \$200,000.00 per acre as of January 1, 2017. The resultant MAG revenue of \$52,206,000 per year is up \$12,149,902 from the current annual of \$40,056,098. Further, MAG will be increased again to \$205,000.00 per acre as of January 2018 for a total MAG revenue of \$53,511,150 per year. Commencing January 1, 2019, MAG will be subject to an annual CPI based escalation until reaching an amount of \$216,000.00 per acre per year (\$56,382,480 MAG revenue per year). Thereafter, the MAG will increase at a rate of 75 percent of the percentage of the actual rate of growth in total compensation per acre on the 261.03 acres.

Potential Berth 306 and associated 41-acre backland, and additional future acreage - Upon request by EMS, the Harbor Department will negotiate with EMS to develop an expansion of the premises on this area. EMS to have the right to request such development until December 31, 2025. Thereafter, the Harbor Department will notify EMS if it desires to proceed with development with another party. EMS will then have six months to decide whether to proceed with a terminal development project.

Any unsolicited offer made by EMS may be approved or denied in the Harbor Department's sole discretion and is subject to compliance with applicable law, including but not limited to, City Charter, CEQA, and the National Environmental Policy Act (NEPA). If these areas are to be developed for another party, EMS will cooperate to determine accessibility requirements and compensation will be modified accordingly.

GRI - As of January 1, 2020, EMS will be subject to any GRI increase of the "Merchandise Not Otherwise Specified" (NOS) rate in Tariff No. 4. The percentage increase of the NOS rate adopted by the Harbor Department is reduced, but not below zero, by the sum of percentage increases previously applied to TEU rates by the five year adjustment process since the date of the immediately previous NOS increase. TEU rates are increased by the percentage resulting from this calculation.

Release of Claim - EMS has previously asserted that its premises expansion rights under Section 2(e) of the Permit as approved in 1993, remain unsatisfied. To preserve those rights, EMS, as a precursor to a potential lawsuit against the Harbor Department, lodged Claim No. C13-4009 (Claim) with the City Clerk in April 2013, which the Harbor Department denied in June 2013. The Harbor Department and EMS agreed to suspend the statute of limitations under which EMS would be required to sue the Harbor Department via multiple tolling agreements, the most recent of which was signed in September 2016. The premises expansion provisions of the Tenth Amendment (Transmittal 3) will replace the Permit provisions underlying the Claim and, in consideration of their inclusion in the Tenth Amendment, EMS will fully and finally release all rights underlying the Claim.

Effective Date - The Amendment will become effective upon execution by the Executive Director and Board Secretary after City Council approves the Amendment. However, the applicability of the provisions will be as of January 1, 2017.

The proposed terms result in an increase in compensation from the current levels. However, it should be noted that the ROR generated by the proposed revisions, while an improvement over current levels, remain lower than the targets set forth in the Harbor Department's Leasing Policy (Section VIII Rates, Fees and Charges), which

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calls for a target ROR of 10 percent on land and 12 percent on Improvements (resulting in a “blended” target rate of 11.09 percent). Taking into consideration the condition of the current market, especially to the uncertainties surrounding consolidation and the re-formation of numerous shipping alliances, the ROR which is expected to increase from 8.1 percent to 10.21 percent, is reflective of the current market and helps the Harbor Department meet numerous strategic objectives.

Based upon the above terms, staff believes that the substance of the proposed Tenth Amendment offers strong strategic and economic value to the Harbor Department, as it will (a) ensure that EMS will bring additional volume to the Port of Los Angeles resulting in significant additional revenue per year to the Harbor Department, (b) increase MAG significantly thereby providing improved borrowing capacity and enhancing certainty of revenue, and (c) resolve the threat of litigation by a full and complete release of the pending claim brought by EMS. For all of these reasons, staff believes it is in the best interest of the Harbor Department and City of Los Angeles.

ENVIRONMENTAL ASSESSMENT:

The 30.28 acre Space Assignment Area was assessed in the Final Environmental Impact Report (Final EIR) for the proposed Berths 302-306 American President Lines Container Terminal Project certified June 7, 2012, and the Addendum to the Final EIR dated October 17, 2016. Accordingly, the Director of Environmental Management has determined that the proposed project was previously assessed under CEQA and is therefore exempt from further CEQA review pursuant to Article II, Section 2(i) of the Los Angeles City CEQA Guidelines. Future Berth 306, its associated 41-acre backland, and any adjacent acreage that may be acquired or developed in the future was not assessed in the Addendum dated October 17, 2016, and therefore would be subject to further CEQA review before any activity could be approved for those locations.

FINANCIAL IMPACT:

EMS' throughput trended down slightly over the ten-year period that ended in 2015, with the ten-year average at 1.393 million TEUs. Estimated revenues provided by continued flat performance during the remainder of the extended Permit under the current reset process (assuming 2 percent annual inflation) total \$1.8 billion on 36.2 million TEUs, with a net present value of \$1.0 billion. CMA-CGM forecasts annual throughput will increase to 2.354 million TEUs by 2024 held flat thereafter for a total of 60.0 million TEUs. Under this outlook, revenue under the amended TEU rates total an estimated \$2.1 billion, with a net present value of \$1.2 billion, a 20 percent increase. Under the existing compensation structure, MAG revenue increases from \$153,454 per acre to an estimated \$196,371 per acre by 2043, resulting in a total MAG revenue of \$1.2 billion with a net present value of \$700 million. Under the amended compensation structure, MAG is set at \$200,000 per acre as of January 1, 2017, rising to an estimated \$236,000 per acre by the end of the Permit term. Total MAG revenue is estimated to reach \$1.5 billion with a net present value of \$800 million, a 14+ percent increase. No Harbor Department capital expenditures are required to obtain the additional throughput or revenue. The TEU rate increase provided by the arithmetic reset process that would have been effective January 1, 2017, of approximately 13 percent, was reduced to CPI percent in exchange for the CMA-CGM volume commitment. Revenues under the higher CMA-CGM TEU forecast at the lower TEU rates are greater than revenues

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generated by continued flat performance at higher rates. While the proposed ROR does not meet the target levels noted in the Harbor Department Leasing Policy, by approving this amendment the ROR is expected to increase from 8.1 percent to 10.21 percent compared to the blended ROR target of 11.09 percent.

CITY ATTORNEY:

The Tenth Amendment has been approved as to form and legality by the Office of the City Attorney.


TRANSMITTALS:

- 1. Site Map
- 2. Space Assignment
- 3. Tenth Amendment



JACK C. HEDGE
Director of Cargo & Industrial Real Estate

FIS Approval: *MB* (initials)
CA Approval: *CBZ* (initials)



FOR MICHAEL DiBERNARDO
Deputy Executive Director

APPROVED:

Mark Bleavin
FOR EUGENE D. SEROKA
Executive Director

ES:MD:JH:ST:raw
Author: Sumita Thappa
BL629raw Eagle Marine 10th Amend