Container terminal leasing/pricing methods and their economic effects

by Thomas J. Dowd

Income from leasing container terminals and terminal facilities over the last fifteen years has risen from miniscule levels to a majority of total income at some ports.

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Income from leasing container terminals and terminal facilities over the last fifteen years has risen from miniscule levels to a point where it now represents a majority of the total income at some U.S. ports[1]. This paper provides an overview of the methods used to lease container terminals and terminal facilities, examines the leasing methodologies and pricing approaches used by U.S. public port authorities, and discusses the economic effects that each of these might have on a port.

Terminal leasing developed primarily as a means for ports to establish long-term relationships with water carriers. Long-term lease relationships were initially appealing because of the capital-intensive nature of containerization and the need for a secure base upon which to issue bonds to finance new facilities. To accomplish this goal and encourage carriers to commit for the long term, ports developed a pricing structure that gave financial incentives to the water carrier as well as financial benefits to the port.

Each port or carrier defines its competition differently; each lease reflects such difference. Therefore, the subject of terminal leasing virtually defies the use of generalities. Each port appears to approach the subject of leasing in its own manner, negotiating terms and conditions that fit its own unique requirement. There is no average or typical lease.

Semantics are confusing too, since many ports refer to the lease document as a *lease*, whereas others refer to it as a *preferential assignment*, even though the documents in question are identical in their essential provisions. One reason that some ports use the term *preferential assignment* instead of *lease* is to avoid creating leasehold interest that would be subject to property taxes in some jurisdictions.

What is a lease?

Accountants classify land, buildings, and machinery as fixed assets. A fixed asset can be viewed as a bundle of services rather than an object.[2] A fixed asset gives off service after service ad infinitum. One who purchases a fixed asset in fee simple is in reality acquiring ownership of all the future services renderable by that asset. If the owner of a fixed asset does not wish to enjoy the current services of his asset, then that particular service is lost. In effect, an idle fixed asset implies income forgone.

A lease is a contractual arrangement by means of which the use of a fixed asset is transferred for a restricted time by its owner to a potential user, while its title is retained by the former. In such an arrangement, the owner is referred to as the *lessor* and the potential user as the *lessee*. The above definition would include preferential assignments, in which case the parties would be the *assignor* and *assignee* rather than *lessor* and *lessee*.

If the lease is merely a contract of sale of currently usable services, it is a one period lease. If the owner (lessor) also

sells the future services as they become currently usable, then it is a periodically renewable lease.

Someone leases a fixed asset from its owner for a variety of reasons. Among the more common are that the asset whose services are desired is not for sale or that it would not be financially feasible to pay to own the asset since funds could be used more profitably elsewhere. To purchase a fixed asset (to purchase all of the services renderable by a fixed asset ad infinitum) involves an investment that ties up a larger sum of capital than does the purchase of each service as it is used.

An overview of Los Angeles-Long Beach Port, one of the largest port facilities in the nation.

Types of leases

Terminal leases can be classified most readily by the form of their compensation computation. Using this method, there are three basic types of terminal leases — flat rate, mini-max, and shared revenue.

If compensation is a specific amount for a specified time period (e.g. $1 million annually or $35,000 per acre annually), the lease can be classified as a flat rate lease.

The flat rate lease is relatively simple since it required no tariff rates or cargo auditing. The basis for the compensation can be a "fair" return on the value of the property or it can be some estimated per unit rate based upon a study to determine estimated throughput or it can be a figure unrelated to either "fair" return or throughput that will entice the water carrier to agree to the lease.

If the compensation is stated on a specific scale with a minimum and maximum amount (e.g. tariff rates with a guaranteed minimum of $250,000 annually and a maximum of $2 million annually, or tariff rates on a guaranteed minimum of 500,000 tons annually and a maximum of 3 million tons annually), the lease can be classified as a mini-max lease.

The mini-max lease form provides for compensation to the port for use of a terminal in relation to the cargo throughput, while the flat rate lease does not. The mini-max lease contains both a guarantee of minimum compensation to the port and a lid of maximum tariff payments by the lessee. It provides a means by which the port can share some of the benefits of increased throughput, and still limit its own risk through the use of a guaranteed minimum compensation level.

Compensation computation for a shared revenue lease is similar to the mini-max lease since both have a guaranteed annual minimum dollar amount or tonnage, and tariff rates are applied to the cargo throughput. However, in a shared revenue lease, there is no maximum annual amount of compensation payable. Instead, the port and the lessee share the tariff revenue, above a specific dollar or tonnage level, on all throughput. For example, the lessee guarantees a minimum annual compensation of $750,000 and remits 100% of the tariff charges to the port until he has paid the port $1 million; then the lessee remits 75% of the tariff charges until he has paid $2 million to the port. After that the lessee remits only 50% of the tariff charges to the port on all cargo for the remainder of the year.

Another example would be a minimum guaranteed throughput of 750,000 tons with 100% of the tariff charges being paid to the port on the first one million tons, 80% of the tariff charges on the next 500,000 tons, 75% on the next 500,000 and 50% on all cargo over two million tons.

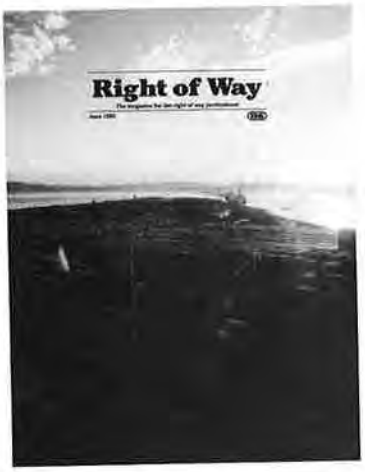
The choice of a trigger mechanism (e.g. dollars of tariff charges paid to the port, throughput tonnage, TEU's[3], ship calls, etc.) is very important. For example, if dollars of tariff charges paid to the port are used as a trigger mechanism, a tariff increase would benefit the lessee, not the port, since a lessee could reach the maximum of a mini-max lease or a sharing step of a shared revenue lease with less cargo.

If used, a dollar trigger mechanism can be made less risky from the port's standpoint if it is incorporated into a lease having a short time period (maximum 2 years) between rental renegotiations.

Although some mini-max and shared revenue leases use both wharfage and dockage[4] tariff charges to fund lease rental payments, the majority use only wharfage. This tends to directly tie the lease compensation to the amount of cargo throughput.

Strategy considerations

Leasing of container terminals and terminal facilities is a form of volume pricing. In fact, long-term leases of container terminals and terminal facilities are agreements involving incentive pricing at less than the published tariffs. For



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the majority of mini-max and shared revenue leases, the port's published tariff is the basis for pricing these leases. Thus, a terminal leasing program has two major components — a pricing strategy and a leasing strategy.

Pricing strategy

The subject of pricing cannot successfully be dealt with as an entity unto itself. Pricing must be viewed as one element in a much broader port management concept[5]. This concept has three elements. The first is the port's planning and development philosophy and the port's goals and objectives. The second is the port's investment criteria and policies. The third is the port's pricing policies and techniques. These three elements are closely interrelated. Significant change in any one of these three elements directly affects the other two elements. This means that a port's overall objectives, be consistent with the port's development and planning philosophy, and be a logical extension of the port's investment criteria and policies.

There are three basic approaches that ports consider in formulating their pricing. The first is a purely economic approach which argues for marginal cost pricing. The second is a financial approach which argues for prices to be set to recover fixed and variable costs and provide an adequate rate of return. The third approach is a public enterprise approach which argues for prices to be set to recognize the need for the port to be a means to foster local development and existing local economic activities[6]. This approach usually requires subsidization by taxpayers or other port customers.

The economic approach would be used by ports that are primarily concerned with being self-supporting (breaking even). The financial approach would be used by ports that want to maximize profit as their main port goal. The public enterprise approach would be used by ports that are primarily concerned with maximizing throughput and can afford to subsidize certain operations and functions in order to capture cargo.

Each of these approaches has its own strengths, but their basic requirements are often in conflict. The resolution of this conflict is the first step toward formulation of a pricing policy that is each port's foundation for rationally pricing facilities or services.

There is no single pricing approach that is accepted and applied uniformly by all U.S. ports. Nor can it be said that there is a "best approach." Ports are different and these differences are reflected in the pricing approach or combination of approaches that they use. There is nothing inherently desirable or undesirable in this diversity and lack of uniformity in pricing. The only thing that is mandatory for a successful port pricing policy is that is be supportive of the port's planning and development philosophy and objectives and the port's investment policies and criteria. As simple as this may sound, it is probably one of the most complex management decision area for any port.

Leasing strategy

Initially, a main reason for a port to have a long lease relationship with a

water carrier was to use it as a firm cash flow base for bond issues to finance terminal facilities. Ports now have additional motivation for leasing programs. For most ports, this additional motivation is to tie up container tonnage with some sort of long-term agreement. At some ports that have invested heavily in container handling equipment, this has created a deliberate and determined effort to secure commitments from as many carriers as possible to use their container facilities for a protracted period of time. Sometimes these relationships are with a water carrier and sometimes they are with a terminal operator, who in turn has commitments from water carriers.

Each lease form has good and bad features in the eyes of carriers and terminal operators. The effects of each lease form on the port's financial statement are different. The incentives and disincentives for the steamship firm and/or terminal operator are different for each lease form. We must look at each of these lease forms separately to determine which one fits the requirements of a specific port. Thus, the choice of a proper lease form is an important management decision requiring careful analysis. Each of the methods of leasing container terminal facilities has its own strengths and weaknesses, which a port must understand in order to create a leasing strategy that will be supportive of the port's goals and objectives.

An analysis of the effects of the main compensation methodologies and various approaches to pricing used in leasing of container terminal facilities brings this matter into sharper focus.

The selection of one of the three terminal leasing methods should be based on some form of study to determine the anticipated level of activity or volume of use by the prospective lessee. The basis for this calculation of anticipated throughput can be the historic throughput records (if the prospective lessee is a present port customer) or it can be a complex computerized study with extensive forecasting and analysis. These studies — or, more specifically, the accuracy of these studies — can be critical to the decision about a leasing method.

Empirical evidence suggests, however, that the accuracy of throughput forecasts has diminished over the years.[7] There are several reasons given for this decline in accuracy but two seem to be most persuasive. The first argues that through freight rates provide for the land as well as ocean transport costs and this rating system often gives the steamship operator almost full control over the routing of shipments. If a steamship firm has a very favorable lease with a specific port (a lease that provides for either economy of scale rewards or other volume incentives), then the steamship firm is tempted to route cargo via this port. Empirical evidence indicates that an increase in cargo volume can be expected when the terminal agreement goes from straight tariff to lease.[8] For example, when steamship lines entered into flat rate or mini-max leases, the anticipated volume figure for the year was often reached in only a few months. This type of increase could only be explained by the steamship firm's diverting cargo from other ports.

Empirical evidence indicates that an increase in cargo volume can be expected when the terminal agreement goes from straight tariff to lease.

The second reason for the diminished accuracy of the traffic forecast is that shared revenue leases allow the port to share in tariff revenues on every thing that goes through a facility and there is no longer a pressing reason for elaborate studies to determine anticipated throughput.

Even so, each of the three container terminal leasing methods does require some form of study to determine anticipated throughput.

What are the potential objectives and effects of the various terminal leasing methods?

Flat rate lease

The flat rate lease provides the port with a steady level of income or cash flow, and provides an incentive to the lessee to generate business through the leased facility, i.e., to maximize its productive use.

The flat rate lease provides both parties with a known cost/reward point. The port is assured of a specific income regardless of the volume of business at the facility and the lessee is assured of a specific expense cost regardless of the volume of business at the facility.

In effect, the flat rate lease usually sets up a form of win/lose relationship for both parties. If the lessee does less business at the facility than the port anticipated when it agreed to the rent/compensation level, then the port wins and the lessee loses because the per unit revenue is higher than anticipated by the port and the per unit cost is higher than the lessee anticipated. Conversely, if the lessee does more business at the facility than the port anticipated, then the lessee wins and the port loses, because the per unit cost is lower than the lessee anticipated and the per unit revenue is lower than the port anticipated.

The flat rate lease situation provides the greatest incentive to the lessee to generate business for the terminal. The obvious reward provided by the economies of scale encourages the lessee to put as much cargo as possible through a terminal on a flat rate lease. This can be extremely appealing to a port that sets pricing according to the public enterprise approach.

The economy of scale potential for the lessee in a flat rate situation is very significant. If the port sets the flat rate based on "x" amount of anticipated throughput and the actual amount of throughput is five times the anticipated amount, then the lessee's per unit cost is one-fifth of the port expectation. Assuming that the flat rate price would have produced a "fair return" to the port on a per unit of throughput based on the port's estimate of throughput, then by exceeding estimated throughput the lessee pays less per unit than "fair return."

A flat rate lease situation normally places a heavy reliance on the accuracy of the anticipated throughput calculation. The rent level is usually set to pro-

Flat rate leases leave little possibility of earning money that can be set aside for terminal replacement or expansion.

vide a fair rate of return on a per unit basis to the port assuming that the actual throughput and the anticipated throughput are the same. If the actual throughput is higher than anticipated, the per unit rate of return to the port is less than a fair level.

The annual rate for flat rate leases can be set with little concern for per unit throughput. The rate may be based strictly on a rate of return on historical or market value of the facility or sometimes on competitive factors that override the normal concern for covering expenses or earning a specific rate of return on the facility.

The potential for the port to subsidize the lessee is very high in a flat rate lease agreement. If a port is anxious to build up throughput and is willing to accept an assured level of income in exchange for the possible side effect of subsidizing the lessee, a flat rate lease is ideal.

As a general statement, flat rate leases, especially if there are insufficient escalation provisions or renegotiation option points, are not usually financially rewarding to the port. Normally, the best that a port can hope for financially from a flat rate lease is that it will break even (not have to subsidize the lessee), but there is little possibility of earning money that can be set aside for terminal replacement or expansion.

Mini-max lease

The mini-max lease is a way to overcome some of the potential risk of heavy subsidization of the lessee and still retain some incentives for the lessee to increase throughput at the leased facility.

The mini-max lease creates a potential win/win situation for both parties. It provides the port with some protection from a decline in cargo throughput, and it provides the lessee with an incentive to put more cargo through the leased facility. The economy of scale potential for the mini-max lessee is less than for a flat rate lessee, and the potential for the port to subsidize the lessee is diminished in comparison with a flat rate lease agreement. Subsidization still occurs in a mini-max lease, but only after the maximum compensation level has been reached.

Although an improvement over a flat rate lease from the port's revenue earning standpoint, the mini-max lease still allows for subsidization at some level. It, like the flat rate lease, usually does not produce sufficient net revenue to set aside for terminal replacement or expansion. The mini-max lease places substantial reliance on the forecast of anticipated throughput since determination of the maximum compensation point is critical to limiting the amount of subsidization risk to be assumed by the port.

Even with a mini-max lease, ports are faced with the need to gain some benefit from tariff increases in order to keep compensation levels adequate between compensation renegotiation times. Depending on how the lease is structured, tariff increases are effective.

With a mini-max lease based on the total tariff charges paid to the port, if a port raises its tariff rates, much of the benefit of the increased rates accrues to the lessee, who can now reach the maximum rent payment level with a lower throughput. In this example, raising tariff rates, rather than bringing in more revenue from a mini-max lessee, actually increases the level of subsidization to the lessee. Conversely, with a mini-max lease based on tonnage or TEU's, if a port raises its tariff rates, the benefit of the increased rates accrues to the port.

Theoretically, the minimum in a mini-max lease should cover the cost of amortizing the port's investment in the terminal facilities plus a "fair" rate of return on the port's investment. Some formulas include the land value in the determination of the port's investment in the terminal facilities and some do not. The determination of the maximum in a mini-max lease does not appear to follow any standard pattern. Some ports use a complex formula involving anticipated throughput, inflation data, and cost indexes; some just set the maximum at a percentage of anticipated throughput; while still other ports appear to set the maximum level at an amount that amortizes the port's investment in land and facilities plus a small rate of return and the minimum at an amount that amortizes the port's investment in the facilities only.

Shared revenue lease

The shared revenue lease sets up a win/win situation for both parties. There is some protection to the port for cargo volumes being lower than anticipated and an incentive to the lessee to generate business for the facility. If the sharing formula provides for sufficient revenue to the port to cover marginal costs at all times, there is almost no risk that the port would subsidize the lessee or that the lessee would pay less than a fair return.

The shared revenue lease was created to provide a financial incentive to thd lessee as well as to give financial advantages to the port. It provides for both a sharing of revenues and risk; it forms a limited partnership of the port and the lessee.

The use of the shared revenue lease is usually rertricted to steamship firms that can guarantee a substantial minimum throughput or to terminal operators who can obtain substantial minimum throughput guarantees from their customers. Thus, the shared revenue lease will not be available to all firms and operators.

While each port must establish its own return on investment (ROI) values, sharing levels and sharing steps, it is possible to outline a general procedure for a shared revenue lease. This procedure involves four steps:

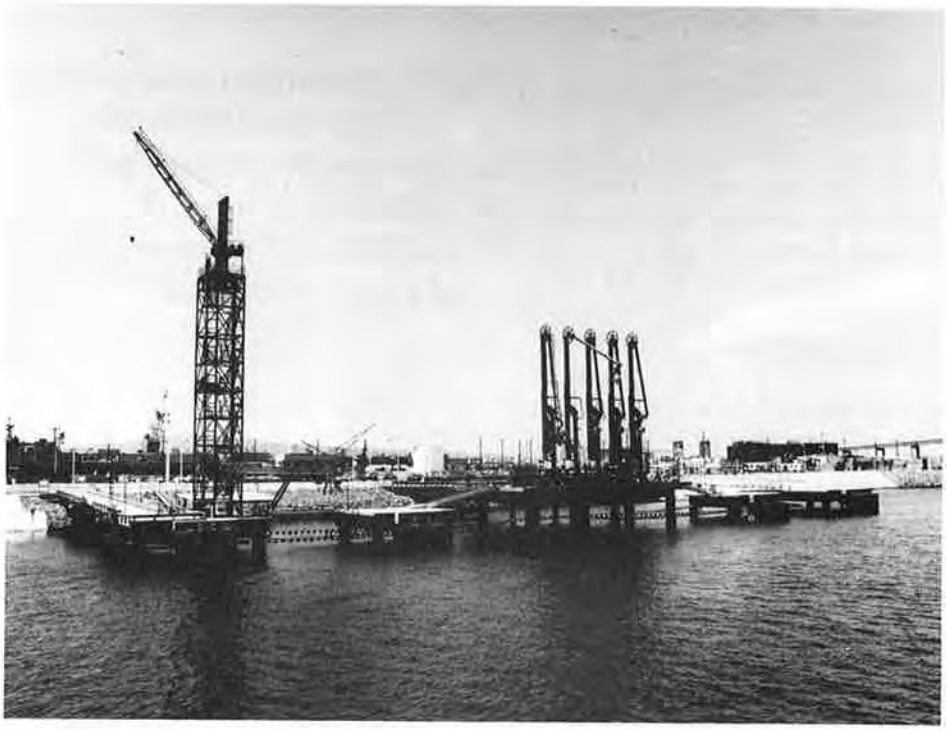
- Step 1 is to calculate the facility's annual rental level. The facility to be leased (including the land) is valued at fair market and a return on investment rate is applied to this value to determine the facility's annual rental level.
- Step 2 is to add various direct and indirect costs (administrative overhead, any maintenance performed

by the port, etc.) in order to determine the "reasonable total annual rental amount." (This "reasonable total annual rental amount" is the same as the minimum level amount in a mini-max lease.)

- Step 3 is to determine the "guaranteed minimum annual rental amount" to be stipulated in the shared revenue lease. This is accomplished by multiplying the "reasonable total annual rental amount" by some percentage. This establishes the risk level the port will accept.
- Step 4 is to determine sharing steps to be used after the lessee has paid the port an amount equal to the "reasonable total annual rental amount."

While there is no uniform approach to structuring a shared revenue lease, it is possible to provide a formulae example of how one could be structured. This formula would start by establishing the value of the facilities to be leased, including the land and all improvements. To this value the port would apply a rate of return of 12%. Administrative overhead and cost of port performed maintenance could be added on to determine the "reasonable total annual rental amount." The port would take 75% of the "reasonable total annual rental amount" and make that the "guaranteed minimum annual rental amount." The lease would stipulate that the lessee remits 100% of wharfage tariff charges to the port until such time as he has paid an amount equal to the "reasonable total annual rental amount." Thereafter, on all additional cargo the lessee would remit to the port 60% of wharfage tariff charges. Thus, in slack times the port would always be assured of receiving at least 75% of the "reasonable total annual rental amount," and in good times the port would benefit by receiving revenues in excess of the "reasonable total annual rental amount" at the same time as the lessee received a reduced throughput at the leased facility.

Although the shared revenue lease is the most complex type of leasing method, it is the only one that provides for both the port and the lessee to share the rewards for high volume throughput and share the risks of low volume throughput. The potential reward sharing is usually the key element in a port's decision to opt for the shared revenue lease agreement.



Leased oil terminals.

Economic risks uncertainties in leasing

In an analysis of the leasing methodologies, areas of economic risks/uncertainties surface. Without recognition of these risk/uncertainty situations and efforts to minimize them, the economic value of any leasing program can turn from positive to negative.

As noted before, heavy reliance on the forecast of anticipated throughput is a major risk in flat rate leases. This is less true of the mini-max situation and less yet of the shared revenue agreement.

As a port moves from flat rate to mini-max to shared revenue leasing, it reduces the risk/uncertainty created by the need to have an accurate forecast of anticipated throughput as a basis for compensation computations. It is important to note that this risk/uncertainty is not totally eliminated even with a shared revenue lease because traffic forecasts are still used to determine the eligibility of a potential lessee to enter into a shared revenue lease and to establish the revenue sharing steps that comprise the compensation formula.

Another form of risk/uncertainty is created by the effects of inflation and rising costs. This can be lessened in two ways. One way to lessen the effects of inflation and rising costs is through tariff increases. However, an increase in the tariff does not always benefit the port, nor does a tariff increase ever accrue 100% to the benefit of the port regardless of what method of leasing is used. The benefit of tariff charges paid as a trigger mechanism, is passed directly to the lessee in the form of an increase in subsidization. For a mini-max or shared revenue lease using volume (tonnage or TEU's) as a trigger mechanism for the compensation computation or sharing step determinant, only a portion of the benefit accrues to the port. The shared revenue lease using a tonnage trigger mechanism should produce the most benefit to the port from a tariff increase.

The second way to lessen the effects of inflation and rising costs is to build into any lease the ability to renegotiate the compensation formula and/or rent at frequent intervals (3 years appears to be standard in newer leases and 5 years seems to be a prudent maximum). In the case of a flat rate lease, the renegotiation or compensation is the best way to ensure a fair rate of return and the only way that the port retains control over the amount of subsidization being afforded the lessee. This is also true of the mini-max lease that uses total tariff charges paid as a trigger mechanism for the minimum and maximum compensa-

tion computations.

Although still a necessary lease provision, the option for renegotiation of the compensation formula is less important for mini-max leases with volume trigger mechanisms and even less important for a shared revenue lease with volume trigger mechanisms because the compensation levels for these leases can be increased without a renegotiation of the compensation formula; the port need only raise the level of tariff rates. However, it must be remembered that raising the level of tariff rates will affect all of the port's customers subject to tariff charges, not just those with leased facilities.

In some instances, ports have attempted to use a stipulated ROI (return on investment) in order to ensure that the port will be guaranteed "fair" return on its investment over the life of the lease. Use of a stipulated ROI over and above a minimum annual rental payment of other overhead compensation is most effective if the factors in the ROI computation formula (value of the facility and rate of return) are renegotiated at intervals during the life of the lease. At least the value of the facility should be renegotiated from time to time in order that is reflect market value as it changes instead of locking in book value or some other valuation amount for the life of the lease.

The use of a pegged index such as the Consumer Price Index (CPI) in a terminal lease has limited validity. Using the CPI may be useful in a flat rate lease, but only as a trade-off for extending the renegotiation of rent formula beyond a prudent length (e.g. 3 years). The same rationale is applicable to the use of stipulated periodic escalations. Both these devices tend to obscure the lease rental payment's true reflection of the value of the facility and the actual costs incurred and revenues received by the port and the lessee. Any rental formula that uses a factor not directly involved with costs and revenues of a specific terminal can create incentives and disincentives for the parties to the lease that are beyond their individual control.

Renegotiation dilemmas

Ports that lease terminals face a major problem of analysis and timing in the renegotiation of the level of compensation for a lease. When a lease is signed, the compensation level is normally fixed for some period of time (normally 3 to 5 years) after which it is renegotiated. This renegotiation point can be midway into the leasing period (the fifth anniversary of a 10-year lease) or it can occur at the lease option point (the point when the original lease term expires but when the lessee has the option to extend the lease for some additional time period).

Renegotiation and option points often determine whether the lessee will be subsidized, and, if subsidized, the extent of the subsidization.

Normally, the port reserves the right to renegotiate the level of compensation (by raising the rent or adjusting the minimum and maximum levels or the step points in a shared revenue lease) at intervals throughout the original period of the lease or when options are exercised and the lease is extended.

Assuming that the lease does not contain some limiting language (e.g. the compensation cannot be increased more than a factor of 1.5 at any renegotiation/option point or the compensation for the original term of the lease and any extensions shall be no more than the percentage difference in the CPI from the original signing date to the renegotiated option date), the renegotiation of the level of compensation is a process by which the port attempts to bring the new compensation level into line with current costs, inflation trends, and desired return on investment requirements.

The seriousness of the problem of renegotiating the level of compensation can normally be measured by the magnitude of increase that is proposed. If the proposed increase in the level of compensation is minimal, the renegotiation may go almost routinely; if it is large, there may be a risk of terminating the lessee/lessor relationship. By having renegotiation points built into the lease to allow adjustments at frequent intervals, the potential for having a large increase proposed at any renegotiation or option time can be somewhat controlled.

Some of the risk of this renegotiation of the compensation level turning into a major confrontation that could threaten the existence of the entire lessee/lessor relationship can also be removed by using an arbitration clause. This clause stipulates that if the parties cannot reach agreement on a new compensation/rent level, the parties must enter into binding arbitration.

From the port's standpoint, these renegotiation and option points often determine whether the lessee will be subsidized and, if subsidized, the extent of that subsidization. In a larger sense, these renegotiation points also establish precedents for renegotiation the compensation levels for the other port leases.

The most serious threat to the port is this point is that the new level of compensation will be so high that is will cause the lessee to look for terminal agreements at other ports. This is the point at which a port is extremely vulnerable to a raid by another port. Of course, the risk of such a raid or the potential for a termination of the lessee/lessor relationship is much higher when the entire lease is being renegotiated than when only the level of compensation is being renegotiated. From the lessee's standpoint, these renegotiation points determine the competitive balance between the lessee and his competitors. Often this requires consideration of potential competitors in other ports as well as competitors in the port with whom he is negotiating.

There is another dimension to this particular dilemma. There is often a strong pressure for lessees at the same port to seek "equitable treatment." A lessee may be willing to accept a new compensation rent level if he recognizes that the other lessees at the same port will be subject to similar increases as their renegotiation points come up or when their leases expire. This strategy puts pressure on the port to somehow reassure the first lessee subject to new levels of

compensation that he will not lose his competitive position forever. The method by which a port solves this dilemma may be more important than how it determines new compensation levels.

Terminal operator leases

A port can lease a terminal or part of a terminal to a stevedore firm or terminal operator for use as a public terminal. Such a leasing arrangement is often referred to as a management or operating agreement. It is usually written for a short or intermediate term (5 to 10 years) and contains frequent optional extension points. For example, a 10-year agreement might contain nine annual option renegotiation points. The agreement would stipulate that the terminal operator have a specified tonnage throughput in each year of the agreement or the agreement could be terminated by the port. This allows the port to ensure that the terminal operator aggressively markets the facility or the lease agreement is terminated and a new operator is brought in. The method of compensation computation for these lease agreements normally is directly related to throughput (e.g., the port shares tariff revenue with the operator just as in a regular shared revenue or mini-max lease).

When a terminal operator has an operating agreement with the port to operate a public terminal, the port may use the terminal. These separate use agreements set up mini-max or shared revenue relationships between the port and the carriers. These separate use agreements can be used as leverage for efficient use of terminal space. Provisions for a lowering of wharfage charges after a carrier has a specified annual throughput per acre of terminal space assigned can encourage carriers to request less assigned space in a terminal and to use the assigned space in the most efficient manner. Such provisions provide a definite economic cost to carriers who request large blocks of quantifiable economic reward for those who request only the space that is actually required for efficient operations.

Secondary user clause

One common provision, the secondary user provision, is found in virtually every terminal lease. It is a reservation by the port to make a secondary use or assignment of the facility or portion of the facility, as long as it does not interfere with the operations of the lessee. This retention of control over the property is often required because of state statutes or the authority's bylaws or policies that prevent the port from relinquishing complete control of its facilities to others.

Containers being unloaded from a ship.

The secondary clause can be a very powerful marketing tool. In fact, it can actually alter the port's ability to increase earnings, the lessee's incentive to increase throughput, and the efficiency with which leased facilities are utilized.

From a practical viewpoint, it seems only prudent to put a secondary user or assignment clause in any lease in order to encourage a lessee to use land and/or facilities in an efficient manner. By reserving secondary use/assignment, a port ensures that its land and facilities can be used efficiently, because it allows the port to bring in additional business (ships) when the leased facilities are not being fully used by the lessee.

The disposition of the revenues generated by the secondary user clause is being used as a marketing tool. If all of the revenue from a secondary use goes to the port, there is no incentive to the lessee to attempt to find other shipping lines to use the facility. This forces the entire burden of actively soliciting secondary users on the port's own marketing staff. If a portion of the secondary user revenues is shared with the lessee (either through crediting them to the lease compensation or by allowing the lessee to remit less than was due under the tariff), then the lessee will also be actively soliciting secondary users.

By using the secondary user clause as a marketing took, a port can effectively create additional incentives for the lessee to seek throughput, increase revenues and ensure more efficient use of leased facilities.

Comments and conclusions

In the diverse and ever-changing competitive environment of the United States port system, there is no "best" method of terminal leasing nor is there a "best" approach to pricing. These two conclusions are the most important to come of the year-long research effort for this paper.

Reading some two hundred terminal leases, interviewing port officials and

The Queen Mary-Spruce Goose complex — a leased facility from the Port of Long Beach.

terminal operators from all over the United States, and analyzing a multitude of terminal leasing situations made it clear that each leasing method and each pricing approach has its own strengths and weaknesses, its own incentives and disincentives. However, three useful generalizations can be made:

1. If a port's goals and objectives are to maximize throughput and provide benefits to the local economy through increased employment in the maritime industries and the port is willing to substantially subsidize terminal lessees, then the flat rate lease is the most effective vehicle to accomplish these goals and objectives.
2. If a port's goals and objectives are maximization of throughput and employment with minimal potential for subsidization of terminal lessees, then the mini-max lease is the most effective leasing method.
3. If a port's goals and objectives are maximization of profits, employment, and throughput with negligible potential to subsidize terminal lessees, then the revenue sharing lease is the most effective leasing method.

The key to success in any leasing program is to ensure that the port's leasing and pricing strategies are supportive of its goals and objectives. A clearly defined destination is all important!

Notes

1. Discussion with port executives at Los Angeles, Long Beach, and Oakland.

2. Dowd, Thomas J. "Container Terminal Leasing — An Overview." Unpublished paper, March 1982.

3. TEU = the abbreviation for Twenty Foot Equivalent Unit, the common unit used in indicating the capacity of a contain ship or terminal.

4. Wharfage = the charge assessed against the cargo passing or conveyed over, onto, or under any wharf.
Dockage = the charge levied against the vessel for berthing space.

5. Glickman, David L. (Consultant to The Port Authority of New York and New Jersey), "Port Planning and Port Pricing," a speech to the American Association of Port Authorities' Port Pricing Conference, January 1982.

6. Discussions with Professor David Olson, University of Washington, Political Science Department.

7. Perry, Ernest L. (Executive Director, Port of Los Angeles), "Pricing Uniformity — Fact and Fiction," a speech to the American Association of Port Authorities' Port Pricing Conference, January 1982.

8. Ibid.

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Media (cont. from pg. 27)

accessible wetlands area and wondered whether there would be lands available in the Company's ownership that would be suitable for this purpose.

Because of the close cooperation with the Public Relations Department that had developed from answering hundreds of questions, the Land Management Department quickly became aware of the wildlife preservation group's request. Studies have been developed over the past year. Other departments have been consulted. A package is being prepared for presentation to the group. If they find it suitable for their purposes and accept the Company's offer, a press release will be issued. This release will outline the goals of our joint efforts and will generate a favorable public reaction. Thus, the efforts of many are rewarded in full view of the public.

Looking toward the future, advocates of media use can point to possible sponsorship of TV shows with an outdoor news magazine format. Instead of waiting for the public to find out about projects and the avalanche of questions from curious citizens, why not make plans to anticipate the inquiries and cover the situation by using the media constructively? This is already happening more frequently, due to increasing a Land Department's awareness of media potential.

We have found the media to be a valuable asset. The resultant news is good for our company and the departmental cooperation is good for our customers and ratepayers.

Don't forget!
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