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American Association of Port Authorities
AAPA
Alliance of the Ports of Canada, the Caribbean, Latin America and the United States

Presentation to: AAPA Spring Conference

"Global Finance – Sources for Port Development"

March 19, 2013

Ira Smelkinson

Morgan Stanley

ira.smelkinson@morganstanley.com

Presentation Overview

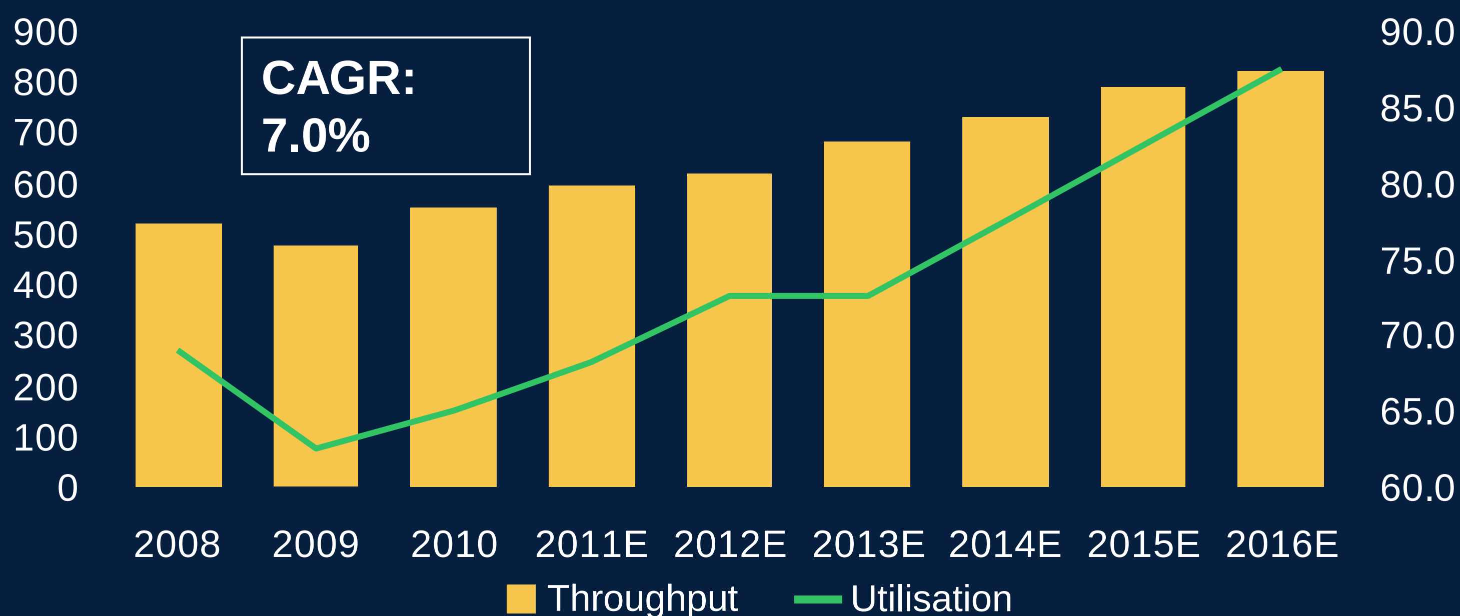
- Tools Available to Finance Port Expansion
  - Private funding sources
  - Public funding sources
- Current Conditions
- Future Threats

Solid Growth Forecasted for Port Investments

- Strong medium to long term growth prospects, increased economic activity, global trade liberalization, and outsourcing are bullish for the port sector
- Increased market share of containers

Global Throughput Forecast

TEU (MM)



Source: Drewry Annual Review of Global Container Terminal Operators, August 1, 2011

Outlook for Future Development

- **Strong medium to long-term growth prospects, economic activity, global trade liberalization, reduced import tariffs and outsourcing are bullish for the port sector**
  - **Containers set to continue trend of increasing their market share of world cargo**

Resilient Traffic Volumes

- Drewry expects global container throughput growth or 7%+ per annum over the next six years:
  - Between 1990 and 2010, container port throughput grew at an annualized rate of 9.2%, significantly higher than the 1.8% and 3.1% rates recorded by seaborne liquid products and dry bulk commodities, respectively
- Drewry estimates that global operators handled 69% of throughput in North America in 2010 up slightly from 2009
  - The region recovered well from the effects of the economic crisis, with a throughput of 45.4 million TEU, almost 14% higher than in 2009
- Drewry's North American regional throughput index for March 2012 was up 6.5% y-o-y
  - Among the regions, North America witnessed average increases in container volumes, trailing Oceania (10.5%), China (8.5%), Indian Sub Continent (7.7%), and Far East (6.8%), but ahead of Africa (2.3%), Latin America (2.0%), and Europe (0.7%)

Favorable Supply Demand Outlook

- With a recovery in global trade and the suspension of port construction activity since the onset of the economic downturn, analysts expect a favorable demand-supply backdrop to emerge for port operations

Outlook for Future Development

Increase in Sizes of Ships Globally

- Average ship size has increased on all trade routes. The increase in average ship size is forecast to continue, as over 61% of the current containership order book (in terms of TEU) is made up of ships in excess of 8,000 TEU
- Growth in transshipment volumes, with smaller ships moving containers from hub ports.
- Increased demand on port facilities, as the required operating drafts of the fleet have risen from ~10 meters in the 1970s to more than 15 meters today
  - The ability to handle larger ships translates into a greater competitive advantage, and this is a significant factor in attracting shipping lines to any particular port

Increasing Traffic From Bulk Commodities

- With a recovery in global trade and the suspension of port construction activity since the onset of the economic downturn, analysts expect a favorable demand-supply backdrop to emerge for port operations

Financing Port Development

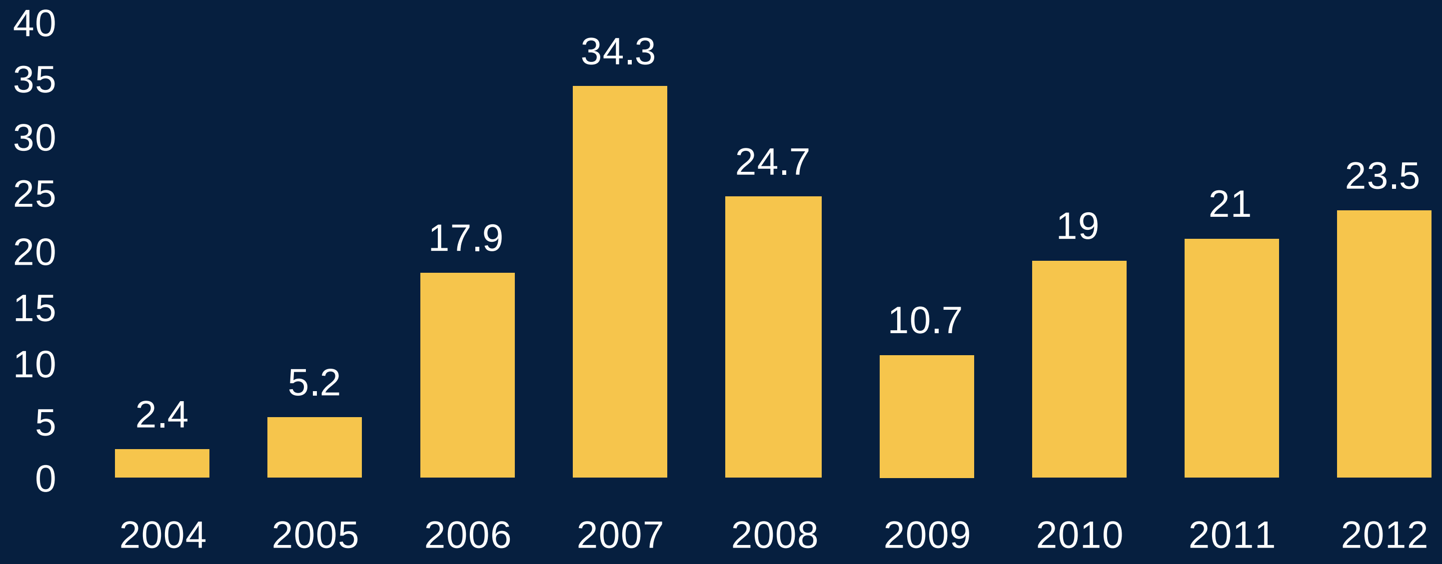
- Port development in the U.S. has been dominated by issuance of tax-exempt bonds
- Private development / P3 transactions continue to play a role

Increasing Infrastructure Funding

- Infrastructure fundraising has continued to trend upwards since the financial crisis
- In addition to equity funding raised, there are a growing number of funds focused on mezzanine and debt financing

Global Infrastructure Fundraising (1)

Since 2004
$Bn



Source: Probitas Partners, January 2013

(1) Excludes strategics such as Cintra, Abertis and Transurban, and pension funds such as OTPP, CPP and Borealis

Who Invests in Infrastructure?

- **We currently see four major types of players in the Infrastructure sector**
  - **Operating Companies**
    - **“Separated”**
    - **“Integrated”**
  - **Infrastructure Funds**
  - **Direct Invest Pension Funds**
  - **Others**

Operating Companies

- Usually linked to Construction groups

  Two “models” exist:
  - “Separated” companies: independent players generally with a Construction firm as main shareholder
  - “Integrated” companies: groups with a major Construction component which also have an Infrastructure division
- Mostly focused on greenfield / brownfield projects
- Major focus generally has been on toll-roads

Infrastructure Funds

- Independent, bank-sponsored or traditional private equity firms
- Potential to put resources to work, teams with increasing number of people
  - Variety of skills, mostly financial-related
- Generally more IRR-driven than dividend yield-driven
  - Target IRRs on existing assets: 12%-15%
- Different sectors of focus, equity ticket sizes, stake targets and corporate governance requirements

Direct Invest Pension Funds

- Pension funds with dedicated group of infrastructure investors within broader investment team
  - Long hold periods (can be 20+ years)
  - Minimal early year yield requirements and low IRR target (10%-15%)
  - Looking for long-dated assets to match long-dated liabilities
- U.S. pension funds beginning to grow more active

Others

- Sovereign wealth funds are increasingly participating in infrastructure
  - Will take minority stake either pre- or post-bid; not a lead investor
  - Potential concerns over CIFIUS
- Other institutional investors and private equity / hedge funds also expressing interest in minority stakes, such as via mezzanine piece

What Are The Characteristics of Infrastructure?

- **Infrastructure assets are characterized by:**
  - **Limited competition, usually operating in quasi monopolistic location and with high barriers to entry**
  - **Operating in a transparent and clear regulatory environment, which allows for predictable revenue**
  - **Long-term organic growth arising from factors such as GDP growth**
  - **Usually proven stable demand/volume even under shock scenarios**

Essential Infrastructure	✓ Limited competition ✓ High barriers to entry / local monopolistic characteristics ✓ Provider of critical/needed service
Useful Life	✓ Long useful life ✓ Able to support long tenor leverage ✓ Increasing returns to shareholders to offset long dated liabilities
Stable Earnings	✓ History and/or expectation of steady continued use ✓ Low correlation with economic conditions ✓ CPI linked price increases in some cases
Cash Generative	✓ Highly cash generative ✓ Favorable interest coverage position ✓ Strong margins
Cash Generative	✓ Favorable regulation, especially in businesses with significant capex requirement ✓ Transparency and consistency in tariff regime

Port Facilities / Assets Meet These Criteria

Private Participation

- Interest in Having the Private Sector Participate in the Project or Terminal
  - Port may not want to take the risk with their existing revenues
  - May not have the existing revenue, nor the credit
  - The revenues may be too uncertain, and therefore the risk may be too great to get additional credit
- Private Sector Resources
  - The private sector has resources & access to credit
  - The revenue case must be compelling and should cover debt service plus a decent return on their equity

Private Sector Participation Diversifies Risk/ Insulates Financial Resources Away From Port

Overview of Infrastructure Investors

Infrastructure Funds / Pension Funds

- Long-term investment horizon
- Lower early year yield requirements and IRR target (12%-15%)
- Optimal capital structure would be the key
- Pension funds have no additional management fees and very long-dated investment horizon
- Exit and control rights would be key discussion points

~ $50 Bn in available equity capital

Sovereign Wealth Funds

- Access to large pools of capital
- Interest in high quality assets
- Preference for minority investments / passive investors
- Security concerns / political undercurrents especially with Middle-Eastern and Chinese funds
- Deal structure may be an issue
- FIRPTA or other tax issues

~ $2 Trillion in available capital

Private Equity Funds / Hedge Funds

- Limited activity in PE2PE minority stake sale market
- Growing interest in involving themselves in a mezzanine type role, though limited opportunities in this regard
- Ability to meet valuation expectation?

Lack of large sized, high quality assets leading to “pent-up” demand

Private Capital Case Study—Maryland Port Authority

- Maryland Port Authority concession for SeaGirt Terminal
- Concession and project financing completed
- Ports America to operate for term on concession

Financing Highlights:

- Combination of private equity capital and tax-exempt project debt provided financing
- Borrowing cost of sub 6% with investment grade rating

Private Capital Case Study—Virginia Port Authority

- Commonwealth of Virginia process to evaluate proposals for long-term concession of Port of Virginia
- Currently two proposals pending
- VPA Board scheduled to meet March 26
- If applicable, final submissions scheduled for Spring 2013

Active Submissions:

- APM Terminals
- Maher Terminals LLC/JP Morgan IIF Acquisitions LLC

Tax-Exempt Financing for Ports

While tax-exempt financing has been the workhorse funding source for port development, its use is coming into credit/public focus

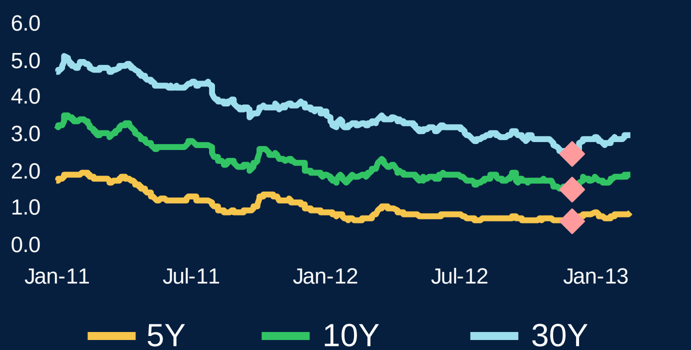
- Tax exempt bonds provide ports with long dated, low cost funding source
- Use of revenue, tax supported, or private transactions can be structured in the tax-exempt market
- Investor demand for varying types of credit quality

"A Stealth Tax Subsidy for Businesses Faces New Scrutiny" – The New York Times, March 4, 2013

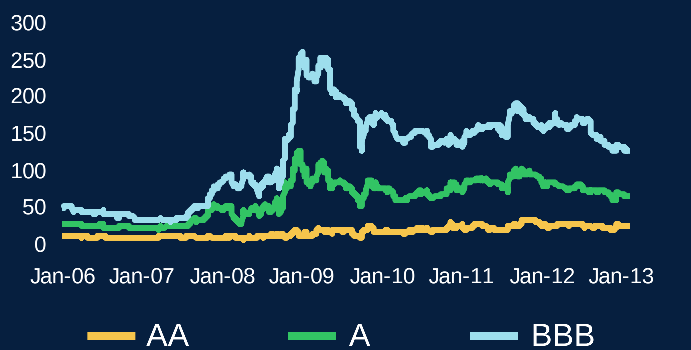
Tax Exempt Market Conditions—Appealing for Issuers

- **Conditions in municipal bond market are favorable for Ports**

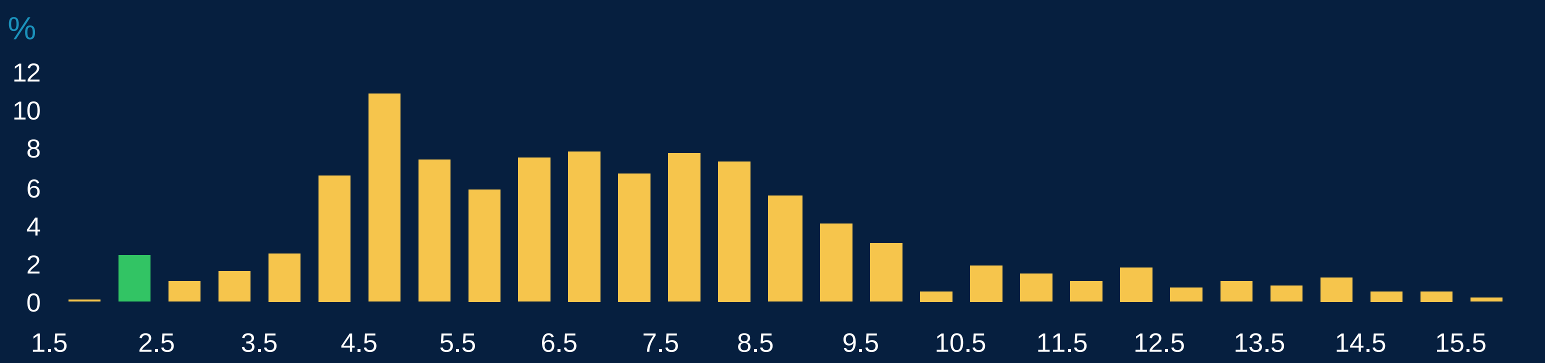
Rates Are Low



Credit Spreads Are Narrowing



Treasury Rates Are Low

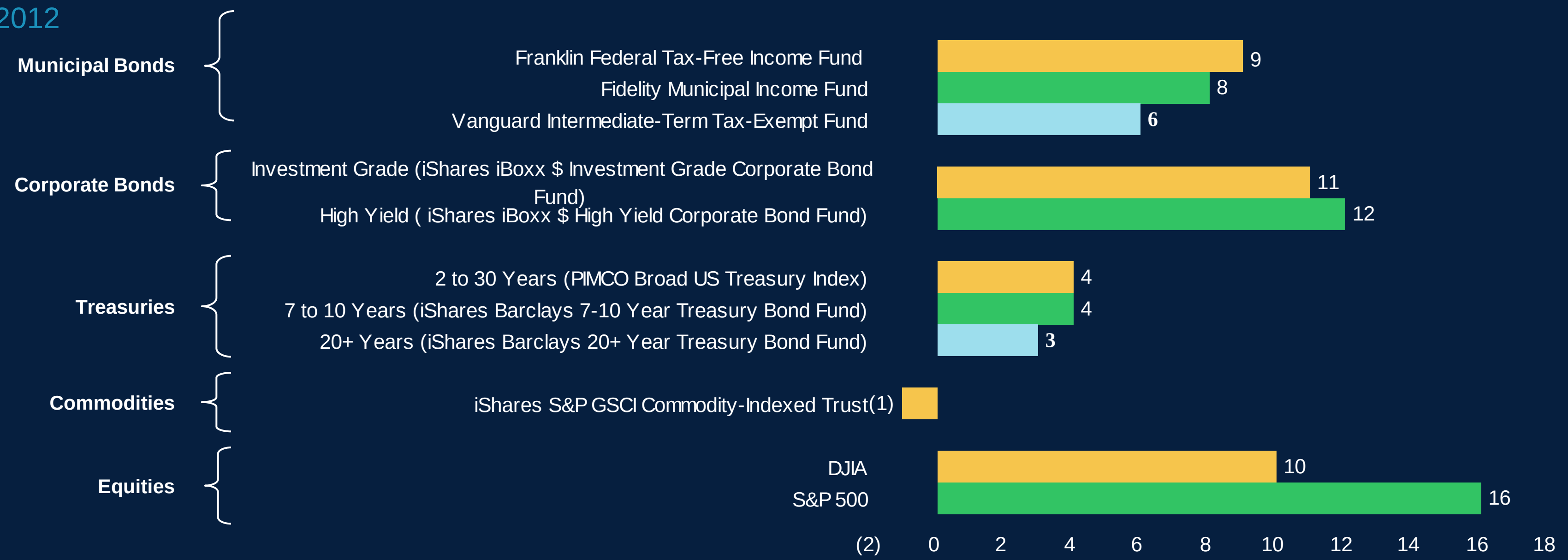


Tax Exempt Market Conditions—Appealing for Issuers

- Municipal bonds were among the best performing investments in 2012
  - Benefited from rally to historically low rates
  - Moderate issuance volume
- Investors that may not have traditionally participated in the municipal market began to take notice in 2012
  - Especially when ratios move wider vs. Treasuries
  - Cross-over buyers can broaden the audience for the State's credit

Total Return Comparison

2012



Source: Bloomberg; Morgan Stanley

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Funds Continue to Invest in the Muni Market

- During 2012, over $50 billion entered municipal bond funds
- Trend continues in early 2013

Fixed-Rate Long-Term Municipal Issuance

Source: Thomson Reuters SDC

Municipal Bond Fund Flows

Source: Investment Company Institute

2013 Risks to Credit – "What Ifs?"

- **While Morgan Stanley is broadly constructive on credit in 2013, there remain several potential risk factors that could negatively impact the market**

European Concerns Re-Emerge	• Focus shifts from ECB-generated liquidity (via the LTRO) back to fundamentals, putting pressure on sovereigns and banks in Europe
U.S. Fiscal Drag	• Political gridlock resulting in the U.S. not meaningfully resolving its fiscal issues could lead to recession in the U.S. and balance sheet deterioration
Regulatory Overlay	• Implementation of Dodd-Frank, in particular the Volcker Rule, depresses activity in secondary corporate bond markets • Basel 3 capital rules increase funding costs for broker-dealers
Reduced Liquidity	• In 2012, inflows into fixed income were largely offset by $1Tn of new issue supply – if new issue supply reduces in 2013 and dealer inventories remain at record lows, investors may shift funds to more liquid equities
Rapid Rise in Interest Rates	• Pressure on returns as a result of recent new issues being underwater from a dollar price perspective • Losses in cash and fixed income instruments
Unwind of "Flight-to-Quality" Bid in U.S.	• Shift out of high quality fixed income corporates, back into equities
Middle East Tensions	• Geopolitical environment in Syria, Israel or Iran escalates resulting in increased military activity
China Economic Slowdown	• Pressure on Asia / Australia spreads

Key Dates: Sequestration, Budget and Debt Ceiling

- **The Obama Administration has proposed a 28% cap on the exemption of municipal interest**
- **It is unlikely that this proposal will be enacted outside the context of overall tax reform or a larger deficit deal**

Sequestration – March 1, 2013

- $1.2 trillion of automatic spending reductions spread out annually over 10 years started March 2013
- Sequestration forces automatic spending cuts on non-exempt discretionary and mandatory programs, split evenly each year between defense and non-defense spending
- $85.4 billion of spending cuts are currently going into effect and will spread out over the remaining seven months in FY2013

Continuing Resolution – March 27, 2013

- The Continuing Appropriations Resolution of 2013 provides for federal operations through March 26
- Federal government will be halfway through current fiscal year when the current CR expires and Congress must enact another CR, or shutdown non-essential government functions as well as furlough employees
- Good possibility of an extension of the current CR or a new CR that is part of the sequestration negotiations

Congressional Budget Process – April 15, 2013

- Congress set up a process to encourage its members to pass a concurrent budget resolution for FY2014
- Failure to pass a budget resolution by April 15 will result in an escrow of congressional members' compensation until a resolution is passed or the last day of the 113th Congress
- A single reconciled resolution need not be produced, and therefore we expect to see continuing resolutions in the current and next fiscal years

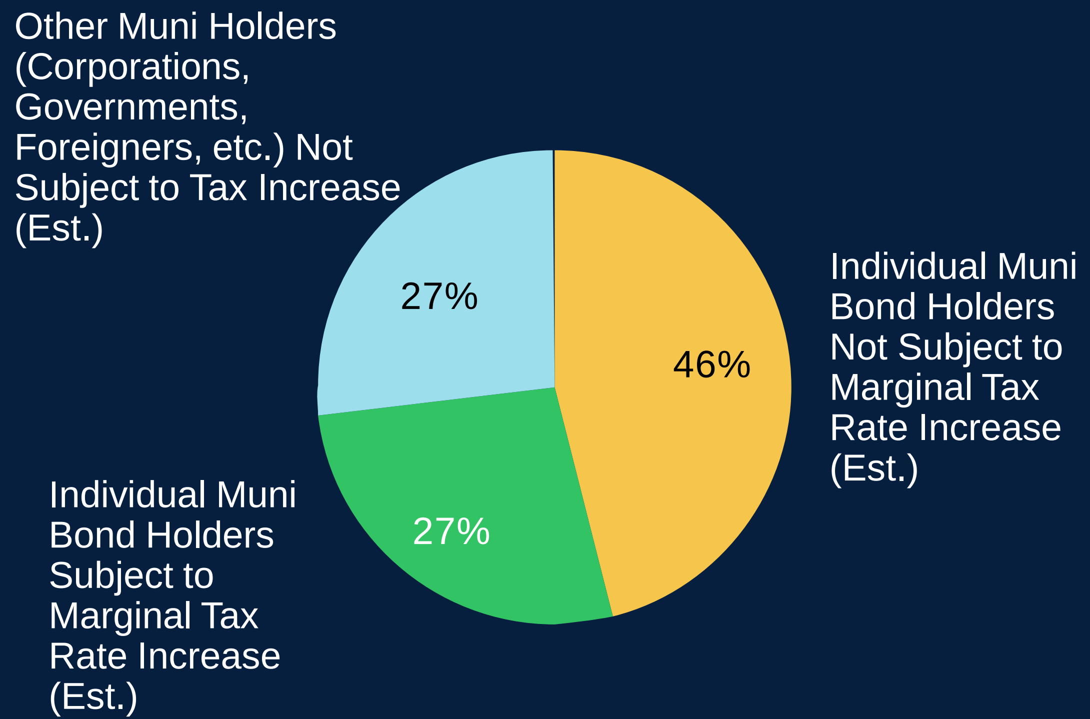
Debt Ceiling – May 19, 2013

- U.S. Treasury can continue to issue debt since the public debt limit suspended through May 18
- Indications are that Treasury will again resort to extraordinary measures to delay a default on government obligations
- Likely that the debt ceiling will be addressed before Congress goes on recess in August
- Without a global agreement, expect series of short-term suspensions to continue

Status of Municipal Tax Exemption and Sequestration

- **Investors have yet to focus on potential changes to municipal interest exemption**

Current Muni Bondholders: A Tax Value Increase for a Quarter of the Market



Source: Morgan Stanley Research, IRS data as of 2009, Federal Reserve Z Report

(1) Individual muni bond holders subject to a tax increase may be understated as the estimate is based on adjusted gross incomes above $500K

Muni Tax Treatment at Risk – How a 28% Cap Bridges the Political Gap

Spending-Cuts-Only Solution: Would Require Untenable Curtailment of Major Government Programs

Revenues	$bb	% total
Total	2,571	100.00%
TOTAL	**2,571**	**100.00%**

Expenditure Item	$bb	% total
Social Security	769	20.56%
Health Care Programs	854	22.80%
Income Security	367	9.80%
Federal Civilian and Military Retirement	144	3.83%
Veterans	70	1.86%
Other Programs	97	2.60%
Discretionary (Defense)	635	16.98%
Discretionary (Non-Defense)	583	15.58%
Federal Interest Outlays	224	5.98%
TOTAL	**3,743**	**100.00%**

Deficit	-1,171	31.30%*

Source: Morgan Stanley Research, Congressional Budget Office: Updated Budget Projections: Fiscal Years 2012 to 2022, March 2012

(1) Data for 2012

*31% is the percentage of the deficit as a percentage of total expenditures

The Threat to Tax Value – Why?

A Cap on Muni Tax Exemption Is Likely to Garner Serious Consideration

Deduction	Projected value (2013-17) (MM)	% of $2 Trillion Deficit Reduction Goal
Exclusion of employer contributions for medical ins.prem.and medical care	1,012,320	51%
Deductibility of mortgage interest on owner-occupied homes	606,420	30%
Net Exclusion of Contributions to 401(k) plans	428,760	21%
Accelerated depreciation of machinery and equipment (normal tax method)	374,640	19%
Exclusion of net imputed rental income	337,380	17%
Exclusion of capital gains (except agriculture, timber, iron ore, and coal)	321,470	16%
Exclusion of interest on state and local bonds	306,170	15%
Net exclusion of pension contributions and earnings for employer plans	298,040	15%
Deductibility of state and local taxes other than on owner occupied homes	295,050	15%
Deductibility of charitable contributions, other than education and health	238,720	12%
Deferral of income from controlled foreign corporations	216,020	11%
Step up basis of capital gains at death	182,210	9%
Capital gains exclusion on home sales	171,110	9%
Social Security benefits for retired workers	149,280	7%
Exclusion of interest on life insurance savings	140,630	7%

Source: Morgan Stanley Research and Office of Management and Budget estimates of February 2012

(1) Interest on municipal bonds includes state and local bonds and other tax-exempt bonds

The Threat to Tax Value – Why?

Both parties appear to agree on tax reform as a tactic as they debate $2 trillion in potential fresh deficit reduction [(1)]:

- **Democrats** propose $1 trillion in spending cuts and $1 trillion in new tax revenue, achieved through reducing exemptions and deductions in the tax code (similar to the 28% cap)
- **Republicans** propose $2 trillion in spending cuts. They support reducing deductions and exemptions, but only doing so in a revenue-neutral way (i.e., using new revenue to lower tax rates)

For munis, this means two key market catalysts may be misestimated:

1. The proposal to cap muni interest is likely to be included in any proposal that raises revenue through tax reform
2. The demand boost from tax hikes on those making more than $450k (joint) may not price into the market if Republicans start debating rolling back tax rates

Thus, we maintain a 25% probability of a cap on muni interest in our forecast

- **50% probability** of Congress taking up tax reform instead of "kicking the can" on sequestration
- **50% probability** that munis would remain in a tax capping proposal after legislative deliberation

This probability should rise quickly if the prospects of tax reform as a solution to the debt burden/budget

(1) According to The Hill, "Dems look for up to $1T in new revenues," 1/7/2013

Muni Tax Treatment at Risk – How a 28% Cap Bridges the Political Gap

Tax-Only Solution: Substantial & Politically Unfeasible Tax Rate Increases Required

(Getting the Budget Deficit to 3% of GDP in 10 Years)

Marginal Income Tax Rates			
Current Rates	Raise All Rates	Raise Top Three Rates	Raise Top Two Rates
10.0	13.7	10.0	10.0
15.0	20.6	15.0	15.0
25.0	34.3	25.0	25.0
28.0	38.4	52.6	28.0
33.0	45.2	61.9	72.4
35.0	48.0	65.7	76.8
Rates on Capital Gains and Qualified Dividends			
Tax Bracket	Raise All Rates	Raise Top Three Rates	Raise Top Two Rates
10.0	0.0	0.0	0.0
15.0+	20.6	28.2	32.9

Source: The Urban Institute

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(1) Calculations based on achieving a budget deficit-to-GDP ratio of 3% in 2019 assuming a baseline budget path (adjusted for AMT patch) and relying on personal tax rate hikes alone

Muni Tax Treatment at Risk – How a 28% Cap Bridges the Political Gap

How a Cap on Muni Exemption Would Work

		Muni Interest		Tax Rate		Tax
Tax Owed	=	$100,000	x	39.60%	=	$39,600
Tax Exemption	=	$100,000	x	28.00%	=	$28,000
Tax Liability	=					$11,600
Effective Tax Rate	**=**	**$11,600**	**/**	**$100,000**	**=**	**11.60%**

Source: Morgan Stanley Research

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(1) Assumes a tax rate of 39.6% based on the new top tax rate. Assumes a 28% cap on muni tax exemption as proposed by President Obama

The Threat to Tax Value – Options for Pricing in Potential Reforms

Impact on Yields

Current Muni Rate	2.00%
Top Tax Rate	39.6%
Cap	28.0%
Net Tax	11.6%
Adjusted Muni Rate	2.26%
Change (bps)	26.24

Source: Morgan Stanley Research

Morgan Stanley

(1) Assumes a tax rate of 39.6% based on the new top tax rate. Assumes a 28% cap on muni tax exemption as proposed by President Obama

Conclusion

- Capital will continue to be available for port issuers
- Underlying credit and business factors will provide opportunities for private capital and for traditional public tax exempt capital sources
- Borrowing conditions are currently favorable but changes may be afoot
- Legislative focus on changes to municipal exemption could raise a port’s financing cost
- Need to focus on how this incremental cost may lead to deferred/scrapped projects and fewer costs