

THE ART OF THE POSSIBLE

**NAVY NATIONAL EUL FORUM
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NAVY NATIONAL EUL FORUM

OPPORTUNITIES IN THE FREIGHT SPACE

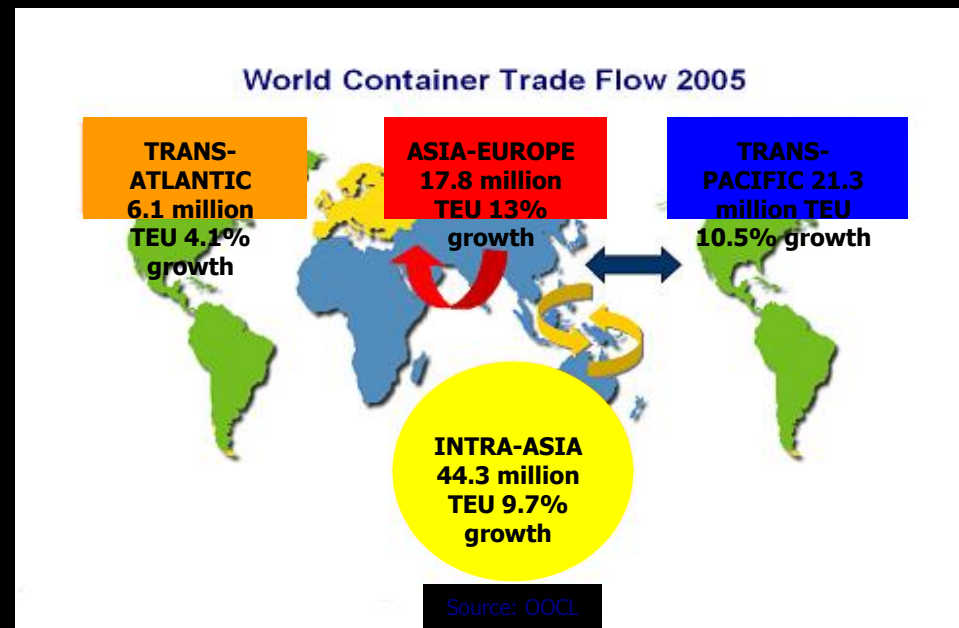


TRENDS IN THE FREIGHT MARKET

Global **marketplace integration** is driving the distribution of economic activity, as well as the expansion of world trade.

The emergence of new economic powers such as **China and India** is forcing all trading nations to adjust, or be left behind.

In an increasingly connected world, the key for both the private and public sectors will be an integrated approach to *physical and policy infrastructure*.

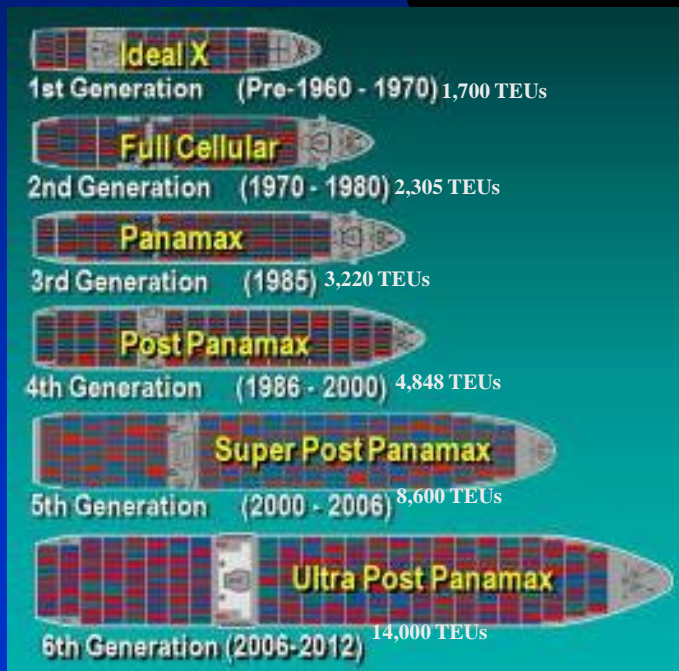


TRENDS IN THE FREIGHT MARKET

NEW AND LARGER VESSELS WILL ALTER PORT OF ENTRY AND INTERMODAL PATTERNS



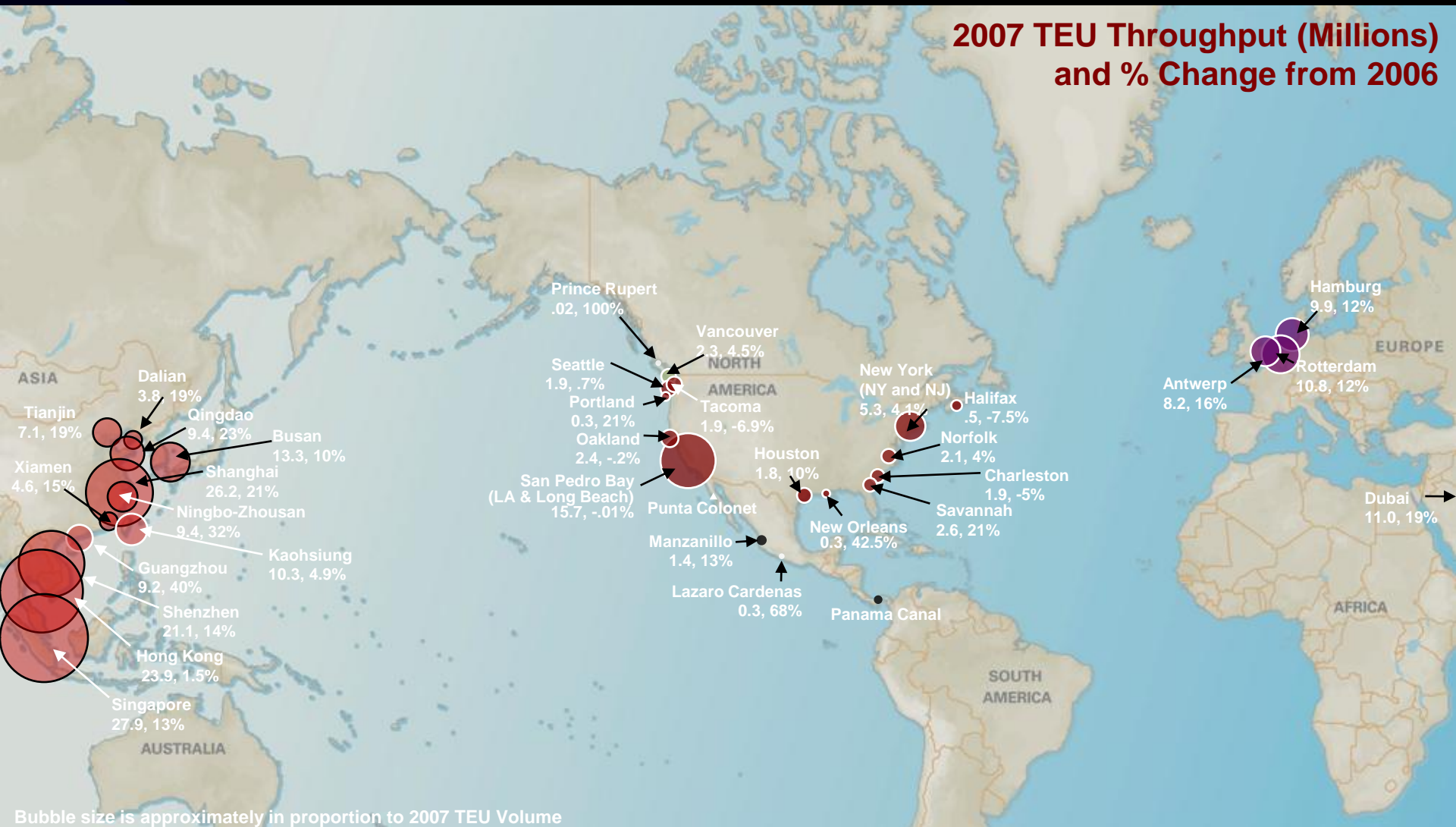
- ▶ One Ultra Post Panamax Class vessels can carry 14,000 TEUs
- ▶ One Ultra Post Panamax Class vessel has capacity for 25 intermodal trains
- ▶ New Super and Ultra vessels will require deeper channels, larger cranes and more efficient port processing, and more storage space



TRENDS IN THE FREIGHT MARKET

CONTAINER PORT GROWTH

2007 TEU Throughput (Millions)
and % Change from 2006



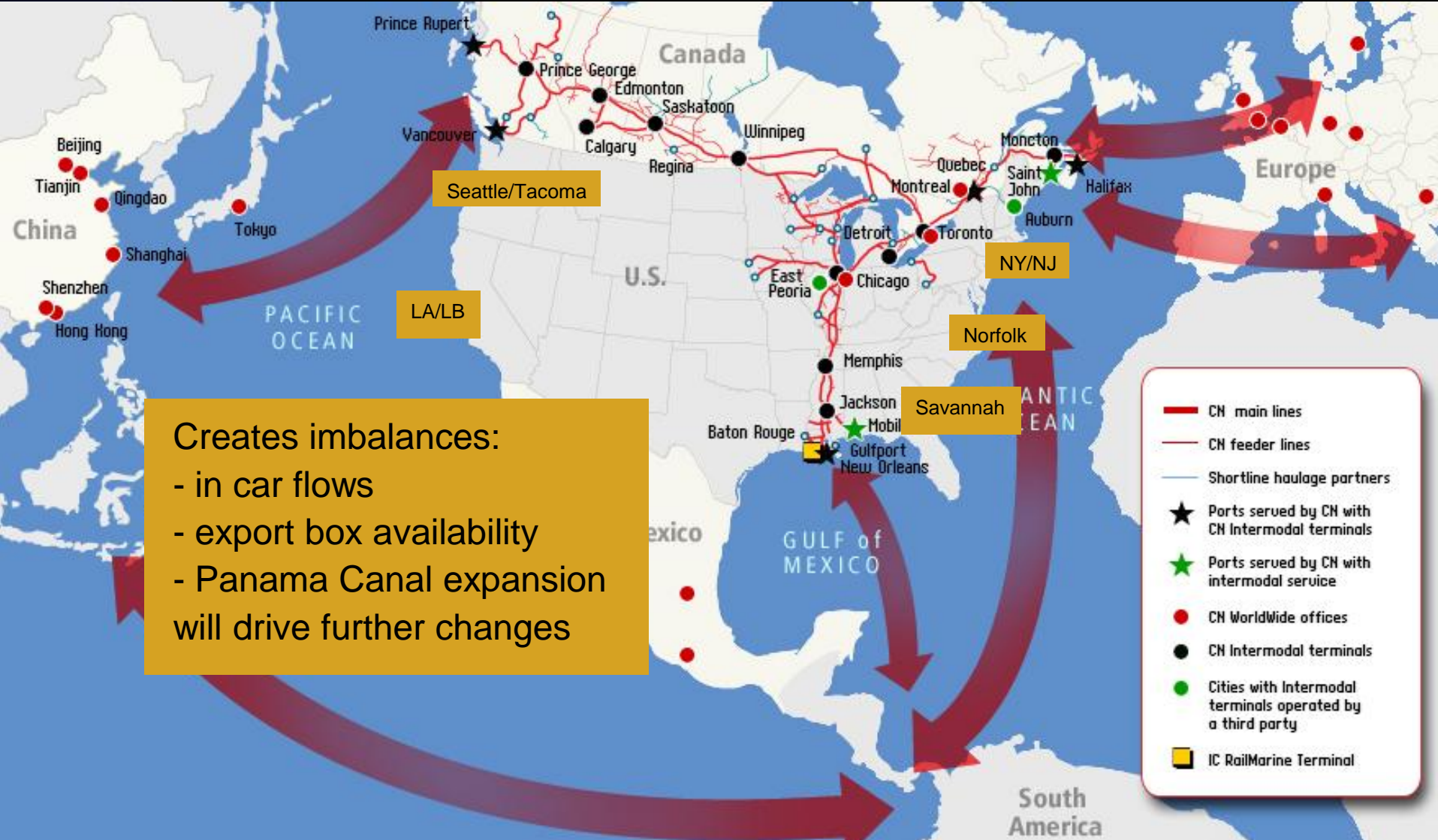
TRENDS IN THE FREIGHT MARKET

- ▶ Due to increased costs in certain Ports, congestion, labor, and other issues retailers and importers developed alternative gateway ports and diverted freight from the Southern California market.
- ▶ East Coast ports handled 26.3% +/- of Asia originated freight in 2008.
- ▶ Asian freight moving from East Coast Ports to the Midwest and Southeast is producing volume growth on Eastern railroads.

Asia to US Ocean Trade Lanes



SHIPPERS USE ALL-WATER ROUTES TO MITIGATE SUPPLY CHAIN RISK



TRENDS IN THE FREIGHT MARKET

DC DEVELOPMENT AROUND PORTS



- ▶ Major retailers are, based on a variety of issues, establishing large DC's near Eastern Ports
- ▶ New York: most big box retailers and one third of the US population is within a 24 hour delivery radius.
- ▶ Norfolk: Wal-Mart, Home Depot, Target, Cost Plus, Hud Logistics.
- ▶ Savannah: Pier 1, Wal-Mart, Home Depot, IKEA, Target, Bombay Company.
- ▶ Houston: Wal-Mart (4 mil sq-ft), Home Depot, Target, Lowe's , and IKEA.

TRENDS IN THE FREIGHT MARKET

Since the second quarter of 2007 the pacific eastbound trade has registered six negative growth quarters out of the last seven quarters.

Other trades, specifically the Asia-Europe Trade, stayed strong through the end of 2007 and even into the beginning of 2008, then collapsed after Chinese New Year in February of 2008.

Many economists predict that global trade will return to pre-2007 levels by 2010 and this same group predicts that growth will resume from there.

Historically, the majority of containers from Asia to the US transited over the Ports of LA and Long Beach with about 50% of the freight being West Coast destined freight and the balance moving to destinations beyond the West Coast.

TRENDS IN THE FREIGHT MARKET

The onward delivery system---rail and truck---was and is incrementally important to the economical and efficient movement of goods to the consumer. The condition of this onward delivery system has been the focus of considerable attention over the past 5+ years especially after the difficulties experienced in recent years by one of the Class I Railroads and by the trucking industry.

In the 60's and 70's there was a shift in the process to transloading which gave rise to a need for additional space along the West Coast. Ports such as Seattle and Tacoma, and again the LA/LB Port complex were the centers of this activity.

In 2007/2008 we saw strong evidence that this process is once again in favor---goods are being transloaded from ocean containers to other conveyances and then moved to Midwest and East Coast destinations.

In 2007-2008, the Class I Railroads that service the Midwest customers and the Eastern Railroads, raised their rates to move containers and intermodal units by as much as 30-40% across a wide variety of freight corridors. Many of you may be aware that this caused the ocean carriers to announce that they would no longer allow ocean containers to move forward to certain inland points.

TRENDS IN THE FREIGHT MARKET

In 2007-2008 increased rail rates, along with the rising cost of moving freight across the LA Gateway caused approximately 8.9% of the freight base that would normally be discharged on the West Coast to migrate to all water service to the Gulf or East Coast.

Artificially high inland rail rates from the western railroads, concerns regarding labor, increased fees such as Pier Pass, the Green Truck initiative (especially significant to carriers who do not have their own terminal operations), etc. are all factors that have contributed to the development of this trend to move freight to Ports other than the West Coast.

This trend, by all accounts, and based on a recent in-person survey conducted by DBA of all major ocean carriers in the USA at a decision making level, indicates that this trend will continue throughout 2009 and beyond.

TRENDS IN THE FREIGHT MARKET

BCO's are building distribution capabilities along the East and Gulf Coast that will enable them to be less reliant on West Coast Ports.

During the survey referred to earlier one major carrier indicated that less than 38% of freight on their ships was freight that actually needed to be discharged on the West Coast. Other carriers concurred with this finding.

Migration away from the West Coast Ports is likely to continue in the decade to come. Thus after years of dominating the US Maritime trade, the West Coast ports are being threatened and economic forces are beginning to favor greater movement to the Gulf and East Coast Ports for the Asian trade.

If this is true, and we believe it is, freight and its attendant activities, including transloading, warehouse/distribution, trucking, rail related activities such as intermodal yards, light manufacturing, etc. will likely move to the deep water Ports on the Gulf and East Coasts.

TRENDS IN THE FREIGHT MARKET

It is no surprise, I am sure, that we believe Houston, Corpus Christi, Mobile, Norfolk-Portsmouth, and Philadelphia are the most likely targets for growth. Charleston and Savannah should also benefit from this shift.

The International Port of Coos Bay, Oregon may be added to the list of Ports that will directly benefit from increased land side costs over the LA/LB Gateway. Coos Bay has lots of inexpensive land, good draft, excellent ingress/egress to the inner harbor, and is in a state that, while environmentally active, does not have a legislative branch that is seeking to assess accessorial charges that will increase the freight bill. The Port is purchasing the local short line railroad and investing \$64+ million to rehab the line and create a direct connection with the UPRR and BNSF—both railroads are cooperating. Developers should be interested in this Port.

Tacoma, Seattle, and Portland are trying hard to develop themselves as alternatives to the LA/LB Port complex.

We assume the western railroads will begin to adjust rates and services in an effort to recapture market share.

INDUSTRIAL REAL ESTATE

According to a story recently published in the Journal of Commerce and written by Bill Mongelluzzo, “the industrial real estate market in the United States is entering a deep and painful recession, but developers of warehouses and distribution centers should experience a return to normal growth in about two years”.

Attendees at the same real estate conference that Bill attended or wrote about were told “the current environment is marked by declining land values, especially at distribution hubs located outside of immediate port areas, high vacancy rates and falling rents and that at the same time, the cost of capital is increasing rapidly, if developers are lucky enough to find lenders willing to invest in the sector”.

“Industrial real estate that is tied to port operations generally outperforms other sectors of the industry. Los Angeles-Long Beach is by far the largest port complex in the U.S., handling about three times the container volume of the next largest port, New York-New Jersey, and has a large local consumption base that creates a need for warehouse space”, said Rob Antrobus, Vice President of AMB Property.

INDUSTRIAL REAL ESTATE

From that same article we quote--“Furthermore, developers in Southern California did not over-build during the boom times, and concentrated on quality properties such as transload warehouses geared toward high-volume importers. As a result, the vacancy rate in Los Angeles County is less than 5 percent, and in the port area it is less than 3 percent, which would be considered good in many parts of the country even when the market is strong. The Inland Empire located 40 to 50 miles east of Los Angeles is suffering more than the coastal regions with a vacancy rate of about percent”.

This same article goes on to state, “Development of new warehouses and distribution centers is grinding to a halt. Importers, exporters and domestic shippers that require space today should find plenty of options at reasonable leasing rates. Rents will continue to decline at least into next year before the market stabilizes, and growth could return in 2010.”

CONCLUSIONS

Some of the fundamental freight transportation market factors are (no big surprises here):

Cargo decision making and routing is being driven by costs not only at the Port level but those costs associated with the onward delivery system. This is causing a shift away from what might be considered the traditional gateway ports in the freight transportation market.

All water services are on the rise and decisions to expand this market are based on a lower cost per mile, rising costs at West Coast ports and in particular in the LA Basin, and a variety of other issues including, but not limited to, labor, congestion (projected), etc.

The improvements to the Panama Canal when completed will allow larger vessels, operating at lower costs, to have greater access to Ports on the Gulf and East Coast.

CONCLUSIONS

Both the private and public sectors will, in the current economy and into the future, want to find ways to use current assets more effectively.

The private sector will want to find ways to control and hopefully reduce the cost of freight transportation-logistics.

Both sectors, while objectives may differ, may have capabilities and needs, that if carefully identified at the planning stage, will allow infrastructure based private sector projects to be funded at a lower cost, and may allow projects on the Navy's side of this equation to be brought to market sooner, more effectively, and more efficiently.

This process may also yield a higher rate of return to the Navy and to the developers.

RECOMMENDATIONS

Focus attention on select transportation providers and users and Ports. Work with these groups to prepare a capabilities and needs analysis focused on infrastructure.

Using that analysis as a base develop a matrix detailing what the current and projected needs of these private sector groups might be.

Work with Base Commanders, Navy Headquarters staff, and the EUL staff to develop a prioritized matrix of current and potential EUL projects.

Integrate and prioritize the data and information contained in the two matrices and create a master list of current and potential private and public sector projects.

Work with senior management in both the private and public sectors to bring these projects together at the planning stage.

Engage the developers in the process.