Debt & Financial Management Guidelines

prepared for the

Virginia Port Authority

Finance Committee Discussion

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Presentation Overview

- Objective: Provide information only, No action required
  - Why implement financial & debt management guidelines?
  - What are the key elements of sound debt & financial management guidelines & procedures?
  - What do other ports do?
  - How might VPA develop targets in its debt & financial management guidelines, given its financial performance – past and projected?

Presentation Outline

I. Background
II. Key Elements for Consideration
III. Rating Agency Considerations
IV. Potential Elements for VPA Guidelines
V. Appendix

I. Background

Background

- Formally adopted, written financial & debt management guidelines are a best practice
  - Statement of financial commitment by the governing body
  - Provides a guidepost for management's financial decision-making
  - Acknowledged by credit agencies as a marker of sound financial management
- VPA is a hybrid entity with operational and risk profiles that range from a traditional state agency to a private, corporate concern with exposure to global risks
- VPA has two borrowing programs with vastly different credit profiles reflecting this range of activities

Background (con't)

- Sound financial & debt guidelines should be customized to mitigate relevant, specific risks while promoting fiscal stability
- Long term adherence & commitment to guidelines is paramount, so they must be appropriately flexible for the long term
- Written financial guidelines & procedures can help design a framework to meet future objectives
  - Set thresholds for affordability of debt burden
  - Assure sufficient reserves for working capital, economic down turns & other risks
  - Define allowable financing mechanisms & set acceptable risk thresholds
  - Memorialize management procedures

VPA's Existing Policies: Derivatives Policy & Variable Rate Debt Policy

- In 2005, VPA adopted a Derivatives Policy as well as a Variable Rate Debt Policy
- Derivatives Policy describes permitted techniques and uses of swaps, hedges & other derivatives
- Variable Rate Debt Policy describes specific objectives for utilizing variable rate debt and permitted instruments of variable rate debt
- Variable Rate Debt Policy limits unhedged variable rate exposure to approximately 20% of total outstanding debt for each of the Bond Resolutions
- Both policies delineate risks & mitigation techniques
- Both policies proscribe required analysis and sets benefit thresholds
- Both policies establish execution & on-going monitoring procedures

II. Key Elements for Consideration

Elements of Effective Financial Guidelines

- Realistic & matched to the organization's specific needs
- Achievable & sustainable over the long term
- Sets clear limits & goals
- Embedded as part of the organization's financial management culture
- Written & formally adopted by the governing body
- Commitment evidenced through constant adherence
  - In up & down financial cycles
  - Throughout changes in management
  - Across political/governance transitions

Debt Affordability Measures

- Affordability measures relate annual debt costs to annual available revenue
- Debt service coverage most typical measure for revenue bonds
  - Ratio of net revenue available for debt service in a given year divided by annual debt service
- High ratings typically follow higher coverage, all other factors held equal
- A variety of coverage calculations may be performed using different calculations for net revenues or including different categories of debt

VPA Debt Service Coverage Covenants

- Resolution 97-5 (Port Revenues)
  - Debt service coverage covenants exist for senior debt service (currently all outstanding bond issues), but not subordinate debt service (currently all debt issued through MELPs)
  - 1.10x covenant of Pledged Net Revenues (VPA Net Revenues + Deposits to CEMA) / Current Year Senior Debt Service
    - Example: VPA's FY12 Pledged Net Revenue Covenant = (25,917,309 + 4,701,389) / 17,389,491 = 1.76x
  - 1.35x covenant of Pledged Adjusted Net Revenues / Current Year Senior Debt Service (VPA Net Revenues + Deposits to CEMA + Current Expenses Paid by CPF)
    - Example: VPA's FY12 Pledged Adjusted Net Revenue Covenant = (25,917,309 + 4,701,389 + 4,032,026) / 17,389,491 = 1.99x
- Resolution 02-4 (Commonwealth Port Fund Revenues)
  - Debt service coverage covenants limited to the issuance of additional bonds at 1.10x using maximum annual debt service

Debt Affordability Measures (con't)

	Debt Service Coverage Covenant based on Bond Resolution	Debt Service Coverage Policy/Practice
Harbor Dept of LA	1.25x	2.0x
JAXPort	1.25x	None
Long Beach	1.25x	2.0x
NC Ports	1.35x on Parity Indebtedness, 1.05x on Parity and Subordinate Indebtedness	None
NY/NJ	1.0x	None
Oakland	1.25x on Senior Lien, 1.10x on Intermediate Lien	None
SC Ports	1.20x	None
Seattle	1.35x	1.80x
Tacoma	1.35x on Senior Lien, 1.0x on Subordinate lien	2.0x on All-in Debt Service Coverage
Tampa	1.20x	None
Virginia Port Authority	1.10x Pledged Net Revenues and 1.35x Pledged Adjusted Net Revenues on Senior Lien	None

Reserves

- Building & maintaining reserves is a best financial management practice
- Reserves provide liquidity and financial flexibility
- Reserves support high quality credit ratings
- Reserves can be maintained for different purposes
- Reserve policies are typically set to be a floor
- Typical measures for revenue bonds include days cash on hand and net working capital

Reserve Policies of Other Ports

	Name of Reserves	Minimum	Goal/Target
Harbor Dept of LA	Emergency/ACTA Fund, Special Operating Fund	Emergency/ACTA Fund: Minimum of $47 million	Special Operating Fund: Target balance will be the difference between the average of the Port's operating expenses over a 5 year period and the Emergency/ACTA Fund
JAXPort	Reserve Fund	None	5% of the notional amount of each interest rate swap initially executed. All income created from the use of interest rate swaps and caps is deposited into the reserve fund
Long Beach	Unrestricted cash	1.64x prior years operating expense (= 600 days)	None
NC Ports	Capital Reserve Fund	5.0% of prior year revenues	None
NY/NJ	General Reserve Fund (GRF), Consolidated Bond Reserve Fund (CBRF)	GRF: At least equal to 10% of the par value of outstanding bonds legal for investment CBRF: The balance remaining of all net revenues of the Port's existing facilities after deducting payments for debt service and the amount necessary to maintain the GRF at its 10% minimum	The port maintains total reserve funds in an amount equal to at least the next 2 years' bonded debt service on outstanding debt secured by a pledge of the General Reserve Fund
Oakland	Port Operating Reserve Fund; Port Bond Reserve Fund; Capital Reserve Fund	12.5% of operating expense budget (Port Operating Reserve Fund); $30 million (Port Bond Reserve Fund); $15 million (Capital Reserve Fund)	None
Seattle	General Fund; Airport Development Fund; Renewal and Replacement Fund	9 months of working capital maintained in General Fund and Airport Development fund; $5 million maintained in Renewal and Replacement Fund.	None
Tacoma	Unrestricted cash	None	Unrestricted cash should be sufficient to meet capital budget requirements and any unexpected capital requirements without affecting ongoing operations

Pay-As-You-Go (PAYGO)

- PAYGO guidelines help to maintain an affordable debt burden
- Recurring use of PAYGO adds financial flexibility to the annual budget
- Functionally, a "reserve equivalent"
- Typically PAYGO policy thresholds are floors
- Measures vary
  - Percent of annual budgeted revenue
  - Percent of CIP or CapEx
- PAYGO practices of other ports
  - Port of L.A.: "It has been the Port's practice to purchase equipment on a pay-as-you-go basis; however, the Port shall have the ability to consider lease purchase transactions…"
  - Port of Long Beach: "..shall seek to fund at least between 2 and 5 percent of the overall capital program from current resources, depending upon the specific projects and annual budgetary constraints." (excerpt from the City of Long Beach Debt Policy)

III. Rating Agency Considerations

VPA's Senior Lien Terminal Revenue Bond Ratings

Moody's	S&P	Fitch
Aaa	AAA	AAA
Aa1	AA+	AA+
Aa2	AA	AA
Aa3 (stable)[1]	AA-	AA-
A1	**A+ (stable)[2]**	A+
A2	A	**A (stable)[3]**
A1	A-	A-

1. Moody's rating as of July 24, 2013.
2. S&P rating as of July 10, 2013.
3. Fitch rating as of April 30, 2012.

Terminal Revenue Bond Credit Factors Aided by Financial Guidelines

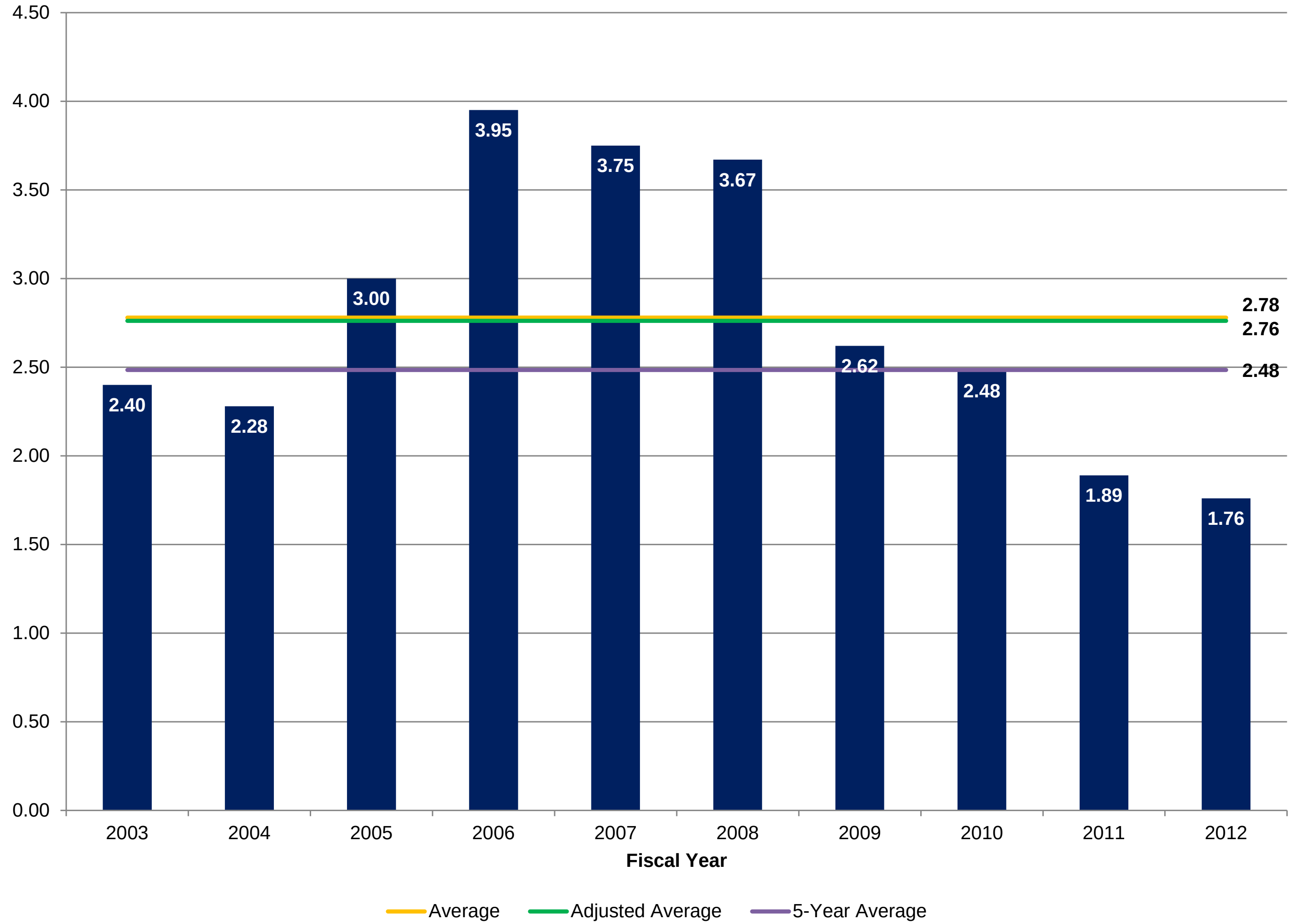
- Moody’s cites liquidity & coverage falling below current & historical levels as factors that could lead to a downgrade
- S&P indicates that liquidity is “…weak for the rating” and that “if debt service coverage declines below 2012 levels, we could lower the rating”
- Fitch cites that coverage level in 2011 is adequate but lower than previous years, and may be pressured in upcoming years

IV. Potential Elements for VPA Guidelines

Art & Science of Setting Thresholds

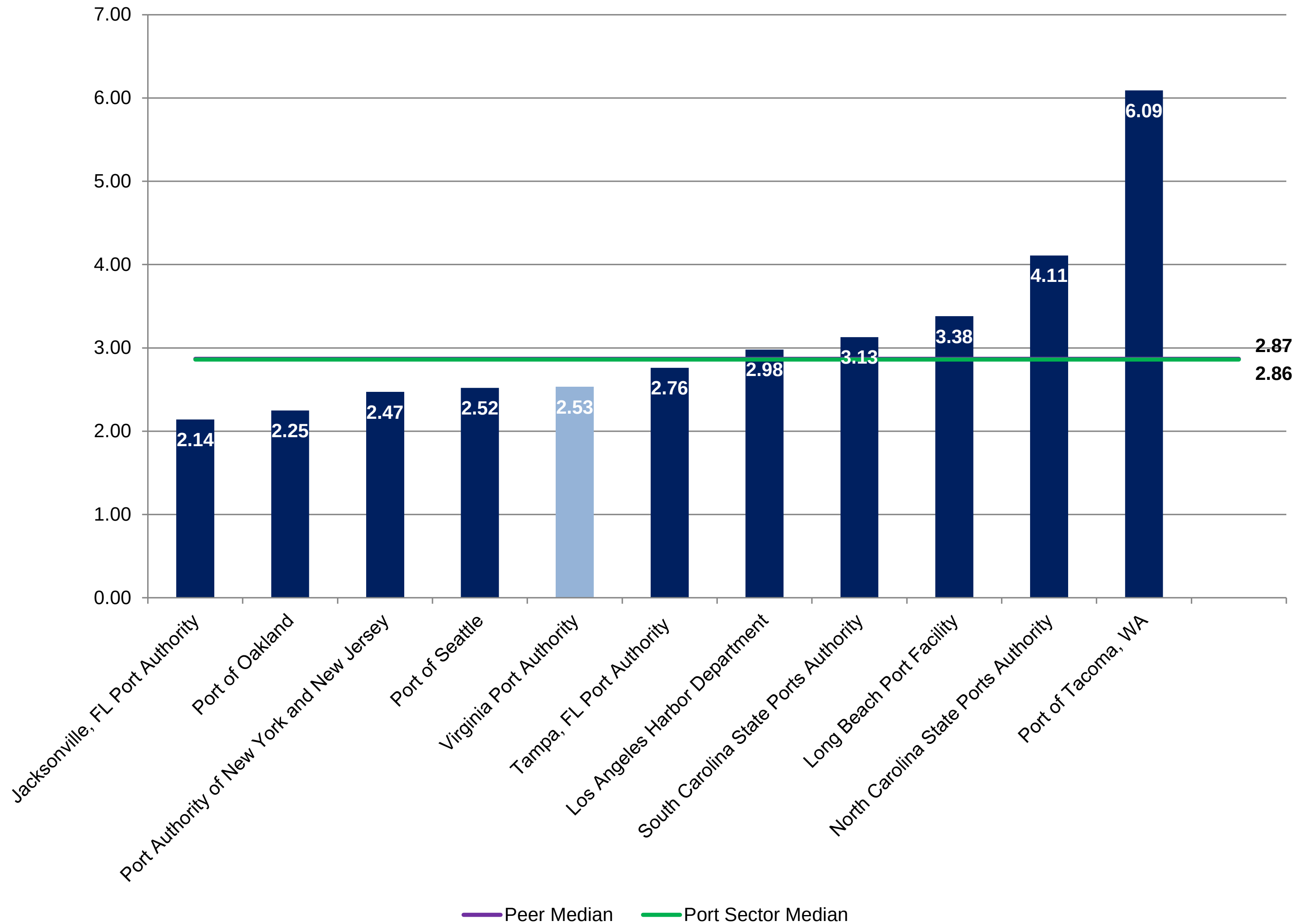
- Peer group comparisons
- Rating medians
- VPA's ranges of historical financial performance
- VPA's forecasts of future financial performance
- Goal is compliance
  - Flexibility vs. discipline
  - Reasonable vs. aspirational
- Balance of principles with procedures

VPA History: Senior Debt Service Coverage (Pledged Net)



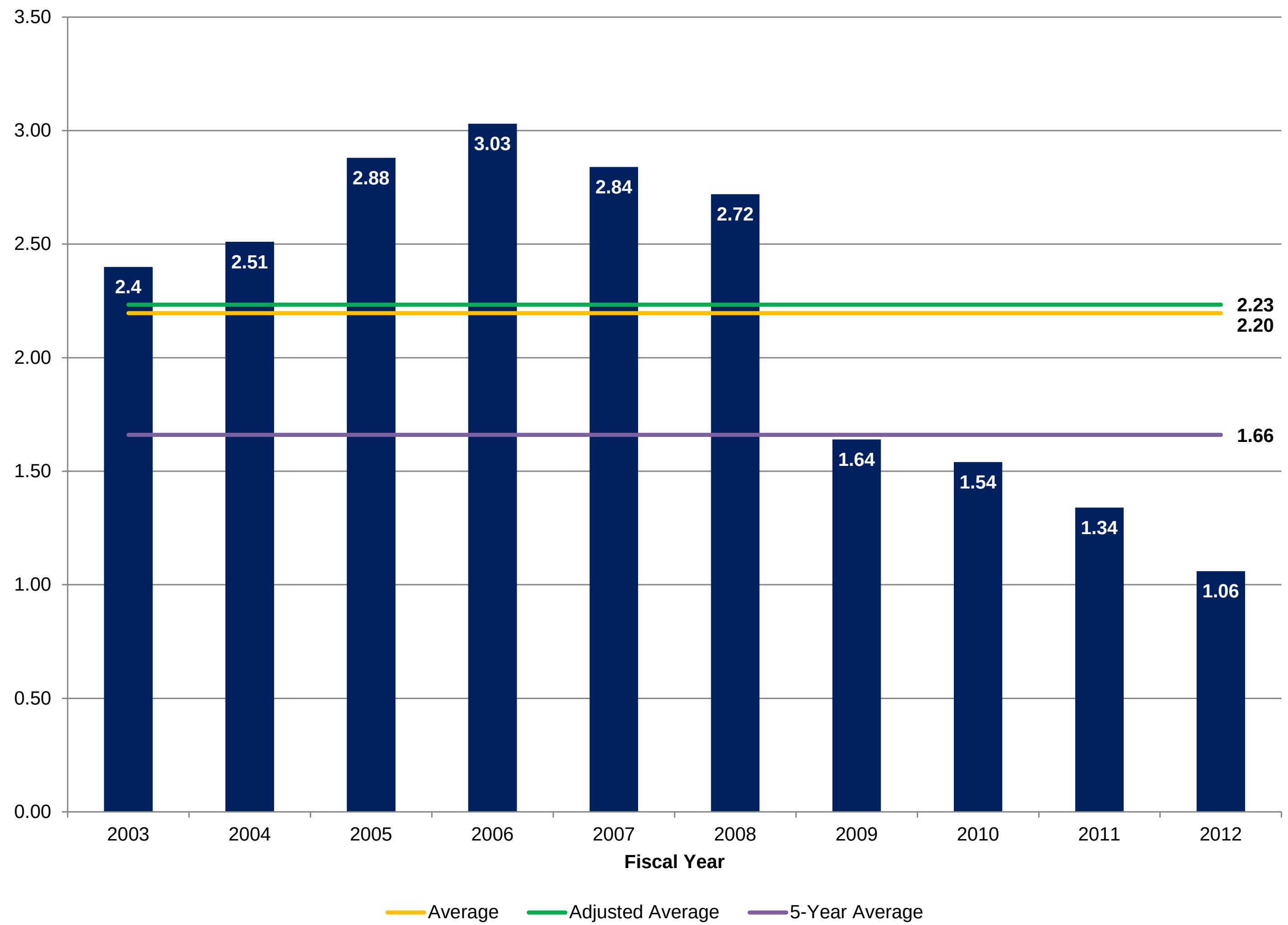
Note: 5-year average is from 2008-2012. Adjusted Average is from 2003-2012, but without the highest and the lowest data points. Average is from 2003-2012.

Comparable Data: Senior Lien Debt Service Coverage



Source: Moody's Financial Ratio Database. Port of Tacoma and Port of Long Beach data as of FY11. All other data as of FY12.

VPA History: All-In Debt Service Coverage (Pledged Net)



Note: 5-year average is from 2008-2012. Adjusted Average is from 2003-2012, but without the highest and the lowest data points. Average is from 2003-2012.

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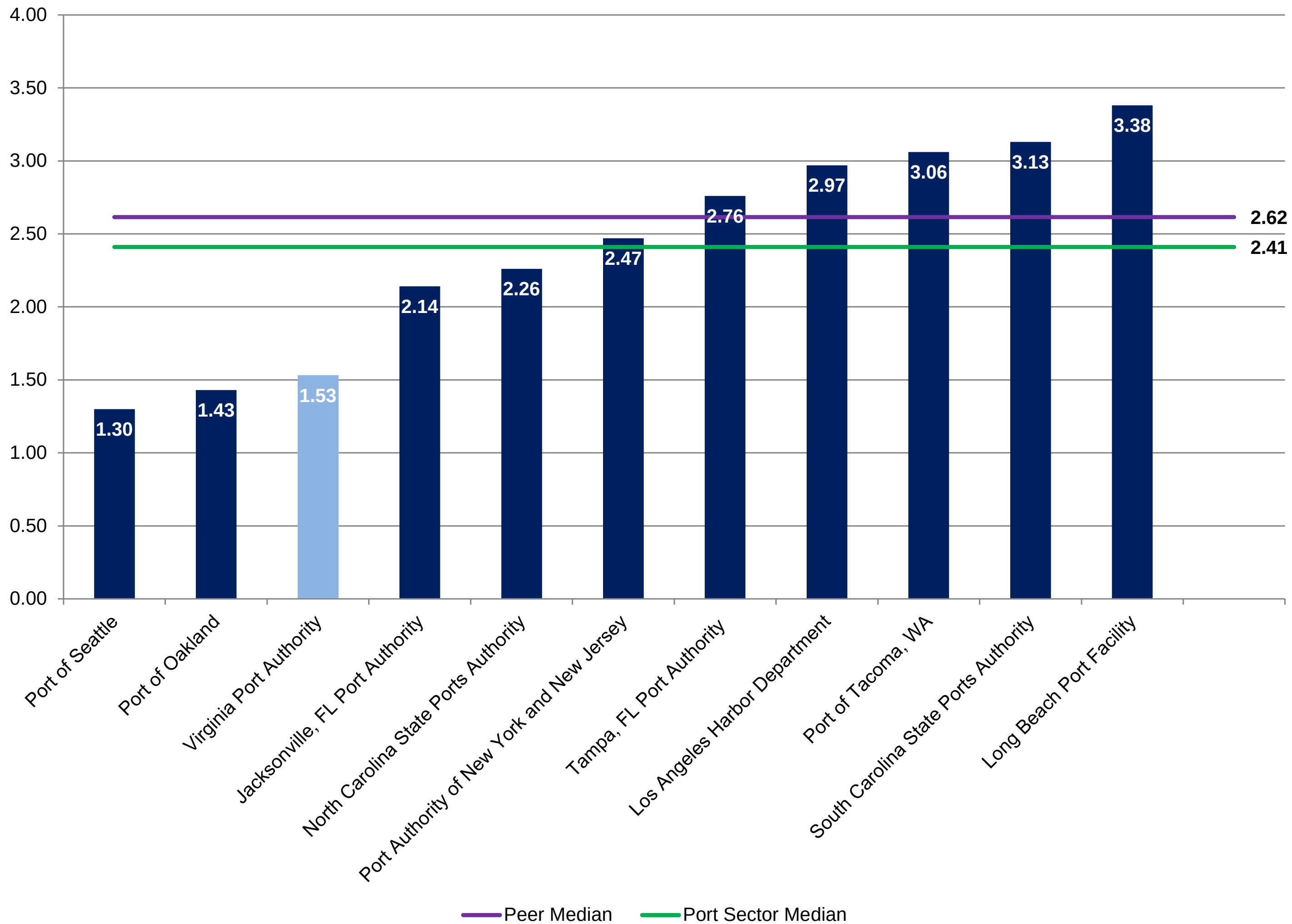
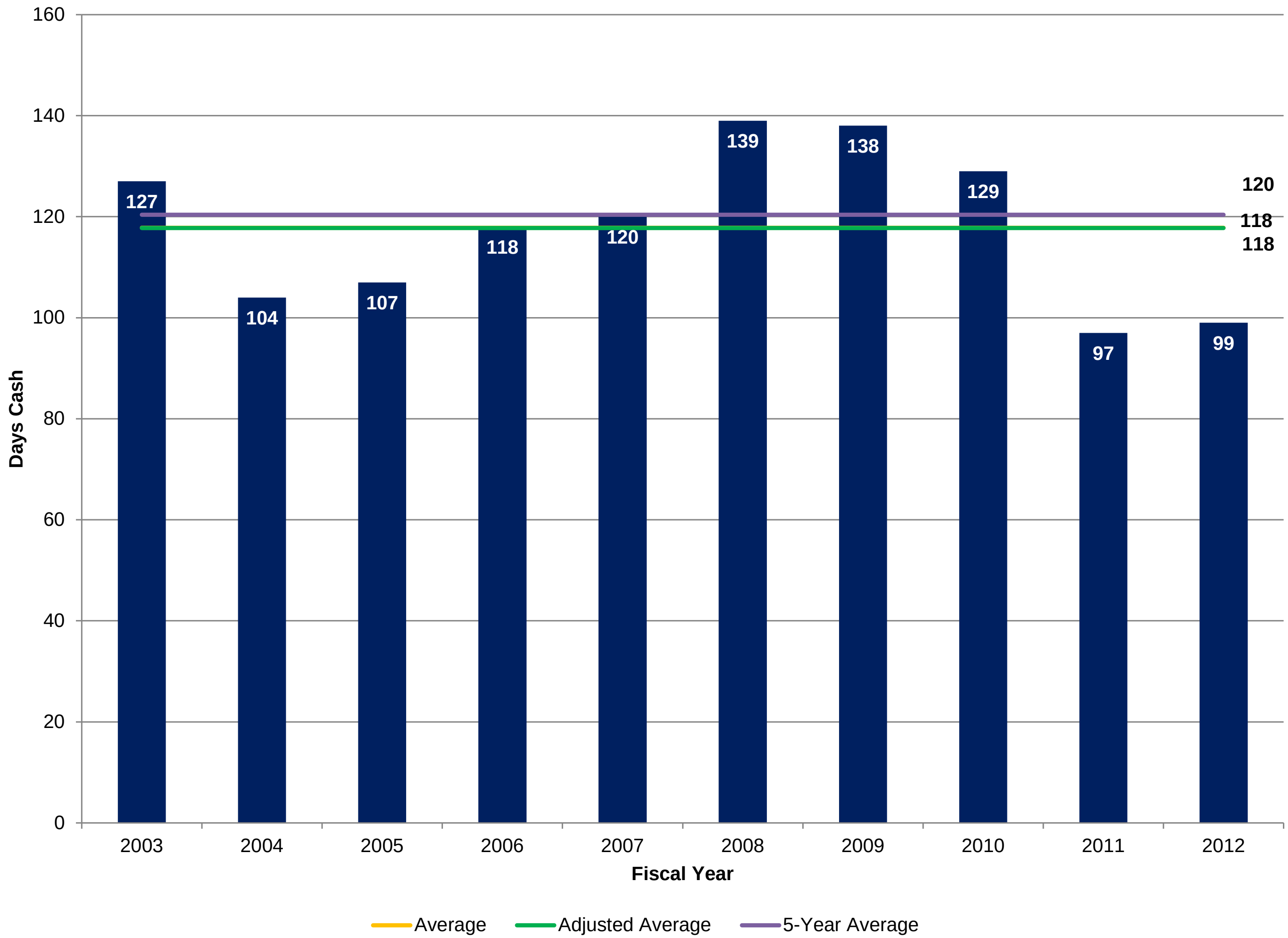


Source: Moody's Financial Ratio Database. Port of Tacoma and Port of Long Beach data as of FY11. All other data as of FY12.

VPA History: Days Cash on Hand



Note: 5-year average is from 2008-2012. Adjusted Average is from 2003-2012, but without the highest and the lowest data points. Average is from 2003-2012.

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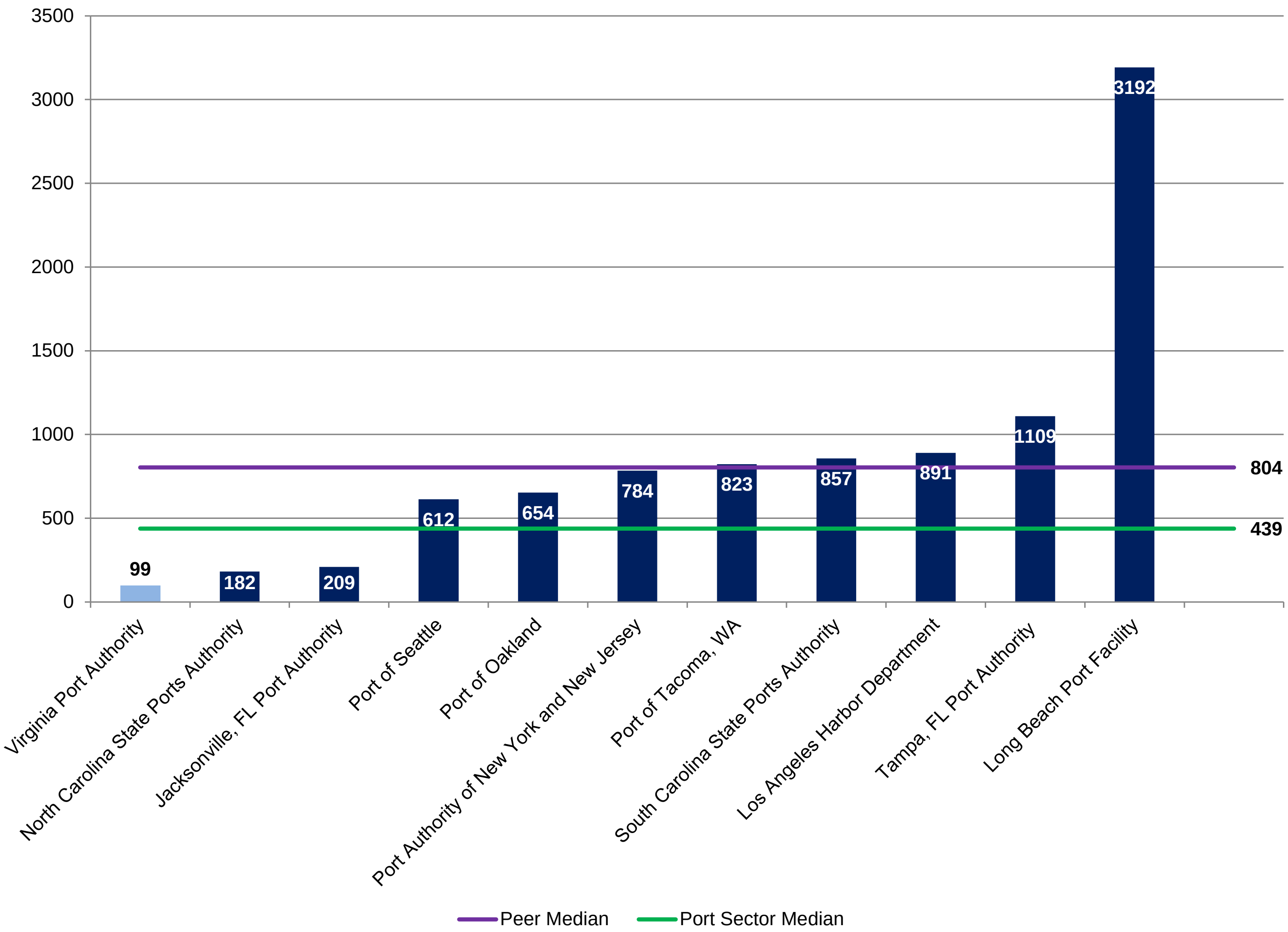


Source: Moody's Financial Ratio Database. Port of Tacoma and Port of Long Beach data as of FY11. All other data as of FY12.

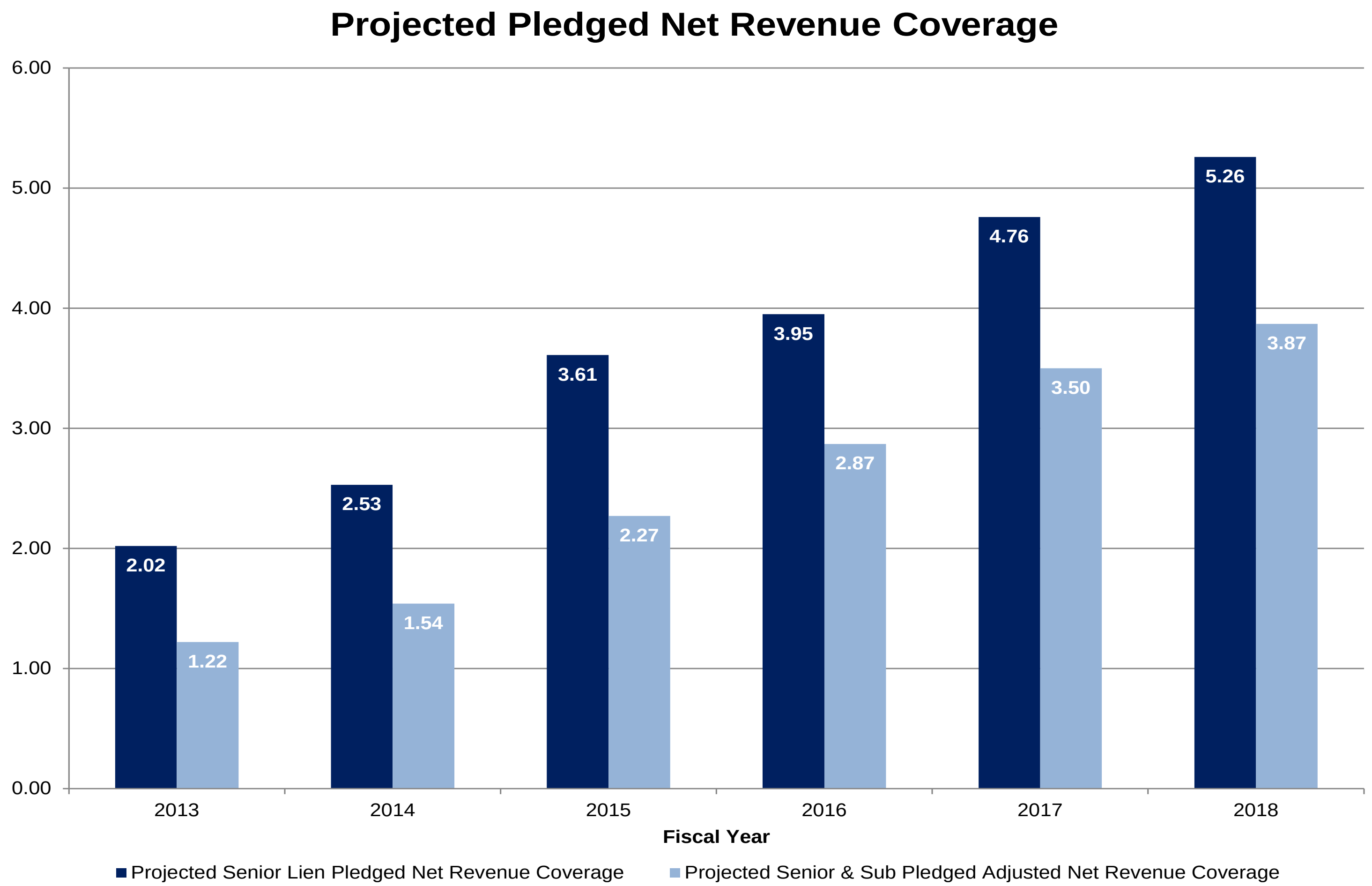
Summary of VPA Historical Performance

VPA's historical performance is a basis for developing thresholds for the debt guidelines.

Measure	VPA High	VPA Low	VPA Average (10 Years)	VPA Adjusted Average (10 Years)	VPA Average (5 Years)	Peer Median	Rating Agency Threshold/ Comment
Senior DSC	3.95	1.76	2.78	2.76	2.48	2.87	2.86
All-In DSC	3.03	1.06	2.20	2.23	1.66	2.62	2.41
Days Cash	139	97	118	118	120	804	439

Projected Debt Service Coverage

VPA's projected performance is another important consideration for developing thresholds for the debt guidelines.



Source: Draft CE Report, dated June 25, 2013.

Additional Potential Guidelines

- Other Reserves
  - Working capital/liquidity reserve
  - Maintenance & Use of external liquidity support
  - Risk management reserves
  - Capital/Economic Development Opportunity Reserve
- Debt
  - Structural provisions (Term, CapI, Amortization, Call provisions)
  - Types of debt (CIBs, CABs, others not covered under existing policy)
  - Refinancing thresholds
  - Methods of sale
  - Procedures regarding underwriters
- Formalize reliance on Treasury Board Guidelines for issuance of Commonwealth Port Fund bonds

Next Steps

- Continue evaluation of VPA financial data
- Analysis & testing of projected ratios using alternate forecast scenarios
- Draft detailed document for review & continued discussion by stakeholders
- Record & address questions & comments stemming from today's discussion
- Revisit discussion at January 2014 Finance Committee
- If appropriate, Finance Committee to forward for full Board consideration in March 2014

V. Appendix

Terminal Revenue Bonds: Moody's Rating History

Stable outlook (removal of negative outlook) reflects VPA's competitive position among east coast container ports with low-to-mid single digit container volume growth and no revenue bond debt issuance in the near-term to fund capital improvements.

Upgrade reflected cargo and revenue growth, sound capital planning, stable financial management and performance, and maintenance of a low senior lien debt ratio due to its ability to issue bonds backed by the Commonwealth (Aaa).

Date	Analysts	Rating	Outlook	Purpose
July 24, 2013	Kurt Krummenacker Jason Aingorn	Aa3	**Revised to Stable**	Series 2013 Rating
May 15, 2012	Kristina Alagar Cordero AJ Sabatelle	Aa3	Negative	Surveillance
April 8, 2010	Maria Matesanz Baye Larsen	Aa3	Negative	Series 2010 Rating
May 11, 2009	Baye Larsen Kurt Krummenacker	Aa3/MIG-1	**Revised to Negative**	Series 2009 BAN Rating
June 2, 2008	Baye Larsen Maria Matesanz	Aa3/MIG-1	Stable	Series 2008 BAN Rating
February 6, 2007	Joshua Schaff Bart Oosterveld	Aa3	Stable	Series 2007 Rating
September 13, 2006	Joshua Schaff Bart Oosterveld	**Upgraded to Aa3**	Stable	Series 2006 Rating
January 5, 2006	Anne Van Praagh Thomas Paolicelli Bart Oosterveld Robyn Kapiloff	A1	Stable	Surveillance
December 13, 2004	Anne Van Praagh Edward Roche Bart Oosterveld Patrick Mispagel	A1	Stable	Surveillance
June 6, 2003	Anne Van Praagh Kevin Carney Edward Roche	A1	Stable	Series 2003 Rating
July 14, 1998	Bart Oosterveld Mary Francoeur Chee Mee Hu	A1	Stable	Surveillance
May 5, 1997	Mary Francoeur Chee Mee Hu	A1	Stable	Series 1997 Rating

Negative outlook reflects the substantial decrease in FY09 cargo and coverage levels, expected continued decline in coverage levels, and the uncertainty surrounding the timing and scope of the economic recovery.

Terminal Revenue Bonds: S&P Rating History

Upgrade reflected continued growth in container volume and strong debt service coverage despite competition from new APM terminal.

Date	Analysts	Rating	Outlook	Purpose
July 10, 2013	Todd Spence Anita Pancholy	A+	Stable	Series 2013 Rating
December 14, 2012	Todd Spence Georgina Rovirosa	A+	Stable	Surveillance
September 6, 2011	Todd Spence Adam Torres	A+	Stable	Surveillance
April 13, 2010	Joseph Pezzimenti Adam Torres	A+	Stable	Series 2010 Rating
May 12, 2009	Joseph Pezzimenti Adam Torres	A+	Stable	Series 2009 BAN Rating
June 5, 2008	Joseph Pezzimenti Adam Torres	**Upgraded to A+**	Stable	Series 2008 BAN Rating
February 23, 2007	Joseph Pezzimenti Kurt Forsgren	A	**Revised to Positive**	Series 2007 Rating
September 16, 2006	Matthew Hobby Joseph Pezzimenti	**A**	Stable	Series 2006 Rating
June 18, 2003	Matthew Hobby Reid Tomlin	A	Stable	Series 2003 Rating
May 19, 1997	Seth Lehman	A	Stable	Series 1997 Rating

Revised outlook based on long history of robust cargo trends, strong historical financial performance, favorable competitive position, and continued strong debt service coverage.

Terminal Revenue Bonds: Fitch Rating History

Downgrade reflects significant declines in container volume, weakened financial position, anticipated decline in coverage, and loss of customers to APM terminal.

Date	Analysts	Rating	Outlook	Purpose
April 30, 2012	Emma Griffith Scott Zuchorski	A	Stable	Surveillance
May 16, 2011	Emma Griffith Scott Zuchorski	A	Stable	Surveillance
May 14, 2009	Robert Botschka Mike McDermott	**Downgraded to A**	Stable	Surveillance
March 6, 2007	Peter Stettler Corey Modeste	A+	Stable	Series 2007 Rating
September 29, 2006	Peter Stettler Corey Modeste	**Upgraded to A+**	Stable	Series 2006 Rating
March 24, 2005	Peter Stettler	A	Stable	Surveillance
June 11, 2003	James S. Gilliland Peter Stettler Jessica Soltz-Rudd Nelsie Smith	A	Stable	Series 2003 Rating
June 5, 1997	Andrea R. Bozzo Claire G. Cohen	A	Stable	Series 1997 Rating

Upgrade reflected consistently sound financial performance, growing container-based trade activity, balanced level of activity between imports and exports, and its diverse mix of both shipping lines and trading partners.