Cruising for Profits: Cruise firm reaps profit while port carries risks

But the latest lease gives taxpayers a better deal

Thursday, December 14, 2006

By KRISTEN MILLARES BOLT
P-I REPORTER

Seattle's cruise line business is making a lot of people big money. The Port of Seattle, which spent tens of millions of dollars to bring the ships here, hasn't been cashing in on the jackpot.

Six years after the first cruise ship line decided to make Seattle a summer home for its ships, the port is nowhere close to breaking even on the huge investment it made to lure the vessels to town.

That despite the fact that nearly 200 ships now visit Seattle each summer, bringing more than 350,000 passengers who crowd the city's waterfront sightseeing, eating and shopping.

The question is, why isn't the port -- and, by extension, why aren't King County taxpayers -- getting a bigger cut of the money?

The answer is that the port has sent much of its profit to Cruise Terminals of America, a third-party operation that runs its cruise ship terminals.

The investment and work that Cruise Terminals of America have done has been minimal -- essentially only the paid hours of its three full-time employees and five part-time employees.

Meanwhile, the port has put up tens of millions of dollars in actual investments and hundreds of millions of dollars in existing assets needed to attract the ships, including construction of an $18 million cruise ship terminal that will soon be torn down for an even more expensive, taxpayer-funded terminal.

zoom JOSHUA TRUJILLO / P-I

Celebrity Cruises' ship Mercury docks at the Port of Seattle's Pier 66 in July. Nearly 200 ships now visit Seattle each summer.

Using money directly from the property tax levy on King County homeowners, the port even buys the third-party operator its furniture, signs, awnings and equipment.

And as far as profits go, the port wasn't seeing anything steady before 2004; CTA fared much better. The unequal split continued until last year, when the port renegotiated.

"It's about risk, and it's about reward, and there was too much risk for too little reward," Port Chief Executive Mic Dinsmore said.

But in a highly unusual arrangement, CTA is now guaranteed at least $300,000 a year by the port -- even if the number of visiting cruise ships drops to zero because of something like a terrorist attack. No other port business partner is guaranteed to make money.

"The port is pretty good at finding experts to run matters that they can't do, but this sounds like they were held at gunpoint," said Patricia Stambor, a longtime port watcher who was on the port's advisory committee for the development of its current harbor strategies.

"They wanted to attract the business and saw a lot of opportunities for it to be an economic multiplier for the region, but in negotiating these particular contracts, it sounds like the port is up a creek."

Port Commissioner John Creighton, like many others at the port, said the cruise business' success is a net benefit to the region because it creates jobs and brings in tourist money and is a credit to the collaboration between the port and CTA.

"It looks like a sweetheart deal in hindsight because the number of cruise ships exploded, and CTA was making a lot of money," Creighton said. "Hindsight is 20/20. I wasn't around then, but no one expected the cruise business to take off like it did. Could we have pushed harder and struck a better deal for the port? I don't know."

zoom JOSHUA TRUJILLO / P-I

The view from the Bell Harbor International Conference Center and cruise ship terminal shows the dock used by ships, foreground, and Port of Seattle cranes, background.

Where's the money?

The port, which risked $18 million on the new cruise building at Terminal 30, signed away 75 percent of the net operating income of the cruise business to CTA in the 2003 agreement with the company. Under the terms of that lease contract, the port ceded CTA the first $1.1 million in annual revenue, taking a 55 percent cut after that.

In 2003, the port lost $1.3 million, before depreciation, on its cruise operations alone. After depreciation -- a non-cash expense that reflects the slipping value of a property over time -- the port lost $3.6 million. That same year, a CTA balance sheet shows its net income at $961,000, according to a Seattle P-I review.

In 2004, the first year in which the port began to show a steady profit, its heftier investment and expenses left it with $171,000 in profit, while CTA made $1.4 million, according to the port's financial statements and CTA's end-of-year balance sheets.

Since 2000, the port's $44.6 million investment in its cruise buildings has earned it only $3 million before depreciation, according to port documents.

After depreciation, the port has lost $13.5 million since 2000.

Putting an exact number on overall CTA profits is difficult, because it is a private business and is not required to share its financial information. But according to port documents, the net proceeds to CTA from the cruise business have totaled $6.6 million since 2000.

CTA general manager Jean Cox declined to discuss her company's earnings.

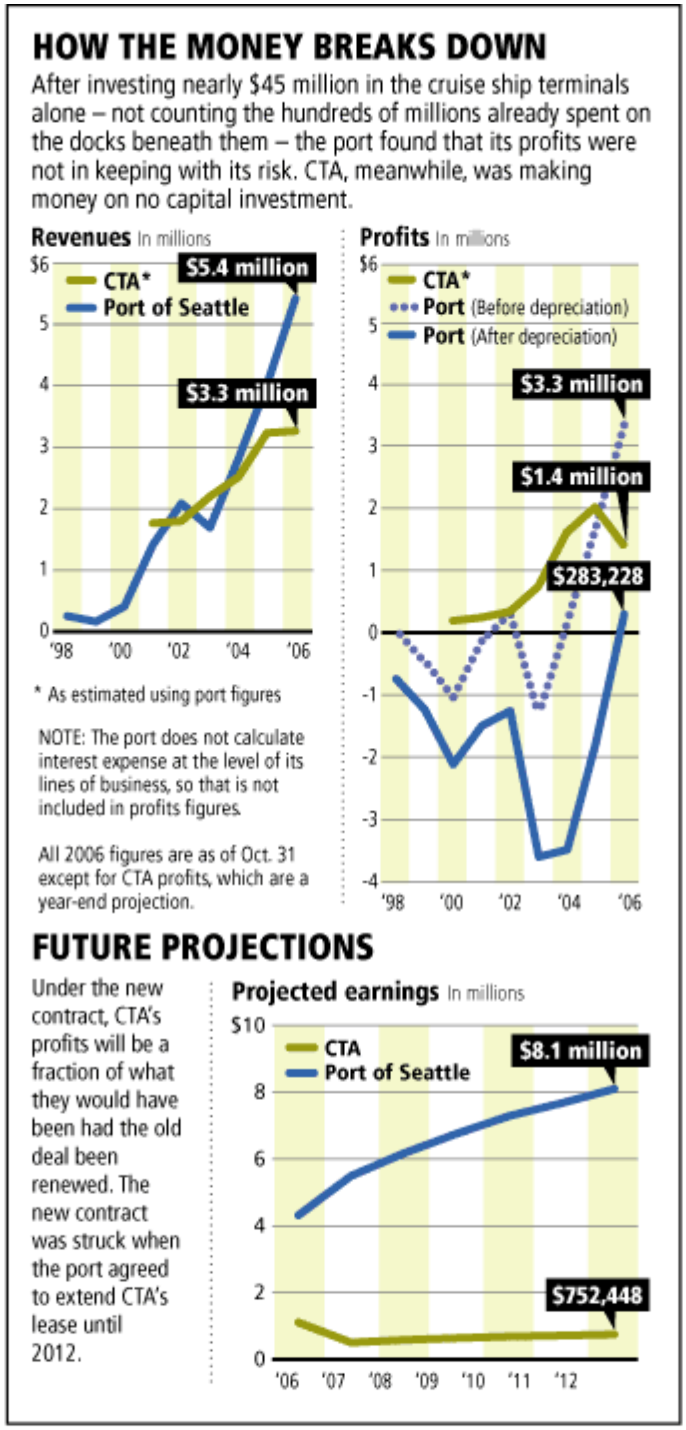
But port staff members were concerned that CTA was making too much money for the duties it was performing, and last year renegotiated the port's deal with the company to ensure that CTA's share of the profits went down.

Even though CTA was making decent returns, and the port wasn't, many port officials said this kind of arrangement is a proper way to stimulate the local economy.

"If we pay to build out infrastructure, and we don't get all that money back, I am OK with that," said Creighton, who approved CTA's most recent contract, in 2005. "But we shouldn't be cutting sweetheart deals with industry."

Yet under the terms of its new contract, the port continues to pick up basic business expenses for CTA:

- The company will receive $200,000 per year in taxpayer subsidy for its fixtures and furniture -- totaling $1.4 million over the seven years of the lease.
- This is in addition to a $500,000 tenant improvement allowance for the $60 million cruise facility the port is building at Terminal 91, a project that was originally estimated to cost $6 million.
- The port has signed up to provide $100,000 per year to CTA for maintenance.



Some port watchers question why the port -- with its 1,647 full-time positions managing operations ranging from its commercial ship operations to an international airport -- even needs CTA to oversee the cruise business. Seattle's main cruise competitor, the Port of Vancouver in British Columbia, runs its operations profitably and by itself.

"If I thought we could run the business as cost-effectively and as profitably as CTA, we would have done that," port chief Dinsmore said. "We do not have the expertise."

In making its choice, the Port of Seattle said CTA's owners -- joint venture partners SSA Marine, General Steamship Agencies and Columbia Hospitality -- had the skills to make the business work.

"We had people who could tie up ships and make it work, but we really didn't have the overall management in house," said Mark Knudsen, the port's deputy managing director of seaport operations.

Teaming up specifically to bid on the project, the CTA partners beat out another bidder that was already running Los Angeles' successful cruise business.

The port gave CTA the contract based on its experience -- though CTA's general manager had not run a cruise ship terminal before -- and its local connections. Its parent companies had a lot of know-how: SSA Marine with loading and unloading ships, General Steamship with acting as a ship's agent and Columbia Hospitality with providing hospitality.

Who does what?

CTA schedules the ships with the port's approval, manages the terminal's security and sets it up for ship arrivals, overseeing the food and flowers about to be loaded onto ships and helping guests by putting out signs and coffee. It also coordinates with Columbia Hospitality, which books the terminals for events.

But essential functions, such as the actual loading of those provisions, passenger baggage handling, coordinating the shore crew with the ship's arrival and concierge services, fall outside of CTA's contract with the port.

Instead, CTA's joint venture partners and their competitors contract directly with the cruise lines, or, in the case of Columbia Hospitality and its concierges, with the port.

"It appears that everything was contracted out to one of its major partners, including working with the longshoremen," said Port Commissioner Lloyd Hara. "So you wonder what (CTA's) general function is, aside from that they're in between the port and users of the docks."

Port documents obtained by the P-I indicate that CTA's joint venture partners have tried to use CTA's position as terminal operator to sell their services to cruise lines.

The port staff had to remind CTA in a letter that its duties were to provide customer service, even if it meant that the cruise lines did not want to buy the stevedoring services of one of its joint venture partners, SSA Marine.

In fact, several of the port commissioners -- who must authorize port contracts, budgets, and projects -- were uninformed about the port's deal with CTA. They believed that those services CTA was trying to sell to cruise ships were what the port was paying the company for in the first place.

One aspect of the relationship with CTA is that it allows the port to put distance between itself and labor unions who do work for the cruise industry. The port has had tense relationships in the past with the International Longshore and Warehouse Union and with the Teamsters.

Besides, the port said, it can't hire the kind of talent that CTA has. "It's a seasonal business, and so for us to have to staff up the employees and lay them off during the winter is a difficult thing to do," Knudsen said.

Dinsmore said labor costs would rise significantly if the port were to take over operations.

The CTA's Cox said: "We have an extremely dedicated staff, and the fact that they are willing to do seasonal work is huge."

CTA collects passenger and dockage fees from the cruise lines and distributes a portion of them to the port, which sets the rates. Those fees are the bulk of the port's cruise business revenues, which are provided in the form of lease payments from CTA.

Asked why she believed that the port continues to use CTA's services, rather than running the business itself, Cox said, "Because we're doing a good job.

"When we first started, we had some projections that went out to 2005," Cox said.

"The actuality has far exceeded those projections -- we probably didn't anticipate the second terminal in 2003, which was a great boon to all of us with the growing Alaska business. It really was great."

The port owns the land on which it builds the cruise facilities, which it also markets to cruise lines. The port maintains the docks and most of the buildings and buys the equipment necessary to run the cruise operations.

The port has never audited CTA, even when the company's slice of the pie grew wildly beyond the port's expectations -- and out of proportion to its investments in the business.

CTA's relationship with the port has changed over time, beginning as a management agreement in 2000 in which the port paid CTA a flat fee to oversee its cruise business at Pier 66, later giving it a cut of the revenues and profits from those operations.

But when the port decided to give the company a no-bid opportunity in 2003 to lease the new $18 million cruise facility at Terminal 30, it changed CTA's contract at Pier 66 from a management contract to a lease agreement.

It was that contract, in effect from May 2003 to December 2005, that saw CTA's revenues and profits surge ahead while the port was left treading water, paying off its investments slowly. The port was getting 25 percent of the net operating income, and 55 percent of revenues above $1.1 million.

Knudsen said the port figured that in its first two years running the newly opened Terminal 30, CTA had learned to run the terminals more efficiently than it had anticipated, leaving the port with an unsatisfactory deal. It was time to go back to the drawing board.

Reining in profits

Normally unflagging in its support of tenant success, the port staff decided that CTA's profits were excessive, given how much responsibility the port still had in the matter.

"The port staff, on their own initiative, came to us and said this is too lucrative for CTA," said Port Commissioner Bob Edwards. "They said it wasn't right that they were getting so much money for what they were doing, so they went in and renegotiated."

Already in the design work for the $60 million cruise project at Terminal 91, the port used the upcoming expiration of CTA's contract to bring its business partners to the table.

Three years earlier, the port staff had been touting that same contract with CTA as a good one because of the risk that CTA was taking in assuming operations of the business -- which proceeded to boom.

CTA general manager Cox said: "The pot was growing, and CTA agreed at the port's initiation to go back to the table. And CTA just asked for a longer lease because of that adjustment."

When asked what money CTA had invested for its part, Cox said, "Capital investments? CTA did not make a capital investment." Under the new deal with the port, CTA's future annual profits are projected to hover at an average of $650,000 -- a fraction of what they would have been under an extension of the original contract.

zoom Joshua Trujillo / P-I

The view from the Bell Street Pier Cruise Terminal, which is run by Cruise Terminals of America.

The port's success in renegotiating, however, raises the question of how much money it has left on the table from the past six years of operations -- and why it continues to hire CTA to run them. If it were to run the cruise business itself while keeping expenses low, the port calculated, it could pull in $3 million more than it currently foresees in profits over the next six years.

Dinsmore said that that study, which he commissioned, was a negotiating tool that did not accurately reflect the higher labor costs the port was likely to generate if it took over the operations.

The CTA's Cox does not see an unfair distribution of risk versus profit in the business arrangement.

"I think of the amount that CTA has invested in the whole business since the beginning -- when I say invested, let's talk time and expertise and connections and all of that, so I think that it is fair," she said. "I think the whole thing is fair."

Those connections were supposed to help fill the cruise terminals with profitable uses during the six winter months, helping to boost revenues for the structures, which sit mostly empty on the weekdays during the cruise season as well. But they didn't.

Because of the way the earlier lease was structured, the port would end up kicking back money to CTA during the off-season -- around $15,000 per month -- if CTA couldn't book any ships into the berth space. In the new lease, the port will take over the terminal in the off-season, hoping to fill its berths with fishing trawlers. Until last year, the port received an average of half of the annual revenues of the cruise business.

Though the port regularly invests millions of dollars to maintain its terminals for use by its tenants, CTA is one of only two companies doing business with the port to receive working capital to cover incidental operational expenses. The other is Columbia Hospitality, CTA's joint venture partner.

The port calls its taxpayer-funded subsidy of CTA normal to the process of running a business.

"The working capital fund was port money, in a port account, all of it spent on the expenses of running a port business, whether it was the vendor doing it or us doing it," said Knudsen, who oversees seaport operations. "If we had run it ourselves, we would still have had those expenses."

Under the new contract, the port continues to absorb many of the expenses associated with running the cruise business, splitting whatever remains 50-50 with CTA.

The port retains ownership and final approval of CTA's purchases and has turned down a few proposals in the past -- such as when CTA wanted the port to buy a barge, speculating that it would help business. The port turned that down because CTA hadn't lined up any contracts to justify the expense.

Typically, the port has pointed to the benefits of its contracts with other terminal operators as ways to reduce risk to the port.

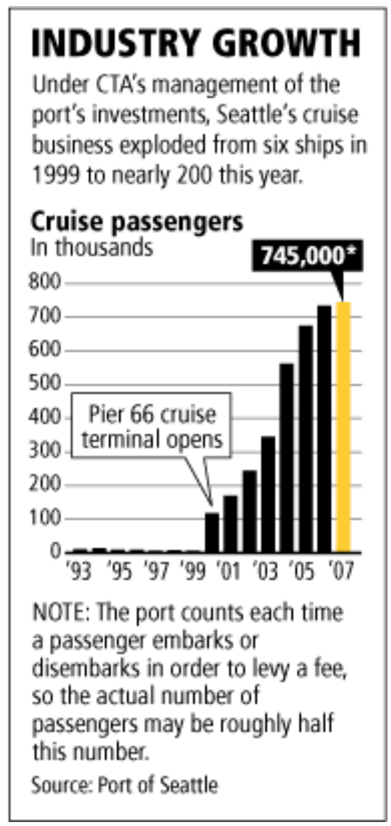
But in this case, the port has assumed all of the risk of the business -- using taxpayer money to guarantee private industry profits in the name of economic development.

For Port Commission President Pat Davis, the philosophy behind the port's actions is simple: "To make as much money as you can, everywhere you can."

Dinsmore agrees, reflecting that the port's actions have been "what public stewardship is all about."

A CLOSE PARTNERSHIP

The Port of Seattle wears two hats as a public entity with private business obligations, using a series of public/private collaborations to fulfill its mission as an economic engine for the region. In its relationship with Cruise Terminals of America, or CTA, which runs the port's cruise operations at Pier 66 and Terminal 30, the port assumed all the risk of creating Seattle's booming cruise business -- without getting a share of the profits that some felt reflected the public's investment.



Partnership highlights

The port says it could not have known how much the cruise business would grow when it crafted CTA's first lease contract, giving it a disproportionate share of the profits. Its relationship with CTA changed in 2003 from a management agreement to a lease agreement, extended last year.

Before March 2000

The Port of Seattle managed cruise operations. In March 2000, the port hired CTA to manage cruise terminal operations.

March 2000 – December 2000

Management fee paid to CTA by port:

- $12,000 to $25,000 per month

January 2001 – May 2003

Management fee paid to CTA by port:

- $5,000 per month

- 5% of gross revenue
- 20% of net operating income

May 2003 – December 2005

Port and CTA switch to a lease agreement under which the CTA leases the terminals from the port. Rent payments from CTA to the port:

- $10,000 per month
- 55% of revenue in excess of $1,100,000
- 25% of net operating income
- 80% of net parking income at Terminal 30

January 2006 – December 2006

Rent payments from CTA to the port:

- 0% of first $400,000 of revenue
- 65% of next $4.5 million of revenue
- 70% of revenues in excess of $4.9 million

January 2007 – December 2012

Rent payments from CTA to the port:

- 0% of first $400,000 of revenue
- 73% of next $4.5 million of revenue
- 76% of revenue in excess of $4.9 million

CRUISE BUSINESS ECONOMIC IMPACT

When the port takes losses from its cruise investments, it cites the gains of the region. Figures provided by the port tell a story of an economy buoyed by cruise passenger and crew spending, ship provisioning and support businesses. No independent economic impact studies have been conducted -- except by cruise associations and cruise ship companies. An economic consulting firm hired by the Port of Seattle estimated Seattle's 2004 cruise season to have created:

More than **1,730** direct, induced and indirect jobs in Washington. Of those:
809 are direct jobs -- held within firms serving vessels and passengers.
296 are induced jobs -- created by the earnings of those directly employed in companies supporting the cruise industry.
628 are indirect jobs -- created by the spending of those companies, not the individuals.
Nearly **$59 million** in local wages and salaries, including $19.5 million in direct wages and salaries.
$5.8 million in state and local taxes.
$208 million in revenue to local businesses supplying services to the cruise vessels, passengers and crew, as well as to businesses related to Sea-Tac Airport. Of the overall number, $178.8 million is direct business revenue.
Source: 2004 estimates by John C. Martin Associates, economic consulting firm hired by the Port of Seattle