

Punta Colonet & Arizona's Role as a Gateway for Asian Trade

Overview

Although the recession has slowed trans-Pacific trade projections, the long term trends indicate continued growth. It is estimated that by 2018, the U.S. West Coast Ports will have reached their maximum efficient capacity and their ability to expand will be restricted by urban development and environmental restrictions. This projected West Coast capacity restriction has created an opportunity for the establishment of a new West Coast mega-port in Punta Colonet, Mexico.

Historically, Arizona has served an increasing amount of Asian freight that enters or leaves the U.S. through the ports of Long Beach and Los Angeles. Though Arizona generates approximately \$340 million in container based exports each year (supporting an estimated 4,300 Arizona jobs, and resulting in approximately \$27 million in State and Local taxes collected), Arizona imports approximately \$9 billion of goods from Asia through the LA/Long Beach ports,. This remarkable trade imbalance, coupled with the fact that Arizona serves as a pass-through state for roughly 1/3 of the nation's trade, underscores the need to identify business strategies that stimulate value-added trade opportunities and economic growth for the State of Arizona.

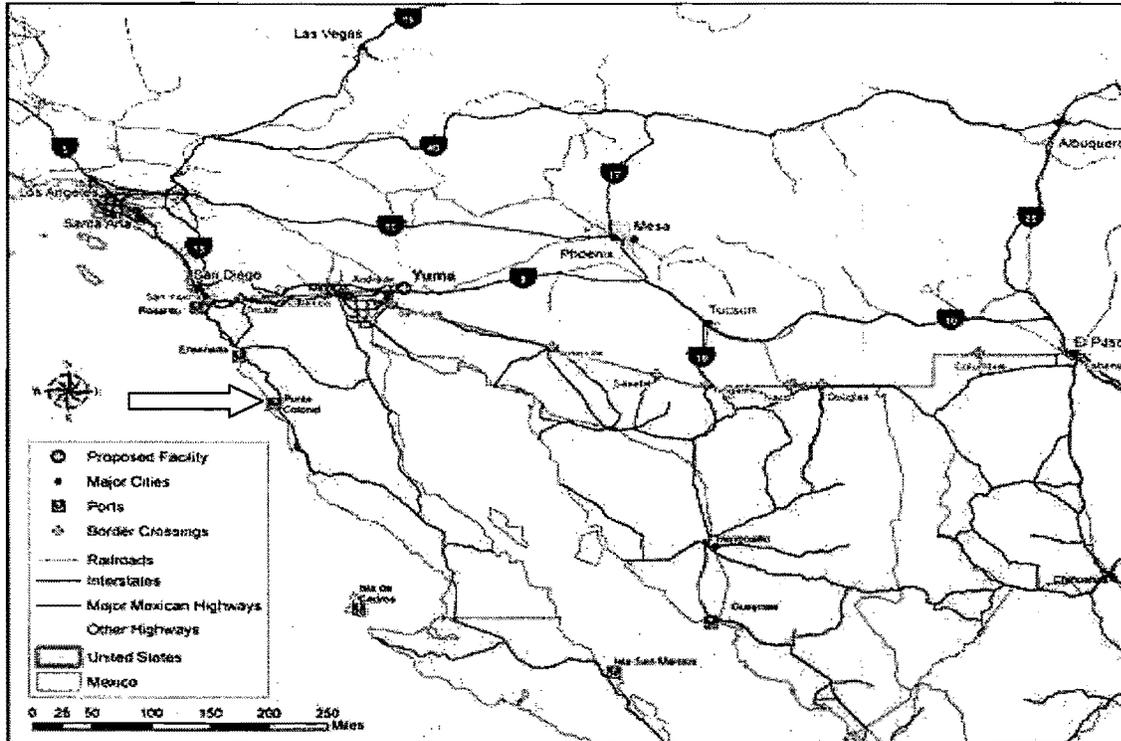
The establishment of a new mega-port in Punta Colonet, coupled with (1) a direct rail connection from that port through a border crossing in southern Arizona, and (2) an inland port in Arizona that serves as a platform for Asian trade flows from West Coast Ports, has the potential to significantly alter Arizona's competitive position relative to international and national trade, generate thousands of new jobs, and improve the State's tax base.

Punta Colonet Background Information

In September 2008 the Mexican federal government released a Request for Proposal (RFP) to construct a new mega-seaport in Punta Colonet, located in Northern Baja California.

The Mexican RFP indicated that up to two U.S. border crossings, at points located between Calexico/Mexicali and El Paso/Juarez may be chosen. Various statements by the Mexican Secretary of Transportation identify the Yuma region as one of the more obvious locations for a rail crossing from the Punta Colonet Port into the U.S. The bulk of the cargo processed by the Punta Colonet Port is expected to be transported directly to the U.S. market via the creation of a 205-mile rail line, which will serve as a land bridge from the Punta Colonet Port to the United States.

The Punta Colonet Port would be a greenfield development, as there currently is no existing infrastructure. The project is being structured as a joint port-and-rail project, requiring terminal operators, railroads, and construction companies to team up in a consortia to win the bid. The three primary contracts that will be awarded through this process will be 45-year concessions for (A) the establishment and management of the port authority; (B) the development and operation of marine terminals; and (C) the



development and operation of rail facilities. The estimated range of total investment of the Punta Colonet Multimodal Project as proposed by the Mexico's Secretariat of Communication and Transportation and the consortia is roughly between \$2.7 billion to \$5.0 billion (US dollars). As originally conceived, Punta Colonet was projected to have an ultimate capacity of 4 to 6 million TEUs annually, building from an initial volume of 1 million at the scheduled opening between 2012 and 2014, and growing to its ultimate capacity by 2030. This volume would generate approximately 7 trains a day in each direction growing upwards to 25 trains a day in each direction at full buildout.

In early 2009, the Mexican government announced that the bidding processes for the development of Punta Colonet would be modified. The combination of the economic slowdown (resulting in reduced trade flows) and the financial crisis created some uncertainty regarding the ports's viability. The most apparent modifications are Mexico's intent to mitigate some of the risk by retaining a consultant team (International Crossings and Bridges and the Felipe Ochoa Associates) to determine the most viable U.S. crossing points and a commitment to identify a means for both BNSF and UP to participate in the conveyance of the cargo. A new RFP, anticipated later in the Fall 2010 will specify the timeline and scope of the Punta Colonet development.

Arizona Opportunity

The Governor's CANAMEX Task Force, led by former Congressman Jim Kolbe, in conjunction with Arizona's Department of Transportation, has been advancing a study with Wilbur Smith Associates and Cambridge Systematics to evaluate the feasibility and market potential of constructing a state of the art multimodal logistics facility and industrial park, the Arizona Multimodal Logistic Center (AzMLC) that would serve as a

US platform for Asian trade flows through the proposed Punta Colonet port (much like the Inland Empire services the LA/Long Beach ports). The conceptual model for the AzMLC would be the Alliance Project in Texas, which to date has attracted \$5 billion in private investment, generated over \$150 million in property tax revenues and created over 24,000 full time jobs. The AzMLC would serve as the primary U.S. gateway for the Punta Colonet development project. It is important to emphasize that the study appears to indicate that even without Punta Colonet, Arizona can support a major economic engine, e.g. inland port, within the Sun Corridor to service the massive amounts of inbound trade.

The assumptions underlying the desire to perform the CANAMEX study were: (i) the Punta Colonet Port will be the first major port constructed on the West Coast of North America in the past several decades and its construction may represent an unprecedented opportunity for Arizona to create a platform to take advantage of and profit from global Asian trade flows; (ii) a rail crossing in Arizona and development of a major “gateway” value-added multimodal logistics center and industrial park, may be an important way to guarantee that Arizona does not remain a pass-through state for trade; (iii) Arizona may have the right combination of assets to support the development of a major economic development engine (AzMLC), including the region’s geographic proximity to the new port at Punta Colonet as well as major U.S. markets, the region’s excellent existing and expanding rail, highway and airport infrastructure, and the ability to customize the design and location of the AzMLC to meet current and emerging trade trends

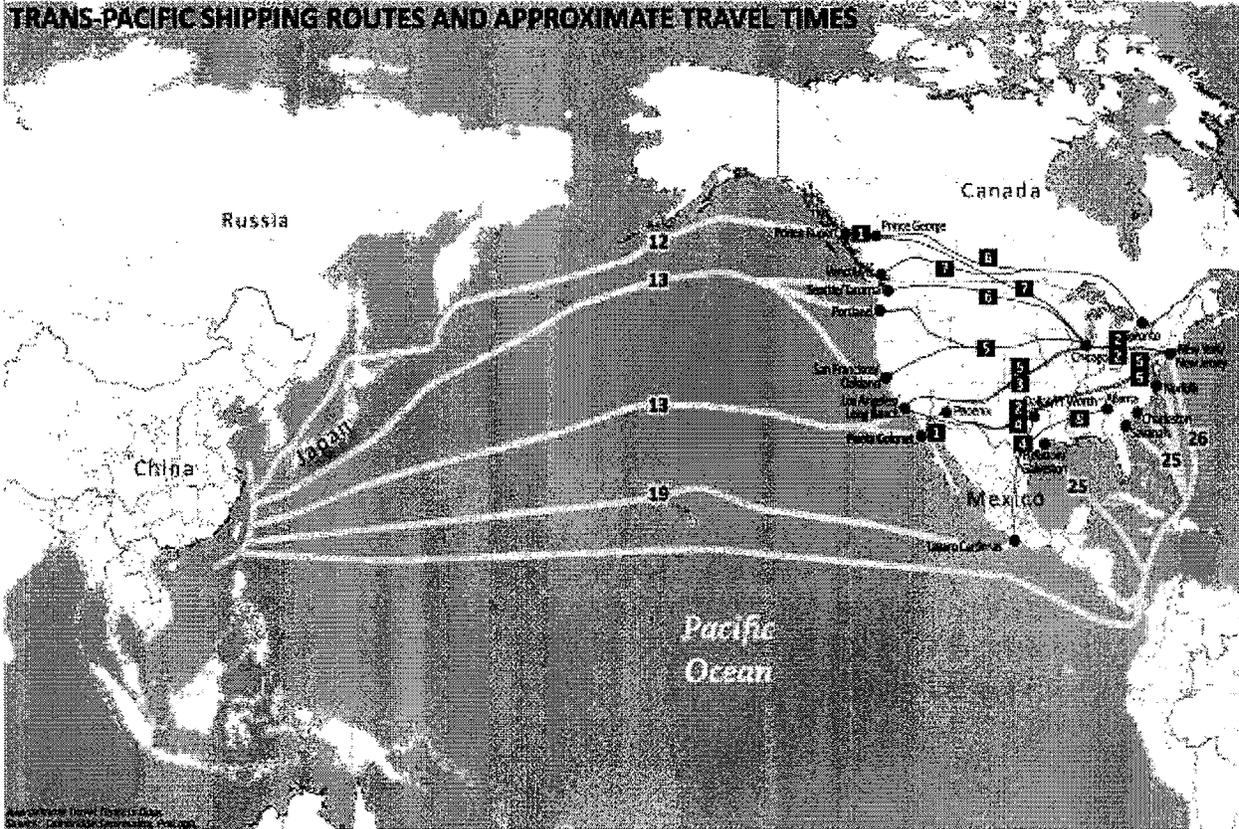
Preliminary finding from the CANAMEX study suggest considerable opportunity for Arizona to establish the AzMLC. Distance, cost and increased congestion at the U.S. West Coast Ports coupled with key factors support the feasibility of a multimodal logistic center, e.g. interstate access and Class 1 intermodal rail service, available land, access to air cargo facilities, trade and logistic expertise, close proximity to major consumer markets.

The image below highlights shipping advantages measured in days. Additionally, an initial estimation of costs indicates the route through Punta Colonet may be slightly less expensive than through LA/LB.

Revised projections for the U.S.’s west coast ports indicate that they are not expected to reach 100% utilization until 2030, however they will be at 80% capacity by 2018. Recognized as the point of maximum efficiency, a port’s productivity is often affected by congestion when it reaches 80%. The capacity deficit will be approximately 1 million TEUs in 2020, rising steeply to a deficit of over 10 million TEUs by 2030. This deficit could be accommodated by Punta Colonet.

A key challenge for Arizona is that a rail crossing in the Yuma region would likely place a significant burden on Southern Arizona’s infrastructure and communities. In particular, the Yuma area is home to one of the country’s most vibrant agribusiness centers. Accordingly, a new rail crossing to service the Punta Colonet Port would be

desirable if the region were to realize some level of economic benefits, and if efforts were made to mitigate negative impacts to the region's existing activities, particularly as related to the rail route's impact on the agribusiness industry.



**Shanghai-New York
Via Los Angeles
20 Days**

**Shanghai-New York
Via Punta Colonet
and AZ
19 Days**

Next Steps

Mexico

Following the modifications in 2009, Mexico solicited feedback from the potential bid pool. These interviews illuminated three primary concerns. 1) Border Crossing Location; 2) Secure and Expedited Service to the U.S. and 3) Viability of Port beyond being an overflow for Los Angeles/Long Beach.

Investors were not willing to make the considerable investments required for a new seaport and rail line without the assurances that a border crossing location was secured. To mitigate this risk two consultant groups (International Crossing and Bridges and the Felipe Ochoa Associates) have been retained by Mexico's Secretariat for Communication and Transportation to identify the specific location of the border crossing for the Punta Colonet Project (as opposed to requiring the bidders to select their desired crossing and initiate their own cross-border negotiations to secure the

desired route). Some of the leading factors that will influence the viability of a particular crossing point include accessibility to rail on the U.S side, the ability to tap into more than one Class I rail network, and the amount of bureaucracy and environmental issues with each proposed site.

The SCT consultants are reviewing information for five locations, three of which are in Arizona.

- Mexicali, Baja California/Imperial Valley, California
- Algodonas, Baja California/Andrade, California
- San Luis Rio Colorado, Sonora/San Luis, Arizona
- Nogales, Sonora/Nogales, Arizona
- Agua Prieta, Sonora/Douglas, Arizona

The assessment of each location will take several months and will need to include community outreach to ensure local support for the rail crossing. The San Luis location, likely located east of the new commercial port of entry with the rail line paralleling for some distance the Area Service Highway (ASH), offers the most obvious advantages to support Arizona's goal for a multi-modal logistic center. What follows is an initial review of each location.

Mexicali, Baja California/Imperial Valley, California

- Favored by Union Pacific due in large part to its unfavorable experiences with the Yuma region during an earlier bid process for the PC port's development.
- Existing rail line divides the binational communities of Calexico (not unlike the experience in Nogales, AZ) and creates congestion, safety and security concerns.
- Feasibility studies indicate this location adds an additional 70 miles due to the current configuration of the rail track
- Environmental and regulatory requirements in California are a challenge
- Offers no economic benefit for Arizona

Algodonas, Baja California/Andrade, California

- Currently the site of a small port of entry serving pedestrians, personal vehicles and small commercial trucks, a new rail crossing would be required
- Originally an undisclosed site south of this location was favored by UP, however certain alignments may put the rail line into the middle of the most productive mass of agricultural lands in Yuma. Although further study may identify a site, further south the Colorado River is largely delta
- May include impacts for up to 2 Native American Tribes (Quechan & the Cocopah)
- Potentially offers no economic benefit for Arizona

San Luis Rio Colorado/San Luis, Arizona

- Topographically suitable land east of new commercial port of entry
- Minimal impact to community or agricultural land and provides a barrier to further urban encroachment on strategic military installations
- Identified by some Yuma stakeholders as a viable route
- Potentially less cumbersome or lengthy presidential permit process due to extensive environmental and feasibility analysis already conducted for construction of San Luis II and the Area Service Highway (US 195).
- Provides Arizona important leverage point to secure economic benefits within Southern Arizona and the Sun Corridor
- Offers the only opportunity within Arizona to make a connection to both Class I railroads (UP and BNSF).
- Provides opportunity to establish a security paradigm that ensures and maintains the chain of custody of international cargo expeditiously to the U.S.

Nogales, Sonora/Nogales, Arizona

- Existing rail line bifurcates the existing binational communities and creates congestion, safety, and security concerns
- Hilly topography and land ownership create considerable obstacles
- Would not offer an opportunity for BNSF, thus furthering the monopoly of UP, an issue in the Mexican bid package.

Agua Prieta, Sonora/Douglas, Arizona

- Favored by BNSF because of some existing easements, which if retracked would divide the existing binational communities and create congestion, safety and security concerns.
- Offers no economic benefit to Arizona because the State lacks the infrastructure in Southeastern Arizona to support an inland port facility, therefore the trains would simply pass through our State and move into New Mexico and Texas.

Arizona

At this juncture, we believe it is critical that a strong and consistent message is articulated by Arizona stakeholders:

“We are excited and enthusiastically committed to working with SCT to identify a rail crossing from Mexico into Arizona, provided that (1) Arizona is able to participate in the economic activity through the development of a large inland port, similar to the inland port in Alliance, Texas, (2) appropriate actions are taken to mitigate negative impacts in the border area, and (3) the rail crossing solution results in improved rail connectivity for the Yuma region.”

The CANAMEX Task Force is coordinating data sharing with Mexico and a broad-based stakeholders group within Arizona and the U.S. To date, numerous technical and environmental reports and maps have been provided to assist with the border crossing assessment and to emphasize the viability of Arizona as the U.S. gateway to Punta Colonet. On April 19-21st, a series of high-level meetings were organized with the SCT

consultant to underscore our interest and requirements. Stakeholders included the private sector, Yuma officials, the Maricopa Association of Governments, Arizona Mexico Commission, Greater Phoenix Economic Council, Arizona Department of Transportation, the Governor's Office and the CANAMEX Task Force. Additional meetings were arranged last month with the Mexican consultants and the SCT official in charge of Punta Colonet.

Discussions are underway with DHS to create the necessary security protocol for the PC port to be included in the Container Security Initiative. Like the old adage cargo at rest is cargo at risk, the CSI program mandates that international ports meet stringent security requirements to be enrolled. In the PC port, it is envisioned that the cargo would be loaded at an Asian port within the CSI program, traverse the ocean where it would be offloaded to trains for immediate and expeditious transport to the U.S. The proposed rail route is expected to be able to maintain high and consistent speed levels minimizing the opportunities for the introduction of illegal conveyance. In addition, GPS and secure seal technologies would be deployed to reduce risks.

Maintaining a secure chain of custody offers an important advantage to Arizona. With the pressure to quickly move the cargo to the U.S., it is likely that value-added opportunities which may have been performed in Mexico due to lower labor cost will instead be conducted north of the border in Arizona. The movement of goods by rail is not conducive to numerous stops, thus it is imperative that Arizona identify the types of value added enhanced activities that could incentivize the cargo to stop. One of the priorities of the AZMLC study is to identify and develop these activities. Moreover, Arizona has traditionally shouldered the burden of increased freight movements by both truck and rail through the State without a commensurate benefit. As the U.S. gateway to these Asian trade flows, we may be able to finally alter our role and the rewards.

The State of Arizona has the potential to reap significant benefits (jobs, tax revenues, business creation, etc.) from the proposed Punta Colonet port provided that (1) the Yuma area is selected by SCT as the US rail crossing point for the port, and (2) an inland port facility (AzMLC) is developed within Arizona to take advantage of the Asian trade flows. If the PC Port is constructed and the rail land bridge links the PC Port to Arizona, we will have an opportunity to alter Arizona's traditional position as a "pass through" state for trade. Accordingly, the State should take all necessary actions to support SCT's selection of the Yuma area as the primary U.S. border crossing point, and work with the citizens of Yuma to identify an acceptable rail connection that mitigates negative impacts within the region.