



## MEMORANDUM

November 4, 2022

**TO:** MEMBERS, PORT COMMISSION  
Hon. Willie Adams, President  
Hon. Kimberly Brandon, Vice President  
Hon. John Burton  
Hon. Gail Gilman  
Hon. Steven Lee

**FROM:** Elaine Forbes  
Executive Director 

**SUBJECT:** Request approval of a proposed revision to the Port's operating reserve policy

**DIRECTOR'S RECOMMENDATION:** Approve the Attached Resolution No. 22-58

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*This item was presented as an informational item at the October 11, 2022 Port Commission meeting and is now before the Port Commission for approval. The changes from the informational staff memorandum are to focus on the request to amend the Port's operating reserve policy, correct typographical errors and make clarifications for consistency.*

### **EXECUTIVE SUMMARY**

The dramatic revenue reductions caused by the COVID-19 pandemic created unprecedented pressures on the Port. In Fiscal Year (FY) 2021-22, the Port's revenues were less than its expenses, resulting in an operating loss. Due to this loss, the Port failed to meet a debt coverage ratio requirement for its revenue bonds, and as a result hired a consultant to recommend financial adjustments to improve its coverage ratio. These recommendations include adjusting tenant rent as the market recovers, reducing costs incurred for services by the Fire Department, reviewing operating efficiencies with other City departments, and improving various internal financial practices.

In addition to the analysis to improve its debt coverage ratio, Port staff reviewed the Operating Reserve Policy, created in 2008, which requires reserves equal or greater to 15% of annual expenses. Staff recommends updating the policy to reflect actual Port

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practices and the risks unique to the Port enterprise by increasing the reserve requirement to 50% of annual expenses.

While the recent award of \$117 million in stimulus from the State of California has provided a needed short-term reprieve from the financial impacts of COVID-19, the return of tourism and the improvements discussed in this report will improve the long-term financial strength of the Port.

## **BACKGROUND**

The Port is proud of its strong 'A/Aa3/A' bond ratings. Rating agencies regularly review Port finances, and often cite our large fund balance and strong fiscal policies as critical components of their rating. While our ratings are stable<sup>1</sup> and the Port has made all debt service payments on time and in full, the revenue losses due to the COVID-19 pandemic caused the Port to fail one of its two debt service coverage ratio requirements for the first time in its history.

Under the bond indenture, which is our agreement with bond holders, the Port must meet the following two coverage ratio requirements:

1. The Port's operating income (revenues less expenses) must be at least equal to or greater than 1.0x the Port's revenue bond debt service, and
2. The Port's operating income plus amounts in fund balance<sup>2</sup> must equal or be greater than 1.3x the Port's revenue bond debt service.

In FY 2020-21, the first full fiscal year of the pandemic, the Port failed to earn positive operating income and therefore failed the first coverage requirement. However, because of the Port's large fund balance, the Port satisfied the second requirement.

Of critical importance, this initial ratio failure was not an event of default. Under the bond indenture, the coverage failure in FY 2020-21 required the Port to hire a consultant to review its operations and provide recommendations to improve its coverage ratio.

## **OPERATING RESERVE AMENDMENT**

In February 2008, the Port Commission adopted the Port's current Operating Reserve Policy through Resolution No. 08-12 (Operating Reserve Policy), requiring an operating reserve of at least 15% of annual operating expenses equal to at least two months of

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<sup>1</sup> Last affirmed at by Fitch in May 2022: <https://www.fitchratings.com/research/us-public-finance/fitch-affirms-port-commission-of-san-francisco-at-a-outlook-stable-06-05-2022>

<sup>2</sup> The bond holder agreement refers to a Revenue Stabilization Fund in the coverage requirement. The Port's fund balance serves as the Revenue Stabilization Fund; therefore, this report uses the more common term fund balance.

essential expenses. At the time of adoption, the Port's policy followed the recommendation of the Government Finance Officers' Association (GFOA).

The Port's fund balance serves as its operating reserve and has far exceeded the minimum 15% in every year since 2008. At the end of FY 2018-19, prior to the COVID-19 pandemic, the Port's fund balance equaled 67% of annual expenses. During the pandemic, fund balance dipped as low as 50% of annual expenses (end of FY 2020-21) but is now on an upward trajectory due to the Port's successful application for \$117 million in stimulus funds.

Since adoption of the Operating Reserve Policy, the GFOA amended its best practices guidelines to no longer recommend a specific percentage, but instead recommend a level of reserve that takes into account each public entity's own unique circumstances.

Given the economic uncertainty that COVID-19 imposed upon the Port and the need to utilize fund balance to offset revenue losses, the Port contracted with its financial advisory firm Backstrom, McCarly, Berry & Co., LLC to review its Operating Reserve Policy. On March 5, 2021, Backstrom issued the following recommendation:

*We recommend building and maintaining the operating reserve at least equal to 6 months of the operating budget when businesses re-open and the local economy returns to normalcy. Until then and while this crisis endures, a strategy to maintain a reasonable unrestricted fund balance of 2 to 3 months to ensure that the Port has the budget resources to maintain operations in a scenario that requires the Port to seek BOS approval to reappropriate portions of its large unspent capital funds.*

Port staff proposes implementation of this recommendation, revising the Port's mandatory operating reserve to a minimum of 50% of annual operating expenses (or six months), and during any economic crisis to ensure the reserve falls to no less than 25% (or three months).

## **RECOMMENDATION**

Port staff recommends that the Port Commission approve the attached resolution revising the Port's Operating Reserve Policy to require maintenance of a minimum of 50% (or six months) of annual operating expenses, and during any economic crisis to ensure the reserve falls to no less than 25% (or three months) of annual operating expenses.

Prepared by: Nate Cruz, Acting Deputy Director of  
Finance and Administration

**PORT COMMISSION  
CITY AND COUNTY OF SAN FRANCISCO**

**RESOLUTION NO. 22-58**

- WHEREAS, In February of 2008, the Port Commission approved the current Operating Reserve Policy through Resolution No. 08-12 (“Operating Reserve Policy”), requiring an operating reserve of at least 15% of annual operating expenses; and
- WHEREAS, Prior to the COVID-10 pandemic, the Port far exceeded the minimum reserve amount of 15% and had not drawn upon the reserve to subsidize operations; and
- WHEREAS, As a result of the COVID-19 pandemic total Port revenues fell by 40% of their pre-pandemic levels, resulting in operating losses in both FY 2020 and FY 2021, causing the Port to draw upon the operating reserve in order to maintain critical services and capital investments; and
- WHEREAS, During the pandemic, the Port hired a financial advisor to review the reserve policies of comparable agencies as well as current recommendations of the Government Finance Officers Association; and
- WHEREAS, The financial advisor recommended increasing the operating reserve minimum to 50% of annual operating expenses, and during any economic crisis to ensure the reserve falls to no less than 25% of annual operating expenses; and
- WHEREAS, Port staff concurs with the findings of the consultant, and believes it is in the best interest of the Port to increase the operating reserve to a minimum of 50% of annual operating expenses, and during any economic crisis to maintain an operating reserve of no less than 25% of annual operating expenses ; and, now therefore, be it
- RESOLVED, That Port maintain an operating reserve equal to the estimated cost of 50% (or 6 months) of annual operating expenses, and during any economic crisis Port maintain an operating reserve equal to the estimated cost of 25% (or 3 months) of annual operating expenses, and that the Operating Reserve Policy remain in full force and effect except as amended by this Resolution.

***I hereby certify that the foregoing resolution was adopted by the Port Commission at its meeting of November 8, 2022.***

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Secretary