

MEMORANDUM

February 8, 2018

TO: MEMBERS, PORT COMMISSION
Hon. Kimberly Brandon, President
Hon. Willie Adams, Vice President
Hon. Leslie Katz
Hon. Doreen Woo Ho

FROM: Elaine Forbes
Executive Director

SUBJECT: Informational Presentation on the Port's Fiscal Year (FY) 2018-19 and FY 2019-20 Biennial Operating Budget

DIRECTOR'S RECOMMENDATION: Informational Only

EXECUTIVE SUMMARY

This item provides an overview of the Port's proposed Fiscal Year (FY) 2018-19 and FY 2019-20 Biennial Operating Budget to allow for Port Commission and public feedback. Approval of the budget is scheduled for the next Port Commission meeting on February 27, 2018. Please note that the Charter requires departments to submit their budgets to the Mayor and the Controller's Office on February 21st. Should the Port Commission request adjustments at its February 27th meeting, Port staff will work with the Mayor's Office to reflect those changes in its budget submission.

The Port's proposed FY 2018-19 budget is \$192.6 million, a \$46.0 million (31.3%) increase from FY 2017-18. This includes \$103.2 million for Operating Expenses, \$54.1 million for Capital and \$35.3 million for Reserves. The proposed FY 2019-20 budget is \$161.3 million, a \$31.3 million (-16.2%) decrease from the proposed FY 2018-19 budget. This includes \$105.2 million for Operating Expenses, \$19.3 million for Capital and \$36.8 million for Reserves. While this budget is primarily supported by ongoing sources, staff recommend a total of \$47.8 million in one-time sources to fund the Capital Budget, including \$17.5 million in General Fund support to implement the San Francisco Seawall Program and Mission Bay Ferry Landing projects.

The proposed budget reflects the Port's commitment to prudent fiscal management and economic stability while laying a foundation for future growth and major infrastructure investments along the Waterfront. This spending plan closely manages growth in

This Print Covers Calendar Item No. 11A

operating expenses and continues a marked increase in capital investments through both direct spending and by designating net operating revenues for future investment. The biennial budget also acknowledges recommendations from the City's Controller's Office and Mayor's Office of Public Policy and Finance to control expense growth and grow revenues because citywide personnel costs continue to grow disproportionately to revenue projections. This trend can only be addressed through managing personnel growth and/or expanding revenues significantly.

STRATEGIC OBJECTIVES

The proposed FY 2018-19 and FY 2019-20 biennial operating and capital budgets are integral to implementing the Port's FY 2017-22 Strategic Plan. Funding over the next two years directly aligns with delivery of the Strategic Plan objectives including:

- *Sustainability*: Consolidation of environmental staff under the Planning and Environment Division will support cross training and collaboration and enable the division to plan for and implement sustainability programs.
- *Resiliency*: Continued funding for the San Francisco Seawall Program will support the Port's work to address the dual threats of earthquake and flooding risk along The Embarcadero for a safer City.
- *Renewal*: Resources for the Waterfront Land Use Plan update and major development projects will help identify and address major renewal needs .
- *Engagement*: Additional resources for the Public Information Office, including plans to fully update the Port's website, will foster proactive Port marketing and media relations.
- *Livability*: Continued partnership with WETA to expand our ferry system network at the Ferry Building and Mission Bay will expand public transit and ease traffic congestion.
- *Economic Vitality*: Funding for numerous capital projects supporting Maritime and Real Estate will encourage economic activity along the entire waterfront;

Consolidation of the Development and Real Estate staff will strengthen asset management and strategic development and leasing initiatives; and

Introduction of the Chief Operating Officer position will align the business objectives of the Maritime and Real Estate & Development divisions.

Lastly, the proposed budget is central to meeting crucial *Stability* objectives of the Strategic Plan:

- *Targets capital reinvestment in Port assets to maintain and improve current and projected financial performance* – The recommended capital projects will support

revenue stabilization and result in a net revenue benefit of \$26.3 million over the next 10 years (figure is discounted to adjust for inflation). These additional funds meet the Port's goal to increase revenue, will help support growing operating costs and may be reinvested in additional State of Good Repair (SOGR) projects identified in the Port's five-year Capital Improvement Program (CIP) and ten-year Capital Plan.

- *Meets the Port's Capital Policy to invest 25% of operating revenue in capital* – Both fiscal years of the budget far exceed the policy goal, by directly investing and designating net operation revenues equal to 55% and 35% of operating revenues in each respective year. Notably, an average of 26% operating revenues is directly invested in capital over the two fiscal years, exceeding the policy requirement prior to designating revenues for future investments .
- *Adheres to critical Port fiscal policies for maintaining prudent operating reserves* – As in prior years, the budget includes a 15% Operating Reserve for Port Operating Expenses.

While the proposed budget does not meet the Port's long-range revenue objective of \$125 million, Port staff will continue to seek and prioritize capital investments that will preserve and/or grow the Port's revenue base and will be prudent in managing the operating budget.

CITY BUDGET OUTLOOK

The City and County of San Francisco ("City") has enjoyed an extended period of economic expansion. Lasting approximately nine years, from 2009 to today, this period of growth is the third longest in U.S. history since 1945. Given that it would be an historic anomaly to avoid a recession in the next five years, the City is projecting lower revenue growth rates through FY 2021-22. As it predicts slower revenue growth, the City's increasing personnel costs are placing a higher demand on available resources. Considering these trends, the Mayor's Office of Public Policy and Finance currently projects General Fund shortfalls of \$88.2 million for FY 2018-19 and \$173.4 million in FY 2019-20, for a cumulative shortfall of \$261.6 million in the two-year period.

To address the budget deficit, the Mayor's Office of Public Policy and Finance directed General Fund departments to submit ongoing budget savings equal to 2.5% of their General Fund Support for each fiscal year for a cumulative 5% savings. Enterprise departments were directed to absorb all known cost increases by increasing revenues or reducing expenditures. Additionally, to control citywide growth in personnel costs the Mayor's Office has instructed all City departments that they may not add any full-time equivalents (FTEs) to the budget.

As an enterprise department, the Port must be self-sustaining. The proposed budget reflects prudent management of Port resources, seeking to balance a diverse set of priorities including future growth in areas such as Pier 70 and Seawall Lot 337, state of good repair investments in our facilities, and the San Francisco Seawall Program, with the need to control personnel expenses. The budget meets that goal by absorbing

operating expense growth through revenue increases, while meeting the Port's operating reserve and capital policies. The budget includes recommendations for new positions, but these FTEs are offset by salary savings (e.g. other budgeted positions will be held vacant) or are contingent upon the availability of project funding and do not count towards the citywide position count. Also, while Port staff recommends requesting \$17.5 million from the City's General Fund to support the San Francisco Seawall Program and the Mission Bay Ferry Landing Project, the request is consistent with the Mayor's budget instructions, given that the projected deficit assumes an allocation of General Fund monies to support the City's capital program. The Port's projects will be reviewed along with other capital requests to determine the best use of General Fund support.

PORT BUDGET OUTLOOK

The Port's fiscal outlook for the coming two fiscal years is steady but faces challenges from growing personnel costs paired with reduced revenue projections resulting from the Piers 68-70 shipyard closure, softening cruise revenues, and a general market slowdown in sales that is slowing growth in Percentage Rents from real estate tenants.

The proposed budget addresses these challenges by applying a reasonably optimistic outlook for new lease revenues and only allowing discretionary expenditure growth in strategic areas, including interim operational support for the Shipyard, investment in critical information technology systems that will improve the Port's financial and asset management, and funding to achieve California Environmental Quality Act (CEQA) approval of the updated Waterfront Land Use Plan. The budget addresses staffing needs through position substitutions and project-funded positions that are contingent upon the availability of funds.

This approach alleviates strains on an operating budget stretched under the weight of many demanding priorities. Examples of the major challenges and opportunities before the Port include:

- The Port's 24+ million annual visitor volume requires more security, environmental stewardship, and maintenance resources;
- Development of the park network and revitalization of sections of the waterfront require planning, programming, and maintenance;
- Activation of Port properties is driving higher permit volumes, requiring additional staffing resources and coordination with other City departments;
- Over \$100 million in capital investments over the past five years is requiring the Engineering Division to reexamine project management staffing;
- New development projects at Pier 70 and Seawall Lot 337 require additional staff, consultant, and interdepartmental support resources; and

- Implementation of the San Francisco Seawall Program requires top notch technical expertise, coordination with other City departments, a strong public outreach campaign, and significant public investments that are well beyond the Port's means.

Through strategic investments this budget proposal meets these challenges, provides stability in the face of an evolving economic climate and positions the Port to implement critical projects over the next two years and beyond.

BUDGET OVERVIEW

The Port's proposed FY 2018-19 budget is \$192.6 million, including \$103.2 million for Operating Expenses, \$54.1 million for Capital and \$35.3 million for Reserves. The \$46.0 million (31.4%) increase from FY 2017-18 budget is driven by growth in all areas, including Operating Expenses (\$10.6 million, 11.4%), Capital Investments (\$29.2 million, 117.5%) and Reserves (\$6.2 million, 21.3%).

The proposed FY 2019-20 budget is \$161.3 million, including \$105.2 million for Operating Expenses, \$19.3 million for Capital, and \$36.8 million for Reserves. The \$31.3 (-16.2%) decrease from the proposed FY 2018-19 budget is driven by \$2.0 million (2.0%) growth in Operating Expenses and \$1.5 million (4.3%) growth in Reserves, offset by \$34.8 million (-64.3%) decline in Capital Investments.

Table 1: Summary of Total Port Sources and Uses (\$ Millions)

	Budget 2017-18	Proposed 2018-19	Change from FY 2017-18		Proposed 2019-20	Change from FY 2018-19	
			Amount	%		Amount	%
Sources							
Operating Revenues	\$ 104.5	\$ 102.3	\$ (2.2)	-2.1%	\$ 106.5	\$ 4.2	4.1%
Estimated Fund Balance	30.8	45.2	14.4	46.8%	25.2	(20.0)	-44.3%
South Beach Harbor & Marina	4.9	4.7	(0.2)	-4.1%	4.9	0.2	4.6%
Development Recoveries	1.6	7.0	5.5	351.6%	9.1	2.1	30.0%
Transbay Payment	0.6	0.6	-	0.0%	0.6	-	0.0%
Ongoing, Subtotal	\$ 142.3	\$ 159.8	\$ 17.5	12.3%	\$ 146.3	\$ (13.5)	-8.5%
Operating Revenue	-	15.0	15.0	0.0%	15.0	-	0.0%
General Fund	3.5	17.5	14.0	400.0%	-	(17.5)	-100.0%
General Fund, Revolving Capital Fund	-	-	-	0.0%	-	-	0.0%
Other Departmental Contributions	0.8	0.3	(0.5)	-62.5%	-	(0.3)	-100.0%
One-time, Subtotal	\$ 4.3	\$ 32.8	\$ 28.5	661.6%	\$ 15.0	\$ (17.8)	-54.2%
Total Sources	\$ 146.6	\$ 192.6	\$ 46.0	31.3%	\$ 161.3	\$ (31.3)	-16.2%
Uses							
Operating Expenses	\$ 81.7	\$ 85.8	\$ 4.1	5.0%	\$ 86.4	\$ 0.6	0.7%
Programmatic Projects	4.3	6.2	1.9	44.6%	4.6	(1.6)	-25.8%
Development Projects	2.6	7.5	4.9	188.5%	9.6	2.1	28.0%
South Beach Harbor & Marina	4.0	3.7	(0.3)	-7.5%	4.6	0.9	24.3%
Operating Expense, Subtotal	\$ 92.6	\$ 103.2	\$ 10.6	11.4%	\$ 105.2	\$ 2.0	2.0%
Port Capital Appropriations	\$ 17.8	\$ 35.3	\$ 17.5	98.4%	19.0	(16.3)	-46.1%
General Fund, Other City Investments	6.2	17.8	11.5	185.4%	-	(17.8)	-100.0%
South Beach Harbor & Marina	0.9	1.1	0.2	24.5%	0.3	(0.8)	-72.7%
Capital Budget, Subtotal	\$ 24.9	\$ 54.1	\$ 29.2	117.5%	\$ 19.3	\$ (34.8)	-64.3%
Designation to Future Capital	\$ 16.2	\$ 21.5	\$ 5.3	32.6%	\$ 23.1	\$ 1.6	7.5%
15% Operating Reserve	12.9	13.8	0.9	7.0%	13.7	(0.1)	-0.7%
Reserves, Subtotal	\$ 29.1	\$ 35.3	\$ 6.2	21.3%	\$ 36.8	\$ 1.5	4.3%
Total Uses	\$ 146.6	\$ 192.6	\$ 46.0	31.4%	\$ 161.3	\$ (31.3)	-16.2%
Capital Policy - 25% Oper. Revenues	\$ 26.1	\$ 25.6	\$ (0.6)	-2.1%	\$ 26.6	\$ 1.1	4.1%
Total Investment & Designation	\$ 34.0	\$ 56.8	\$ 22.8	67.1%	42.1	(14.7)	-25.8%
Port Capital Appropriations	17.8	35.3	17.5	98.4%	19.0	(16.3)	-46.1%
Designation Required	8.4	-	\$ (8.4)	-100.0%	7.6	7.6	0.0%
Designation - Additional	7.9	21.5	\$ 13.6	173.6%	15.5	(6.0)	-28.1%
Actual Percent Achieved	33%	55%	23%	71%	40%	(0.2)	-29%

FUNDING SOURCES

The Port's proposed FY 2018-19 and FY 2019-20 budget is supported by a variety of ongoing funding sources, including Operating Revenues, Fund Balance, South Beach Harbor and Marina fees, Development Recoveries, and an annual payment from the Transbay Cable Company that directly supports capital.

The budget is also supported by one-time sources dedicated to the Capital Budget, either through direct investment or by designated funds to future capital investments. In addition to \$17.5 million in General Fund support recommended for the Seawall Project and Mission Bay Ferry Landing, the budget reflects \$15 million in one-time revenues in each year (\$30 million total) from expected property sales. The one-time sources would support the Capital Budget through direct investments and by designating any unused balances to future capital investments.

The FY 2018-19 and FY 2019-20 revenue budget reflects changes in Maritime and Real Estate sources as the Port addresses the closure of the Piers 68-70 shipyard, softening cruise revenues, and a general market slowdown in sales that is slowing growth in Percentage Rents. These challenges urge the Port to continue to identify new revenue sources by investing in facilities to facilitate interim leasing opportunities and to continue to pursue opportunities such as increased cargo at Pier 80 through Pier 96.

Total sources identified in the FY 2018-19 budget are \$192.6 million, a \$46.0 million (31.3%) increase over the FY 2017-18 budget. The year over year change in the budget is due to a \$17.5 million (12.3%) increase in Ongoing Sources and a \$28.5 million (661.6%) increase in One-time Sources.

Total sources identified in the FY 2019-20 budget are \$161.3 million, a \$31.3 million (-16.2%) decrease from the proposed FY 2018-19 budget. This change is driven by a \$13.5 million (-8.5%) decrease in Ongoing Sources and a \$17.8 million (-54.2%) decrease in One-time Sources.

Operating Revenues

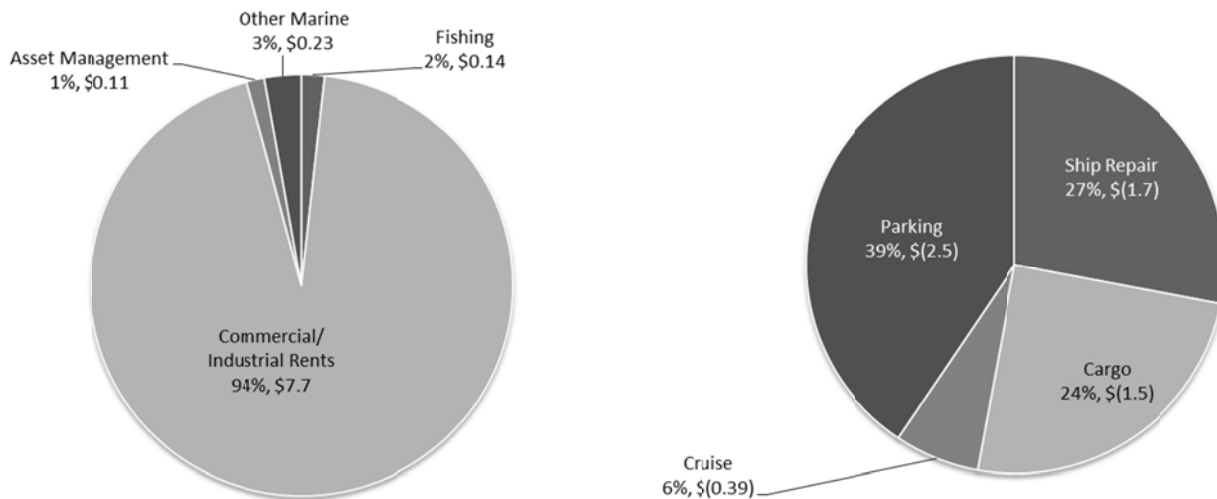
The Port's Operating Revenues include rents, fees and fines related to Maritime, Real Estate and Development and other smaller revenue-generating operations of the department. As detailed in **Table 2**, Operating Revenues in FY 2018-19 are \$102.3 million, which represents a \$2.1 million (-2.1%) decrease from the FY 2017-18 approved budget. Operating Revenues in FY 2019-20 are \$106.5 million, a \$4.2 million (4.1%) increase over the proposed budget for FY 2018-19.

Table 2: Summary of Port Operating Revenues (\$ Millions)

	Budget 2017-18	Projected 2017-18	Change from FY 2017-18 Budget		Change from FY 2017-18 Projected		Proposed 2018-19	Change from FY 2018-19 Budget		Proposed 2019-20
			Amount	Percent	Amount	Percent		Amount	Percent	
MARITIME										
Cargo	\$ 8.5	\$ 6.6	\$ (1.7)	-20.1%	\$ 0.2	3.4%	\$ 6.8	\$ 0.2	3.1%	\$ 7.0
Ship Repair	1.7	-	(1.7)	-100.0%	-	0.0%	-	-	0.0%	-
Harbor Services	2.0	2.0	(0.1)	-5.7%	(0.1)	-5.7%	1.9	0.0	0.8%	1.9
Cruise	8.4	7.3	(0.6)	-7.1%	0.5	7.2%	7.8	0.2	2.6%	8.0
Fishing	2.3	2.3	0.1	3.1%	0.1	5.1%	2.4	0.0	1.3%	2.4
Other Marine	1.7	1.8	0.2	10.0%	0.1	5.3%	1.9	0.1	5.3%	2.0
Total Maritime	\$ 24.6	\$ 19.9	\$ (3.9)	-15.7%	\$ 0.8	4.3%	\$ 20.8	\$ 0.6	2.7%	\$ 21.3
REAL ESTATE										
Commercial/Industrial	\$ 54.1	\$ 53.9	\$ 1.4	2.7%	\$ 1.6	3.0%	\$ 55.5	\$ 6.2	11.2%	\$ 61.8
Parking	23.7	23.2	0.2	0.7%	0.7	3.0%	23.9	(2.6)	-11.0%	21.2
Total Real Estate	\$ 77.7	\$ 77.1	\$ 1.6	2.1%	\$ 2.3	3.0%	\$ 79.4	\$ 3.6	4.6%	\$ 83.0
ALL OTHER										
Asset Management	\$ 0.3	\$ 0.3	\$ 0.1	24.2%	\$ 0.1	50.1%	\$ 0.4	\$ 0.0	9.4%	\$ 0.4
Facilities Maintenance	0.0	-	-	0.0%	0.0	0.0%	0.0	-	0.0%	0.0
Engineering	0.8	0.9	0.0	2.0%	(0.0)	-4.4%	0.8	-	0.0%	0.8
Finance & Admin.	0.9	1.1	(0.0)	-2.2%	(0.2)	-18.4%	0.9	-	0.0%	0.9
Planning	-	0.0	-	0.0%	(0.0)	-100.0%	-	-	0.0%	-
Executive	0.0	0.1	-	0.0%	(0.0)	-55.9%	0.0	-	0.0%	0.0
Total All Other	\$ 2.1	\$ 2.3	\$ 0.1	3.4%	\$ (0.1)	-6.3%	\$ 2.2	\$ 0.0	1.7%	\$ 2.2
SUBTOTAL	\$ 104.5	\$ 99.3	\$ (2.2)	-2.1%	\$ 3.0	3.0%	\$ 102.3	\$ 4.2	4.1%	\$ 106.5
South Beach Harbor	\$ 4.9	\$ 4.7	\$ (0.1)	-2.8%	\$ 0.1	1.3%	\$ 4.8	\$ 0.1	3.0%	\$ 4.9
GRAND TOTAL	\$ 109.4	\$ 104.0	\$ (2.5)	-2.3%	\$ 2.8	2.7%	\$ 106.9	\$ 4.4	4.1%	\$ 111.2

As shown in **Figures 1 and 2**, below, over the two-year period, the major driver of revenue growth is commercial/industrial rents, whereas the major drivers of revenue loss are the loss of parking lot revenues, the closure of the shipyard, and restructuring of cargo revenues from Pasha Automotive.

Figure 1 and 2: Major Drivers of Revenue Growth and Revenue Loss/Adjustment from FY 2018-19 and 2019-20 Budgets (\$ Millions)



Revenue Growth:

Commercial/Industrial Rents – Port Commercial/Industrial Rents derive from established lease rates and percentage rent from leasing office, retail, warehouse and industrial property to non-maritime tenants.

In FY 2018-19, Commercial/Industrial Rent is expected to increase \$1.6 million (2.1%), for a total of \$55.5 million, and by an additional \$6.2 million (11.2%) in FY 2019-20 for a projected total of \$61.8 million. While much of the increase over the two-year period (\$2.4 million, 29%) is associated with steady growth in commercial and industrial base rents, this growth is offset by a projected decline in percentage rents (-\$0.8 million) compared to budget. This cooling in percentage rents is consistent with the citywide projection for economic slowdown and should be closely monitored as a potential weakness in the budget.

Notably, the largest factor in projected Commercial/Industrial Rents is anticipated leasing at facilities currently being improved or planned for development. Tenants are slated to move in at Piers 19, 23, and 29 (former America’s Cup venues), Pier 31, and Pier 38 in the coming fiscal years, generating an estimated \$1.5 million and \$5.5 million in FY 2018-19 and FY 2019-20, respectively. This revenue is contingent, however, upon Port staff’s ability to complete funded capital improvements, identify prospective tenants, and complete new lease or development agreements for these facilities.

Other Marine – This revenue category consists of ferries, water taxis, ceremonial and idle ship berthing, and miscellaneous marine-related tenants. Estimates include the dockage of three US Department of Transportation Maritime Administration vessels (or “MARAD vessels”) at fixed annual rent of \$0.5 million through 2019 and assume a new agreement with similar terms after that. This category estimates a revenue increase of

\$0.2 million (10%) for FY 2018-19, and an additional \$0.1 million (3%) for FY 2019-2020.

Fishing – Fishing revenue derives from fishing vessels and fish processing operations and includes dockage, wharfage, and rent. Dockage is estimated based on actual occupancy rates, projections for fishing tours in the next year, and annual inflation. Wharfage is estimated based on a percentage of passengers on sport fishing boats. Lastly, Rent is derived from fishing equipment storage lockers. Revenues from these business areas are projected to increase by \$0.1 million in FY 2018-19 and \$0.1 million in FY 2019-20, accounting for 6% of projected revenue growth over the two-year period.

Revenue Losses/Adjustments:

Parking – Port parking revenue is generated from street parking meters, monthly parking stalls, rent from Port parking lots managed by parking operators, and parking ticket fines.

In FY 2018-19, parking revenue is expected to increase by \$0.2 million (0.7%) for a total of \$23.9 million and then decrease sharply by \$2.6 million (11%) to \$21.2 million. This represents 39% of the Port's total revenue losses over FYs 2018-19 and 2019-20. The major drivers of this loss are declines in parking rent, which is falling due to the closure of lots for development, and in parking citation revenues, which are declining due to greater enforcement, higher fines that incentivize proper payments at meters, and improved technological amenities (i.e. pay-by-phone and meters that accept credit cards). The drop in citation revenues is consistent with trends observed by the SFMTA citywide.

Ship Repair — Ship repair revenue is generated from ship repair operations at Piers 68-70. The Port is currently seeking a new ship repair operator; however, the budget assumes no revenue for FY 2018-19 or FY 2019-20. This represents a loss of approximately \$1.7 million in annual revenue, accounting for \$3.4 million and 27% of revenue losses over the two-year period.

Cargo – Cargo revenue derives from cargo shipping operations and related rents, including dockage fees charged to vessels berthed along Port property, wharfage fees from the loading and unloading of cargo from vessels, crane rental fees for the use of Port cranes for loading and unloading operations, rent from leasing of Port property to tenants with cargo operations, and demurrage charged to store autos or other cargo activities at Port facilities.

Overall, Cargo is performing well under the Port's relatively new operator partnership with Pasha Automotive. However, when staff developed the FY 2016-17 and FY 2017-18 biennial budget, the draft agreement with Pasha stipulated that the Port would receive gross revenue and then distribute Pasha's share. Subsequently, the executed agreement stipulated the opposite, resulting in much lower net revenues to the Port. While this change also resulted in significantly lower expenditures in the form of

operator payments, the impact to revenues accounts for most of the “loss” seen in the budget. Additionally, auto volume through the facility has been lower than originally projected.

Taking these factors into account, the budget reduces Cargo revenues by \$1.7 million (20.1%) from FY 2017-18 to FY 2018-19, with increases of \$0.2 million (3%) between FY 2018-19 and 2019-20 as auto volumes grow. Overall this change accounts for 24% of the Port’s total revenue reduction over the two-year period.

Cruise – Cruise revenue is generated from passenger cruise vessel operations, including dockage and wharfage fees that are charged to cruise ships for berthing at Port facilities as well as the loading and unloading of passengers. Additionally, the Port recovers fees from cruise lines to offset utility charges for use of the shoreside power system at the James R. Herman Cruise Terminal.

The budget projects that cruise revenues will decrease by \$0.6 million (7.1%), for a total budget of \$7.8 million in FY 2018-19. This budget reflects actual bookings of 77 cruise calls and 275,000 passengers, and the actual performance of the parking revenue at the cruise terminal. Revenues are budgeted to bounce back after this temporary decline, adding \$0.2 million (2.6%) in FY 2019-20 due to increases in passenger volume and special events. Overall, this adjustment accounts for 6% of revenue losses. As demonstrated in **Table 3**, special events at the cruise terminal are performing well, expecting to gain \$0.4 million in FY 2018-19 and remain constant in FY 2019-20. Wharfage and dockage revenues also assume 77 calls and approximately 275,000 passengers in FY 2018-19, with growth in passenger volume in FY 2019-20 as larger ships call on San Francisco.

Table 3: Summary of Cruise Traffic and Revenues

	<u>FY 2017-18</u>	<u>FY 2018-19</u>	<u>FY 2019-20</u>
Cruise Calls	77	77	77
Passenger Volume	274,763	275,000	283,250
Wharfage and Dockage	\$ 5,270,000	\$ 4,997,800	\$ 5,147,900
Shoreside Power	\$ 1,000,000	\$ 1,000,000	\$ 1,000,000
Special Events	\$ 1,228,000	\$ 1,387,100	\$ 1,428,700
Rent	\$ 197,000	\$ 202,600	\$ 208,700
<u>Parking Revenue</u>	<u>\$ 564,000</u>	<u>\$ 245,100</u>	<u>\$ 252,500</u>
Total Cruise	\$ 8,259,000	\$ 7,832,600	\$ 8,037,800

Fund Balance

The Port uses its Fund Balance to fund the Capital Budget and maintain the 15% Operating Reserve. Fund Balance accumulates as a result of year-end surplus and designating projected net operating revenue to future capital projects.¹

While Operating Revenues contribute to steady year-over-year growth in funding sources, Fund Balance creates significant swings in funding due to variances in one-time sources. Fund Balance is unusually high, at \$45.2 million, in FY 2018-19 due to high capital designations included in the FY 2016-17 and FY 2017-18 operating budgets (\$13.4 and \$16.2 million respectively) and the accumulation of net revenues in FY 2016-17 that were not appropriated to the capital budget. While still high, the second year of the budget reflects a significant decline in Fund Balance, to \$25.2 million, due to the spend down of prior year balances.

South Beach Harbor and Marina

South Beach Harbor generates revenue as a full-service marina consisting of 700 slips with concrete docks, a 640-foot recreational and commercial Guest Dock, and the Pier 40 Maritime Center.

The proposed budget includes \$4.7 million in FY 2018-19, a \$0.2 million (-4.1%) decrease from FY 2017-18, and \$4.9 million in FY 2019-20, a \$0.2 million (4.6%) increase from the proposed FY 2018-19 budget. These changes reflect annual inflation of berthing rates to fully support the harbor's operating expenses, including staffing, non-personnel expenses and debt service on the facility's Cal Boating loans.

The Port is striving to build in sound fiscal policies and practices to South Beach Harbor's budget. The proposed budget allocates net operating revenues to capital improvements, including \$1.1 million in direct capital investments in FY 2018-19 and \$0.3 million in FY 2019-20. Any unallocated net operating revenues are designated to future capital in FY 2019-20. The Port will continue to maximize net revenues from the South Beach Harbor budget to support infrastructure repairs and enhancements necessary to sustain a safe and enjoyable facility.

Development Recoveries

In recent years the Port has made a tremendous effort to complete negotiations on Development and Disposition Agreements (DDAs) with developers including Forest City and the Giants for projects at Pier 70 and Seawall Lot 337. During this effort, the Port funded project transaction costs including professional services, legal costs from the

¹ Rather than fund capital projects directly from Operating Revenues, this practice ensures that funds are fully realized before they are committed to capital projects. At the end of the fiscal year, designated revenues are converted to Fund Balance for appropriation in the following year's Capital budget. This methodology adheres to a citywide practice.

City Attorney and outside counsel, Office of Economic and Workforce Development (OEWD) staff time and Planning Department permitting fees through its operating budget. Exclusive Negotiating Agreements (ENAs) between the Port and developers for projects including the Forest City and Orton Development projects at Pier 70, Mission Rock at Sea Wall Lot 337 and Seawall Lot 351, allowed the Port to recover its transaction costs from developers.

Completion of the DDAs signals the start of development for both the Forest City Pier 70 and the Giants Seawall Lot 337 projects. As development begins, the Port must provide a variety of services, support and oversight to facilitate planning, permitting and, ultimately, construction of the projects. This effort will require the Port to increase its staff, professional services and work order budgets. As with the ENAs, these Port expenses will be eligible for reimbursement by the developers, keeping the impact on the Port's operating budget neutral. This arrangement facilitates the Port's goals for growth and infrastructure investment along the Waterfront while allowing the Port to maintain prudent levels of operating staff and expenditures.

The proposed FY 2018-19 budget includes assumed recoveries of \$7.0 million from developers, a \$5.5 million (351.6%) increase from the FY 2017-18 budget. The FY 2019-20 budget includes assumed recoveries of \$9.1 million, a \$2.1 million (30%) increase to reflect the expenditure of a project balance in the subsequent fiscal year. These levels of spending and associated recoveries directly reflect the expansion of resources, including Port staff, consultants, interdepartmental coordination agreements, and interdepartmental work order agreements, necessary to support the major development projects. The Port will only recover sufficient funds from the developers as is needed to cover actual expenses.

One-Time Sources

The proposed budget includes \$32.8 million in FY 2018-19 and \$15.0 million in FY 2019-20 in one-time sources. These amounts represent a \$28.5 million (661.6%) increase from FY 2017-18 and \$17.8 million (-54.2%) reduction in the next fiscal year. Rather than rely on uncertain funding to support the Port's operating budget, these one-time sources support the proposed FY 2018-19 and FY 2019-20 Capital Budget through direct investments in each fiscal year or by designating un-programmed balances to future capital investments.

Operating Revenues – Land Sales

The proposed sources for this budget include one-time Commercial/Industrial rents from planned sale of the Ferry Building (\$15.0 million in FY 2018-19) and an affordable housing credit from the Mayor's Office of Housing from the sale of Seawall Lot 322-1 (\$15.0 million expected in FY 2019-20).

General Fund Support

The other significant one-time source of funds is a \$17.5 million General Fund request recommended by Port staff to support the San Francisco Seawall Project (\$6.5 million) and the Mission Bay Ferry Landing Project (\$11.0 million). The Port will submit a request for these funds to the Capital Planning Committee (CPC), which will evaluate these projects alongside other City department requests. Once the CPC determines how to invest the General Fund capital allocation for FY 2018-19, approved funding levels will be included in the Mayor's Budget and will undergo consideration by the Board of Supervisors.

OPERATING EXPENSES

The proposed \$103.2 million FY 2018-19 Operating Budget reflects a \$10.6 million (11.4%) increase over the FY 2017-18 budget. The proposed \$105.2 million FY 2019-20 budget reflects a \$2.0 million (2.0%) increase from the proposed budget for FY 2018-19. This budget includes general Operating Expenses, which support the core day to day operations of the Port, Programmatic Projects, Development Projects, and South Beach Harbor and Marina operations.

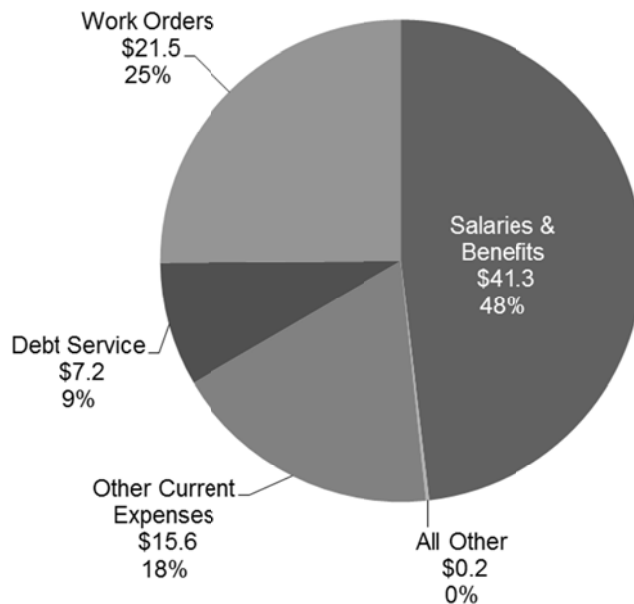
Table 5: Summary of Port Operating Expenditures & Projects (\$ Millions)

	Budget 2017-18	Change from 2017-18 Budget		Budget 2018-19	Change from FY 2018-19 Budget		Budget 2019-20
		Amount	Percent		Amount	Percent	
Salaries & Benefits	\$ 39.2	\$ 2.1	5.4%	\$ 41.3	\$ 1.6	3.9%	\$ 42.9
City-wide Overhead	\$ 0.2	\$ -	0.0%	\$ 0.2	\$ -	0.0%	\$ 0.2
Other Current Expenses	\$ 13.1	\$ 0.2	1.7%	\$ 13.3	\$ (1.3)	-9.8%	\$ 12.0
Materials & Supplies	\$ 1.6	\$ 0.0	1.2%	\$ 1.6	\$ -	0.0%	\$ 1.6
Equipment	\$ 0.6	\$ 0.1	10.8%	\$ 0.7	\$ (0.1)	-14.3%	\$ 0.6
Debt Service	\$ 7.2	\$ 0.0	0.0%	\$ 7.2	\$ 0.0	0.2%	\$ 7.2
Interdept.Work Orders	\$ 19.8	\$ 1.7	8.8%	\$ 21.5	\$ 0.4	1.7%	\$ 21.9
Operating Expense, Subtotal	\$ 81.7	\$ 4.2	5.1%	\$ 85.8	\$ 0.6	0.7%	\$ 86.4
Programmatic Projects	\$ 4.3	\$ 1.9	44.6%	\$ 6.2	\$ (1.6)	-26.5%	\$ 4.6
Development Projects	\$ 2.6	\$ 4.9	188.5%	\$ 7.5	\$ 2.1	28.0%	\$ 9.6
South Beach Harbor	\$ 4.0	\$ (0.3)	-8.4%	\$ 3.7	\$ 0.9	24.6%	\$ 4.6
Operating, Total	\$ 92.6	\$ 10.6	11.4%	\$ 103.2	\$ 2.0	2.0%	\$ 105.2

Operating Expenses – General

As shown in **Figure 2**, Salaries and Fringe Benefits related to Port personnel and Work Orders are the largest components of the Operating Expenses, comprising 48% and 25.3% of total expenditures in FY 2018-19, and 49.6% and 25.4% in FY 2019-20, respectively. Over the two-year period, personnel costs are the primary driver for growth, followed by growth in work orders.

Figure 3: FY 2018-19 Major Expenditure Categories (\$ Millions)



The specific trends behind the expenditure changes in the FY 2018-19 and FY 2018-19 budgets are described below.

Salaries and Fringe Benefits

One of the Port's greatest assets is its staff, which comprises approximately 48% of all Operating Expenses. Salary and fringe expenditures increase by a total of \$2.1 million (5.4%) in the FY 2018-19 proposed budget and by an additional \$1.6 million (3.9%) in the FY 2019-20 proposed budget. As detailed below, much of the growth is related to the cost of existing staff, but proposed new and substituted positions also contribute to the additional cost.

Existing Employees – The cost of existing personnel increases by \$1.6 million (4.3%) in the FY 2018-19 proposed budget. This change includes \$0.7 million for salaries due to the wage increases guaranteed by current labor Memoranda of Understanding. Additionally, a \$0.9 million increase in fringe benefits reflects the cost of maintaining the City's retirement system at the required levels. In FY 2019-20, the cost of existing employees increases by an additional \$1.6 million (3.8%), including \$0.9 million for salaries and \$0.7 million for fringe benefits.

Proposed Position Changes – The budget proposal does not add to the department's total count of operating positions. The proposal includes 29 position substitutions, 29 reassignments and 3.5 new FTE, offset by -3.5 FTEs from increased salary savings. These position changes meet the Mayor's budget instructions for no FTE growth, while allowing the Port to adapt to evolving needs. The budget also includes 3.5 FTEs net new project funded positions, the result of 12.0 FTEs new and 8.5 FTEs deleted. These

changes result in \$0.5 million additional in new personnel expenses each fiscal year, as detailed in *Attachment II – Proposed Position Changes, FY 2018-19 and FY 2019-20*.

The proposed changes seek to maximize Port staff resources without significantly increasing total staffing. Also, reassignments of staff reflect restructuring that has occurred under the leadership of a new Executive Director. Major aspects of these changes include:

- Dissolution of the Operations Division – The concept of a separate Operations Division did not work well organizationally and, as a result, the budget redistributes staff to their original locations as follows: Business Services moves back to the Finance and Administration Division; Real Estate-Finance, Lease Administration, and Special Events move back to the Real Estate and Development Division; and the Homeland Security program now sits in the Maritime and Finance and Administration divisions.
- Realignment of Functional Areas – Additional reorganization includes the shift of development staff from the Planning and Development Division to the Real Estate and Development Division, and the shift of environmental staff from various divisions to a newly centralized Planning and Environment division. This shift better reflects the close ties between the Port’s development projects and its real estate work while recognizing the clear link between the Port’s environmental efforts and stewardship and land use planning. Notably, the latter shift reflects a reversal of prior efforts to embed environmental staff in the Engineering, Real Estate, Planning, Maritime, and Maintenance divisions.

As a result of these changes, 6.0 FTEs will be transferred from Planning and Development to Real Estate and Development, 3.0 FTEs environmental staff will be transferred to Planning and Environment Division, and 17.0 FTEs will be transferred from Operations to the various divisions.

Other Operating Expenses

Other Current Expenses – The budget for Other Current Expenses increases by \$0.2 million (5.2%) in FY 2018-19 and then declines by \$1.3 million (-9.8%) in FY 2019-20. The fluctuation is largely due to the professional services needs in Planning and Development, Communications, and Engineering, some of which are one-time investments in FY 2018-19.

Equipment – Funding for Equipment increases by \$0.1 million (10.6%) in FY 2018-19. Specific requests for FY 2018-19 include replacement vehicles in the Finance and Administration Division (two vans) and the Maintenance Division (two trucks), in accordance with the Port’s Fleet Management Plan filed with the City. Additionally, the Maintenance Division requests one new drivable sidewalk pressure washer, a replacement sewer line jetter and a replacement boat trailer and three replacement pressure washers; and the Information Systems Division requests a Xerox multifunction print center, a NetApp storage unit, and Palo Alto firewalls.

Funding for Equipment decreases by \$0.1 million (-14.3%) for FY 2019-20. Proposed equipment includes replacement vehicles in the Finance and Administration Division (two sedans) and Maintenance Division (four trucks), in accordance with the Port's Fleet Management Plan filed with the City. Additionally, the Information Systems Division requests two more NetApp store units and Cisco server and networking equipment; and the Maintenance Division requests replacements for a bandsaw and a precision surface grinder, and a new conduit/pipe threading machine, new high-pressure air refilling compressor, and new pipe line camera.

Debt Service – Debt Service remains relatively flat in FYs 2018-19 and 2019-20, staying around \$7.2 million, as part of the payment schedule for the Port's debt portfolio, including the 2014 Port Revenue Bonds and the 2013 Certificates of Participation.

Work Order Payments – Funding for Work Order Payments increase by \$1.7 million (8.8%) in FY 2018-19, and an additional \$0.4 million (1.7%) in FY 2019-20, as detailed in **Table 6** below.

Table 6: Summary of Interdepartmental Work Orders (\$ Millions)

	Budget FY 2017-18	Change from FY 2017-18		Proposed FY 2018-19	Change from FY 2018-19		Proposed FY 2019-20
		Amount	Percent		Amount	Percent	
Risk Management (AAO)	\$ 3.1	\$ 0.5	16.1%	\$ 3.6	\$ 0.3	7.9%	\$ 3.9
City Attorney	3.4	-	0.0%	3.4	-	0.0%	3.4
SFMTA Parking & Traffic	1.1	-	0.0%	1.1	(0.0)	-0.5%	1.1
PUC – Light, Heat & Power	2.0	0.6	30.0%	2.6	0.0	1.5%	2.6
SFPD Police Security	0.6	0.1	16.7%	0.7	-	0.0%	0.7
SFPW – Street Cleaning	0.3	-	0.0%	0.3	(0.0)	-8.3%	0.3
SFFD Fire Boat	3.7	0.1	2.7%	3.8	0.1	2.6%	4.0
SFFD Fire Inspection	-	0.2	0.0%	0.2	(0.0)	-10.0%	0.2
Department of Real Estate	0.1	0.1	100.0%	0.2	0.0	18.4%	0.2
OEWD – Special Events	-	0.1	0.0%	0.1	(0.0)	-5.0%	0.1
Workers' Compensation	0.9	-	0.0%	0.9	0.0	1.3%	0.9
Environment – Urban Trees	-	0.0	0.0%	0.0	-	0.0%	0.0
All Other	4.6	-	0.0%	4.6	(0.1)	-2.2%	4.5
Total	\$ 19.8	\$ 1.7	8.8%	\$ 21.5	\$ 0.4	1.7%	\$ 21.9

The notable changes include:

- **Public Utilities** – The PUC provides power to the James R. Herman Cruise Terminal's shoreside power system. As more ships become equipped to access our system, demands for power will increase. This \$0.6 million (28.1%) adjustment in FY 2018-19 accounts for projected increases in utilization, which will be fully offset through Cruise revenues.
- **Risk Management** – The work order to the Risk Management Office, under the Department of Administrative Services, is projected to increase by \$0.5 million for FY 2018-19 and of \$0.3 million for FY 2019-20 (16.4% and 7.7%, respectively) to reflect the growing cost of the Port's existing insurance portfolio. Notably, the

Executive Director has asked staff to work with the Risk Management Office in FY 2018-19 to reevaluate the Port's insurance needs in an effort to rein in this ever-growing expense.

- Fire Boat & Inspection – The cost of operating the Fire Boat and fire inspection staffing is growing by \$0.2 million and \$0.1 million in each respective fiscal year due to citywide personnel expense trends.
- Fire Inspection (Special Events) – Port staff requested a new work order to SFFD Fire Inspection for special events permitting, accounting for a \$0.2 million increase per year for FYs 2018-19 and 2019-20. With an additional inspector on hand to focus on special event, the preexisting Fire Inspection team may focus on fire-safety permitting issues.

Programmatic Projects

Formally known as “Annual Projects”, Programmatic Projects reflect operating activities that cannot be defined by a specific spending category (e.g. professional services, or materials and supplies). By placing funds in a project, staff has the flexibility to spend funds in whatever manner necessary to successfully deliver their programs. While most of these projects are budgeted for specific fiscal years, some projects span multiple years and do not close out until the program is completed.

The proposed FY 2018-19 budget for Programmatic Projects is \$6.2 million, a \$1.9 million (44.6%) increase from the FY 2017-18 budget, with a reduction of \$1.6 million (-26.5%) in FY 2019-20. The spike in funding for the first budget year is primarily due to two strategic investments including funding to deliver the Port's Maintenance Management System Replacement Project – a critical next-phase of the Port's transition to a new financial system. A new Maintenance Management system, and the concurrent retirement of the Port's Oracle-based financial software, will support stability in the Accounting and Finance Divisions. Additionally, the budget includes a one-time \$1.0 million investment to support shipyard operations at Piers 68-70 while the Port seeks a new operator.

South Beach Harbor

Operating expenses for South Beach Harbor are \$3.7 million in FY 2018-19, a \$0.3 million (-7.5%) decrease, and \$4.6 million in FY 2019-20, a \$0.9 million (24.3%) increase. Net operating revenues of \$1.1 million and \$0.3 million are allocated to capital projects in FY 2018-19 and FY 2019-20 respectively, as detailed below.

Waterfront Development Project

Based upon projected spending, the budget includes \$7.5 million in FY 2018-19 to implement the Port's obligations under the Development and Disposition Agreements (DDAs) and Exclusive Negotiating Agreements (ENAs) related to the Forest City development at Pier 70, Mission Rock at Sea Wall Lot 337, Teatro Zinzanni at Seawall

Lot 324, and other upcoming projects. This funding level is a \$4.9 million (188.5%) increase from the FY 2017-18 budget due to an expanding workload required to deliver these major projects.

The budget for FY 2019-20 is \$9.6 million, a \$2.1 million (28%) increase over the proposed FY 2018-19 budget, to replenish the project after spending down an existing project balance.

CAPITAL EXPENDITURES

With several years of sustained strong revenues and the Port's policy to set aside 20-25% of operating revenues for capital, this Capital Budget continues a trend of substantial capital investment by the Port. The proposal sustains the Port's commitment to spending the majority of the Capital Budget on projects that keep Port facilities in a state of good repair and safe for tenants and visitors and also includes funding to improve capital project delivery and deepen the Port's revenue base through facility improvements.

As described in full detail within Item 11B, "Informational Presentation on the Fiscal Year 2018-19 and FY 2019-20 Biennial Capital Budget" report, the proposed Capital Budget is \$54.1 million in FY 2018-19 and \$19.3 million in FY 2019-20. These funding levels represent a \$29.2 million (117.5%) increase from FY 2017-18 and a \$34.8 million (-64.3%) decrease from FY 2018-19. This fluctuation in programming is in part due to large one-time source assumptions for the Mission Bay Ferry Landing and Seawall Program (\$17.5 million) and a considerable volume of projects that are currently underway and are in immediate need of additional funds for completion (\$19.0 million).

RESERVES

The proposed budget includes three key areas for reserves, including a Designation to Future Capital and the 15% Operating Reserve. These investments total \$35.3 million, a \$6.2 million (21.3%) increase from FY 2017-18. Funding then increases by an additional \$1.5 million (4.3%) for a total of \$36.8 million in FY 2019-20. Notably, the Designation to Future Capital may be reduced in the spring of 2019, in the event that collective bargaining by the City and its labor unions result in higher personnel expense costs.

NEXT STEPS

Comments, input and feedback from the Port Commission and the public are welcomed and appreciated. In accordance with the City Charter, staff will submit the budget to the Mayor and Controller's Office on February 21, 2018 and then return to the Port Commission for final approval on February 27, 2018. If the Commission requests any changes at its February 27th meeting, Port staff will work with the Mayor's Office to reflect those changes in its budget submission. Subsequently, the Port's budget will be included in the Mayor's Proposed Budget to the Board of Supervisors in May 2018. The Board of Supervisors will then review and finalize the FY 2018-19 and FY 2019-20

budgets by August 1, 2018. Staff will update the Port Commission on any major changes made to the budget during Mayoral and Board of Supervisors review.

Pursuant to City Policy, the Port is preparing its two-year budget for FY 2018-19 and FY 2019-20. Although the second year of the budget will be fixed upon adoption this summer, Port staff may bring a supplemental appropriation to the Port Commission, Mayor and Board of Supervisors in 2019 if there are new sources and a need arises to increase operating or capital spending in FY 2019-20. Otherwise, staff will work within the approved funding resources and will dedicate their time to updating the Port's Five Year Financial Plan and 10 Year Capital Plan.

CONCLUSION

The Port's proposed FY 2018-19 and 2019-20 Biennial Operating Budget is \$192.6 million and \$161.3 million respectively, reflecting a \$46.0 million (31.4%) overall increase from FY 2017-18 and a \$31.3 million (-16.2%) reduction from the proposed FY 2018-19 budget. The primary fluctuations in the budget are due to additional capital spending in the first year of the budget allocating available fund balance to capital infrastructure. Additionally, the budget includes large one-time sources, including a \$17.5 million total General Fund request and two \$15.0 million one-time land sales in each fiscal year.

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Attachments:

- I. Fiscal Year 2018-19 and Fiscal Year 2019-20 Budget Overview
- II. Operating Revenues
- III. Operating Expenses by Division
- IV. Proposed Position Changes