MEMORANDUM

December 8, 2016

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

FROM: Elaine Forbes
Executive Director

SUBJECT: Informational Presentation on the Port's Five Year Financial Plan for Fiscal Year 2017-18 to 2021-22

DIRECTOR'S RECOMMENDATION: Informational Item

EXECUTIVE SUMMARY

Under Charter Section 9.119, the City and County of San Francisco ("the City") is required to prepare a five-year financial forecast in every odd fiscal year. The forecast must project expenditures and revenues, propose actions to balance the budget during each year of the plan, and discuss strategic goals and corresponding resources for City departments. The purpose of this item is to give an overview of the City's financial outlook and provide an update on the Port's Five Year Financial Plan for FY 2017-18 to 2021-22 ("Financial Plan") to allow for Port Commission consideration and feedback.

Overall the Port's financial outlook is strong, with surplus revenues projected for each year of the Financial Plan while maintaining a 15% Operating Reserve and meeting the Port's Capital Policy requirements. While the forecast assumes maintained efforts to control expenses and moderate revenue growth, the Port's effort to deepen its revenue base through new leasing opportunities and development projects is critical to the Port's fiscal stability. Otherwise, growth in employee salaries and benefits, and other general operating costs, would outpace growth in the Port's revenues.

Factors that could negatively impact or further improve the financial forecast are included in Low Case and High Case scenarios for the plan. Examples of negative drivers include dampened revenue growth and delayed leasing of vacant facilities due to an economic slowdown. Alternatively, positive drivers include reduced personnel expense growth resulting from the City's upcoming labor negotiations, stronger market conditions driving higher rents, and the implementation of development projects that would further deepen the Port's revenue base.

STRATEGIC OBJECTIVES

The Port's Financial Plan is central to meeting crucial *Stability* objectives of the Port's 2016-2021 Strategic Plan:

- *Target capital reinvestment in Port assets that maintain and improve current and projected financial performance* – The projected Base Case Scenario reflects $11.3 million in new operating revenues derived from facilities that the Port has or will invest in with the intention of deepening its revenue base. Without these new income streams, the Port would face difficult tradeoffs to achieve a balanced operating budget.

- *Step up and subsequently exceed policy to set aside 25% of net revenue to invest in the repair and replacement capital budget annually* – The Financial Plan applies the Capital Policy requirement to each scenario, helping maintain an average capital budget of $15.6 million annually over the five-year period.

- *Adhere to critical Port fiscal policies for maintaining prudent operating reserves* – The Financial Plan includes a 15% operating reserve for Port Operating Expenses in each scenario.

- *Increase Port annual revenues to $125 million by 2021* – The Financial Plan forecasts that the Port will achieve this revenue objective by FY 2019-20 with the inclusion of South Beach Harbor revenues. By FY 2021-22, the end of the Financial Plan, Port annual revenues are projected to reach $132.5 million.

CITYWIDE FINANCIAL OUTLOOK

Mayor Edwin Lee is preparing to introduce the City's Five Year Financial Plan for Fiscal Years 2017-18 to 2021-22 to the Board of Supervisors. While the details of the plan are not yet available, costs related to employee retirement and health expenses and the voter-approval of fiscally impacting propositions in the November 8, 2016 election are driving up funding requirements that are not fully matched with City revenue projections.

Per the City Charter, the Mayor will propose actions to balance revenues and expenditures during each year of the plan, and discuss strategic goals and corresponding resources for City departments. Key details of the City plan will be provided to the Port Commission in an update to this report, following formal release of the City's Financial Plan.

PORT FINANCIAL OUTLOOK

The Port Financial Plan for Fiscal Years 2017-18 to 2021-22 ("Financial Plan") makes three projections for the five-year period: Base, Low and High Case scenarios. Each scenario applies inflation assumptions that the City's Controller's Office provided, meets the Port's Operating Reserve and Capital Policy requirements, and then applies other specific assumptions related each individual case:

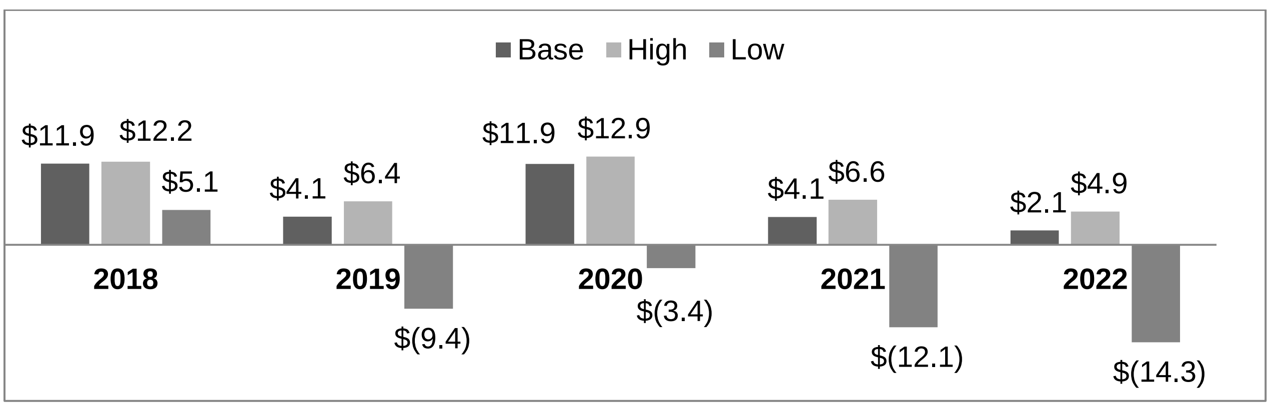
- *Base Case* represents what is "most likely" based on current economic trends, planned real estate leasing activities and other outcomes from previous Port Commission decisions; does not assume any savings resulting from labor negotiations.

- *Low Case* assumes impacts from an economic slowdown, including reduced percentage rents, slower implementation of real estate leasing, and lower performance in key Maritime business areas including Cruise and Cargo.

- *High Case* assumes that labor negotiations ease personnel expense growth, new leases and development projects yield stronger revenue performance, and that key Maritime business lines are very strong.

The details of these scenarios are provided in **Attachment 1**. As shown in **Figure 1**, only the Low Case Scenario forecasts budget deficits that would require the Port to make tradeoffs to balance. The Base and High Case scenarios project operating surpluses that are directed into capital investments in subsequent years.

Figure 1: Revenue Surplus/Deficit in Three Scenarios ($ Millions).



BASE CASE SCENARIO

The Base Case Scenario is consistent with the City's Financial Plan assumptions about the ongoing strength of the economy with moderate revenue growth, offset by significant inflationary assumptions for personnel expenses and Consumer Price Index ("CPI") assumptions for most non-personnel expenditures. The Financial Plan also reflects Port staff's current knowledge regarding 1) Port Real Estate and Maritime operations, 2) the timing and value of upcoming leasing and parking opportunities for

Port facilities, and 3) adjustments to operating expenses. Taking these factors into consideration, net operating surpluses are projected for each year of the Base Case, primarily due to new revenue streams offsetting growing operating expenses. Notably the Port is projected to meet its $125 million annual revenue goal by FY 2019-20.

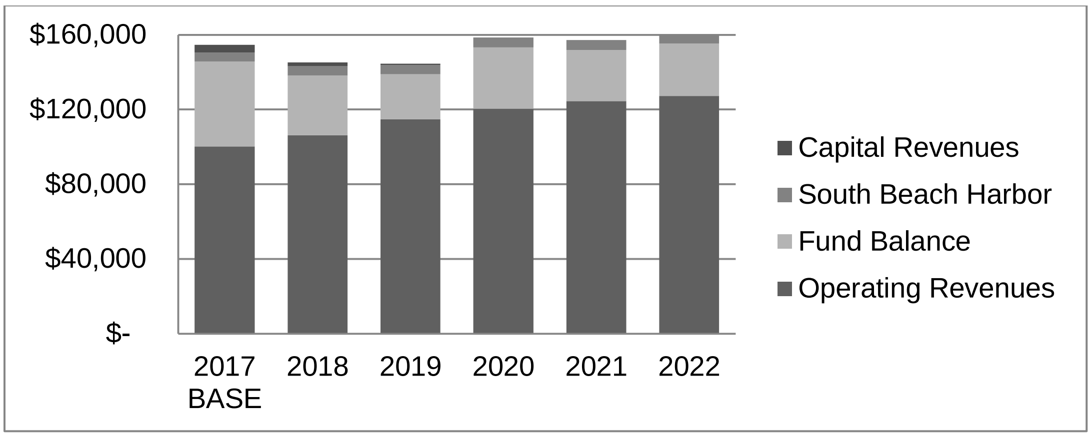
Table 1: Base Case Scenario ($ Thousands) – The Port's financial outlook is strong with a net operating surpluses projected for each year of the plan.

Fiscal Year	2017 (Current)	2018 (+1)	2019 (+2)	2020 (+3)	2021 (+4)	2022 (+5)	Change from Current	% Change
Sources								
Estimated Fund Balance	$ 45,407	$ 31,984	$ 24,045	$ 32,879	$ 27,266	$ 27,950	$ (17,456)	-38%
Operating Revenues	$ 100,291	$ 106,292	$ 114,746	$ 120,386	$ 124,408	$ 128,018	$ 27,727	28%
South Beach Harbor	$ 4,772	$ 4,921	$ 5,081	$ 5,238	$ 5,396	$ 5,561	$ 789	17%
Capital Revenues	$ 4,243	$ 2,100	$ 550	$ -	$ -	$ -	$ (4,243)	-100%
Sources, total	**$ 154,713**	**$ 145,297**	**$ 144,423**	**$ 158,502**	**$ 157,069**	**$ 161,529**	**$ 6,816**	**4%**
Uses								
Operating Reserves	$ 12,290	$ 12,782	$ 13,367	$ 13,971	$ 14,627	$ 15,312	$ 3,022	25%
Percent of operating expenses	15.0%	15.0%	15.0%	15.0%	15.0%	15.0%	0.0%	0%
Operating Expenses	$ 86,266	$ 89,679	$ 93,725	$ 97,896	$ 102,414	$ 107,127	$ 20,861	24%
South Beach Harbor	$ 4,772	$ 4,921	$ 5,081	$ 5,238	$ 5,396	$ 5,561	$ 789	17%
Capital Policy Budget	$ 37,960	$ 26,023	$ 28,137	$ 29,546	$ 30,552	$ 31,454	$ (6,506)	-17%
1. Capital investments	37,960	22,344	11,229	18,908	12,639	12,639	(25,322)	-67%
2. Designation to Capital	-	3,679	16,908	10,639	17,913	18,816	18,816	0%
Percent of operating revenues	38%	24%	25%	25%	25%	25%	-13%	-35%
Uses, total	**$ 141,288**	**$ 133,404**	**$ 140,309**	**$ 146,652**	**$ 152,989**	**$ 159,454**	**$ 18,166**	**13%**
Balance	**$ 13,425**	**$ 11,892**	**$ 4,114**	**$ 11,850**	**$ 4,081**	**$ 2,075**	**$ (11,350)**	**-85%**
KEY ASSUMPTIONS								
Real Estate	$ -	$ 1,723	$ 7,292	$ 9,503	$ 9,940	$ 10,243		
1. Backlands - Leases	-	-	2,700	3,900	4,017	4,138		
2. 19th and Illinois Parking	-	-	516	531	547	564		
3. Pier 19 - Shed Lease	-	325	633	1,349	1,390	1,431		
4. Pier 23 - Shed Lease	-	1,115	1,813	1,868	1,921	1,976		
5. Beltline Building - Lease	-	-	76	79	81	83		
6. Pier 29 Bulkhead - Jamestown	-	-	20	189	343	355		
7. Pier 29 1/2 - Office & Parking	-	189	388	400	412	424		
8. Pier 31/ Pier 48 - Elections	-	95	1,145	1,187	1,229	1,271		
9. Percentage Rents, Recession	-	-	-	-	-	-		
Development Projects	$ -	$ 371	$ 355	$ 282	$ 286	$ 1,054		
1. Pier 70 - Forest City	-	-	-	-	-	-		
2. SWL337 - Mission Rock	-	-	-	-	-	-		
3. Pier 38 - Development	-	-	-	-	-	-		
4. SWL324 - Teatro Zinzani	-	371	483	496	483	921		
5. SWL322-1 - MOH Development	-	-	(352)	(363)	(374)	(385)		
6. Pier 31.5 - NPS Alcatraz Ferry	-	-	225	149	177	518		

Funding Sources

The Port's funding sources include Fund Balance, Operating Revenue, Capital Revenues, and South Beach Harbor revenues. All funding sources are projected to increase $6.8 million (4%), starting with a base year total of $154.7 million in FY 2016-17 and ending with $161.5 million in FY 2021-22. This change is primarily driven by growth in Operating Revenues ($27.7 million) and South Beach Harbor fees ($0.8 million) offset by reductions in Fund Balance (-$17.4 million) and Capital Revenues (-$4.2 million).

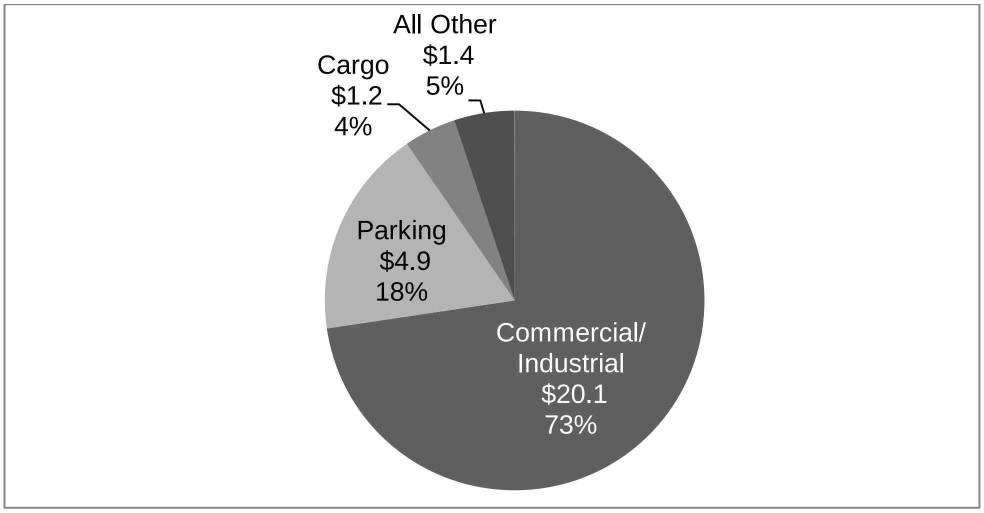
Figure 2: Funding Sources ($ Thousands) – Operating revenues are the primary driver of growth in funding sources, with $27.7 million in total projected growth.



<u>Fund Balance</u> – Growth in the Port's total funding sources is offset by a $17.4 million (38%) decrease in Fund Balance that is a result of an unusually high level of available funding in FY 2016-17 that far exceeded the policy requirement. After the Financial Plan base year, annual fund balance levels to an average of $28.8 million per year. Fund Balance is supported by designations of net operating revenues required to meet the Port's Capital Policy, projected operating surpluses, and assumed expenditure savings from prior years.

<u>Operating Revenues</u> – Growth in the Port's funding sources is driven by a $27.7 million (28%) increase in Operating Revenues, which are projected to grow from $100.3 million in FY 2016-17 to $128.0 million in FY 2021-22. This growth includes $2.3 million (10%) growth in the Port's Maritime business lines, with Cargo projecting a $1.2 million (18%) increase due to the establishment of Pasha Automotive at Pier 80. Notably, $11.3 million (41%) of this projected revenue growth is derived from new revenue streams from a new parking lot, new leases, and development projects. Because of these new funding streams and an assumption of continued strength in the economy, the Port is projected to reach its $125 million annual revenue goal by FY 2019-20.

Figure 3: Summary of Changes to Operating Revenue ($ Millions) – Commercial/Industrial Rents, Parking and Cargo represent 94% of the $27.0 million overall growth in operating revenues over the five-year projection period.



The following operating assumptions support this change:

1. *Commercial/Industrial Rent* – The Port's commercial/industrial rents are projected to increase by $20.1 million (38%), from $52.6 million in the first year to $72.8 million in FY 2021-22, with an average annual growth of $4.0 million (8%) per year. This change represents 73% of operating revenue growth and assumes current rent roll with an average annual CPI of 3.1% and the inclusion of $11.3 million revenues projected from the following Real Estate and Planning initiatives.

   - **Backlands Laydown Space** – In FY 2015-16 the Port funded a capital project to prepare land located at Piers 90-96 along Amador Street for future leasing opportunities such as construction laydown, vehicle parking and storage types of uses. Based upon current monthly parameter rents of $0.40 per square foot for land and assuming a two-year lease-up period starting in FY 2018-19, the site is projected to generate up to $4.1 million per year by FY 2021-22. With high demand for this space, Port staff is striving to identify the highest and best use to meet revenue potential while fostering the development of the Pier 80-96 Maritime Eco-Industrial Center.[1]

   - **Piers 19, 23, 29 Bulkhead, Beltline Building** – These former 34th America's Cup (AC34) venues are all currently vacant and available for leasing as office and warehouse space. Both the Pier 19 shed and the Pier 23 office are on track to be leased out by FY 2017-18, whereas the Beltline Building is expected to be leased in FY 2018-19. The Pier 29 Bulkhead is currently under lease negotiations

[1] The Port defines the Maritime Eco-Industrial Center as an area that co-locates maritime industrial uses to enable product exchange, optimize use of resources, incorporate green design and green technologies on-site, fosters resource recovery and reuse, to provide economic opportunities that employ residents, minimize environmental impacts and incorporate public open space for enjoyment and habitat.

for retail use of the space that will yield an estimated $0.4 million after rent credits. Together, these facilities are projected to generate an additional $3.8 million in annual revenues by the end of the five-year period.

- **Piers 29½ - 31/Pier 48** – The renovation of the historic Pier 31 is planned for completion in FY 2016-17, allowing for new leasing in FY 2017-18. The Port has worked with the Department of Elections to transfer their lease from their current location at Pier 48 to Pier 31, with an increased annual rent of approximately $0.2 million. Upon vacating Pier 48, Port staff intends to utilize Pier 48 for interim parking until the Mission Rock Project is underway, generating an estimated $1.1 million parking rents. Additionally, the Port expects to lease office space and provide parking in Pier 29 ½, generating an additional $0.4 million. Together, these facilities are projected to generate an additional $1.7 million in annual revenues by the end of the five-year period

- **Teatro ZinZanni Theater and Boutique Hotel, Seawall Lot 324** – On September 8, 2015 the Port Commission authorized staff to enter into an Exclusive Negotiation Agreement with Teatro ZinZanni and its financial partner, Kenwood Investments No. 6, LLC, operating together as TZK Broadway, LLC, for the lease and development of a dinner-theater and a maximum 200-room, 40-foot high boutique hotel and an approximately 7,500 square foot privately financed public park. Construction of the site is planned for the summer of 2017, at which point the project will generate approximately $0.5 million in net new rents, increasing to $0.9 million in FY 2021-22.

- **Mayor's Office of Housing (MOH) Low Income Development, Seawall Lot 322-1** – On March 11, 2014 the Port entered a Memorandum of Understanding with the San Francisco Mayor's Office of Housing ("MOH") to allow MOH to solicit a developer to enter into a lease with the Port for the development of affordable housing at Seawall Lot 322-1. If the development occurs, the Port will lose $0.4 million in annual revenues that are currently generated from a parking lot at that site. Rather than pay rent for use of the site, the developer will pay fair market value in the form of developmental credits.

- **Pier 31½ National Park Service Agreement** – The Port is preparing to enter a new agreement with the National Park Service at Pier 31½ for the landing to Alcatraz. Port staff is working on an agreement that will generate approximately $0.2 million in net new revenues starting in FY 2018-19, growing to $0.5 million by FY 2021-22 compared to projections for the current NPS lease.

2. *Parking Revenue* –Parking revenues are projected to increase by $4.9 million (21%), from $23.1 million in the first year to $33.0 million in FY 2021-22. Of this growth, $0.6 million is projected from the completion of the 19th and Illinois Street parking lot, which is funded in the FY 2017-18 capital budget. This change represents 18% of operating revenue growth, assuming current trends, an existing supply of parking meters and an annual inflation of 1-2%. This projection does not include revenues

lost as a result of the MOH and Teatro Zinzanni development projects described in Commercial/Industrial Rent.

3. *Cargo Revenues* – Cargo revenues are projected to increase by $1.2 million (19%), from $6.7 million in the first year to $7.9 million in FY 2021-22. This change represents 4% of total operating revenue growth and assumes steady increases in the transport of automobiles at Pier 80 by Pasha Automotive, reaching approximately 150,000 vehicles by FY 2021-22.

4. *Other Port Revenues* – Other Port revenues represent $1.4 million (5%) of operating revenue growth in a variety of business lines that are not projecting significant increases or decreases. These revenue sources include Cruise, Ship Repair, Harbor Service, Fishing, and other miscellaneous revenues. For revenue growth that is not based upon existing leases or agreements, the Financial Plan assumes CPI.

   - *Ship Repair* projections assume ongoing base rents from BAE ($1.2 million) that grows by CPI. This projection is lower than actual performance in recent years, when the Port collected percentage rent from BAE because of strong business. However, competition from a new large dry-dock in Oregon and mid-size ship repair facilities at Mare Island in Vallejo, California, are impacting BAE's business.

   - *Cruise* projections assume approximately 80 cruise calls generating 300,000 passengers ($5.6 million), special events ($1.2 million in FY 2016-17), and parking ($0.2 million in FY 2016-17) that grows by CPI.

<u>South Beach Harbor</u> – South Beach Harbor revenues are comprised of berthing, parking and other fees collected at the special facility. The facility revenues are projected to increase by $0.8 million (17%), assuming CPI on all fees.

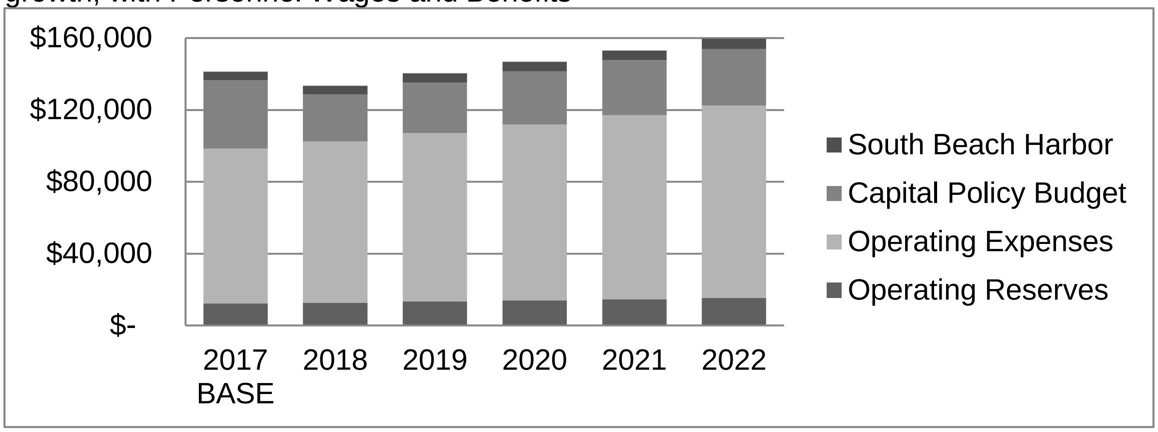
<u>Capital Revenues</u> – The Port FY 2016-17 budget includes $4.2 million in grant funds, developer contributions to transaction costs, and a $550,000 annual Transbay Cable payment that is projected to phase out by FY 2018-19.

While the funding is not identified in the Financial Plan, the Port is working diligently to secure Capital funding sources for two top priority projects – the Seawall Resiliency Project ($489.5 million) and the Mission Bay Ferry Landing Project ($35.7 million). As detailed in the Port's 10-Year Capital Plan for FY 2017-18 to 2026-18, these projects have a citywide benefit and are too costly for the Port to support. Examples of potential external sources for these projects include a General Obligation Bond, the Department of Transportation TIGER Grant Program, and the State share of tax increment derived from development projects along the waterfront.

Use of Funds

The Port's use of funds includes an Operating Reserve, Operating Expenses, the Capital Policy Budget and South Beach Harbor expenses. These expenditures and reserves total $141.3 million in FY 2016-17 and are projected to increase by $18.2 million (13%), to $159.5 million in FY 2021-22. This change is primarily driven by reductions in the Capital Policy Budget (-$6.5 million) offset by growth in Operating Expenses ($20.9 million), Operating Reserves ($3.0 million), and South Beach Harbor ($0.8 million).

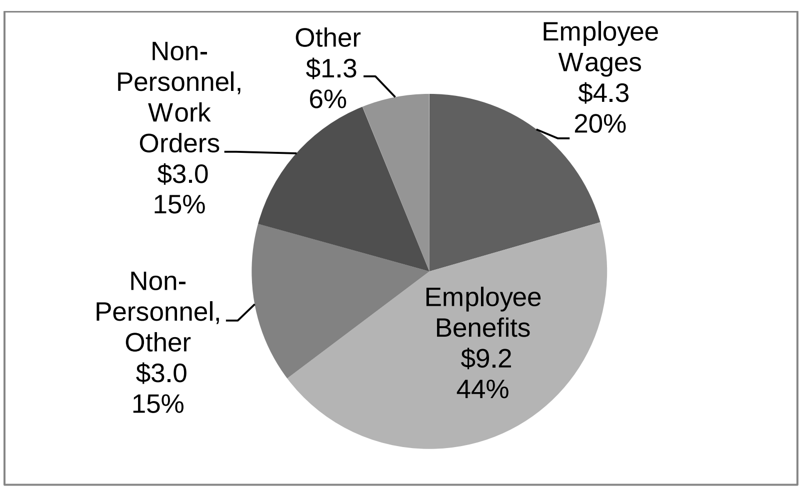
Figure 4: Use of Funds ($ Thousands) – Operating expenses are the largest driver of growth, with Personnel Wages and Benefits



Operating Reserves – The Port's Operating Reserves are projected to increase by $3.0 million (25%), from $12.3 million in FY 2016-17 to $15.3 million in FY 2021-22, as the reserve aligns with growing operating expenses.

Operating Expenses – The Port's Operating Expenses is the largest driver in growth in the use of funds, with a projected $20.9 million (24%) increase, from $86.3 million in FY 2016-17 to $107.1 million.

Figure 5: Summary of Changes in Use of Funds ($ Millions) – Employee wages and benefits are the largest expenditure growth driver.



The key drivers of this change include:

1. E*mployee Wages* – Personnel salaries are projected to increase by $4.3 million (17%), assuming negotiated labor rates through FY 2016-17 and CPI inflationary increases of 3-3.1% thereafter. The Financial Plan does not assume the cost of new operating personnel, with the assumption that the Port would make tradeoffs within the budget to offset the cost of new staff.

2. *Employee Benefits* – Personnel benefits are projected to increase by $9.2 million (79%), primarily due to high inflations rates for employer contributions to employee retirement, retiree health benefits, and health insurance rates. While some benefit costs grow by CPI, they only represent $0.5 million (6%) of the overall growth. In contrast, the Port's retirement contribution drives $6.8 million (74%) of the total increase due to an average 20% annual inflation; this trend is projected to continue through FY 2021-22, with gradual declines in growth thereafter. Additionally, health plan costs drive $1.1 million (12%) of the total increase due to a 9% annual inflation and retiree health plan costs drive $0.7 million (8%) of the total increase due to a 7% annual inflation. While prior financial plans projected large increases in these costs, recent actuarial guidelines have forced the City to recognize that populations are living longer and require additional resources to ensure ongoing coverage.

3. *Non-Personnel Costs* – Non-Personnel expenditures, including materials and supplies, professional services, work orders to other City departments including Fire Boat services, debt service, and facilities maintenance projects are projected to increase by $7.4 million (15%) primarily due to an assumed 3-3.1% CPI and planned payment schedules, such as for debt service. One exception includes a 5% projected inflation rate for insurance premiums, which have historically grown at much faster rates than other expenses. Additionally, this projection includes a new $0.3 million annual expense for park maintenance at Crane Cove Park starting in FY 2017-18.

<u>South Beach Harbor</u> – The South Beach Harbor budget supports all personnel, non-personnel, debt service, and capital improvement costs related to the special facility. The facility budget is projected to increase by $0.8 million (17%), assuming all labor and CPI factors applied to other expenses within the Port budget.

<u>Capital Policy Budget</u> – The Capital Policy Budget is comprised of capital investments and the Port's designation of net operating revenue to capital for future spending. In each fiscal year, the sum of these two categories must be equal to 20% operating revenues, growing to 25% in FY 2017-18. The Capital Policy budget declines by $6.5 million (17%), from $38.0 million in FY 2016-17 to $31.5 million in FY 2021-22, due to an unusually high capital budget in FY 2016-17 that far exceeded the Capital Policy requirement.

LOW CASE SCENARIO

The Low Case Scenario reflects the possibility of an economic slowdown. The following assumptions in the Low Case Scenario lead to $68.2 million reduced net operating revenues over the five-year period compared to the Base Case, resulting in a $7.5 million (10%) reduction in capital investments:

Reduced Percentage Rent – During the last recession, Port Percentage Rent declined to approximately $15.5 million in FY 2010-11. Port Percentage Rents have recovered by 35% since that time, totaling $20.6 million in FY 2015-16. The Low Case Scenario assumes a similar reduction to Percentage Rents beginning in FY 2017-18, deepening in FY 2018-19, and then gradually recovering into FY 2021-22.[2]

Delayed Leasing – Assuming a recession would reduce demand for leased space this scenario reflects delays and lower rents from currently vacant facilities over the five-year period. This scenario results in $25.5 million less in collected revenues compared to the Base Case.

Cruise – The Low Case Scenario for Cruise assumes an economic downturn that reduces passenger volume from 300,000 down to 250,000, as we saw in the last recession. This change would result in a $0.8 million (10%) reduction to Cruise revenues.

Cargo – If Pasha Automotive is unable to accelerate its operations because of reduced demand for vehicles, the Port's Cargo revenues could be reduced by as much as $1.4 million per year compared to the Base Case, assuming 75,000 vehicles per year rather than a gradual increase from 50,000 to 150,000 vehicles assumed over five years in the Base and High Case Scenarios.

Ship Repair – Due to competition with other ship repair companies, the Low Case Scenario assumes potential reductions in BAE's current base rent ($1.2 million) to pre-2015 rent ($1.0 million), for a reduction of $0.2 million (17%), which then grows by CPI.

In the event of such deficits shown in **Table 2**, Port staff would need to identify ways to control operating expenses or find new revenues that are not currently considered for the Financial Plan.

[2] FY 2010-11 Percentage Rent was $15.5 million. The forecast assumes that the economic slowdown would begin to occur midway through FY 2017-18, with full impact beginning in 2018-19.

Table 2: Low Case Scenario ($ Thousands) – This scenario assumes lower revenue growth that may occur as the result of an economic slowdown. Operating deficits will need to be addressed, either through expenditure reductions or identifying new revenue opportunities.

Fiscal Year	2017 (Current)	2018 (+1)	2019 (+2)	2020 (+3)	2021 (+4)	2022 (+5)	Change from Current	% Change
Sources								
Estimated Fund Balance	$ 45,407	$ 31,984	$ 22,454	$ 31,229	$ 25,099	$ 25,783	$ (19,623)	-43%
Operating Revenues	$ 100,291	$ 97,921	$ 99,585	$ 102,921	$ 106,431	$ 109,809	$ 9,518	9%
South Beach Harbor	$ 4,772	$ 4,921	$ 5,081	$ 5,238	$ 5,396	$ 5,561	$ 789	17%
Capital Revenues	$ 4,243	$ 2,149	$ 550	$ -	$ -	$ -	$ (4,243)	-100%
Sources, total	**$ 154,713**	**$ 136,975**	**$ 127,671**	**$ 139,389**	**$ 136,926**	**$ 141,154**	**$ (13,559)**	**-9%**
Uses								
Operating Reserve	$ 12,290	$ 12,782	$ 13,367	$ 13,971	$ 14,627	$ 15,312	$ 3,022	25%
Percent of operating expenses	15.0%	15.0%	15.0%	15.0%	15.0%	15.0%	0.0%	0%
Operating Expenses	$ 86,266	$ 89,679	$ 93,725	$ 97,896	$ 102,414	$ 107,127	$ 20,861	24%
South Beach Harbor	$ 4,772	$ 4,921	$ 5,081	$ 5,238	$ 5,396	$ 5,561	$ 789	17%
Capital Policy Budget	$ 37,960	$ 24,480	$ 24,896	$ 25,730	$ 26,608	$ 27,452	$ (10,508)	-28%
1. Capital investments	37,960	22,393	9,638	17,258	10,472	10,472	(27,489)	-72%
2. Designation to Capital	-	2,088	15,258	8,472	16,136	16,981	16,981	0%
Percent of operating revenues	38%	25%	25%	25%	25%	25%	-13%	-34%
Uses, total	**$ 141,288**	**$ 131,862**	**$ 137,069**	**$ 142,836**	**$ 149,044**	**$ 155,452**	**$ 14,164**	**10%**
Balance	**$ 13,425**	**$ 5,113**	**$ (9,398)**	**$ (3,447)**	**$ (12,119)**	**$ (14,298)**	**$ (27,723)**	**-207%**
KEY ASSUMPTIONS								
Real Estate	$ -	$ 111	$ 1,351	$ 3,459	$ 4,128	$ 4,257		
1. Backlands - Leases	-	-	-	1,350	1,950	2,009		
2. 19th and Illinois Parking	-	-	-	516	531	547		
3. Pier 19 - Shed Lease	-	-	-	-	-	-		
4. Pier 23 - Shed Lease	-	-	-	-	-	-		
5. Beltline Building - Lease	-	-	-	-	-	-		
6. Pier 29 Bulkhead - Jamestown	-	-	-	-	-	-		
7. Pier 29 1/2 - Office & Parking	-	-	189	388	400	412		
8. Pier 31/ Pier 48 - Elections	-	95	1,145	1,187	1,229	1,271		
9. Percentage Rents, Recession	-	16	17	17	17	18		
Development Projects	$ -	$ -	$ (127)	$ 269	$ 852	$ 1,293		
1. Pier 70 - Forest City	-	-	-	-	-	-		
2. SWL337 - Mission Rock	-	-	-	-	-	-		
3. Pier 38 - Development	-	-	-	-	-	-		
4. SWL324 - Teatro Zinzani	-	-	-	483	1,050	1,160		
5. SWL322-1 - MOH Development	-	-	(352)	(363)	(374)	(385)		
6. Pier 31.5 - NPS Alcatraz Ferry	-	-	225	149	177	518		

HIGH CASE SCENARIO

The High Case Scenario reflects the Base Case, with the inclusion of improved expenditure and revenue projections. The following assumptions in the High Case Scenario lead to $13.5 million (41%) in additional net operating revenues over the five-year period compared to the Base Case, resulting in a $4.9 million increase in capital investments:

Employee Salaries – Wages are reduced assuming labor negotiations that lower annual inflation from approximately 3% CPI to 2% growth per year, reducing growth in salaries by $1.0 million (23%) compared to the Base Case.

Cruise-Parking –The parking lot at Pier 27 is currently underutilized due to limited visibility, optimistic pricing strategy, and the challenge of inconsistent availability due to cruise calls. Also, the location turned out to be less convenient than initially expected, as drivers consider it too far from desired destinations, such as the Ferry Building, Exploratorium, PIER 39, and Fisherman's Wharf. Parking revenues could be improved by up to $0.2 million (2%) through improved signage and by aligning pricing to demand.

Cruise, Special Events – An additional $0.3 million (4%) in Cruise revenues may be generated from special events due to the facility operator's efforts to promote and build special events. Specifically, Metro Cruises is placing a major focus on Metro Events branding and marketing of Pier 27 and Pier 35, including a new website, new logo and collateral material, advertising campaign, participation at IMEX as the premier events trade show. The Metro Events Team is also increasing its interface with SF Travel and full participation in their outreach efforts, trade show presence and partnership opportunities. A full-time sales manager for SF events is being added to the team to handle all sales functions in coordination with existing team of three event staff.

Cargo, Pier 96 – If Pasha Automotive is successful in launching its business at Pier 80, the Port and Pasha may partner to expand the auto-transporter's presence in the Pier 80-96 Maritime Eco-Industrial Center. The High Case Scenario assumes that Pasha could increase its vehicle volume by 25,000 (17%), from 150,000 to 175,000, by expanding into Pier 96. This change would increase Port Cargo revenues by $0.5 million (6%).

Ship Repair – If BAE can keep pace with competition in Oregon and Mare Island, primarily in the west coast Cruise and Defense markets, the Port could continue to collect percentage rents from the ship repair tenant, increasing annual revenues by $0.3 million (1%). Notably, the Port has received a letter of intent for the sale of BAE's lease at the shipyard to a small private entity that will be able to take advantage of disadvantaged business enterprise (DBE) set-asides for federal tenders.

Development Projects – Several development projects are currently planned for implementation within the five-year period, but still require further progress before they can be considered in the Base Case. Notably, some of these projects actually reduce operating revenues at specific sites, but they address much needed capital improvements and/or will lead to revenue growth beyond the five-year window. The following assumptions combined reduce net operating revenues in the Base Case by $3.1 million:

1. *Forest City Project, Pier 70* – If the Forest City development project is approved, leases with current tenants at Pier 70 will be impacted beginning as early as FY 2017-18. While Port staff is working diligently to relocate tenants if possible, the forecast assumes that up to $1.5 million in current rent will be discontinued. Forest City is developing a strategy for temporarily relocating tenants from the Noonan Building, which currently serves as an artist's creative space, until a replacement facility is created as part of the development. Any delays in project implementation will result in no impact to current commercial rent at this site.

2. *Giants Development, Seawall Lot 337* – If the San Francisco Giants' Mission Rock project is approved, the Port will begin losing f surface parking percentage rent revenue during the construction period of the first buildings. Starting around FY 2019-20, the Port is expecting to lose approximately $0.7 million (X% reduction), growing to $1.5 million (Y% reduction) in FY 2021-22. Then, as new parcels are prepared for vertical development and rent from each development parcel is brought online, the revenue loss will decrease. Ongoing revenues will continue to improve with inflation and increased demand. Any delays in project implementation will result in no impact to current surface parking rent at this site.

3. *TMG Pier 38 Partners, LLC, Pier 38* – The Port is preparing for the rehabilitation of the Pier 38 bulkhead. Current negotiations with TMG Pier 38 Partners, LLC would net annual net revenues of $50,000 per year after applying rent credits and setting aside an annual $75,000 reserve for potential facility improvements.

Table 3: High Case Scenario ($ Thousands) – This scenario reflects salary savings from the upcoming 2017 labor negotiations, additional revenues resulting from improved operations, and the net impact of development initiatives.

Fiscal Year	2017 (Current)	2018 (+1)	2019 (+2)	2020 (+3)	2021 (+4)	2022 (+5)	Change from Current	% Change
Sources								
Estimated Fund Balance	$ 45,407	$ 31,936	$ 25,666	$ 32,676	$ 28,919	$ 29,599	$ (15,808)	-35%
Operating Revenues	$ 100,291	$ 106,990	$ 115,255	$ 121,249	$ 124,629	$ 128,602	$ 28,311	28%
South Beach Harbor	$ 4,772	$ 4,921	$ 5,081	$ 5,238	$ 5,396	$ 5,561	$ 789	17%
Capital Revenues	$ 4,243	$ 2,100	$ 550	$ -	$ -	$ -	$ (4,243)	-100%
Sources, total	**$ 154,713**	**$ 145,947**	**$ 146,552**	**$ 159,163**	**$ 158,944**	**$ 163,762**	**$ 9,050**	**6%**
Uses								
Operating Reserve	$ 12,290	$ 12,734	$ 13,263	$ 13,816	$ 14,467	$ 15,147	$ 2,857	23%
Percent of operating expenses	15.0%	15.0%	15.0%	15.0%	15.0%	15.0%	0.0%	0%
Operating Expenses	$ 86,266	$ 89,359	$ 93,034	$ 96,863	$ 101,349	$ 106,030	$ 19,764	23%
South Beach Harbor	$ 4,772	$ 4,921	$ 5,081	$ 5,238	$ 5,396	$ 5,561	$ 789	17%
Capital Policy Budget	$ 37,960	$ 26,747	$ 28,814	$ 30,312	$ 31,157	$ 32,151	$ (5,810)	-15%
1. Capital investments	37,960	22,344	12,953	18,860	14,452	14,452	(23,508)	-62%
2. Designation to Capital	-	4,403	15,860	11,452	16,705	17,699	17,699	0%
Percent of operating revenues	38%	25%	25%	25%	25%	25%	-13%	-34%
Uses, total	**$ 141,288**	**$ 133,761**	**$ 140,192**	**$ 146,230**	**$ 152,370**	**$ 158,889**	**$ 17,601**	**12%**
Balance	**$ 13,425**	**$ 12,185**	**$ 6,361**	**$ 12,933**	**$ 6,574**	**$ 4,874**	**$ (8,551)**	**-64%**
KEY ASSUMPTIONS								
Real Estate	$ -	$ 1,723	$ 8,524	$ 10,771	$ 11,247	$ 11,589		
1. Backlands - Leases	-	-	2,700	3,900	4,017	4,138		
2. 19th and Illinois Parking	-	-	516	531	547	564		
3. Pier 19 - Shed Lease	-	325	633	1,349	1,390	1,431		
4. Pier 23 - Shed Lease	-	1,115	1,813	1,868	1,921	1,976		
5. Beltline Building - Lease	-	-	76	79	81	83		
6. Pier 29 Bulkhead - Jamestown	-	-	20	189	343	355		
7. Pier 29 1/2 - Office & Parking	-	189	388	400	412	424		
8. Pier 31/ Pier 48 - Elections	-	95	2,376	2,456	2,536	2,617		
9. Percentage Rents, Recession	-	-	-	-	-	-		
Development Projects	$ -	$ 396	$ (1,061)	$ (1,078)	$ (1,727)	$ (1,256)		
1. Pier 70 - Forest City	-	-	(1,500)	(1,545)	(1,591)	(1,639)		
2. SWL337 - Mission Rock	-	-	-	(700)	(1,442)	(1,485)		
3. Pier 38 - Development	-	25	50	50	50	50		
4. SWL324 - Teatro Zinzani	-	371	483	1,050	1,160	1,333		
5. SWL322-1 - MOH Development	-	-	(352)	(363)	(374)	(385)		
6. Pier 31.5 - NPS Alcatraz Ferry	-	-	259	431	470	870		

STRATEGIC CONSIDERATIONS

As the Port considers scenarios for financial performance robust fiscal policies and goals are critical to the Port's ongoing financial stability. For example, the Capital Policy ensures that the Port considers tradeoffs between operating and capital needs during down cycles in the economy, while maximizing investments to during economic upcycles. This is demonstrated in the Low Case Scenario, wherein the budget faces significant deficits while capital investments only decline by $7.5 million (10%) over the five-year period and there is a $14.0 million average capital budget.

It is now clear, as well, that the Port's Stability goal of achieving $125.0 million in annual revenues is not just a worthy accomplishment, but also a vital step to make sure that the Port can sustain operations while maintaining its facilities. While Operating Expenses in the Base Case Scenario are projected to grow by $20.9 million (24%), including a staggering $13.5 million for personnel, Operating Revenues without new lease and operating agreements would only grow by $16.4 million (16%). With the inclusion of new leases, $11.3 million in additional revenues are projected to support operating costs and allow the Port to further invest in its facilities.

The Port should continue to maintain is strong fiscal practices and consider the following three opportunities new policies and procedures to maximize the Port's potential during strong economic times while furthering its further the Port's stability in the event of an economic downturn, but also maximize its potential during strong economic times.

Capital Improvement Planning

The Port has well-established capital budgeting and capital planning processes; however, a mid-range capital improvement plan (CIP) would improve the Port's ability to strategically plan for and prioritize its capital investments. A CIP would also help the Port plan for major funding opportunities, including through Public-Private Partnerships, federal grants and programs, and state and local funding sources that require involvement in early planning processes.

To demonstrate the need for mid-range planning, the 10-Year Capital Plan catalog's the Port's anticipated capital needs, but it does not go into specific detail regarding the timing and priority of facility renewals. Also, while the biennial capital budget provides a forward view into work that will be conducted in the second year of the budget, the process does not document and plan for projects and project phases that extend beyond the two-year window.

A five-year CIP that identifies specific projects, their phases, costs, as well as available and planned funding sources, would allow staff to identify and plan for investments. Key areas of consideration would be to identify project that will preserve existing revenue, capture new revenue-generating potential, and/or leverage external funding. The CIP would also position the Port to plan for major funding opportunities, including through Public-Private Partnerships, federal grants and programs, and state and local funding sources that require involvement in early planning processes.

This proposed new practice complements existing stability goals by helping the Port identify both risks to and opportunities for financial performance and develop implementation strategies. These strategies might include dedicating staff, and budgeting for project design and permitting that will prepare a project for grant funding or a partnership opportunity.

Pay-Go vs. New Debt

With the recent adoption of the Port's Municipal Debt Policy update, Port staff was asked to examine the Port's bonding capacity. The Port's financial advisor calculated a bonding capacity of $119.6 million $119.6 million in project proceeds, considering both the Port's outstanding revenue bonds and its subordinate obligations, such as the certificates of participation debt. This level of debt would equate to $9.5 million in additional annual debt service, from $7.1 million to $16.6 million. Port Finance staff advises that the issuance of additional debt needs to be balanced with the ability of the Port's operating budget to absorb the additional debt service expense, while meeting the Port's operational needs and the following stability objectives set forth in the Port's 2016-2021 Strategic Plan.

With the completion of this Financial Plan, Port staff advises that the Base Case Scenario of the Financial Plan could reasonably absorb up to $2.0 million in additional annual debt service, which could support approximately $24.0 million in bond proceeds.[3] However, due to a projected decline in net operating balances each fiscal year of the Base Case, and to protect the Port from further hardship in the Low Case, Port Finance strongly recommends limiting new debt issuances to revenue-generating investments that substantially exceed the additional debt service during the entire period that the associated debt is outstanding. Ideally debt-financed projects would generate a return on investment within a 10-year period, as is tested through the Port's capital budget scoring process. A detailed analysis of the 30-year investment horizon would be required to understand the business case for leveraging the Port's bonding capacity in lieu of Pay-Go capital funding or engaging in other funding strategies, such as a public-private partnership.

CONCLUSION

The Port's Five Year Financial Plan for FY 2017-18 to 2021-22 reflects a strong financial outlook that includes surplus revenues in each year of the Base Case and High Case scenarios. Port Staff recognizes that the current Financial Plan relies upon ongoing revenue growth that runs the risk of falling short of projections, particularly in the event of an economic slowdown. Also, while the Base Case of the Financial Plan reflects operating balances for each fiscal year, the positive variance between funding sources and uses declines from year to year as growth in Operating Expenses outpaces growth in Operating Revenues. For these reasons, the Port must continue to identify and pursue opportunities that deepen the Port's revenue base to support both growing operational demands and the critical repair and replacement requirements of the Port's infrastructure.

[3] Assuming 6% interest rate over a 30-year term.

NEXT STEPS

Port staff welcomes and appreciates comments, input and feedback from the Port Commission and the public. Port staff will return to the Port Commission at its next regularly scheduled meeting on January 10, 2017 with an update on the City's Financial Plan and a request to approve the proposed Five Year Financial Plan for FY 2017-18 to FY 2021-22

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ATTACHMENT 1: Port Five Year Financial Plan for Fiscal Year 2017-18 to 2021-22, Base, High and Low Case Scenarios