1. Strategic Planning and Organization of the Port of San Francisco

- **The Port's revenues, which come from its real estate and maritime business activities, fluctuate with changes in the economy. However, over the past six fiscal years the Port's routine operating and facilities maintenance expenses have continued to grow, despite fluctuations in the Port's revenues, resulting in significantly higher growth in the Port's operating expenses compared to the Port's revenues. The Port's operating expenses have grown by 38 percent between FY 1998-1999 to FY 2003-2004 compared to 15 percent growth in revenues. The Port's financial statements show operating losses of $5.4 million in FY 2001-2002 and $4.3 million in FY 2002-2003, including depreciation of the Port's assets. The Port's net assets declined by $6.4 million in FY 2002-2003, indicating that the Port's draw-down on its available resources was not offset by an increase in the value of its total assets.**

- **Despite the fluctuations and uncertainty in revenues, the Port has not controlled its discretionary spending for personnel and other operating expenses, such as office space. The Port has created new positions and upgraded existing positions over the past five years, resulting in 9.5 net new positions and estimated increased salary and fringe benefit costs of approximately $1.7 million annually. The Port created a new management classification in FY 2000-2001, adding nine new Assistant Deputy Director positions to the budget. Although the Port deleted or substituted other management positions to offset the nine new Assistant Deputy Director positions, the Budget Analyst estimates that ongoing salary costs for this new classification have increased by approximately $170,177, or 20.4 percent, from an estimated $834,725 to $1,004,902.**

- **The Port increased its ongoing costs for office space by an estimated $500,000 annually when it relocated its offices from the Ferry Building to Pier One in FY 2001-2002. As part of the relocation, the Port exceeded its estimates for tenant improvement costs by 70 percent, increasing the cost of the Port's tenant improvements from $1 million to $1.7 million.**

- **The Port does not closely monitor its budget. For example, the Port failed to include two capital-funded positions in the Annual Salary Ordinance in FY 2002-2003. In FY 2003-2004, the Port deleted six capital-funded positions in the Annual Salary Ordinance. The Port stated an intention to lay-off these eight positions, costing an estimated $630,000 annually in salary and fringe benefits, on July 1, 2003, but was unable to do so because the Memoranda of Understanding for these eight positions contained a "no lay off" clause in FY 2003-2004.**

- **The Port has failed to manage its workers compensation claims and liability insurance premium costs, which have nearly doubled since FY 1998-1999. Over the past five fiscal years, the Port's general liability insurance costs have increased by $1,124,746, or 173 percent, from $649,841 in FY 1998-1999 to $1,774,587 in FY 2002-2003. The Port's workers compensation costs have increased by $488,766, or 191 percent, from $255,381 in FY 1998-1999 to $744,147 in FY 2002-2003. Although the Port's workers compensation claims and liability insurance premium costs have gone up in part due to industry-wide increases, the Port does not have a formal risk management program to reduce its exposure and costs, contributing to the cost increases. The Port should establish a formal risk management program and implement a mandatory muscular-skeletal and back training program to reduce the Port's most common cause of workplace injury.**

- **The Port could increase its efficiency by combining the Real Estate and Planning and Development divisions into one division and reassigning the Environmental, Health and Safety section of the Engineering and Maintenance Division to the Administrative Services Division. The Planning and Development Division and the Real Estate Division both have business responsibilities for the Port's assets. Combining the two divisions would bring together the skills and expertise of both divisions and allow the Port to develop common strategies and policies for planning for the use of, developing and managing the Port's assets.**

- **Because the Environmental, Health and Safety section is responsible for a variety of environmental programs, including the monitoring of the Engineering and Maintenance Division's compliance with environmental regulations, the Port should reassign the Environmental, Health and Safety Section of the Engineering and Maintenance Division to Administrative Services. This reassignment would promote the Section's independence in overseeing and enforcing environmental compliance and employee safety programs, and to recognize the Environmental, Health and Safety Section's Port-wide responsibilities. As part of the reorganization, the Port should delete the Engineering and Maintenance Division Director position, and re-assign the remaining Engineering and Maintenance Division duties to the Chief Harbor Engineer.**

The Port's Strategic Plan

The Port's strategic plan is included in the annual operating budget. According to the Port's mission statement:

> The Port of San Francisco is a public enterprise committed to promoting a balance of maritime, recreational, industrial, transportation, public access and commercial activities on a safe, secure and self-supporting basis

> through appropriate management and development of the waterfront for the benefit of the people of the State of California.

The Port serves a dual and interlocking role as an enterprise and a trustee of public lands, providing public access and benefit. The Port lists twelve strategic goals in the FY 2003-2004 budget, which include:

- Promoting the Port's maritime industries;
- Increasing the volume of cargo shipping;
- Efficiently managing and improving all Port property;
- Supporting ferry passenger activity on San Francisco Bay;
- Attracting residents and visitors to the waterfront;
- Achieving integrated, well-planned and fiscally sound development consistent with the Port's Waterfront Land Use Plan;
- Developing and maintaining a high level of public understanding and confidence in the Port;
- Improving customer service to Port tenants, customers and the public;
- Maintaining sound and appropriate environmental management practices for all Port property;
- Identifying and implementing appropriate safety and security procedures to protect the health and safety of all workers and visitors to the Port;
- Increasing revenue necessary to remain self-supporting and to fund improvements, maintenance, and prudent reserves; and
- Providing economic development opportunities that produce jobs and revenues that benefit the City, Region, and State.

For each of these goals, the Port has laid out specific tasks to achieve the goal, and revises these tasks each year as specific tasks are achieved or developed. In December of 2003, the Port evaluated the Port's actual activities and achievements of the FY 2001-2002 and FY 2002-2003 tasks, enumerated in the strategic plan. Although the Port was able to identify the achievement of many specific tasks included in the strategic plan, the Budget Analyst found deficiencies in several Port activities underlying the strategic goals. As discussed in subsequent sections of the management audit report, the Budget Analyst identified inefficient practices and the need for improvement in developing and managing Port properties, ensuring coordination of environmental policies and tenant compliance, implementing risk reduction policies, and increasing the Port's revenues and protecting the Port against loss, and other areas of Port activities.

The Port's strategic goals have remained largely unchanged over the past five fiscal years, although the Port added the goal to provide economic development opportunities in FY 2002-2003. The Port has been working on a new strategic plan and mission statement, which were expected to be completed in April of 2004, to be included in the FY 2004-2005 operating budget. According to the Port, the strategic plan should tie in to the Port's five-year financial statement forecast, which was prepared by the Port's Finance section in October of 2003.

However, the Port has failed to tie the Port's strategic plan to the five-year financial statement forecast. According to the Port, the Port's Finance section should prepare the five-year financial statement forecast annually, projecting the Port's financial status for the next five years. Prior to the preparation of the 2003 forecast, however, the Port had not prepared a financial statement forecast since 2000.

The Port's 2003 five-year financial statement forecast projects operating losses in FY 2003-2004 through FY 2007-2008, in contradiction to the Port's goals of promoting and maintaining maritime activities, promoting management and development of real estate assets, and increasing revenues. According to the five-year financial statement projection, the Port's operating expenses will increase at a much higher rate than the Port's operating revenues.

- The Port projects that operating expenses will increase by approximately 7.8 percent in FY 2004-2005, compared to FY 2003-2004 operating expenses, and by approximately 3 percent in FY 2005-2006 through FY 2007-2008, compared to the prior fiscal year.

- The Port projects that operating revenues will increase by 3.5 percent in FY 2004-2005, compared to FY 2003-2004 operating revenues. In FY 2005-2006 and FY 2006-2007, the Port projects that operating revenues will increase by less than one percent compared to the prior fiscal year, and in FY 2007-2008, the Port projects that operating revenues will increase by approximately 2.4 percent.

Because the Port will receive monies for the sale and development of Seawall Lot 330 for condominium housing and other capital grant monies for various Port capital projects, the Port projects an increase in its net assets over the next few years. However, the Port projects a $7.6 million reduction in net assets in FY 2007-2008 because the Port does not project one-time revenues from sales of Port property or capital grant monies in that year.

The Port's Increase in Operating Expenditures

As an enterprise fund department, the Port's operating revenues fund the Port's operating and capital expenditures. As discussed in the Introduction, the Port's revenues, which come mainly from the Port's maritime and real estate activities, fluctuate with changes in the economy and the Port's business activities. Real estate retail revenues fell after September 11, 2001, due to declines in tourism, which impacted Port tenants who pay percentage rents based on gross revenues. The Port has also received one-time revenues, which did not continue into subsequent fiscal years, such as the $25.7 million payment in FY 2000-2001 to the Port by the Municipal Railway (Muni) for rights to Port property in perpetuity.

The Port's operating expenditures for the Port's operating and routine maintenance activities but not for annual or ongoing capital projects, have grown steadily over the past five years, despite fluctuations and slower growth in Port revenues.

- The Port's annual operating revenues increased by 14 percent and its annual operating expenditures increased by 26 percent between FY 1998-1999 and FY 2002-2003.

- The Port's budgeted operating revenues in FY 2003-2004 were 15 percent more than actual operating revenues in FY 1998-1999. The Port's budget operating expenditures were 38 percent more in FY 2003-2004 than actual operating expenditures in FY 1998-1999.

The Port's operating budget includes the Port's expenses for routine operations and facilities maintenance needs, but not for capital projects. The Port's surplus revenues, after deducting operating expenses, contribute to the Port's unappropriated fund balance and can be used as a source of funds to pay for the Port's ongoing capital projects. Table 1.1 provides the Port's actual operating revenues and expenditures from FY 1998-1999 through FY 2002-2003 and budgeted operating revenues and expenditures in FY 2003-2004.

- In FY 2000-2001, Muni paid the Port one-time revenues of $25.7 million for rights to Port property in perpetuity. As noted in Table 1.1, the Port's FY 2000-2001 operating revenue surplus was $32.96 million, including the $25.7 million in one-time revenues from Muni. The Port appropriated $32.1 million of these monies for capital projects in FY 2001-2002.

- In FY 2001-2002, the Port had a $3.47 million operating revenue deficit, requiring a draw-down on the Port's unappropriated fund balance to meet operating expenses. In FY 2001-2002, the Port increased payments to other City departments and for debt payments, including a one-time payment to eliminate a commercial loan balance for the Pier 50 maintenance facility, contributing to the deficit. The increase in the Port's payments to other City departments were primarily to pay workers compensation and general liability costs, City Attorney costs for the Port's legal issues, and increased utility costs.

- In FY 2002-2003, the Port reduced non-essential spending for travel, materials and supplies, and other expenses due to concerns that the Port would be unable to meet its debt service revenue-to-expenditure ratio requirements.

Table 1.1

The Port's Actual Operating Revenues and Expenditures FY 1998-1999 through FY 2002-2003, and Budgeted Revenues and Expenditures FY 2003-2004

	FY 1998-99	FY 1999-00	FY 2000-01	FY 2001-02	FY 2002-03	FY 2003-04 Budget	Percent Increase FY 1998-99 to FY 2003-04
Revenues							
Maritime	$6,073,786	$7,560,511	$7,903,600	$7,472,326	$8,596,358	$9,384,000	55%
Real Estate	34,141,263	36,395,159	38,603,270	39,938,609	38,656,344	38,783,000	14%
One-time Revenues			25,700,000				
Miscellaneous	3,759,165	4,296,596	4,213,858	3,987,582	2,974,709	2,480,000	(34%)
Total	$43,974,214	$48,252,266	$76,420,728	$51,398,517	$50,227,411	$50,647,000	15%
Expenditures							
Personnel	$15,935,953	$17,437,708	$18,825,106	$20,186,019	$21,177,579	$21,948,135	38%
Overhead	373,030	384,216	508,541	652,541	728,426	423,341	13%
Non personal Services	3,807,833	3,515,985	5,272,331	5,972,515	5,431,052	7,785,726	104%
Materials	1,541,154	1,414,145	1,900,778	2,331,411	1,153,812	1,535,378	0%
Equipment	1,099,276	694,711	926,919	883,851	700,560	306,500	(72%)
Debt service	8,976,163	8,881,766	8,728,662	15,550,046	7,019,075	6,159,325	(31%)
FEMA reimbursement		(2,747,679)					
Services other Departments	3,697,102	5,967,737	5,446,245	8,171,996	8,120,317	10,771,441	191%
Work order recovery	(132,290)	(40,138)	(68,426)	(228,768)	(107,927)	(108,800)	(18%)
Fire boat	1,213,085	1,149,914	1,923,669	1,353,785	1,757,278	1,698,435	40%
Total	36,511,306	36,658,365	43,463,825	54,873,396	45,980,172	50,519,481	38%
Surplus/(deficit) Revenues	$7,462,908	$11,593,901	$32,956,903	($3,474,879)	$4,247,239	$127,519	

Source: San Francisco Port Finance section. FY 1998-1999 through FY 2002-2003 data are actual revenues and expenditures, reported on a budget basis. FY 2003-2004 revenues and expenditures are based on the Port's operating budget in the Annual Administrative Ordinance.

As discussed in the Introduction, the Port has had operating losses in FY 2001-2002 and FY 2002-2003, including depreciation and amortization of the Port's assets. According to the Port's audited financial statements, the Port had a $5.4 million operating loss in FY 2001-2002 and $4.3 million operating loss in FY 2002-2003. The Port's unrestricted net assets, which represents the Port's available resources, declined by $11.2 million, or approximately 20 percent, between FY 2001-2002 and FY 2002-2003. Further, the Port's total net assets declined by $6.4 million, or approximately 2 percent, indicating that the decline in the Port's unrestricted net assets was not offset by an increase in the Port's investment in capital assets.

Increases in Discretionary Expenditures

Over the past six fiscal years the Port has increased discretionary expenditures. As noted in Table 1.1, the Port increased expenditures for materials and supplies from $1.54 million in FY 1998-1999 to $2.33 million in FY 2001-2002, an increase of $790,000 or approximately 51.3 percent. The Port reduced spending on non-essential expenses, including materials and supplies, in FY 2002-2003 due to concerns that the Port would be unable to meet its debt service coverage ratio requirements. Other discretionary Port expenditures have continued to increase, including expenditures for salaries and benefits and office space.

Increases in Salary and Fringe Benefit Expenditures

The Port's salary and fringe benefit costs have increased by approximately $5.2 million, or 32.9 percent, between FY 1998-1999 and FY 2002-2003. FY 1998-1999 salary and fringe benefit costs of $15.9 million increased to $21.2 million in FY 2002-2003. Although an estimated two-thirds of the increase in salary and fringe benefit costs have resulted from cost of living adjustments, the Port's costs have also increased from addition of new positions and upward classification of existing positions. The Port has added approximately 9.5 net new full time positions from FY 1999-2000 through FY 2003-2004. Overall, creation of new positions and upward classification of existing positions has resulted in an estimated $1.7 million annually in increased operating expenses.

From FY 1999-2000 through FY 2003-2004, the Port has reclassified upward and added new management, administrative analyst and management assistant positions, maintenance positions, and engineering positions, which were partially offset by reductions in other positions.

New Assistant Deputy Director Positions

In FY 2000-2001, the Port created the classification of Assistant Deputy Director and funded three new Assistant Deputy Director positions in the budget. In FY 2001-2002, the Port funded six additional new Assistant Deputy Director positions, resulting in nine new Assistant Deputy Director positions. Although the Port deleted some management positions, which partially offset the cost of the new Assistant Deputy Director positions, the Port incurred ongoing increases in annual salary costs for these new management positions. The Budget Analyst estimates that the creation of the nine new Assistant Deputy Director positions resulted in a net increase in ongoing annual salary costs of approximately $170,177, or 20.4 percent, from $834,725 to $1,004,902.[1]

Currently, one Assistant Deputy Director position in the Planning and Development Division is vacant, and the Port has stated their intention to substitute this position for a Development Project Coordinator, for an estimated annual salary and benefit saving of $22,000. The Budget Analyst will review the Port's justification for the Development Project Coordinator position during the FY 2004-2005 budget review.

Capital Funded Positions

In FY 2000-2001, the Port created 17 new off-budget positions funded from monies appropriated for capital projects, but did not include these positions in the Annual Salary Ordinance. In FY 2002-2003, the Port included 15 of the 17 off-budget positions in the Annual Salary Ordinance but failed to follow the City's budget instructions to include the other two positions in the Annual Salary Ordinance. The Port continued to employ the incumbents in these two positions, funded from the capital project appropriation, although the positions were not in the Annual Salary Ordinance. The Port deleted six of the 15 positions included in the Annual Salary Ordinance in FY 2003-2004. According to the Port, the Port intended to lay-off eight positions, including the two positions which the Port failed to include in the Annual Salary Ordinance plus the six positions deleted from the Annual Salary Ordinance, on July 1, 2003, but was prevented from doing so because the Memoranda of Understanding covering these eight positions contained a "no layoff" clause in FY 2003-2004. Therefore, the Port has continued to employ eight individuals in positions which are not in the FY 2003-2004 Annual Salary Ordinance, at an estimated annual salary cost of approximately $630,000.

In addition to the eight capital funded positions discussed above, the Port has nine other capital funded positions that are included in the FY 2003-2004 Annual Salary Ordinance. The Port has stated their intention of including eight of these nine capital funded positions in the FY 2004-2005 Annual Salary Ordinance. As discussed in Section 3, the Port has not conducted a comprehensive capital needs assessment nor implemented a formal capital improvement program. In the absence of a formal capital improvement program, the Port cannot reasonably assess its labor needs or effectively designate permanent, on-going positions for capital projects. Further, as discussed in Section 3, these capital-funded positions do not necessarily work on the dedicated projects and have been assigned to other capital projects or to routine engineering and maintenance funded by the operating budget. The Port should formally assess its needs for capital-funded positions and not create any new capital-funded positions or hire into vacant capital-funded position until a formal capital improvement program is established.

[1] The Port deleted eight management positions in the FY 1999-2000 and FY 2000-2001 budget and created nine new Assistant Deputy Director positions. Assuming that the salaries for the eight deleted management positions would have increased at the same percentage rate as the nine new Assistant Deputy Director positions, the Budget Analyst estimates that FY 2003-2004 salaries at top step for the eight deleted positions would be $834,725 compared to $1,004,902 for the nine new Assistant Deputy Director positions.

In FY 2004-2005, the Port should delete the vacant Project Manager and Roofer positions designated for capital programs and code the remaining seven positions designated for capital programs as "limited tenure" positions, with the intention to delete the capital-funded position when the project is completed or the funding source eliminated. The deletion of these positions would result in salary and fringe benefit cost savings of approximately $204,000.

Long Term Vacancies

The Port has several positions, which have been vacant for more than one year. The Port proposes to delete several vacant positions in the FY 2004-2005 budget, including:

- 1244 Senior Personnel Analyst
- 1657 Senior Systems Accountant
- 7220 Asphalt Finisher Supervisor I
- 9377 Feasibility Analyst

In addition to the positions recommended for deletion by the Port, the Management Audit recommends deletion of one 1446 Secretary II position and one 9395 Property Manager position, which have been vacant for more than one year. The estimated annual salary and fringe benefit savings for eliminating these positions are $534,000.

The Port's Rent Expenses

The Port's rent expenses increased in FY 2001-2002, when the Port's offices moved from the Ferry Building to Pier One. The Port's net increase in annual rent costs is approximately $500,000, as follows:

Rent paid by the Port to the developer for Pier One office	$1,836,624	
Amortization of tenant improvement costs	159,392	
Estimated annual operating expenses	572,137	
Subtotal, Port's rent expenses at Pier One		$2,568,153
Rent paid to the Port by the Pier One developer	(1,341,543)	
Estimated reduction in Ferry Building expenses[2]	(719,857)	
Subtotal, Port savings and income		(2,061,400)
Net Port expenses for Pier One office space		$506,753

[2] The Port paid approximately $719,857 for utilities, scavenger service, security, and custodial services for the Port's offices at the Ferry Building in FY 1999-2000, prior to the relocation of the Port's offices to Pier One.

The Port's net rent expenses for Pier One are approximately $533,708 higher annually than initially projected by the Port due to decreased rent to the Port from the Pier One developer and increased tenant improvement and other expenses, as discussed in the following bullet points. Under the Port's original rent and expense projections for Pier One, the Port would have reduced its net rent expenses upon relocation from the Ferry Building to Pier One by an estimated $26,955 ($506,753 less $533,708).

- Under the lease agreement between the Port and the Pier One developer, the developer pays annual minimum rent to the Port, based on a formula that includes construction and other costs, as discussed in detail in Section 2. However, due to higher than anticipated construction costs, as discussed in Section 2, the developer's annual actual rent to the Port is $1,341,543 rather than $1,782,859 as anticipated in the original lease, a reduction of $441,316.

- The Port's costs for tenant improvements increased from the initial estimate of $1.0 million to $1.7 million, resulting in an increase in annual amortization of tenant improvement costs from the initial estimate of $67,000 annually to $159,392 annually, an increase of $92,392 annually.

Under the lease between the Port and San Francisco Waterfront Partners I, LLC, the Port has the option to expand its current office space at Pier 1 into an additional estimated 3,132 square feet of space at Piers 1 ½ and 3, with estimated annual rent costs ranging from $144,072 to $187,920. The Port should not exercise this option at this time. Under the lease, the Port may exercise the option to lease the additional space at market rate every ten years if the space becomes available.

<u>Discounted Employee Parking</u>

The Port provides discounted parking to employees under its lease agreement with Central Parking to operate parking lots at Seawall Lots 321, 323, and 324. Under the Port's lease agreement with Central Parking, the Port has access to 60 parking spaces on Seawall Lot 321, which includes 6 spaces for Port-owned vehicles and 54 spaces for discounted employee parking. Port employees pay $46.88 per month per space for parking spaces with an estimated market rent value of approximately $150 monthly, or approximately $103.12 per space per month below the fair market rent.

According to the Port, because the Port receives fixed monthly rent rather than percentage rent from Central Parking under the lease for Seawall Lots 321, 323, and 324, the Port does not incur costs for the 54 subsidized parking spaces. The Port awarded the parking lease to Central Parking in 1999 through a competitive bid process, but according to the Port, the discounted employee parking did not become available to Port employees at Seawall Lot 321 until 2002. Although the Port does not currently incur direct costs for discounted employee parking, the Port has relocated employee parking from Pier One to Seawall Lot 351 to Seawall Lot 321 over the past several years. If the Port continues providing discounted employee parking, further relocation of the employee parking or a new lease agreement with a new parking operator could result in new direct costs to the

Port. To avoid future direct costs for parking, the Port should meet and confer with the employee organizations to eliminate discounted parking for Port employees.

Cost Increases for Workers Compensation Claims and General Liability and Vehicle Insurance Premiums

The Port's expenditures for workers compensation claims have increased by 191 percent between FY 1998-1999 and FY 2002-2003. The Port coordinates payment of workers compensation claims through the City's self-insured Workers Compensation program, administered by the Department of Human Resources Workers Compensation Division. The Port carries insurance coverage and pays premiums to private carriers for general liability and vehicle insurance, coordinated by the City's Risk Manager. The Port's general liability and vehicle insurance premiums have increased by 173 percent over the past five fiscal years, as shown in Table 1.2.

Table 1.2

Workers Compensation Claims and General Liability and Vehicle Insurance Premium Costs FY 1998-1999 through FY 2002-2003

	FY 1998-1999	FY 1999-2000	FY 2000-2001	FY 2001-2002	FY 2002-2003	Increase in Expenses FY 1998-1999 to FY 2002-2003	Percent Increase in Expenses FY 1998-1999 to FY 2002-2003
General Liability	$649,841	$652,210	$939,517	$1,647,928	$1,774,587	$1,124,746	173%
Workers Compensation	$255,381	$284,742	$325,968	$639,501	$744,147	$488,766	191%

Source: San Francisco Port and City Risk Manager

Managing Workers Compensation Claims and Liability Insurance Premium Costs

<u>General Liability Insurance Premium Costs</u>

The Port coordinates with the City's Risk Manager to control general liability and vehicle insurance premium costs. The City's Risk Manager works with the Port to identify areas of greatest liability and exposure and to review and purchase insurance policies for the Port. The Port carries various policies with different insurers, including insurance policies covering Port vessels, automobiles, property, and general marine liability. According to the Risk Manager, insurance premiums have increased generally since 2001 because insurers are receiving a lower return on investments, resulting in increased premiums to cover costs without concurrent increases in the amount of coverage.

The City Risk Manager is currently establishing a general risk reduction program and proposes to develop a claims management program to identify the causes and trends of loss. Although the Port would be included in these programs, these programs are in their early stages.

The Port does not currently have policies and procedures governing a risk management program. Although the Port has assigned risk management responsibilities to the Finance Manager, these responsibilities are generally limited to working with the City Risk Manager regarding insurance premium costs. The Port needs to develop its own risk management program. The Port Executive Director should designate a Port manager to serve as risk manager who would report directly to the Port Executive Director regarding the risk management program. The risk management program, among other issues, needs to identify (i) areas of risk reduction, resulting from the Port's security assessment, and potential for reducing insurance costs; and (ii) areas of uninsured risk.

The Port's costs for City Attorney services have increased significantly over the past five fiscal years. The Port's budget for judgment, claims and litigation also increased by 240 percent in FY 2003-2004, from $250,000 in FY 2002-2003 to $850,000 in FY 2003-2004. The Port's designated risk manager needs to work with the City Attorney to identify the Port's exposure to litigation and other risks resulting from the Port's activities, and develop a loss prevention program.

<u>Vehicle Accidents and Insurance Premium Costs</u>

The Port does not have a central process for analyzing or preventing automobile accidents. The City Attorney is responsible for investigating and managing claims, and recommending action, such as denial, settlement, or further investigation of claims, to Port management and the Port Commission. The Port's Finance Manager works with the City's Risk Manager to track and manage insurance premium costs, although the City's Risk Manager performs most of this function.

The Safety Officer is responsible for developing programs to reduce vehicle accidents. Port employees and vehicles are involved in approximately 12 to 15 incidents per year. The Port began maintaining a list of all vehicle accidents, summarizing the incident and analyzing if the accident were preventable in March of 2003. For 15 vehicle accidents involving Port vehicles and employees that were reported between March of 2003, when the Port began maintaining a list, and February of 2004, the Port determined that 11 accidents, or 73 percent, were preventable, but has not taken formal steps to respond to these 11 accidents. The Port has not yet developed a formal system to respond to preventable vehicle accidents, including a formal driver training or loss prevention program.

Further, the Port has not developed formal policies for reporting vehicle accidents. The Port needs to develop a written policy, identifying reporting requirements for vehicle accidents, including criteria covering:

(a) what must be reported,

(b) when the information must be reported,

(c) to whom the information is reported,

(d) responsibility for maintaining and analyzing vehicle accident data, and

(e) reporting the accident to the insurance company.

Vehicle Insurance Premiums

In FY 2003-2004, the City's Risk Manager estimates that the Port's vehicle insurance premium will be approximately $136,480 compared to the Port's premium of $126,785 in FY 2002-2003, an increase of $9,695, or 7.7 percent over two years (3.8 percent per year).

In FY 2003-2004, the Port's existing carrier for automobile liability insurance cancelled the Port's policy and the Port was temporarily un-insured while seeking a new policy. The Port re-established vehicle insurance coverage with an outside carrier in September of 2003. According to the City's Risk Manager, in an analysis of the Port's vehicle insurance premium costs and loss history prepared for the Budget Analyst, the Port's costs for insurance premiums may exceed the Port's costs for vehicle accidents. The City's Risk Manager tracked premium costs and insurance payments for vehicle incidents over a five-year period, as shown in Table 1.3. According to the City's Risk Manager, the five-year auto loss ratio of premium payments to insurance payments of 0.220, as shown in Table 1.3, suggests that the Port should self-insure, but the five-year period analyzed is too short a time frame to make a determination.

Table 1.3

The Port's Auto Insurance Premiums and Insurance Payments for Vehicle Incidents FY 1997-1998 through FY 2001-2002[3]

	FY 1997-1998	FY 1998-1999	FY 1999-2000	FY 2000-2001	FY 2001-2002	Five-year Total
Policy period	2/7/98 to 2/6/99	2/7/99 to 2/6/00	2/7/00 to 2/6/01	2/7/01 to 2/6/02	2/6/02 to 9/29/03	
Deductible	$0	$0	$0	$1,000	$1,000 per incident; $2,500 per theft	
Policy limit	$1,000,000	$1,000,000	$1,000,000	$1,000,000	$1,000,000	
Premium cost	$40,089	$39,310	$50,088	$83,511	$126,786	**$339,784**
Loss payments	$9,684	$10,970	$28,005	$23,043	$2,902	**$74,604**
Ratio of 5-year vehicle loss to premium payment						**0.220**

Source: City's Risk Manager

As noted in Table 1.3, the Port's costs for deductibles for vehicle accidents and theft increased in FY 2000-2001 and FY 2001-2002. Premium costs increased by $43,275, or approximately 51.8 percent, from $83,511 in FY 2000-2001 to $126,786 in FY 2001-2002. The Port needs to work with the City's Risk Manager to determine if the Port should self-insure for vehicle accidents and report to the Port Commission during the FY 2005-2006 budget review on the proposal for self-insuring.

Workers Compensation Claims Costs

The Port's workers compensation claims costs have increased significantly over the past five fiscal years. In FY 2003-2004, the Port projects total workers compensation claims costs of approximately $1.0 million. According to the Department of Human Resources Workers Compensation Division, the Port's expected workers compensation costs in FY 2004-2005 are $882,377.

The Port's total number of new workers compensation claims has not increased over the past three fiscal years. However, the number of indemnity claims, in which employees who are on disability leave and receive both payment for medical costs and indemnity payments in lieu of salaries and which incur the highest cost, was large in FY 2002-2003, compared to the number of medical-only claims, which generally have lower costs. Based on the first seven months of FY 2003-2004, the number of indemnity claims compared to medical claims will continue to be high.

[3] Claims payment data for accidents occurring in FY 2002-2003 is not yet available.

	FY 1999-2000	FY 2000-2001	FY 2001-2002	FY 2002-2003	FY 2003-2004 *
Indemnity claims	15	19	22	28	22
Medical only claims	15	20	18	9	15
Total claims	30	39	40	37	37

* Annualized, based on seven months of claims

For FY 2003-2004, the projected 37 new workers compensation claims equals approximately 15 percent of the Port's workforce of 240 employees. The FY 2003-2004 workers compensation costs of approximately $1.0 million equals approximately 4.6 percent of the Port's salaries and fringe benefit costs of $21.9 million.

State Assembly Bill (AB) 749, which became effective in January of 2003, has increased benefits to injured workers, including increases in temporary and permanent disability, contributing to increases in workers compensation claims costs. AB 749 has impacted the Port's workers compensation costs for injuries that occurred after the effective date of January 1, 2003, and injuries greater than two years old. Because total workers compensation costs for claims that occur in a given year can accrue in subsequent years and many of the Port's employees on temporary disability have claims that are more than two years old, the full impact of AB 749 on the Port's actual workers compensation costs is not yet fully known.

The Port can reduce workers compensation costs through prevention of injury and improved management of existing claims. As noted above, the number of new reported workers compensation claims has remained relatively constant over the past three fiscal years, although the number of indemnity claims has increased compared to medical-only claims.

In the past year, the Port's Safety Officer has implemented semiannual maintenance supervisor safety meetings to increase the accountability of maintenance supervisors for workplace safety. The maintenance supervisor safety meetings review the number, cause and corrective action for incidents resulting in injury, the number of lost workdays, and workers compensation costs. Additionally, responsibility for work place safety inspections is assigned during the meeting and completion of inspections is reviewed.

The Port requires maintenance supervisors to review each incident of reported injury and recommend a corrective action. According to the "Incident Review Report" for July 2003 through December 2003, four of the 17 reported incidents, or approximately 24 percent, resulted in some type of back pain or back injury. Four other injuries involved some form of repetitive motion or muscular-skeletal pain or injury. Therefore, 47 percent of the injuries were back or muscular-skeletal injuries. The Port does not currently have a mandatory training program to reduce back and muscular-skeletal injuries, and should develop and implement an annual muscular-skeletal injury prevention and back training program, which is mandatory for all Port employees.

According to the Port, the Port can be most effective in containing workers compensation costs by managing temporary disability claims. The Port has a program to return injured workers to light or restricted work assignments if their injuries allow their return to work. A third party administrator under contract to the Department of Human Resources Workers Compensation Division manages the Port's workers compensation claims, and according to the Assistant Deputy Director for Environmental, Health and Safety, the Port works with the third party administrator to ensure resolution of claims.

The Port should report annually to the Port Commission and the Board of Supervisors during the FY 2004-2005 budget review on the Port's efforts in managing workers compensation claims, including:

(a) New indemnity and medical-only claims filed during the fiscal year,

(b) The age, annual payment, and expected total payment for all outstanding open claims,

(c) The number of claims closed due to permanent disability settlements, including the age of the claim and the total payments,

(d) The number of employees successfully returned to work during the fiscal year, including employees participating in restricted work programs.

The Port's Failure to Control Operating Expenses

As an enterprise fund department, the Port relies on its own revenues to meet operating expenses and to maintain and improve its capital assets. As noted in Table 1.1, although the Port's revenues have increased by 15 percent between FY 1998-1999 and FY 2003-2004, the Port's expenditures for routine operations and facility maintenance have increased by 38 percent. This equals 6.4 percent average annual expenditure growth compared to 2.5 percent average annual revenue growth. The Port's expenditures for annual and ongoing capital projects are additional to the routine operations and facilities maintenance expenditures.

The Port's capacity to finance capital projects through debt is limited. The Port has not issued bonds since 1984. In 1994, the Port refunded the outstanding bonds and is considering a second refunding in July of 2004. According to the Port, the Port expects to save approximately $1.0 million annually by refinancing its existing debt. In October of 2003, one of the credit rating agencies, Fitch Ratings, affirmed the Port's "A" debt rating on the Port's $27.1 million Series 1994 revenue refunding bonds but changed the outlook from "stable" to "negative". The negative outlook was due to increased credit risk from declining property rental rates, escalating operations and maintenance expenses, and the potential $2.0 million owed by the Port to the City, that was approved in the FY 2003-2004 budget. This transfer to the General Fund was later revised downward to $1.0 million. The Fitch report noted that the Port's operating and maintenance expenses had increased by 26 percent, resulting in decreased debt service coverage.

The Port has not determined its operating needs to reflect the Port's fluctuating operating revenues and has failed to contain its operating costs. Further, the Port has not adhered to its own policies to monitor the Port's expenditures against the annual budget through quarterly reports. By policy, the Finance Unit is supposed to provide a report to the Port's divisions each quarter, showing the variance of actual expenditures to the revised budget and analyzing the financial position of the Port. However, the Finance Unit has not been providing these reports regularly, and the most recent report was dated of December 2002. According to the Port's Finance Manager, the Finance Manager meets monthly with Port Division Directors to discuss year-to-date actual revenues and expenditures. The Executive Director of the Port should enforce the Port's policy to conduct quarterly budget to actual analysis and should present a quarterly report to the Port Commission regarding the budget to actual analysis.

Organization of the Port

The Port has been variously organized by function and by business line. The major functions of the Port include:

- Managing the Port's maritime and real estate activities;
- Planning and managing development of Port properties;
- Maintaining Port facilities and managing capital projects; and
- Managing the Port's finances and administrative affairs.

In FY 2000-2001, the Port established a Chief of Operations, who reported to the Port Director, and was responsible for directing the Port's day-to-day business operations. Human resources, communications, government affairs, environmental, health and safety, information services, business services, and finance and accounting functions were consolidated into the Operations Division. In FY 2002-2003, the Port again re-organized, and the Executive Director became directly responsible for communication and government affairs functions, and the Engineering and Maintenance Division assumed responsibility for environmental, health and safety functions.

Currently, the Port is organized into five divisions, under the direction of five Deputy Directors, all of whom report directly to the Executive Director.

- The Maritime Division is responsible for marketing the Port for maritime uses and managing the Port's maritime contracts, including cargo, cruise, ship repair, commercial and sport fishing, and passenger ferry services.
- The Real Estate Division is responsible for leasing and managing the Port's real property.
- The Planning and Development Division is responsible for the comprehensive land use planning of Port property, managing large-scale Port development projects, and ensuring compliance with State and local regulations for development.

- The Engineering and Maintenance Division is responsible for managing the Port's facility maintenance and capital projects, issuing building permits for properties under the Port's jurisdiction, and implementing a Port-wide environmental, health and safety program.
- The Administrative Services Division is responsible for managing the Port's support services, including Human Resources, Accounting, Finance, Information Systems, and Business Services.

Combining Real Estate Asset Management and Development Functions

One of the Port's core functions is managing and developing the Port's assets, primarily its properties and improvements. The Planning and Development Division is responsible for the planning and development of Port properties in accordance with the Waterfront Land Use Plan. The Planning and Development Division engages in long range planning for Port properties, identifies development projects through the community planning process, conducts the Request for Proposal (RFP) process to select the developer, negotiates the development and lease agreements, and monitors the project through completion. The property is handed off to the Real Estate Division upon full completion of the development. The Planning and Development Division has transferred full responsibility for the Pier One project to the Real Estate Division but has not fully transferred the Ferry Building project until completion of all tenant improvements.

The Real Estate Division manages the Port's properties, including marketing properties to potential tenants, negotiating and monitoring leases, managing day to day activities of properties, and collecting rent revenues. The Real Estate Division also negotiates development agreements and the associated leases for some development projects, such as the reconstruction and remodeling of the Boudin Bakery on Fisherman's Wharf, and other development projects, as discussed in Section 6. Once major projects implemented by the Planning and Development Division have been completed, the Real Estate Division assumes responsibility for the project. Under the leases for the Port's new development projects, the master tenant for the completed project is responsible for all property management, including all operating and facility maintenance costs. For the Pier One office complex and the Ferry Building, the developers have full property management responsibilities. The Real Estate Division, therefore, does not perform property management responsibilities for these properties. As the number of Port properties with a master tenant assuming responsibility for property management increases, the Real Estate Division's functions changes. According to Real Estate Division staff, the Real Estate Division will be responsible for the financial management of properties, including property cash flow, occupancy rates, lease terms and conditions, and other matters.

The Planning and Development Division and the Real Estate Division both have business responsibilities for the Port's assets, whether developing or managing existing properties. The Budget Analyst recommends that the Planning and Development and Real Estate Division functions be combined into one division under one Deputy Director. Combining the two divisions would bring together the skills and expertise of both divisions, including working with the community in the community planning process, planning and implementing development of Port properties, and managing the Port's real estate assets. The Deputy Director would oversee the creation and implementation of the Port's real estate development and management strategies and policies. The four Assistant Deputy Directors would be responsible for developing and implementing policies and procedures for the planning, development, and real estate management processes. Combining the two divisions would allow the Port to develop common strategies for development agreements and ground leases, which are currently under the direction of both the Real Estate Division and Planning and Development Division and increase communication and coordination between development and real estate management activities. This recommendation would result in the deletion on on 9397 Deputy Director position and one 1450 Executive Secretary I position, with total estimated salary and fringe benfit cost savings of approximately $210,000.

Reassigning Environmental, Health and Safety Functions to the Administrative Services Division

The Environmental, Health and Safety section of the Engineering and Maintenance Division has Port-wide responsibility for the Port's injury and illness prevention program and environmental management of Port property. The Environmental, Health and Safety section is responsible for oversight of the Port's employee safety programs, including developing and enforcing compliance with safety procedures and training and managing claims filed by injured workers. Although the Environmental, Health and Safety section considers the Maintenance section of the Engineering and Maintenance Division to be its main client, the employee health and safety program is a Port-wide responsibility, and would be more appropriately placed in the Administrative Services Division, which is also responsible for the Port's human resources function.

The Environmental, Health and Safety section is responsible for a variety of environmental programs, including site investigation and remediation, monitoring Port and tenants' compliance with environmental regulations, and supporting environmental aspects of all other Port Divisions' activities. The Environmental, Health and Safety section's environmental programs serve a Port-wide function, but as noted in Section 6, coordination between the Environmental, Health and Safety section with other Port Divisions, such as Real Estate, has not been consistent. The Budget Analyst recommends re-assigning the Environmental, Health and Safety section to the Administrative Services Division to promote the Environmental, Health and Safety section's independence in overseeing and enforcing compliance with Port employee safety programs. The reassignment of the Environmental, Health and Safety section to the Administrative Services Division would recognize the section's Port-wide responsibilities for employee health and safety and environmental programs.

Elimination of the Engineering and Maintenance Deputy Director Position

The Engineering and Maintenance Division Director oversees the Engineering, Maintenance, and Environmental, Health and Safety sections. The Engineering section is managed by a Chief Harbor Engineer, who is responsible for five subsections and 26 employees, including the Building Inspection and Permits section.

The Maintenance section is also managed by an Assistant Deputy Director, who is responsible for all maintenance planning and maintenance work and 98 employees. The Maintenance section consists of Maintenance I and II, which are supervised by two Harbor Maintenance Superintendents reporting to the Assistant Deputy Director; Maintenance Planning, which is supervised by a Maintenance Manager reporting to the Assistant Deputy Director, and three office staff. The Environmental, Health and Safety section consists of an Assistant Deputy Director and six professional staff, which the Budget Analyst recommends re-assigning to the Administrative Services Division.

The scope of the Engineering and Maintenance Division will be reduced to include the Engineering section, which is managed by the Chief Harbor Engineer, the Maintenance section, which is managed by the Assistant Deputy Director, and the Building Inspection and Permits section, which is managed by the Chief Building Inspector.

The Division Director has overall responsibility for the direction, planning and management of the Engineering and Maintenance Division. Under the Budget Analyst's recommendation, the Environmental, Health and Safety section of the Engineering and Maintenance Division would be reassigned to the Administrative Services Division, reducing the scope and control of the Division Director. Further, the Division Director oversees the Engineering section and the Chief Harbor Engineer, whose salary at the top step is higher than the salary of the Division Director. Further, the salary range for the Chief Harbor Engineer is higher than the salary range for the Division Director, with a top salary of $138,095 annually, compared to the Division Director top salary of $135,459. To compensate for the higher salary range of the Chief Harbor Engineer, the Port has increased the Division Director's compensation to $145,555, which is $9,577 more than the regular Division Director top salary of $135,459. The Budget Analyst recommends deletion of the Engineering and Maintenance Division Director position and reassignment of Engineering and Maintenance Division Director responsibilities to the Chief Harbor Engineer, resulting in estimated salary and fringe benefit cost savings of $180,000 annually. This recommendation acknowledges the reduction in scope and discrepancy in pay in the Engineering and Maintenance Division.

Conclusion

The Port has not systematically controlled its operating expenditures in response to fluctuating revenues, resulting in a 38 percent increase in routine operating expenses compared to a 15 percent growth in operating revenues over the past six fiscal years. The Port's growth in routine operating expenses has contributed to operating losses of $5.4 million in FY 2001-2002 and $4.3 million in FY 2002-2003. In FY 2002-2003, the Port had a $6.4 million negative change in net assets, indicating that the draw-down on the Port's unrestricted net assets, which represents the Port's available resources, was not offset by an increase in the Port's investment in capital assets.

The Port needs to control discretionary spending by thoroughly assessing its operating and capital staffing needs and limiting growth in expenditures for office and other operating costs. The Port also needs to eliminate or avoid unnecessary expenditures, such as discounted employee parking.

The Port's workers compensation and general liability costs have increased significantly over the past few years. The Port can increase its efficiency by developing a more formal risk management and loss prevention program. Because the incidence of muscular-skeletal injuries make up a large part of work-related injuries, the Port needs to institute a mandatory back-training and muscular-skeletal injury prevention program. The Port also needs to assess the viability of self-insuring for vehicle accidents and loss.

The Port can also increase its efficiency and implement necessary organizational independence for regulatory functions by combining real estate asset management and development functions into one division, and by re-assigning the Environmental, Health and Safety to the Administrative Services Division.

Recommendations

The Executive Director of the Port should:

1.1 Enforce the Port's policy to conduct quarterly budget to actual analysis and report quarterly to the Port Commission.

1.2 Not create any new capital-funded positions nor hire into the vacant capital-funded position until a formal capital improvement program is established.

1.3 Proceed with the Port's stated intention to lay-off eight capital-funded positions not included in the Annual Salary Ordinance and to delete one capital-funded Laborer position included in the Annual Salary Ordinance in FY 2004-2005.

1.4 Delete the vacant capital-funded Project Manager position and Roofer position.

1.5 Code the remaining six positions designated for capital programs as "limited tenure" positions in the Administrative Salary Ordinance, with the intention to delete the position when the capital project is completed or the funding source eliminated.

1.6 Delete the following vacant positions, which have been vacant for more than one year:

(a) 1446 Secretary II

(b) 9395 Property Manager

1.7 Proceed with the Port's stated intention to delete the following four vacant positions:

(a) 1244 Senior Personnel Analyst

(b) 1657 Senior Systems Accountant

(c) 7220 Asphalt Finisher Supervisor I

(d) 9377 Feasibility Analyst

1.8 Not exercise the option to expand its current office space at Pier 1 into an additional estimated 3,132 square feet of space at Piers 1 ½ and 3.

1.9 Meet and confer with employee organizations to discontinue parking to employees to avoid future direct costs to the Port for discounted parking.

1.10 Develop and implement an annual muscular-skeletal injury prevention and back training program, which is mandatory for all Port employees, to reduce work place injury and workers compensation costs.

1.11 Report to the Port Commission and the Board of Supervisors during the annual budget review on the Port's efforts in managing workers compensation claims, including:

(a) New indemnity and medical-only claims filed during the fiscal year;

(b) The age, annual payment, and expected total payment for all outstanding claims;

(c) The number of claims closed due to permanent disability settlements, including the age of the claim and the total payments; and

(d) The number of employees successfully returned to work during the fiscal year, including employees participating in restricted work programs.

1.12 Designate the Finance Manager to work with the City's Risk Manager to determine if the Port should self-insure for vehicle accidents and report to the Port

Commission during the FY 2005-2006 budget review on the proposal for self-insurance.

1.13 Designate a Port manager to perform the functions of a risk manager who would report directly to the Port Executive Director regarding the risk management program, including:

(a) Identification of areas of risk reduction, resulting from the Port's security assessment, and potential for reducing insurance costs;

(b) Identification of areas of uninsured risk and proposals to reduce uninsured risk; and

(c) Identification of the Port's exposure to litigation and other risks resulting from the Port's activities, and development of a formal prevention loss program.

1.14 Develop a vehicle accident reporting program, which includes written policies and procedures to report vehicle accidents, including criteria identifying:

(a) What must be reported,

(b) When the information must be reported,

(c) To whom the information is reported,

(d) Responsibility for maintaining and analyzing vehicle incident data, and

(e) Reporting accidents to the insurance company.

1.15 Combine the Real Estate Division and Development and Planning Division into a single division as part of the FY 2005-2006 budget, including deletion of one 9397 Deputy Director position and one 1450 Executive Secretary position.

1.16 Present a quantifiable business case that clearly demonstrates the ongoing cost benefits and justifies the creation of a proposed Development Project Coordinator position during the FY 2004-2005 budget review.

1.17 Re-assign the Environmental, Health and Safety Section of the Engineering and Maintenance Division to the Administrative Services Division.

1.18 Delete the Engineering and Maintenance Director position and re-assign the duties to the Chief Harbor Engineer.

Costs and Benefits

Our recommendations would result in an estimated $1,758,000 annually in reduced salary and fringe benefit costs for the deletion of eight vacant positions, reduction in eight capital-funded positions, and elimination of three positions through re-organization. The Port would also avoid future costs by eliminating discounted employee parking and not expanding Port office space at Piers 1½ and 3. Our recommendations would increase the Port's efficiency, by (a) requiring a systematic assessment of the Port's operating and capital staffing needs, (b) developing a more effective risk management and loss prevention program, and (c) consolidating Port functions more appropriately.