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Port of Oakland:

Despite Its Overall Financial Success, Recent Events May Hamper Expansion Plans That Would Likely Benefit the Port and the Public

October 2001
2001-107

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CALIFORNIA STATE AUDITOR

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October 23, 2001 2001-107

The Governor of California
President pro Tempore of the Senate
Speaker of the Assembly
State Capitol
Sacramento, California 95814

Dear Governor and Legislative Leaders:

As requested by the Joint Legislative Audit Committee, the Bureau of State Audits presents its audit report concerning the operations of the Port of Oakland (Port). Specifically, we reviewed the Port's financial statements to determine the efficiency of its operations and to evaluate the return on the Port's capital and real estate investments.

This report concludes that, overall, the Port effectively managed its assets over the last 10 fiscal years (1990–91 through 1999–2000) and its $1.7 billion capital improvement program should benefit the public and allow the Port to remain financially competitive in the future. We found that two of the Port's three revenue generating divisions—maritime and aviation—performed well during the past decade, while the third—real estate—has shown consistent losses. The real estate division's losses were due to some unsuccessful business undertakings, inaction in controlling its operating costs, and the Port's decision to rent to public and nonprofit entities certain real estate division holdings at below-market rates.

The Port is also in the middle of planning and implementing large capital expansion plans for both its maritime and aviation divisions. Our review of the Port's March 2000 feasibility study found that projections of the maritime and aviation divisions' future revenues and expenses are reasonable and that their respective expansion plans should provide a number of public benefits. However, events have occurred since the March 2000 feasibility study that may significantly affect the aviation division's plans for improving the airport. For instance, the aviation division revised its expansion plan to curb costs when updated construction cost projections proved higher than expected. The revised plan was only recently approved. In addition, an appellate court decision will require the Port to develop a supplemental environmental impact report. Finally, the terrorist attacks of September 11, 2001, could result in costly changes to airport security.

Respectfully submitted,

Elaine M. Howle

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State Auditor

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SUMMARY

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Our review of the Port of Oakland's (Port) financial statements for the past 10 years and its past and future capital improvement projects revealed that:

- ☑ ***Overall, the Port effectively managed its assets, and its $1.7 billion capital improvement program should benefit the public and allow it to remain competitive.***
- ☑ ***Its maritime and aviation divisions have prospered, and their expansion plans are based on reasonable estimates of future revenues and expenditures.***
- ☑ ***Certain recent events may hamper the aviation division's plans to improve the airport.***
- ☑ ***The real estate division consistently operated at a deficit due to unsuccessful business ventures, inaction in controlling operating costs, and the Port's decision to lease certain properties at below-market rates.***

RESULTS IN BRIEF

The Port of Oakland (Port) is an independent, self-supporting department of the city of Oakland charged with managing and operating a seaport, a passenger and cargo airport, and the waterfront real estate in and around the Oakland Estuary. Over the past decade, its effective administration of these properties resulted in an increase of its overall operating income from $4.4 million in fiscal year 1990–91 to $47 million in fiscal year 1999–2000.[1] It is now in the process of planning and implementing a $1.7 billion capital improvement program that includes substantial expansions of both its seaport and airport. This program should not only enable the Port to remain financially competitive but also benefit the public.

Separate revenue divisions are responsible for managing the Port's maritime, aviation, and commercial real estate activities. In recent years the maritime and aviation divisions have contributed to the Port's successful performance, but the real estate division has struggled. The maritime division's management of its resources has been particularly effective: Over the past 10 years it almost doubled its revenues, while its operating expenses increased by slightly more than half. The maritime division's implementation of two important capital improvements—renovating one of its terminals and deepening the channel accessing the port—contributed to its ability to remain competitive with comparable seaports. Although significant delays did occur in the regulatory approval process of the dredging project, the maritime division consistently maintained a reasonable amount of revenue to cover its debt service during the construction. To continue to ensure its competitive position, the maritime division recently implemented its capital improvement program, which includes constructing two new ship terminals, new roads, a rail-freight transfer terminal, and a waterfront recreational park as well as deepening the channel from 42 feet to 50 feet. A feasibility study suggests that projected revenues should be adequate to cover the debt associated with funding these projects.

[1] Operating income is the difference between operating revenue and operating expenses, including depreciation and amortization.

Similar to the maritime division, the aviation division has significantly increased its operating revenues during the past 10 years, and it has nearly doubled the number of passengers using the Oakland airport. This growth is particularly noteworthy considering that the number of scheduled flights serving Oakland has often fluctuated during this period. Although its past capital improvements have been relatively small projects, the aviation division is in the process of planning a substantial expansion of its facilities, including new terminal buildings, roads, and a parking structure. This expansion should benefit the public by relieving traffic congestion and enabling the airport to better serve an increasing number of passengers. Yet, despite the variety of funding sources identified in the initial feasibility study, the aviation division has recently met with a number of setbacks. A new internal review determined that it had significantly underestimated the cost of the expansion, a problem that may be compounded by a recent court decision ordering it to prepare a new supplemental environmental impact report before beginning construction on affected capital improvement projects. Moreover, the terrorist attacks on September 11, 2001, will almost certainly have a significant impact on the airline industry, the consequences of which are difficult to predict.

As mentioned, the Port's real estate division has not shown the same financial growth as the other two. Together, the maritime and aviation divisions have generated roughly 89 percent of the Port's revenues over the past 10 years, while the real estate division generated the remaining 11 percent. In fact, the real estate division has consistently operated at a deficit during this time. Its losses appear to be the result of the real estate division's inability to control high maintenance costs for its properties in Jack London Square, some business decisions that turned out badly, and the Port's decision to use the real estate division to provide benefits to the public that has further exacerbated the division's poor financial situation. In effect, the real estate division has subsidized nine public benefit projects by leasing eight properties for $1 a year and one property for $490 per year. The real estate division plans to improve its profitability but has not yet taken significant action. Although it is currently proposing several large capital improvement projects, the division does not intend to move forward with these plans unless the developers are willing to provide the necessary funding, thus ensuring that the real estate division will not acquire more debt.

RECOMMENDATIONS

To reduce the effect of the commercial real estate division's losses on the Port's operations as a whole, the division should do the following:

- Complete the action plan approved by the board of port commissioners in 1999.
- Examine the effects of management's decisions to lease land at below-market rates to determine if changes in the rates charged could increase revenues without harming the Port's relationships with the community and other municipalities.
- Continue to look for ways to increase revenues and decrease costs associated with managing its assets.

AGENCY COMMENTS

The Port feels that our report will provide the State with the critical information needed to evaluate its value and impact. The Port also feels that it is taking steps to implement our recommendations. ■

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INTRODUCTION

BACKGROUND

In 1927 the city of Oakland amended its charter to establish the Port of Oakland (Port), an independent, self-supporting department responsible for managing and operating 19 miles of waterfront on the eastern shore of the San Francisco Bay. The waterfront properties under the Port's jurisdiction include a seaport; a passenger, cargo, and general aviation airport; and waterfront real estate. A seven-member board of port commissioners (board), nominated by the mayor and appointed by the city council of Oakland, governs the Port. Board members, who represent diverse backgrounds, serve four-year staggered terms without compensation.

Because the State granted the waterfront property to the city of Oakland in a series of Tideland Trust grants, most of the property is subject to state tideland grant restrictions. These restrictions require that tideland property and revenues generated by the use of that property be used for tideland purposes, including commerce, navigation, fishing, and public access to the shoreline. Neither the city nor the Port owns the waterfront property; rather, the Port holds the property in trust for the people of California. The Port's stated mission is to increase the region's economic vitality, create jobs, and provide opportunities for waterfront enjoyment, while also generating earnings to reinvest in its activities.

Figure 1 on the following page shows how the Port uses its waterfront property: 665 acres are devoted to maritime activities, 3,000 acres to aviation, and 1,040 acres to commercial real estate holdings. Separate revenue divisions oversee the maritime, aviation, and commercial real estate activities, while the costs for several supporting divisions and units are allocated among all the Port's enterprises. Figure 2 on page 7 depicts the Port's overall organization. In June 2001 the Port's executive director announced his retirement, and the board subsequently appointed his deputy as the next executive director.

FIGURE 1

Port of Oakland

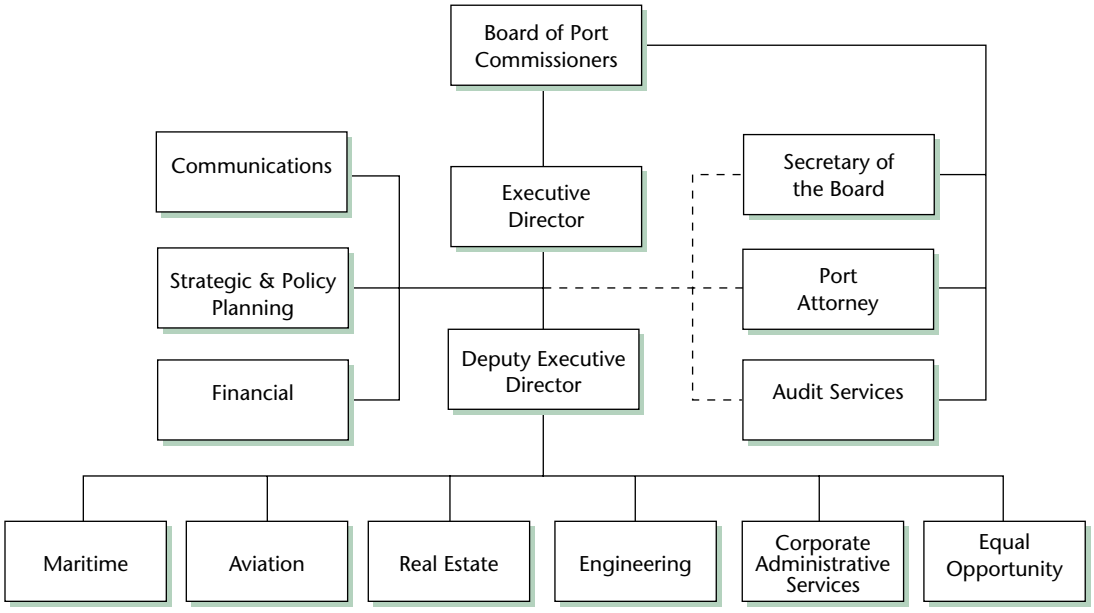
6/01

- Aviation Division area
- Real Estate Division area
- Maritime Division area
- Property does not belong to the Port of Oakland

Source: Port of Oakland.

FIGURE 2

Port of Oakland's Organization Chart for Fiscal Year 2000–01



Source: Port of Oakland.

——— Denotes a direct reporting relationship

- - - - - Denotes an advisory relationship

THE MARITIME DIVISION

The maritime division is responsible for administering Oakland's seaport. It designs, constructs, and maintains marine transportation facilities, and acting as a landlord, it negotiates lease and use agreements for these facilities with private-sector companies. Under the terms of these agreements, the private-sector companies are responsible for managing and operating the facilities, and the maritime division operates the wharf. Currently, the maritime division has several capital improvement projects planned or under construction, including building new marine terminals, improving the rail infrastructure, and increasing the depth of channels and berths from 42 feet to 50 feet. It is also in the process of undertaking environmental mitigation measures to protect and improve air and water quality, developing a wildlife habitat, and improving public access.

THE AVIATION DIVISION

The aviation division operates the Metropolitan Oakland International Airport. Its responsibilities include marketing facilities to tenants, including airlines and air cargo companies. In 2000 the airport boarded nearly 5 million airline passengers and almost 693,000 metric tons of air cargo. To accommodate an increasing demand for passenger and cargo services, the airport plans to add up to 12 passenger gates, build a new multilevel parking and ground transportation center, create new cargo facilities, and improve the roadways providing access to the airport complex.

THE REAL ESTATE DIVISION

The real estate division manages, leases, and develops land located along the Port's waterfront, including office and retail facilities in Jack London Square and a commercial waterfront development along the Oakland Estuary. It is also responsible for overseeing Oakland Portside Associates (OPA). Originally a non-Port entity, the OPA was established in June 1987 as a limited partnership between Portside Properties and its financial partner to construct and manage most of the buildings currently located in Jack London Square. After Portside Properties' financial partner withdrew from the partnership in December 1987, the Port became the majority general partner. In August 1990 it effectively became the sole owner.

SCOPE AND METHODOLOGY

The Joint Legislative Audit Committee asked the Bureau of State Audits to review the financial statements of the Port to determine the efficiency of its operations and to evaluate the return on the Port's capital and real estate investments.

To assess how efficiently the Port manages its operations, we reviewed revenues and expenses for fiscal years 1990–91 through 1999–2000 as reported in the Port's annual audited financial statements. We also reviewed the segmented income statements covering the same period for each of the three revenue divisions.

Because the Port does not maintain complete asset information by division, we were unable to determine the rate of return for each revenue division. Instead, we calculated the rate of return for the entire Port for fiscal years 1990–91 through 1999–2000. This information is presented in the Appendix. We also calculated the Port's debt service coverage ratios from the year-end financial statements for fiscal years 1992–93 through 1999–2000 for each revenue division to determine whether they met the criteria of the Port's bond covenant and its own internal goal. Due to record retention limitations, we were unable to calculate the revenue divisions' debt service coverage ratios for fiscal years 1990–91 and 1991–92.

To determine if the amount of long-term debt proposed to fund a portion of the Port's future capital improvement plans is reasonable, we computed, for each relevant revenue division, the debt service coverage ratios over the next nine years (the Port's planning horizon) using each division's projected revenues and expenses. Then we assessed the adequacy of these projected debt service coverage ratios to support each division's proposed issuance of long-term debt. We also examined the Port's revenue and expense projections to determine whether they were based on reasonable assumptions. The Port's engineering division produced the cost estimates for its proposed construction projects and then had an outside consultant review them to determine if they were reasonable. We therefore relied on the consultant's opinion on the reasonableness of the Port's estimated construction costs.

To compare the Port's fiscal performance with those of similar entities, we researched the characteristics of other ports to determine which were most comparable. However, since most ports differ in size and business structure, we compared the maritime and aviation divisions of the Port to similar business segments of other entities. We did not include the real estate division in our comparisons because real estate activities are generally specific to given geographic areas, and we did not feel a comparison to entities in other parts of the State and country would produce meaningful results.

Finally, we determined whether the Port's projections of the nonfinancial benefits of its capital improvement projects were reasonable by reviewing its calculations and methodology. ■

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AUDIT RESULTS

THE PORT'S MANAGEMENT OF ITS MAJOR BUSINESS LINES HAS GENERALLY BEEN EFFECTIVE

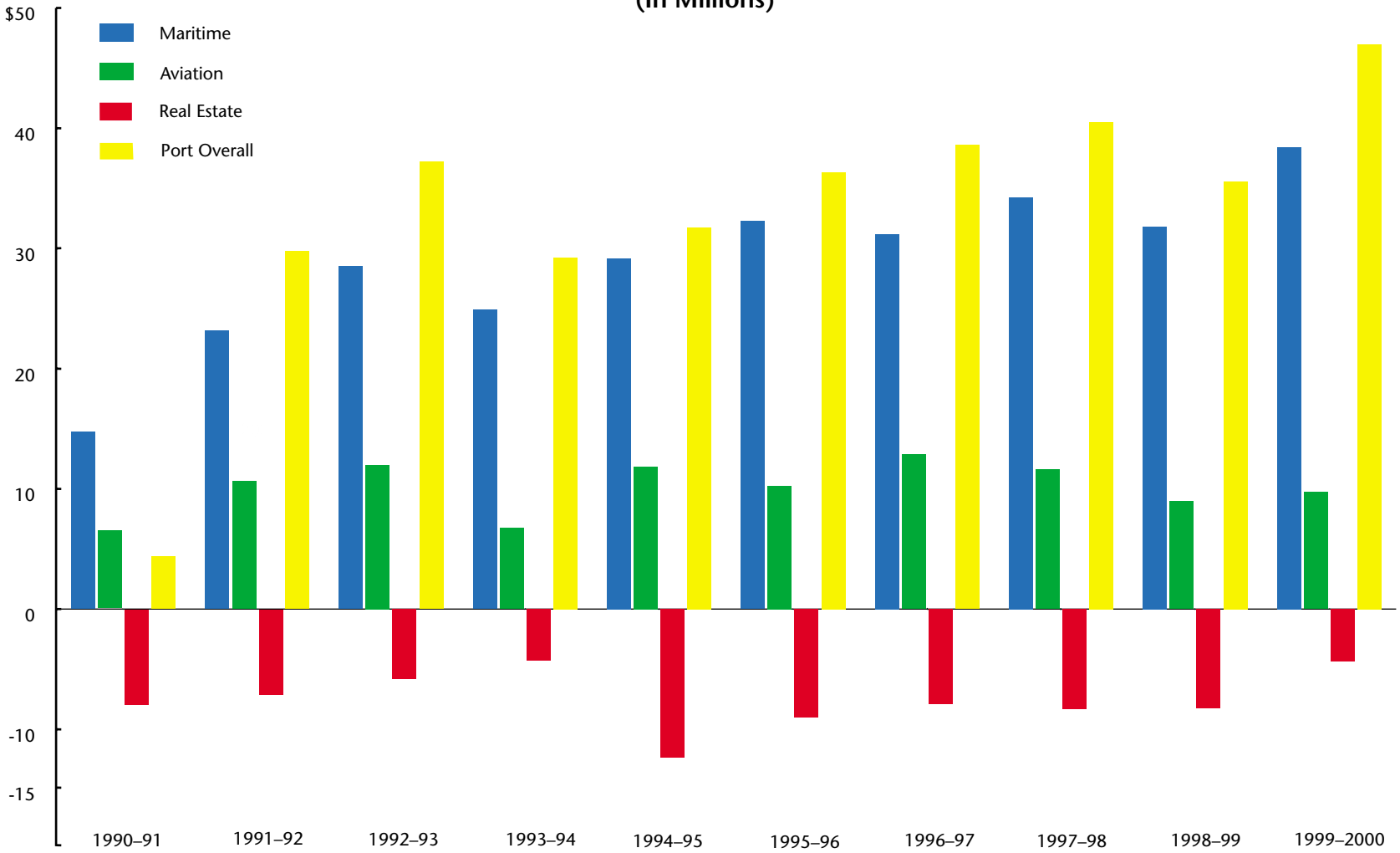
Over the past decade the Port of Oakland (Port) as a whole performed well financially, producing a 10-fold increase in operating income, from $4.4 million to $47 million.[2] From fiscal years 1990–91 through 1999–2000, the Port's operating revenues increased from $98 million to $172.7 million, and its total assets grew from $676 million to just under $1.7 billion. The Port's operating expenses, including depreciation and amortization, increased at a slower rate than its operating revenues, from $93.6 million in fiscal year 1990–91 to $125.7 million in fiscal year 1999–2000. As shown in Figure 3 on the following page, two of the Port's three core revenue divisions—the maritime and aviation divisions—contributed to the Port's successful performance, producing roughly 89 percent of the overall revenue for the Port during this time. In contrast, the real estate division registered consistent losses, in part because the Port decided to use the division to carry out projects to benefit the public, a choice that falls within the scope of its mission.

In general, the Port's past capital improvement projects have proven financially beneficial, with the Port easily covering the costs of its investments. A planned $1.7 billion capital improvement program will expand the Port's seaport by adding new wharf and container terminals, a new access road, and a more efficient railroad system, and will add a new passenger terminal, parking garage, and access road to the Port's airport. We reviewed the Port's initial feasibility study for this program, which was issued in March 2000, and found that estimates of future revenues and expenses at that time were reasonable. We also found that the Port's expansion should offer a number of benefits to the surrounding community, including more job opportunities, less traffic congestion around the airport, and a better environment and improved appearance for the Oakland waterfront.

[2] Operating income is the difference between operating revenue and operating expenses, including depreciation and amortization.

FIGURE 3

Operating Income for Each Division and the Port as a Whole for Fiscal Years 1990–91 Through 1999–2000 (In Millions)



Source: Port of Oakland's audited financial statements.

Unfortunately, certain events that have occurred since the completion of the March 2000 feasibility study may significantly affect the Port's plans for improving the airport. In August 2001 the aviation division increased its construction cost estimate by $453 million. Also, on September 26, 2001, an appellate court ruled that the Port's environmental impact report for the aviation division's expansion plans was inadequate and a new supplemental report would have to be prepared that will require additional time and money.

Finally, the terrorist attack launched on the United States on September 11, 2001, has the potential to negatively affect the Port's financial situation in two ways. First, it is likely that the airport and seaport will require a number of costly security enhancements. Second, business in general and airline passenger business in particular could be slowed substantially. These factors could have a significant impact on the Port's future expenses and revenues.

THE MARITIME DIVISION HAS MANAGED ITS GROWTH EFFICIENTLY IN THE PAST, AND ITS FUTURE PLANS SHOULD INCREASE ITS COMPETITIVENESS

Over the past 10 years the maritime division's management of its resources has been appropriate and effective. During this time, it almost doubled its revenues, but its operating expenses increased by a little more than half. Moreover, the maritime division implemented two important capital improvement projects: renovating one of its terminals and deepening the channel accessing the port. Although some delays did occur in the regulatory approval process for the dredging project, the maritime division consistently maintained a reasonable amount of revenue to cover its debt service throughout the periods of construction. The eventual successes of both the dredging and renovation projects have contributed to the maritime division's ability to remain competitive.

The maritime division currently performs well compared with similar ports. However, to maintain its place in the market, the maritime division has begun implementing its capital improvement program, which will include the construction of two new ship terminals, new roads, a freight transfer terminal, and a waterfront recreational park, as well as the deepening of the channel by an additional 8 feet. According to the

division's feasibility study, its projected revenues should be adequate to cover the debt associated with funding the capital improvement program.

Revenues Have Increased Steadily While Operating Costs Have Risen More Slowly

Overall, the maritime division's financial records show that, although its operating revenues and expenses have steadily increased over the past 10 years, operating expenses grew at a slower rate. As shown in Figure 4, the division's operating revenue almost doubled between fiscal years 1990–91 and 1999–2000, growing from $39 million to $76 million. During the same period, operating expenses increased by $13.5 million (55 percent)—from $24.5 million to $38 million.

Typical Seaport Charges

- **Dockage**–an assessment for use of a berth or dock.
- **Wharfage**–an assessment for passing cargo over the wharf and through the marine terminal.
- **Storage and demurrage**–an assessment for cargo remaining in the terminal beyond a previously agreed upon date.
- **Crane fee**–an hourly charge for the use of port-owned container cranes to support cargo operations.
- **Tariff**–published schedule of rates or charges for a specific unit of equipment, facility, or type of service.

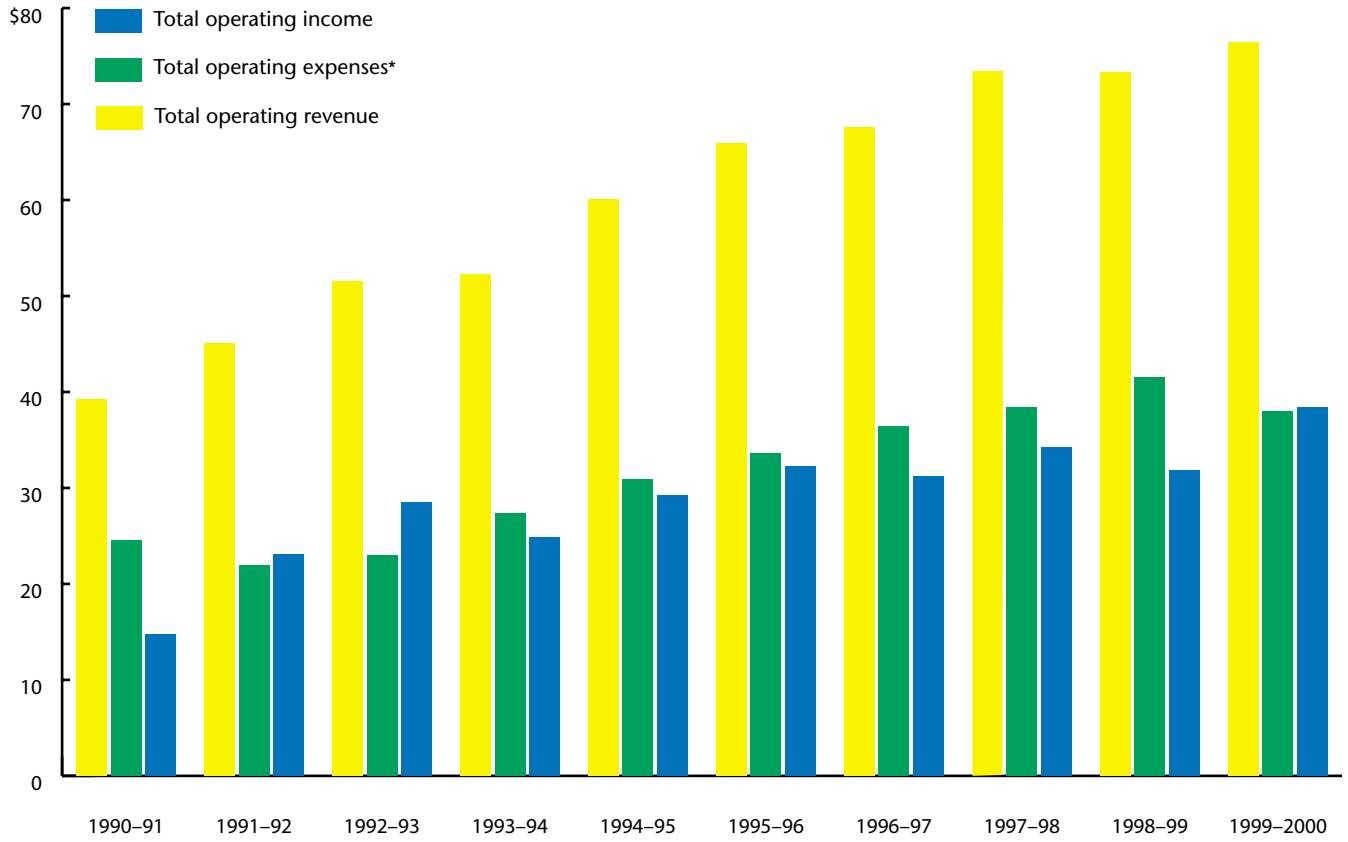
According to maritime staff, the changes in operating revenues were mainly the result of changes in cargo volume. Because the maritime division's primary sources of revenues are the assessments it charges customers for using its facilities and equipment, fluctuations in cargo volume affect the level of its operating revenues. The changes in operating expenses were primarily caused by increases in the maritime division's share of allocated costs. At the end of each fiscal year, costs are allocated to each division (maritime, aviation, and real estate) for its respective share of general operating, maintenance, advertising, administrative, and utility costs. Increases in the cost of removing hazardous waste and maintaining facilities are two reasons why the maritime division's share of allocated costs have grown.

Past Capital Improvements Provided Financial Benefits and Fostered a More Efficient Approach to Current Projects

Although the maritime division neither calculates the historical rates of return on its major capital investments nor maintains the information we would need to calculate them, our examination of its debt service coverage ratio suggests that its past capital improvement projects have benefited it financially. From past projects, the division has also learned from certain mistakes it made and has been able to improve the efficiency of the current capital improvement project.

FIGURE 4

Maritime Division's Operating Revenue, Expenses, and Income for Fiscal Years 1990–91 Through 1999–2000 (In Millions)



Source: Port of Oakland's audited financial statement of segments.

* Operating expenses include depreciation and amortization.

The debt service coverage ratio measures the revenue the Port has available to pay for obligations, such as bonds, over a set period. For example, a debt service coverage ratio of 1.0 would mean the Port had precisely the available revenue needed to make the principal and interest payment on its outstanding bonds, and a ratio above 1.0 would indicate that the Port had more than enough revenue for this purpose. The maritime division considers debt service coverage when deciding whether to invest in major capital improvement projects, and credit-rating agencies use it when determining the creditworthiness of the Port. Since the Port only computes its debt service coverage ratios on an entitywide basis, we computed such ratios for each of its three revenue divisions. As Figure 5 shows, for the past eight years, the maritime division has maintained its debt service coverage ratio above both the ratio of 1.25 required by the Port's revenue bond covenant and the Port's internal minimum ratio of 1.6.

Since part of its revenues are based on leases that reflect the fair market value of its facilities and the amount of cargo moving through the port, the maritime division must invest in capital improvement projects to remain competitive.

Since part of the maritime division's revenues are based on leasing agreements that reflect the fair market value of its facilities and the amount of cargo moving through the port, it must invest in capital improvement projects to remain competitive. We reviewed two major projects: renovating a terminal and deepening the channel to 42 feet.

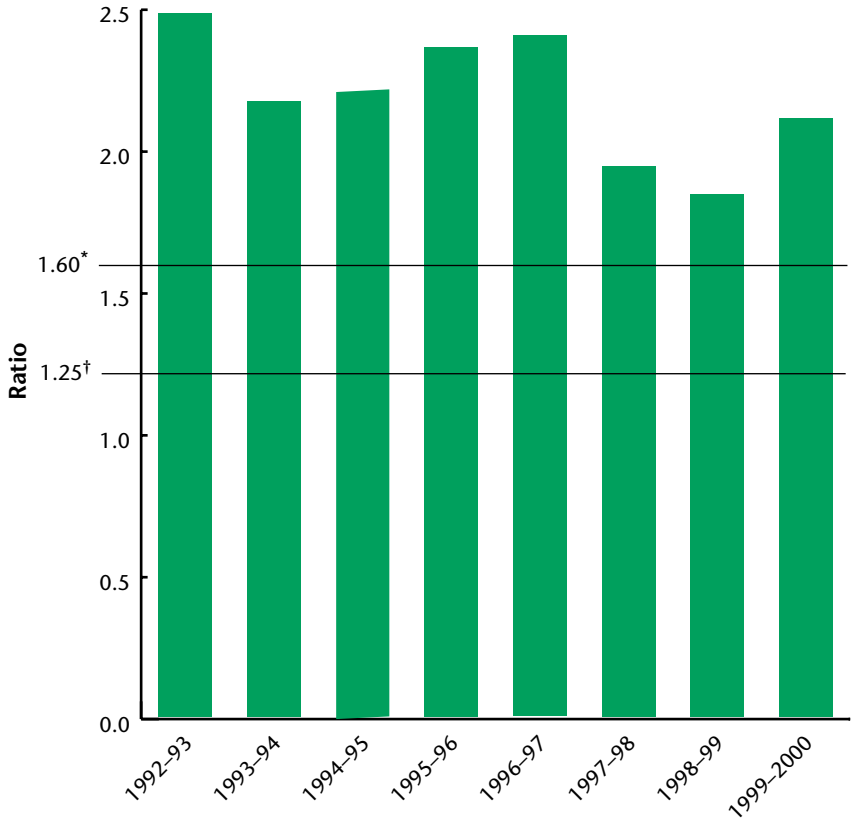
Despite Significant Delays in One Project, Past Capital Improvement Projects Have Offered Financial Benefits

During the period from fiscal year 1992–93 through fiscal year 1999–2000, the maritime division's debt service coverage ratio ranged from a low of 1.84 to a high of 2.48, always remaining well above the Port's internal minimum ratio of 1.6. This high debt service coverage ratio was in part due to the financial benefits provided by the capital improvement projects undertaken by the maritime division. These financial benefits resulted from the division's ability to competitively price its maritime contracts. Generally, the maritime contracts are structured to provide a specified rate of return for the value of the land and berth area (submerged land), as well as for capital improvement projects funded by the Port. When berths are renovated, the value of the land is increased, allowing the maritime division to charge more for its use.[3]

[3] When formulating a pricing strategy for its maritime contracts, division staff routinely review other port agreements obtained either through the Federal Maritime Commission or from other port authorities under the federal Freedom of Information Act.

FIGURE 5

Debt Service Coverage Ratios for the Maritime Division for Fiscal Years 1992–93 Through 1999–2000



Source: Auditor's calculations based on segmented income statements and bond payment records.

* The Port's internal minimum debt service coverage ratio.

† Minimum debt service coverage ratio required by the Port's revenue bond covenant.

One of the larger renovation projects that benefited the maritime division involved an agreement between the Port and one of its tenants for renovations made at the terminal occupied by the tenant. Funding for this project came from the 1992 sale of $53 million in bonded debt. According to the terms of the agreement, the tenant is responsible for paying all principal and interest owing on these bonds. In exchange, the tenant is able to customize the design and construction of the renovated terminal to suit its needs. Thus, the division was able to improve the maritime facilities without directly affecting its own cash flow.

The maritime division's other major capital improvement project was the deepening of the channel and berths from 38 feet to 42 feet. Because it was an improvement to infrastructure, the project did not provide the maritime division with a direct return on its investment. However, by enabling the Port to attract and accommodate larger container vessels, it allowed the maritime division an opportunity to compete with other ports and increased its potential for handling more cargo. Although the dredging project took significantly longer to complete than originally intended, it ultimately benefited the maritime division.

The maritime division's previous dredging project enabled it to attract and accommodate larger container vessels.

The 42-foot dredging project was a joint effort by the U.S. Army Corps of Engineers (Corps of Engineers) and the maritime division. The Corps of Engineers conducted the original feasibility study for the project in 1972, and according to division staff, the original plan was to begin construction and dredging around 1980–82 and to complete the project by 1984–86. However, because the maritime division first had to complete an Environmental Impact Report and Statement (EIR/EIS) for the State and federal government, construction had not yet started when, in 1986, the federal Water Resources Development Act authorized the Corps of Engineers to construct various projects to improve the harbors. According to the manager of the dredging project, the maritime division originally prepared a separate EIR/EIS for the outer and inner harbors but had to start again with a new feasibility study and EIR/EIS because of the new requirements for cost sharing included in the Water Resources Development Act of 1986. The manager further stated that between 1986 and 1994, when the division submitted its final version of the EIR/EIS for the dredging project, the division had already created four or five versions in response to changes in environmental laws, lawsuits, and difficulties in finding appropriate disposal sites for the dredged material. These changes also required supplements to the project's initial EIR/EIS. Although the division filed the original EIR/EIS in March 1988, it did not complete the final supplemental EIR/EIS until May 1994.

One reason the EIR/EIS for the dredging project took so long was that disposal of the dredged material was difficult. The maritime division's initial plan was to dispose of the suitable dredged material at a designated disposal site. However, the division rejected this plan because regulatory agencies, environmentalists, and fishing groups voiced concerns. The intervention and litigation actions by resource and regulatory agencies also halted

subsequent disposal plans. The maritime division was eventually able to negotiate a plan that was acceptable to these agencies after agreeing to dispose/reuse dredged materials in several ways.

Delays also occurred after the maritime division finally started the project in January 1996, when the primary contractor fell behind schedule because needed dredging equipment did not arrive on time. This was just one of many factors that eventually caused the contracting company to file for bankruptcy in January 1997. The Corps of Engineers, with the agreement of the maritime division, worked with the contractor to complete the project while the contractor was going through reorganization prompted by the bankruptcy filing. Although the project was scheduled for completion in May 1997, it was not finished until July 1998.

Past Mistakes Taught the Division to Plan Its Current Dredging Project More Efficiently

The maritime division took just 3 years to complete the feasibility and environmental studies for its current dredging project, compared to 22 years to complete these studies for its previous dredging project.

The maritime division applied many lessons learned from its earlier dredging project to more efficiently plan its current 50-foot dredging project.[4] As previously discussed, the Corps of Engineers first began working on the feasibility study for the 42-foot dredging project in 1972, but the maritime division did not submit a final EIR/EIS until 1994—22 years later. In contrast, the division initiated the feasibility study (including an EIR/EIS) for the 50-foot dredging project in 1996 and completed it in 1999. In addition, by including the Corps of Engineers in the planning process for the current dredging project, the maritime division ensured that the feasibility study was consistent with the Corps' principles and guidelines. Division staff believes that this fact expedited the review process significantly and allowed the federal government to authorize the project in the Water Resources Development Act of 1999, making it eligible to receive federal appropriations beginning in fiscal year 2000–01.

The Water Resources Development Act of 1996 made the Port and the federal government responsible for finding an appropriate disposal site for dredged material from the current project. According to maritime division staff, the division initiated early discussions with interest groups to reach consensus on a preferred plan for reusing dredged materials to mitigate potential lawsuits and interventions like those that delayed the earlier dredging

[4] The 50-foot dredging project is part of the maritime division's latest capital improvement program. This program is discussed further in the following sections.

project. Further, it established an alternative plan in case the original plan proved to be financially unfeasible. The division also entered into negotiations with adjacent communities and businesses potentially affected by the project. These outreach efforts have led to a series of agreements that should minimize the ill effects on the community while allowing the project to move forward.

Finally, the maritime division's former director told us that to avoid the problems it faced when one of its main contractors went bankrupt during the 42-foot dredging project, the division divided the current dredging project into a number of smaller, individual contracts. This action should encourage competition and provide additional control over bids, budgets, schedules, and nonresponsive contractors.

The Capital Improvement Program Should Attract Seaport Customers and Benefit Local Communities

In addition to deepening the channel to 50 feet, the maritime division plans to construct two new ship terminals, new roads, a rail freight transfer terminal, and a park.

The maritime division is in the process of implementing its latest capital improvement program, which calls for the construction of two new ship terminals, new roads, a rail freight transfer terminal, and a waterfront recreational park. In addition to this program, the maritime division is working with the Corps of Engineers on a project to further deepen the channel to 50 feet. To offset the environmental effects of the construction projects, the program includes dozens of mitigation projects aimed at improving the quality of the air, water, land, and biological life around the port. In addition, the division estimates that the program should create 3,580 local jobs by 2020. Based on the maritime division's projected revenues in the Port's March 2000 feasibility study, it appears that the division's operations should generate enough revenue to cover the debt service needed to fund these improvements.

Business for the Seaport Should Increase

According to its strategic plan, the maritime division believes it must make certain investments in capital improvement projects to remain economically viable, to continue to grow, and to provide economic resources for the city of Oakland and the region. The construction of some of the projects included in the maritime division's capital improvement program began as early as 1999; as these are completed, they should help the port handle larger volumes of cargo. For example, a shipping terminal, which occupies two berths, began operations in June 2001, with

The first of two terminals planned to boost the port's capacity for handling shipping containers commenced operations in June 2001.

the first vessel using the terminal on June 18, 2001. It is the first of two terminals planned under the program to boost the port's capacity for handling shipping containers. The construction of the second terminal is under way and scheduled to be complete by July 2002.

In addition, the maritime division has completed the first phase of construction of a rail freight transfer terminal and is in the process of beginning the second phase, which consists of expanding the terminal by approximately 150 acres to accommodate more cargo. Market conditions will dictate the time it will take to complete this phase. The maritime division anticipates completing the second phase in the next three to eight years. According to the March 2000 feasibility study, funding for the second phase is not included in the capital improvement program. When completed, the transfer terminal should provide centralized rail operations within the port and enhance the economics and logistics of the ship-to-rail transfer of containerized cargo, thus ensuring that the maritime division remains competitive with other freight carriers. Moreover, during the fall of 2001, the division should complete a system of new and improved roads that will provide ocean carriers with greater flexibility in moving containers between marine terminals, cargo support facilities, and rail freight transfer terminals.

Finally, the maritime division's project to dredge the channel to 50 feet is scheduled to begin in October 2001. This project should allow the maritime division to serve larger vessels, stimulating additional cargo activity throughout the port. However, maritime division staff believe that if the current dredging project encounters delays, the port could be forced to turn away vessels that require deeper channels than it can now offer. Because the trend in the design of next-generation container ships has been toward increasing their size and draft, many now require a 50-foot water depth to navigate.

The possibility of delays in the current dredging project arises because of its reliance on federal funds. The cost of deepening the port's channel to 50 feet is estimated at $293.2 million. Currently, $130 million is scheduled to come from federal matching funds, as authorized in the Water Resources Development Act of 1999 and allocated by the Corps of Engineers. In fiscal year 2000–01, the maritime division received $4 million of the $130 million of federal funds. The division intends to pay its $163.2 million share from the sale of bonds and its cash reserves. However, maritime division staff states that the division will

Current plans, which assume no delay in the receipt of $130 million in federal funds, call for the 50-foot dredging project to be completed by December 2005.

only match its share of the dredging project's costs when it receives its annual allocation of federal funds. Under its current plans, which assume no delay in the receipt of federal matching funds, the maritime division has scheduled the 50-foot dredging project to be completed by December 2005. However, if the Corps of Engineers allocates less in future annual budgets to the projects it is helping to fund, the maritime division's dredging project may not be completed when planned. Such a delay would inhibit the port's ability to accommodate the largest cargo ships and stall its efforts to increase its market share in this area.

The Local Community Should Benefit From Environmental Mitigation Projects, Increased Tax Revenue, and New Job Opportunities

In addition to offering significant financial gain for the maritime division, its capital improvement program also should benefit the public in a number of direct and indirect ways. For instance, as required by the EIR necessary for expanding the port, the program includes dozens of mitigation projects aimed at improving the quality of the air, water, land, and biological life around the tideland properties. For example, the maritime division has committed to spending nearly $9 million on emission reduction programs and demonstration projects that promote technological advances in improving air quality. Some of these funds will be spent to retrofit diesel trucks, transit buses, cargo-handling equipment, and a tugboat with new engines designed to reduce exhaust emissions.

Under the capital improvement program, the division also plans to create waterfront recreational areas for the public to enjoy. It has allocated $10 million to construct a 30-acre shoreline park that will include an education center, shoreline walkways, fishing piers, picnic areas, and a beach. The park will surround a 190-acre ecological reserve of shallow bay and shoreline habitats. Located in a retired naval basin, the ecological reserve project will use the clean sand dredged from the channel. According to the manager of the dredging program, reusing the dredged material will not only save the maritime division millions of dollars in disposal costs but will also create a new area for shallow-water marine life to flourish.

Because of the expansion planned under the capital improvement program, the maritime division should also generate increased state and local tax revenues in future years. Specifically, the

maritime division's tenants paid $96 million in state and local taxes in 1998, but staff estimate that by 2020 its tenants will contribute approximately $157 million. This projected increase of $61 million is based on the projections of the revenues the maritime division should earn once it completes its capital improvement projects.

The maritime division's expansion projects are expected to create almost 3,600 new jobs by 2020.

In addition to these benefits, the division's expansion projects are expected to create an estimated 3,580 local jobs directly related to the seaport by 2020. To estimate the number of new jobs, the maritime division used a model developed by an outside consultant and widely employed in the maritime and aviation industries. In using the model, Port staff supply a variety of activity measures, such as the amount of container cargo moving through the seaport, to estimate the number of direct and indirect jobs that will result from a new capital improvement project.[5] Once they estimate the number of direct and indirect jobs expected to result from capital improvement projects, Port staff updates the activity measures each year to reassess the project's economic impact. In the past, the model has proven conservative in predicting new job creation. For example, staff used the model to estimate that 2,400 new jobs would be created by calendar year 2000 from the 42-foot dredging project. According to the Port's Office of Strategic and Policy Planning, the economic impact associated with the dredging project as of calendar year 2000 totaled 4,900 new direct and indirect jobs.

The maritime division intends to use the Port's employment development unit to ensure that local residents fill the majority of employment opportunities created by the expansion. The employment development unit acts as a recruiter, finding qualified job seekers within the local community and matching them with seaport tenants with job opportunities. The employment development unit also assists local job seekers facing various obstacles to employment by directing them to resources that will help them overcome these barriers. As portions of the port are expanded and new jobs created, the employment development unit will work closely with job training and education agencies to find local community applicants to fill open positions.

The employment development unit is also striving to ensure that local residents fill a portion of the jobs created by the construction process. The Port developed an agreement between

[5] New direct jobholders spending additional amounts on goods and services creates indirect jobs.

One of the Port's employment goals is that local residents perform 50 percent of the work resulting from the maritime division's expansion plans.

the expansion project contractors and the unions operating within the Port that outlines two main employment goals. The first is to ensure that local residents perform 50 percent of the work that results from the maritime division's expansion plans. The second is to ensure that local apprentices perform 20 percent of the work hours created by the actual construction of the projects. The employment development unit estimates that 900 jobs will result from the construction of the maritime expansion; thus, the construction should create approximately 180 apprenticeships.

Projected Revenues Appear to Be Adequate to Fund the Debt Service on Capital Improvement Projects

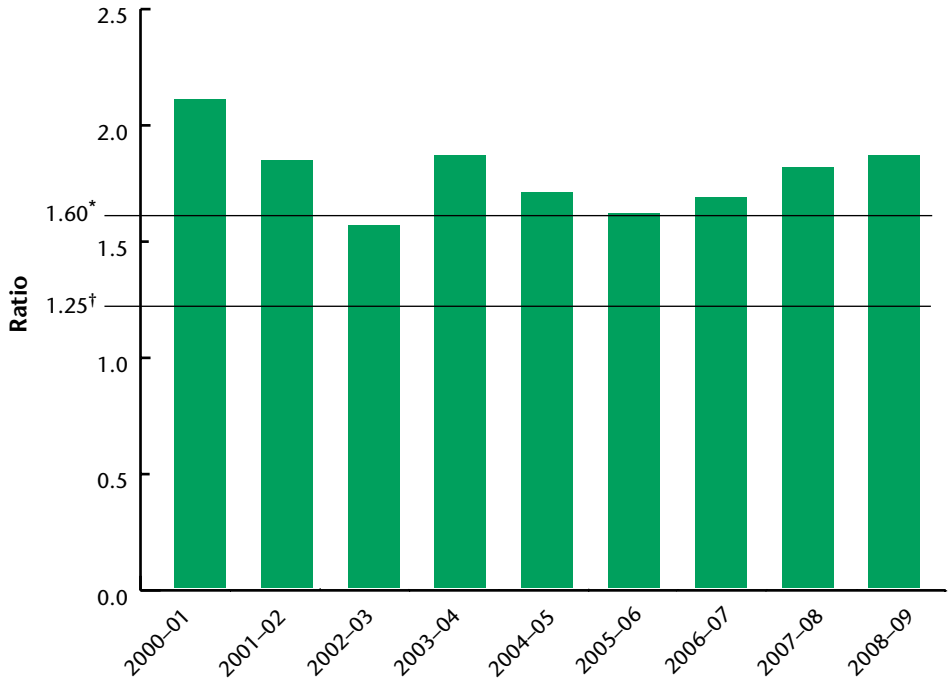
If no major changes occur in its new feasibility study, the maritime division's projected revenues should be substantial enough to cover the future debt service associated with financing its capital improvement projects. As shown in Figure 6, the division's projections for the next nine fiscal years show that it will generate enough revenue to meet the debt service coverage ratio of 1.25 called for in its bond agreements. The division will also achieve its internal minimum debt service coverage ratio of 1.6 except in fiscal year 2002–03, when we project its debt service coverage ratio to be 1.56. Should revenues fall slightly below its projections, the maritime division should still be able to meet its required debt service coverage ratio of 1.25.

The division based its projected revenues in part on minimum guarantee agreements or fixed compensation agreements that it currently has with 19 tenants. Our review of the division's most recent feasibility study indicates that these fixed or guaranteed sources accounted for 68 percent of its projected revenues in fiscal year 1998–99. These fixed or guaranteed agreements are generally long term, with some lasting up to 29 years. However, 15 agreements, including 4 in 2001, will expire within the 9 years for which the maritime division made projections. Of the 4 agreements expiring in 2001, two tenants exercised options to extend their agreements by 2 and 5 years, respectively; one is negotiating a 7-year optional extension; and one has converted to a year-to-year agreement.

According to the division, the other tenants whose agreements expire on or before December 2008 are all long-time occupants of the division's facilities that have always renewed their agreements in the past. The maritime division further stated that because its infrastructure was oriented toward handling containerized cargo,

FIGURE 6

Projected Debt Service Coverage Ratios for the Maritime Division for Fiscal Years 2000–01 Through 2008–09



Source: Auditor's calculations based on the March 2000 feasibility study projections.

* The Port's internal minimum debt service coverage ratio.

† Minimum debt service coverage ratio required by the Port's revenue bond covenant.

it would be hard for most tenants to move to another port in the area that could accommodate the same cargo volume. Because the maritime division's primary means of generating revenues is through these agreements, it is important that they be renewed or extended as expiration dates approach.

The remaining 32 percent of the maritime division's projected revenues come from variable sources, including cargo activity beyond the minimums guaranteed in contracts with tenants as well as miscellaneous port charges. The division projected its variable revenue sources assuming that its planned capital improvements—expanded freight transfer connections, two new cargo terminals (five berths), and renovated terminal facilities—will spur moderate shipping cargo growth. It also assumed a moderate recovery of the Asian economy through 2003 and a robust recovery beyond that. Of the three possible scenarios described in the Port's feasibility study, the division considered

this most likely. Because it functions as a landlord rather than an operating entity, the maritime division based its projected expenses principally on inflation rather than incremental activity changes. In light of the relatively modest increases in the division's expenses in past years—typically less than $3.3 million per year—this assumption seems reasonable.

Although the maritime division is in the process of revising its feasibility study, these revisions should not have a major effect on its projected revenue stream. According to staff at the division, the revisions proposed mostly involve moving tenants from one terminal to another. For example, certain tenants currently in one location plan to move into new berths once they are complete. Because the relocation of these tenants will create vacancies that the division can fill with other tenants, the projected revenues and expenses should remain unchanged, according to division staff. The maritime division is proposing to close the vacated terminals for a year to complete renovations. However, all the renovations to the vacated terminals will not occur at the same time, and once the terminals are renovated, the value of the leasing agreements should increase because of the improvements to the facilities.

Although the maritime division is revising its feasibility study, these revisions should not have a major effect on the projected revenue stream.

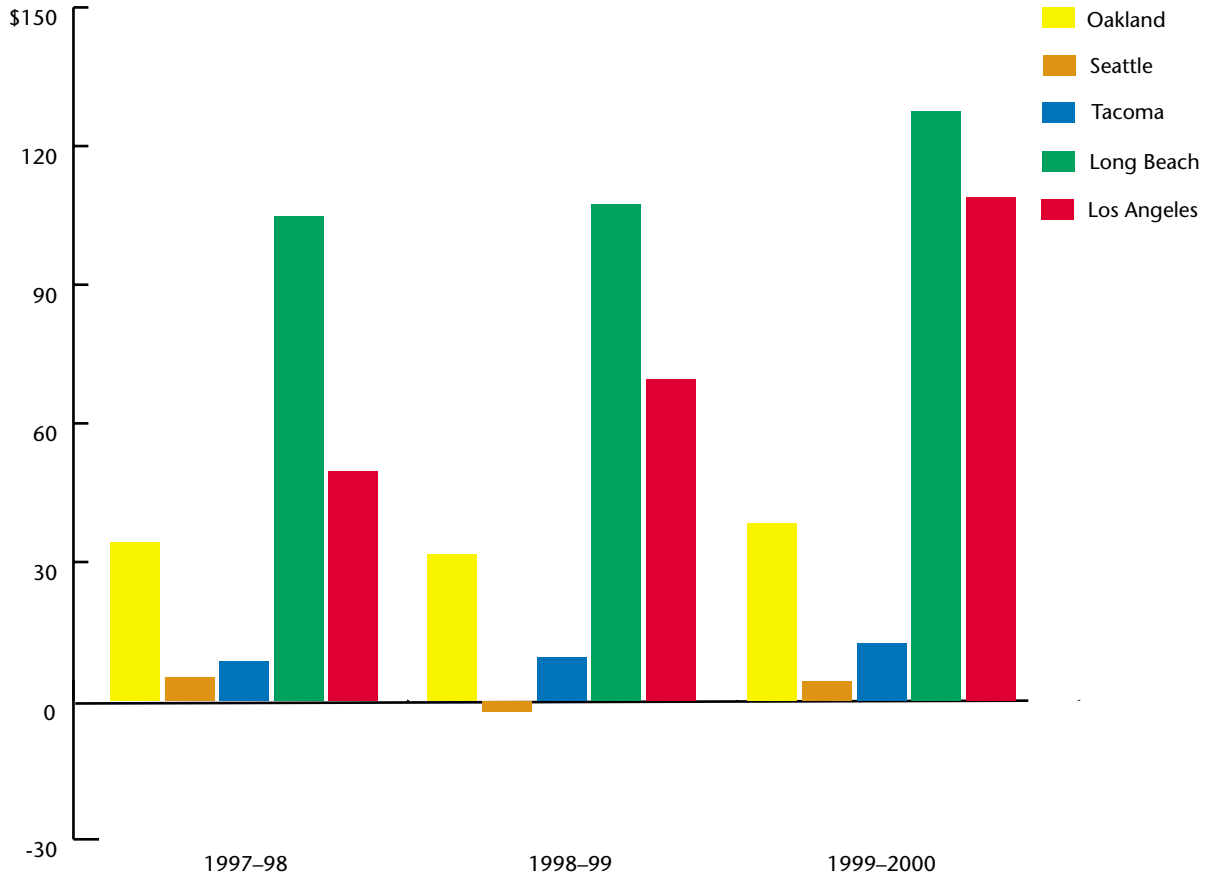
In addition, staff in the maritime division predict that the overall revenue projections may be slightly higher in the new feasibility study, in part because of the inclusion of projected revenues that should be generated once the Oakland Army Base (base) is reconfigured into useable maritime facilities. In April 2001, the Port, the city of Oakland, the Oakland Base Reuse Authority, and the Oakland Redevelopment Agency signed a memorandum of intent to identify the issues and timetable to negotiate a memorandum of agreement conveying the base property to the Port. The division expects the agreement to be finalized by the middle of 2003 and plans to use the land to expand its current container terminals. It also plans to reconfigure the freight transfer terminal to a more efficient location and layout, which should enable the port to handle increased volumes of container cargo. By reconfiguring the transfer terminal, the division will make additional land available so it can further expand the size of its other terminals.

The Division Compares Favorably to Other Ports, but Its Capital Improvement Program Is Necessary for It to Remain Competitive

Overall, the maritime division compares favorably both financially and in terms of cargo volume with the ports located in Seattle, Tacoma, Los Angeles, and Long Beach. As shown in Figure 7, the maritime division's operating income for fiscal years 1997–98 through 1999–2000 exceeded that of the Port of Seattle (Seattle) and of the Port of Tacoma (Tacoma). Although the Port of Los Angeles (Los Angeles) and the Port of Long Beach (Long Beach) generated more operating income over this same period, these ports have more land available to handle larger

FIGURE 7

Comparison of Five Ports' Operating Incomes for Fiscal Years 1997–98 Through 1999–2000 (In Millions)



Source: Audited financial statements for each port.

volumes of cargo. The maritime division has only 665 acres devoted to port activities, while Los Angeles and Long Beach have 7,500 acres and 3,000 acres, respectively.

Of the ports that we compared, we found that the one most similar in business structure to the maritime division is Seattle. According to a 1999 ranking of container volume handled by ports located along the Pacific Coast, Seattle ranks fourth and the Port of Oakland (Oakland) ranks third. However, the one major difference between the two ports is that Seattle receives approximately $35.6 million annually in tax revenues, while all the revenues of the maritime division come from its business operations. Seattle uses its tax revenues to fund acquisition and construction of facilities and to pay environmental expenses. Another difference between the ports is that the maritime division acts as a port landlord, meaning that its tenants are responsible for operating the facilities, while Seattle generally provides all port services using its own employees except to load and unload ships. Such services include, but are not limited to, operating container terminals, grain elevators, and other equipment, as well as loading and unloading rail cars and trucks.

Although we found some similarities between the other ports we analyzed and the maritime division, significant differences exist. Tacoma handles a similar volume of cargo, but its business structure is unlike the maritime division. Long Beach and Los Angeles have different business structures as well, and they are able to handle substantially larger volumes of containers because of their greater acreage, as previously discussed. According to the maritime division's fiscal year 1993–94 business plan, the port's one disadvantage was the limited amount of land available for expansion.

Definitions of Vessel Services from the American Association of Port Authorities

- **Liner cargo**–carried in vessels according to a fixed schedule of routes and ports of call. Most containerized as well as some breakbulk cargo falls in this category. (Breakbulk is cargo handled in units, packages, crates, or bags.)
- **Tramp cargo**–dry cargo carried on chartered vessels. It includes mainly dry bulk cargo such as coal, grain, and fertilizers, as well as steel and, in some cases, automobiles.
- **Tanker cargo**–bulk liquid cargo, such as crude oil, carried on tanker vessels.

According to the American Association of Port Authorities (AAPA), vessel services are categorized into three areas: liner, tramp, and tanker. Since the maritime division mainly services containerized cargo, we compared the ports by their rankings in liner services. In 1999 (the only year data were available), the AAPA ranked Oakland in the top

10 of 50 ports for liner vessel service for U.S. waterborne foreign trade. As shown in Table 1, the highest-ranking ports were Long Beach and Los Angeles. In addition, for 1990 through 1999, the AAPA included Oakland among the top 10 of 164 ports ranked by the value of their annual cargo. Table 2 on the following page shows that the lowest ranking for Oakland was eighth, a ranking it held for 5 of the 10 years, and its annual cargo value grew from $17.2 billion in 1990 to $25.8 billion in 1999. The highest-ranked ports were again Los Angeles and Long Beach.

TABLE 1

Five U.S. Ports Ranked by Vessel Service (Liner) for 1999 (In Thousands of Tons)

Port	Rank	Total Tons
Long Beach	1	18,324,978
Los Angeles	2	17,013,837
Seattle	7	7,613,947
Oakland	8	6,896,643
Tacoma	12	3,845,144

Source: American Association of Port Authorities.

Finally, Table 3 on the following page ranks the ports by their annual capital expenditures. For five of the eight years considered (1992 through 1999), Oakland ranked in the top 10. Like other ports, the maritime division must make capital improvements in order to remain competitive. The amounts spent by its competitors suggest that if the maritime division does not continue with its own expansion plans, it may lose its position among West Coast ports.

TABLE 2

Five U.S. Ports Ranked by Annual Cargo Value for 1990 Through 1999
(Dollars in Millions)

Port	1990 Rank	1990 Cargo Value	1991 Rank	1991 Cargo Value	1992 Rank	1992 Cargo Value	1993 Rank	1993 Cargo Value	1994 Rank	1994 Cargo Value	1995 Rank	1995 Cargo Value	1996 Rank	1996 Cargo Value	1997 Rank	1997 Cargo Value	1998 Rank	1998 Cargo Value	1999 Rank	1999 Cargo Value
Oakland	8	$17,243	8	$18,399	6	$24,132	5	$26,691	5	$29,015	6	$31,095	7	$26,820	8	$25,330	8	$26,170	8	$25,758
Seattle	5	26,737	4	25,882	4	26,891	4	28,357	4	36,135	4	37,113	5	34,079	5	33,625	5	33,982	5	32,227
Tacoma	6	24,303	6	22,017	7	22,967	7	23,086	8	20,851	8	22,786	9	20,557	9	19,519	12	15,018	10	16,985
Los Angeles	1	56,345	1	56,936	1	63,029	1	65,464	1	73,433	2	74,200	2	72,823	2	73,431	2	79,602	2	83,074
Long Beach	3	42,861	3	49,390	3	50,976	2	58,513	2	70,877	1	82,785	1	86,953	1	85,308	1	80,174	1	88,956

Source: American Association of Port Authorities.

TABLE 3

Five U.S. Ports Ranked by Total Capital Expenditures for 1992 Through 1999
(Dollars in Thousands)

Port	Rank	1992	Rank	1993	Rank	1994	Rank	1995	Rank	1996	Rank	1997	Rank	1998	Rank	1999
Oakland	10	$24,998	NA	NA	NA	NA	10	$ 29,913	7	$ 45,269	5	$ 53,542	NA	NA	2	$125,243
Seattle	8	29,851	3	$62,062	NA	NA	4	82,013	3	144,817	3	167,291	2	$135,654	6	62,622
Tacoma	NA	NA	NA	NA	NA	NA	NA	NA	5	57,625	NA	NA	5	71,178	NA	NA
Los Angeles	4	48,400	4	54,991	2	$ 77,524	1	377,513	1	407,099	1	355,074	3	135,228	3	100,820
Long Beach	2	60,800	1	76,000	1	434,100	2	251,100	2	179,690	2	254,561	1	272,992	1	210,872

Source: U.S. Department of Transportation, Maritime Administration.

NA: Not applicable because the port did not rank in the top 10 ports for capital expenditures in that year.

THE AVIATION DIVISION HAS INCREASED ITS REVENUES OVER THE PAST DECADE AND IS IMPLEMENTING EXPANSION PLANS THAT SHOULD SIGNIFICANTLY BENEFIT THE PUBLIC

The aviation division has significantly increased its operating revenues and the number of passengers using the airport in the past 10 years, although its capital improvements have consisted of relatively minor projects. This growth is particularly remarkable considering the fluctuating number of airline flights scheduled during this period. In response to the increased number of passengers it serves, the aviation division is in the process of implementing a substantial expansion of its facilities, including new terminal buildings, roadways, and a parking structure. This expansion should benefit the public by relieving traffic congestion and improving access, and it should enable the airport to remain comparable to other airports of its size that are planning similar improvements.

The aviation division identified a variety of funding sources for the expansion in its March 2000 feasibility study, and financial projections in that study appear reasonable. However, several significant changes have occurred since the March 2000 study was completed. First, the aviation division has increased its estimate of construction costs by almost $500 million. Second, on September 26, 2001, an appellate court responded to a lawsuit filed by four petitioners, ordering that the division prepare a new supplemental EIR before proceeding with the expansion. It is now unclear when the division will be able to begin construction and what additional costs it will face. In addition, the acts of terrorism against the United States committed on September 11, 2001, will certainly have an impact on the airline industry, but it is impossible to predict the precise nature or extent of that impact on the Metropolitan Oakland International Airport (Oakland airport) at this time.

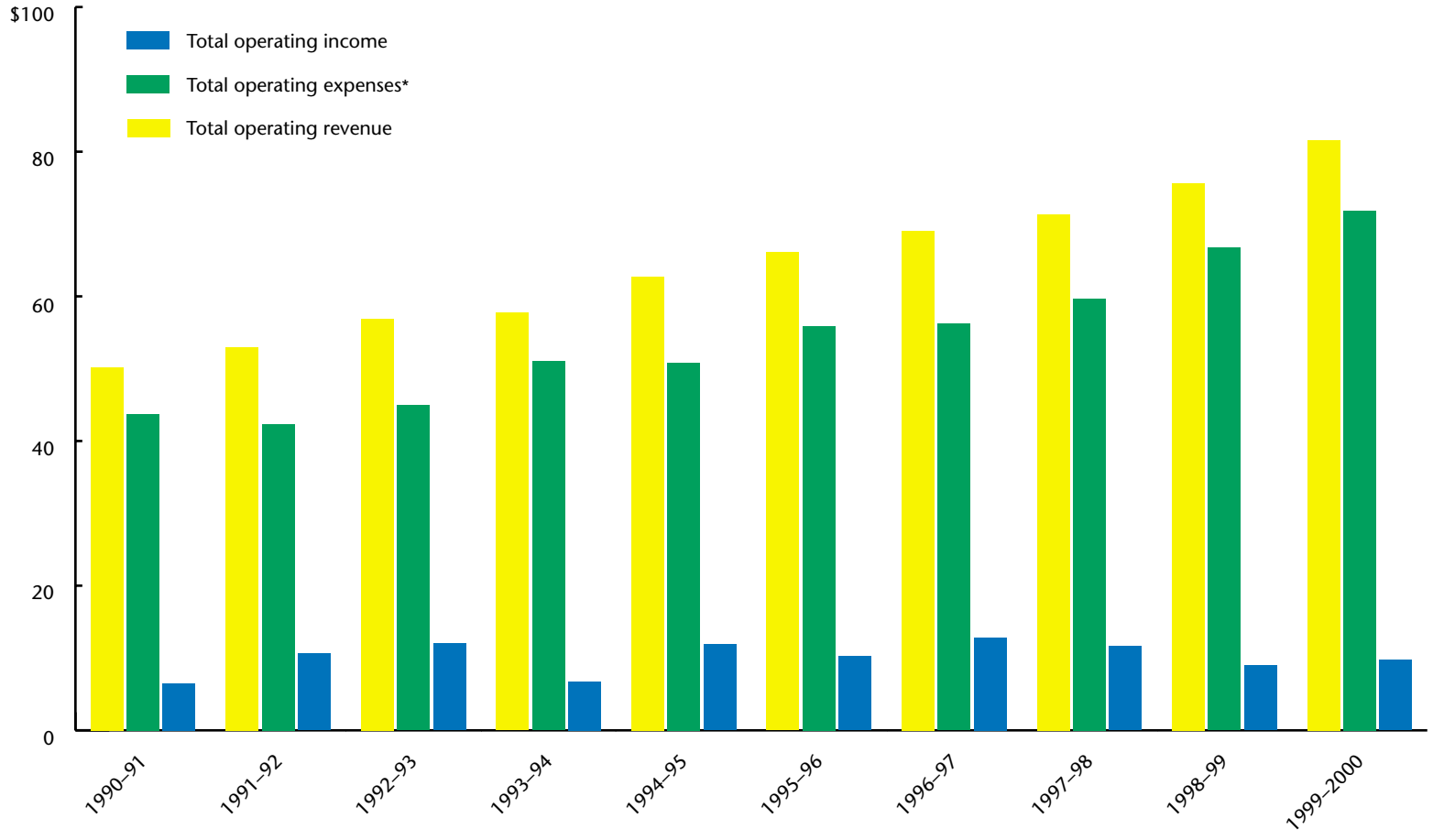
During the last decade, the aviation division's operating revenue increased during all 10 years, and the number of passengers boarding planes increased during 7 of these years.

Revenues Have Increased and the Number of Passengers Using the Airport Has Nearly Doubled

The aviation division has operated at a profit during each of the last 10 years. Despite some volatility in the airlines servicing Oakland airport during the last decade, the number of passengers boarding planes increased during 7 of those years, and the division's operating revenue increased during all 10. Specifically, as shown in Figure 8 on the following page, the airport's operating

FIGURE 8

Aviation Division's Operating Revenue, Expenses, and Income for Fiscal Years 1990–91 Through 1999–2000 (In Millions)



Source: Port of Oakland's audited financial statements.

* Operating expenses include depreciation and amortization.

revenue increased from $50.2 million to $81.5 million (62 percent) between fiscal years 1990–91 and 1999–2000. Revenue growth appears to be primarily due to an increase in the number of passengers boarding Oakland airport flights during the same period, as depicted in Figure 9 on the following page.

The growth at Oakland airport over the last 10 years follows a national trend in the airline industry.

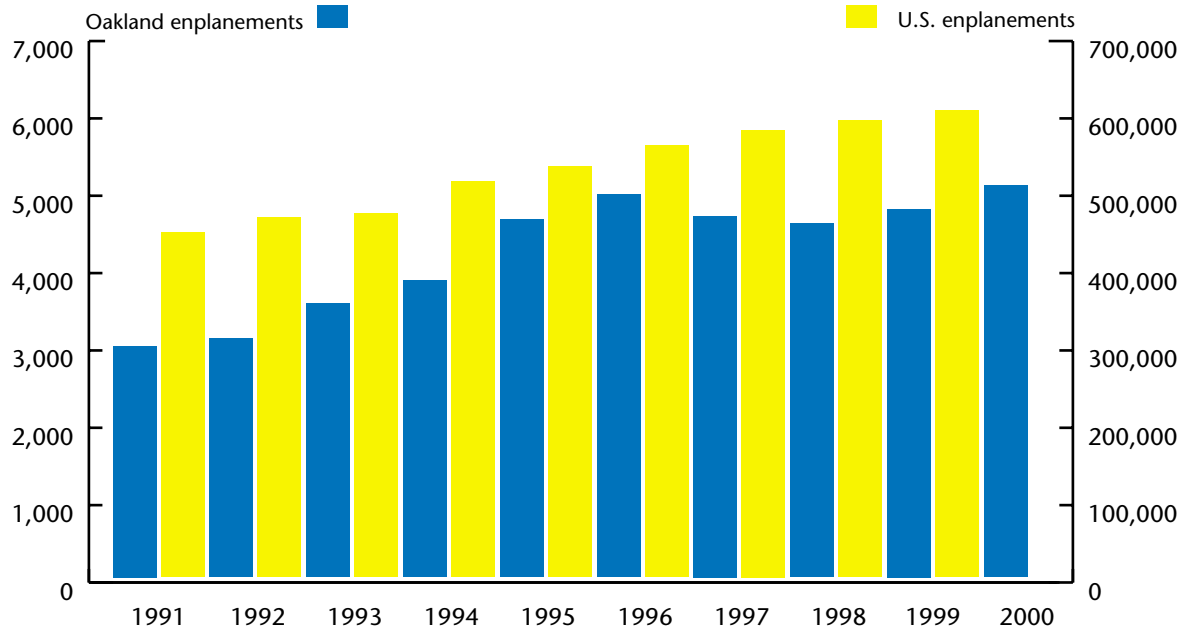
The growth experienced by the aviation division follows a national trend in the airline industry but is still remarkable considering the lack of stability in the number of airlines servicing the airport and the inconsistency in the number of flights offered. For example, in fiscal year 1994–95, United Airlines began "Shuttle by United," offering frequent flights throughout the western United States. A year later, it eliminated the shuttle services to Seattle, Ontario, and Burbank, and a year after that further reduced its service by eliminating some of the flights to Los Angeles. In a similar example, Delta Airlines eliminated its nonstop flight service from Oakland to Salt Lake City in fiscal year 1998–99, canceling approximately 33 flights a week.

Capital Improvements in Recent Years Have Been Relatively Minor

Over the past 10 years the aviation division generated adequate revenues to cover its expenses and the relatively small capital improvement projects it undertook during this time. These capital improvement projects did not, for the most part, generate revenues that we could use to calculate a rate of return on the investment. For example, in 1992 the aviation division expanded the baggage claim area in one of its terminals, and in 1998 it built a new state-of-the-art fire station. At $2.5 million, the baggage claim expansion was the least costly project undertaken during this time, and the fire station was the most expensive at $13.8 million. Although both improvements benefit airport customers, neither generates revenues. However, for each year from fiscal year 1992–93 through fiscal year 1999–2000, the airport generated at least 100 percent more revenue than it needed to cover its debt. As shown in Figure 10 on page 35, the aviation division was able to maintain the debt service coverage ratio required by its creditors of 1.25 and exceeded the Port's more stringent internal goal of a 1.6 ratio.

FIGURE 9

**Passenger Enplanements From 1991 Through 2000*
(In Thousands)**



Source: Port of Oakland and the Federal Aviation Administration.

* The passenger enplanement figure was not available for the United States in 2000.

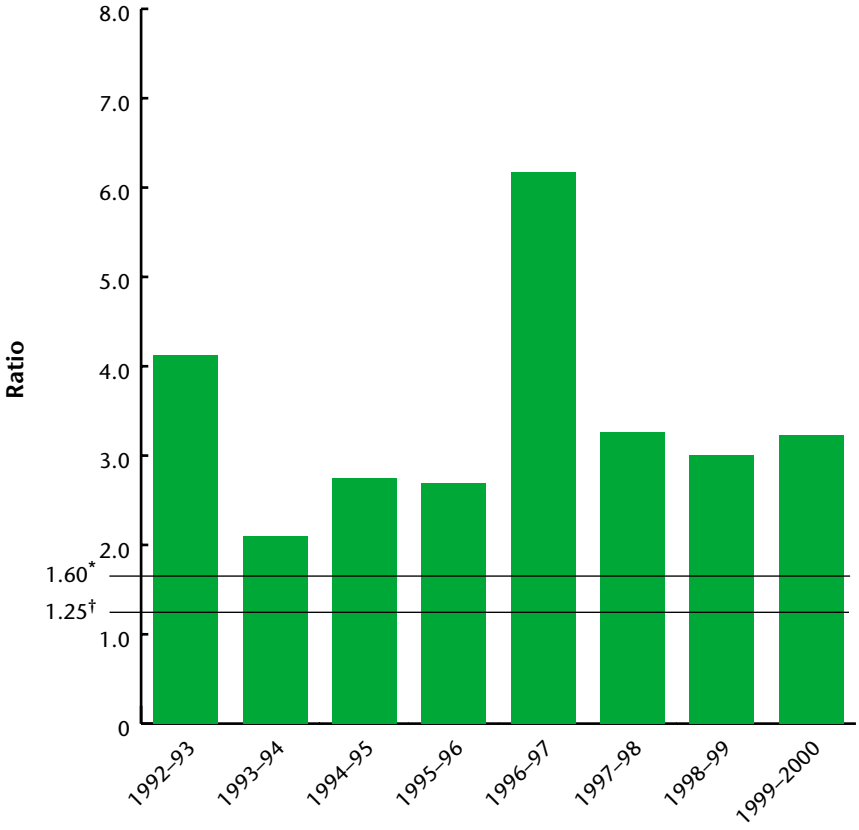
Although Expansion Plans Promise Significant Public Benefit and Are Based on Reasonable Estimates, Recent Events May Necessitate Some Changes

In March 2000 the Port completed and issued its latest feasibility study concerning the aviation division's planned capital improvements of the Oakland airport. The major construction projects proposed in this study included expanding the terminal buildings, extending roadways, and constructing a parking garage. These plans offered a number of benefits to the public, including decreasing traffic congestion around the airport and increasing the number of jobs open to the local community. Moreover, in the March 2000 study, the aviation division outlined a variety of funding sources for the projects that appeared at the time to adequately meet its projected construction costs.

However, since the Port completed this feasibility study, a number of events have occurred that significantly alter the assumptions on which it was based. First, the aviation division calculated that its costs would be higher than it had previously

FIGURE 10

Debt Service Coverage Ratios for the Aviation Division for Fiscal Years 1992–93 Through 1999–2000



Source: Auditor's calculations based on segmented income statements and bond payment records.

* The Port's internal minimum debt service coverage ratio.

† Minimum debt service coverage ratio required by the Port's revenue bond covenant.

predicted, so it started revising its capital improvement plans. Second, while it was in the process of completing this revision, an appellate court upheld the complaints of several petitioners and ordered the division to submit a revised EIR before beginning construction. Finally, on September 11, 2001, terrorists used hijacked planes to attack the United States, an act that will clearly have significant financial consequences for the airline industry. Because it is impossible to predict how these events will affect the aviation division's plans, the conclusions we draw in this section are based on the estimated costs and fund sources outlined in the March 2000 study and do not reflect the impact of recent events.

Planned Capital Improvements Should Reduce Traffic Congestion Around the Airport, Increase Tax Revenues, and Create Jobs

The aviation division's capital improvement plans include expanding the terminal buildings, extending roadways, and constructing a parking garage.

As previously mentioned, the aviation division's March 2000 feasibility study proposed a number of major capital improvements, including expanded terminal buildings, extended roadways, and a new parking garage. These projects offer a number of significant benefits to the public, including less traffic congestion in and around the airport. To accomplish this, the aviation division proposed widening a main roadway leading into the airport, reconstructing two intersections near the airport, and extending a roadway from one side of the airport to the other. The planned expansion should help to accommodate the expected increase in passengers and may result in travelers choosing the Oakland airport over more crowded, alternative airports.

The airport expansion projects should also result in the aviation division generating additional tax revenues for the city, county, and State. For example, in fiscal year 1998–99, the aviation division's tenants paid $111 million in state and local taxes. Division staff estimate that if the projects proceed according to schedule, the division's tenants will contribute approximately $125 million in 2010, an increase of $14 million.

The aviation division further estimates that if the expansion proceeds as planned, its capital improvements should create a total of 2,700 new jobs by 2010, a projection that the division reached by using the model employed by the maritime division. The 2,700 new jobs consist of an estimated 1,900 local jobs directly related to the airport and another 800 jobs created as a result of the goods and services purchased by the individuals filling the direct jobs. In addition to the jobs created as a result of the expansion, employment opportunities for local residents should arise during construction of the expansion projects. Like the maritime division, the aviation division will strive to ensure that local residents perform 50 percent of the work created by the expansion and 20 percent of the work created during the expansion. Port staff projects that 2,200 jobs should be created during the construction of the aviation expansion and conservatively estimates 400 will be apprenticeships.

The March 2000 Plans for Funding Were Based on Conservative Revenue Projections Involving a Variety of Sources

In its March 2000 feasibility study, the aviation division estimated that it would need approximately $937 million to finance its capital improvement program. It anticipated that it would receive this funding through a variety of sources, including federal Aviation Improvement Program (AIP) grants, passenger facility charges, local taxpayer funding, the issuing of commercial paper, and the sale of revenue bonds. Its projections for each of these funding sources appear to be conservative.

The aviation division estimated that it could receive $18.6 million in AIP grants that it could apply toward the airport expansion. AIP grants are allocated by the Federal Aviation Administration (FAA) based on annual congressional appropriation levels. According to our understanding of how the federal allocation levels are computed, the aviation division's expectations seem reasonable. The aviation division also expected $235.6 million to come from passenger facility charges, which are fees collected by airlines and remitted to the airport. The FAA must authorize the collection of passenger facility charges, and the division can only spend the funds on projects that improve safety, reduce noise, or enhance competition between airlines. Oakland airport is currently authorized by the FAA to impose a passenger facility charge of $3 per passenger, but it intends to apply to raise this charge to $4.50 per passenger in 2003. The aviation division expects to receive prompt FAA approval. We found that the division based its estimates of funding from this source on reasonable assumptions of future passenger growth.

Passenger facility charges collected by airlines and remitted to the airport are expected to fund almost $236 million of the expansion program.

The aviation division has been cautious in projecting future funding from local voter measures and grants, only including in the March 2000 study those sources of funding already approved for its use. The division estimated it would receive approximately $73.9 million from Measure B, which Alameda County voters approved in November 1986 to finance the construction of an airport roadway. It also identified an additional $4.5 million in local funding that it was likely to receive in the near future from state and local sources, but because these amounts were not yet certain, the aviation division did not include them in the feasibility study. For example, it expected $1 million from Alameda County, subject to the approval of the county's Congestion Management Agency board.

The aviation division also anticipated issuing bonds and commercial paper to fund its capital improvement projects. To date, the board of port commissioners (board) has authorized a total of $150 million in short-term (270-day) notes—called commercial paper—to fund the airport expansion. It also plans to issue revenue bonds to raise an additional $321.8 million. The Port is authorized to issue any amount of revenue bonds as long as its overall debt service coverage ratio remains above 1.25. Based on the projections of revenues, expenses, and debt service growth included in its March 2000 feasibility study, the Port should be able to issue the necessary amount of revenue bonds to finance the aviation expansion while maintaining its self-imposed minimum debt service coverage ratio at 1.6.

Finally, the aviation division estimated that after payment of its operating expenses and debt service costs, it should have revenue in the amount of $137.5 million to fund a portion of the expansion plans. The division based its estimates on what we believe to be reasonable assumptions of revenue growth, operating expenses, and debt service amounts. For example, the revenue projections reflect decreases during construction periods and increases once construction concludes. During fiscal years 2000–01 through 2002–03, the revenue projections take into consideration that construction of the new airport parking garage will cause a decrease in parking lot revenues. In fiscal year 2003–04, the new parking structure is scheduled to be complete; thus, the division has projected an increase in parking lot revenues. Projections for operating costs appear to be equally reasonable because they are based on historical trends and adjusted for expected increases in future airport activity and staffing requirements.

Preliminary Projections of Costs in the March 2000 Study Prompt Expansion Plan Revisions

Although the 2000 feasibility study estimated the airport expansion would cost $937 million, the aviation division later estimated the cost would total nearly $1.5 billion.

As previously discussed, the funding sources that the aviation division projected in its March 2000 feasibility study of its capital improvement program appear reasonable. However, the division has since discovered that the construction costs it originally estimated were not accurate; therefore, it is currently revising its expansion plans. The March 2000 feasibility study estimated that the airport expansion would cost $937 million. According to the director of aviation, this estimate was based on a preliminary study that was not intended to be fully comprehensive. The aviation division subsequently performed a more thorough review and determined that the actual cost was likely to reach nearly $1.5 billion.

The aviation division presented its new projections to the board in May 2001. On June 1, 2001, the board instructed aviation division staff to consider two measures to cut projected costs and report its conclusions. First, the board directed the division to propose changes in the scope of the expansion project sufficient to reduce the overall cost to $1.1 billion. Second, it asked the division to identify up to $200 million in "soft" cost reductions that would not change the project's scope. These reductions might involve items such as development and design costs, construction and project management costs, consultant costs, and certain mitigation and oversight costs. In response to the board's request, the division submitted a study on June 22, 2001, containing three alternatives to the scope design and eight ideas for reducing costs without changing the project's scope. All the alternatives outlined in the June study include expanding the airport terminal buildings, building a parking garage, and constructing a two-level roadway for passenger pickup and drop-off, as planned for in the March 2000 study.

The board reviewed the study and provided feedback to the aviation staff. On August 3, 2001, the division submitted a decision document to the board containing the staff's final recommendations for the expansion. Although the final expansion plans necessitated a $1.49 billion budget, the aviation division staff believe there may be methods of reducing costs by at least $100 million. Therefore, division staff recommended that the board approve a maximum budget for the expansion of $1.39 billion. The board approved the staff's recommendations for the airport expansion on August 7, 2001. The final revisions to the airport expansion plans were reviewed by consultants, who assessed the reasonableness of the estimated construction costs and underlying assumptions on which those costs were based and found both feasible.

Recent Developments May Affect the Progress of the Planned Expansion

On September 26, 2001, an appellate court ruled that the aviation division must submit a new supplemental EIR for its projects.

After the board's approval of the aviation division's revised plans, two events occurred that are likely to affect the airport expansion. First, on September 26, 2001, an appellate court ruled that the division must submit a new supplemental EIR for its planned projects. The process that resulted in this decision began in December 1997, when the board certified the division's EIR identifying the significant environmental effects and mitigation measures of the airport's expansion plans. Shortly thereafter, four plaintiffs, including the cities of Alameda and San Leandro

and two citizen organizations, filed petitions with the superior court challenging the board's decision to certify the EIR and approve the expansion project. The superior court ordered the Port to set aside approval and certification of the EIR until the division prepared a supplement to the EIR in compliance with the California Environmental Quality Act (CEQA). In June 1999 the board certified and approved the completed supplemental EIR. Subsequently, three of the four original plaintiffs appealed the superior court's ruling.

This led to the appellate court's modified order filed on September 26, 2001. The appellate court ordered the division to prepare a supplemental EIR that included a further discussion of project alternatives and cumulative impacts. The appellate court also found that the EIR failed to comply with the CEQA on four additional points. First, the court found that the EIR did not adequately analyze the noise impacts from additional nighttime flights. Second, the division erred in using outdated information in assessing the emission of toxic air contaminants. Third, the division failed to support with meaningful analysis its decision not to evaluate the health risks associated with the emission of toxic air contaminants. Last, the division improperly deferred devising a mitigation plan for the western burrowing owl, which would be affected by the expansion. Because of these deficiencies, the appellate court also ordered that the aviation division address these additional points in its new supplemental EIR, submit it for public review and comment, and certify it in accordance with the CEQA.

Although preparing a supplemental EIR will take added time and money, an assistant attorney for the Port stated it may be able to proceed with some projects, thus reducing the delay.

The board is currently assessing the impacts of the court's ruling. Although preparing a supplemental EIR will take additional time and money, according to an assistant attorney for the Port, it is conceivable that the division will be able to proceed with some projects while additional environmental review is being done on other projects, thus reducing the delay.

The court's ruling, combined with the aviation division's revisions of the estimated costs of construction, create a degree of uncertainty about the timing and the new sources of funding needed to pay for the revised costs of the airport expansion. This uncertainty is heightened by the fact that terrorists used commercial airplanes to attack the United States on September 11, 2001. Although difficult to predict in the long term, some impact on the airline industry is inevitable.

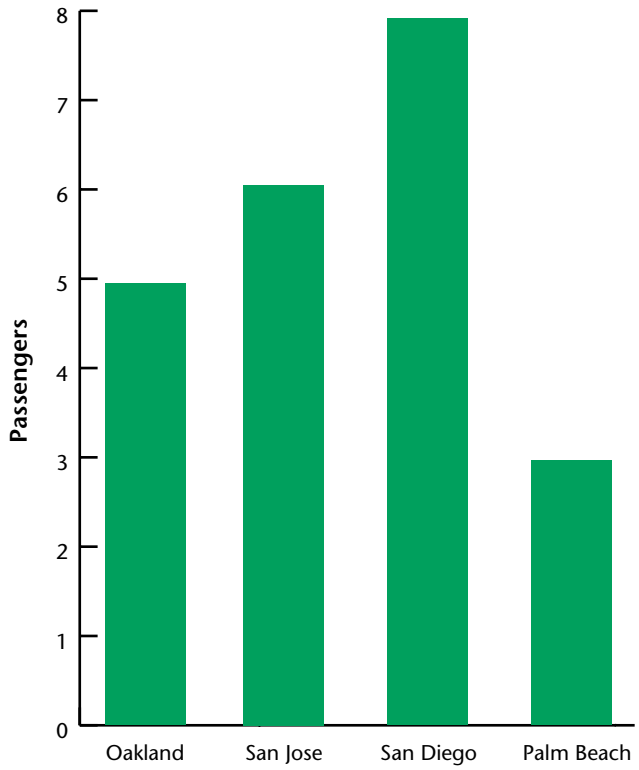
The Expansion Plans Should Enable Oakland to Remain Comparable With Similar Airports

The aviation division is economically comparable with airports having similar operating capacities, such as San Jose International, San Diego International, and Palm Beach (Florida) International airports. As seen in Figure 11, nearly five million passengers boarded planes at the Oakland airport in fiscal year 1999–2000 compared with about six million passengers at San Jose and almost eight million at San Diego.

According to Oakland airport's director of aviation, airlines' cost per enplanement is a common indicator used in the industry. Airports determine the cost per enplanement by dividing the

FIGURE 11

Comparison of Four Airports' Passenger Enplanements for 2000 (In Millions)



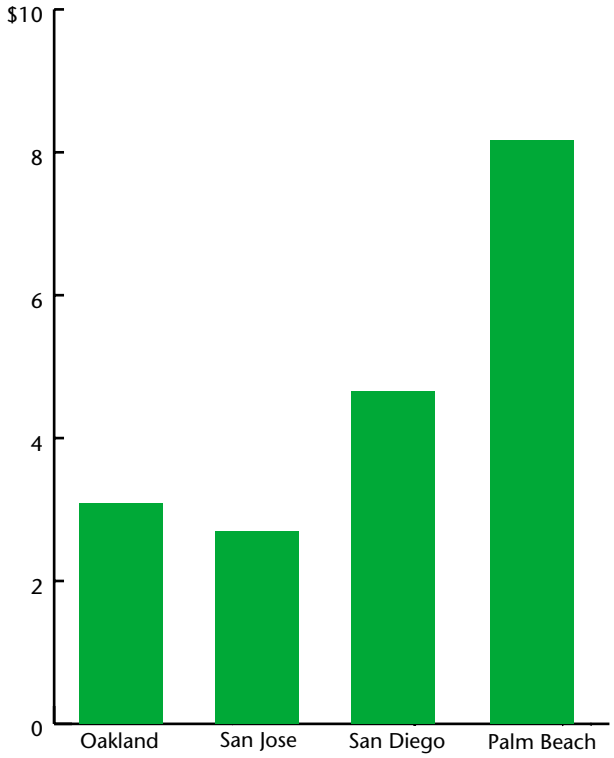
Source: Oakland, San Jose, and San Diego International airports and Palm Beach County Department of Airports.

Note: Data for Oakland, San Jose, and Palm Beach are for fiscal year 1999–2000, and data for San Diego are for calendar year 2000.

total that various passenger airlines pay for using airport facilities by the total number of passengers that board planes.[6] Airlines often use the cost per enplanement to determine whether to fly in and out of a particular airport. Most airports strive to keep their cost per enplanement low so more airlines will want to use their facilities. As shown in Figure 12, Oakland airport's cost per enplanement for fiscal year 1999–2000 was slightly more than $3, the second lowest among the airports we considered. The cost per enplanement at the comparable airports ranged from $2.69 at San Jose to $8.16 at Palm Beach.

FIGURE 12

Comparison of Four Airports' Costs Per Enplanement for 2000



Source: Oakland, San Jose, and San Diego International airports and Palm Beach County Department of Airports.

Note: Data for Oakland, San Jose, and Palm Beach are for fiscal year 1999–2000, and data for San Diego are for calendar year 2000.

[6] Enplaned passengers are those who board the aircraft at a particular airport. In general, airport use is measured by the number of passengers who board aircraft as opposed to those who disembark.

Although the Oakland airport can be compared with other airports in terms of number of passengers and cost per enplanement, we found it difficult to meaningfully compare Oakland airport's cargo function with other cargo airports. Unlike other airports of its size, Oakland airport has two airfields—one used for passengers and a second devoted mainly to general aviation activities involving small private aircraft. Oakland serves as a hub for Federal Express and a mini-hub for the United Parcel Service, two major freight and mail carriers. Consequently, the amount of cargo activity at Oakland airport is much greater than the activity at the comparable passenger airports.

Like Oakland, most of the airports in our review are currently planning expansions. San Jose and Palm Beach International airports both intend to expand their cargo areas, parking facilities, and passenger terminals, as well as improve their roads and runways. San Diego International airport is implementing construction projects designed to expand and improve its terminal facilities. If Oakland airport does not continue its expansion plans, it risks being left behind by comparable airports and losing the position in the industry that it has earned over the past decade.

THE REAL ESTATE DIVISION HAS OPERATED AT A CONSIDERABLE FISCAL LOSS BUT PLANS TO FINANCE FUTURE CAPITAL IMPROVEMENTS WITHOUT INCURRING ADDITIONAL DEBT

The real estate division has consistently operated at a deficit, relying on the other divisions to fund its past capital improvement projects.

Of the Port's three revenue divisions, only the real estate division has failed to significantly increase its revenues over the past 10 years. In fact, the real estate division has consistently operated at a deficit during this time, relying on the other divisions to fund its capital improvement projects. The division's losses were due in part to its unsuccessful business undertakings and the Port's decision to use the real estate division as a means to supply public benefits. To accomplish the Port's overall mission, the real estate division has in effect subsidized a number of public benefit projects, including several parks and an Amtrak station.

Despite plans to improve its profitability, the real estate division has yet to take significant actions toward this end. It is currently proposing several large capital improvement projects, including expanding Jack London Square and developing a large section in

the waterfront area in cooperation with the city of Oakland. However, rather than increasing its debt, it plans to move forward with these projects only if it can find developers who will agree to be responsible for the capital development funding.

Consistent Losses Have Been Due to Costly Public Services, High Operational Expenses, and Ill-Fated Business Decisions

Despite two studies and an action plan, the real estate division has taken few steps to alleviate the financial drain it has had on the Port's overall operations.

Despite two studies and an action plan adopted by the board, the real estate division has taken few steps to alleviate the financial drain it has had on the Port's overall operations. Although real estate is the smallest of the three divisions in terms of revenue production, averaging approximately 11 percent of the Port's total annual revenue, its costs make up about 21 percent of the Port's annual expenditures. As shown in Figure 13 on the following page, between fiscal years 1990–91 and 1999–2000, the real estate division lost between $4.3 million and $12.4 million a year, for an average annual loss of $7.5 million.

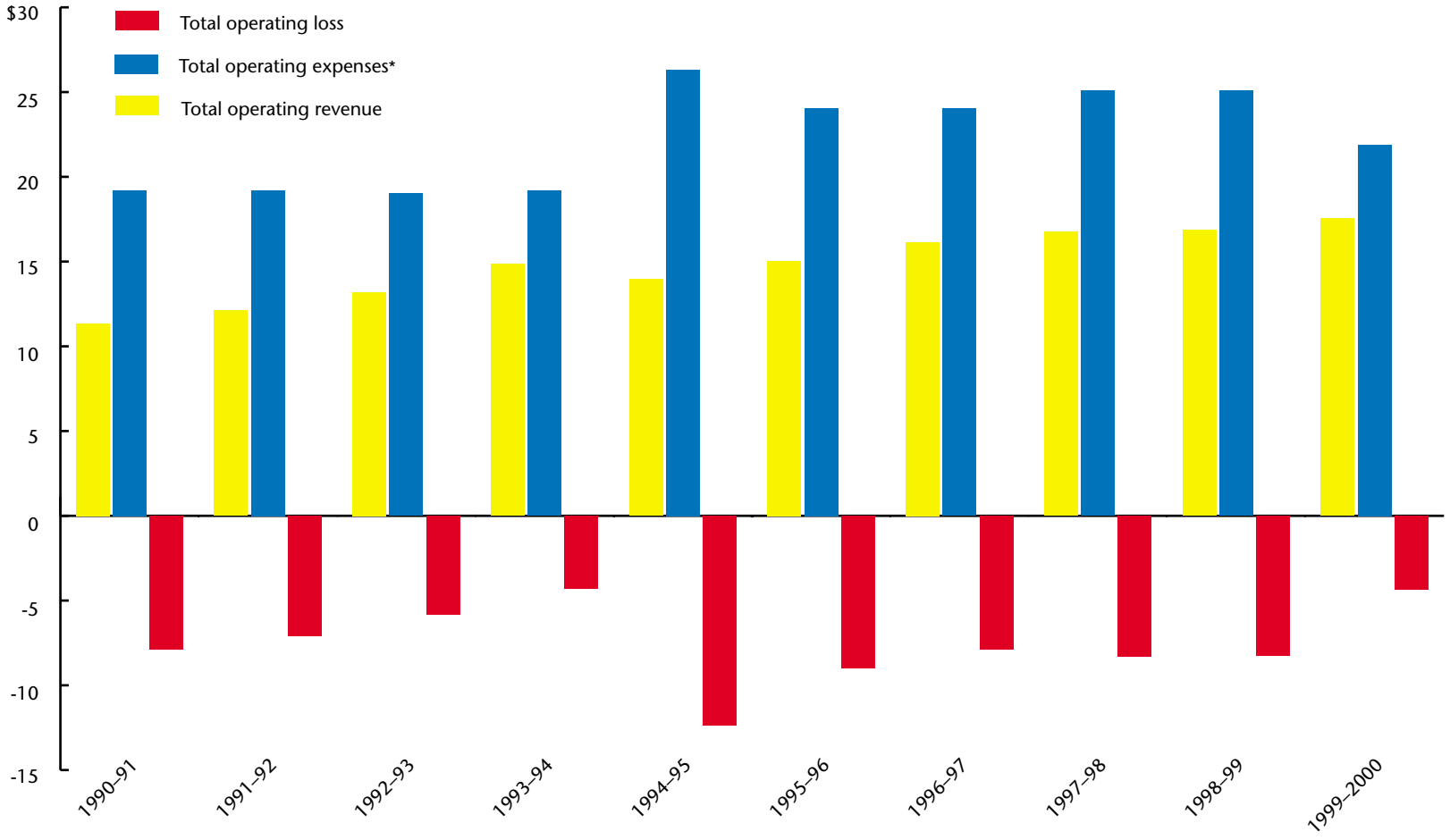
These losses appear to result from at least three different factors. The first is a conscious decision by the Port to have the real estate division enter a number of lease agreements at rates significantly below fair market values. The second relates to the high operational costs associated with the properties located in and around Jack London Square, costs that the real estate division failed to reduce. The third cause seems to be some ill-fated decisions the division made in pursuing certain business deals.

The first of these factors stems from the nature of the Port's mission. The Port has chosen to lease a total of nine different properties, some situated in prime locations, at nominal rates—eight for $1 per year each and one for $490 per year—to the city of Oakland, the Bay Area Rapid Transit, the East Bay Regional Parks District, Amtrak, and the Oakland Fire Department Historical Society. When we asked the Port why it offered these lease terms, its assistant attorney stated that unless required by federal, state, or other legal mandate, the Port will generally direct the real estate division to grant $1-per-year leases only if the board determines it is in the Port's best interests. In making such decisions, the board uses the following criteria:

- The property generates a minimal amount of overall Port revenue, and the acreage is small enough so as not to affect Port revenue.

FIGURE 13

The Real Estate Division's Operating Revenue, Expenses, and Losses for Fiscal Years 1990–91 Through 1999–2000 (In Millions)



Source: Port of Oakland's audited financial statements.

* Operating expenses include depreciation and amortization.

- The tenant is a public agency or nonprofit private entity that will use the property for Tideland Trust uses. According to the Tideland Trust, these uses include commerce, navigation, fishing, and recreation.

- The use provides special and important benefits in developing, operating, or protecting public trust lands and facilities that justify the minimal lease payments.

- The transaction does not result in the Port losing the opportunity to earn substantial net revenues.

- For leases executed after January 1, 1989, the lease will not have a substantial adverse effect on the revenues pledged to service the Port's bond debt.

Although the board considers all these criteria when deciding whether to direct the division to grant a nominal lease, it does not require that all be met before it can make such a decision. The Port's assistant attorney stated that seven of the $1-per-year leases currently in place clearly satisfy the Port's general criteria. According to the assistant attorney, two of the leased properties do not meet these criteria: One is used as a service center for municipal maintenance and supplies and the other for a municipal sewer pipeline. However, because of its minimal value and the fact that it does not interfere with trust uses, the assistant attorney also stated that the failure of the leased property used for the pipeline to meet the criteria was not significant.

Although the Port's decision to lease land at below-market values may accomplish its mission to generate economic growth and waterfront activity, it has been detrimental to the real estate division's financial success.

While the decision to lease land at below-market values may help the Port accomplish its mission to generate economic vitality, jobs, and waterfront activities, it has come at a high price to the real estate division. The real estate division could receive an additional $33.1 million annually in revenue if it leased these properties for their estimated fair market value. To quantify this lost revenue, we asked division staff to provide estimates of what these properties could lease for annually without any further upgrades or development. As shown in Table 4, we used the division's estimates to calculate the annual amount of additional revenue it would earn if it leased the properties at full value, as well as what it would earn leasing the properties at 75 percent, 50 percent, and 25 percent of their value. The total added annual lease revenue would range from a low of $8.3 million a year (at 25 percent of fair market value) to a high of $33.1 million a year (at 100 percent of fair market value). In other words, leasing these nine properties for just 25 percent

TABLE 4

Estimated Fair Market Value of the Real Estate Division's Below-Market Lease Properties

Tenant Name	Property Description and Use	Fair Market Value of Annual Lease	Percent of Fair Market Value			Annual Lease Rate	Lease Expiration
			75	50	25		
Bay Area Rapid Transit District	80 square feet of vacant land for emergency command post	Nominal amount	NA	NA	NA	$ 1	2004
City of Oakland	21 acres for a municipal maintenance yard	$ 1,116,000	$ 837,000	$ 558,000	$ 279,000	1	Pending renegotiation
City of Oakland	0.5 acre for a fire station	26,568	19,926	13,284	6,642	1	Pending renegotiation
City of Oakland	12.7 acres of land and water for a park	674,916	506,187	337,458	168,729	1	2029
City of Oakland	15,543 square feet of land and 7,406 square feet of water for a fire station	29,832	22,374	14,916	7,458	1	2007
City of Oakland	4,474 square-foot easement for a sewer line	5,448	4,086	2,724	1,362	1	2060
East Bay Regional Park District	565 acres of land and water for a park	30,025,908	22,519,431	15,012,954	7,506,477	1	2002
Amtrak	15,000 square feet of building plus land for public rail transportation	1,160,000	870,000	580,000	290,000	1	2061
Oakland Fire Department Historical Society	7,000 square feet of warehouse space	21,000	15,750	10,500	5,250	490	Pending renegotiation
Totals		**$33,059,672**	**$24,794,754**	**$16,529,836**	**$8,264,918**	**$ 498**	

Source: Port of Oakland real estate division.

NA: Not applicable.

of their value would have generated enough revenue to cover the annual loss of $7.5 million that the real estate division has averaged over the last 10 fiscal years.

The Port has commissioned two studies of the real estate division in an effort to improve its profitability—one in 1995 and one in 1998. The 1998 study examined the division's operational problems and made recommendations for improvement. These recommendations included ways to increase revenues while reducing expenses and capital outlays. From this study, the Port

created an action plan in February 1999, which included 10 items and a timetable for completing them. However, it appears that this timetable was unrealistic. As shown in Table 5, as of September 12, 2001, the real estate division had only completed 1 item, had partially completed 7, and the remaining 2 were on hold pending the completion of one of the other items. According to the established timetable, 9 of the 10 action items should have been completed. The director of the real estate division feels that he may have been too aggressive in his timetable because he did not adequately anticipate the time a public entity with multiple stakeholders needs to reach decisions. However, he also feels that the division has made progress in implementing its plan over the past two and a half years. As Figure 13 on page 45 shows, the real estate division did reduce its losses by almost $4 million between fiscal years 1998–99 and 1999–2000.

TABLE 5

1999 Action Plan for the Real Estate Division

Action Item	Scheduled Completion Date	Status as of September 12, 2001
1. Port review and approval of plan	2/16/99	Completed
2. Market or sell Hegenberger Road development parcels	8/31/99	In process
3. Market or secure Jack London Square strategic developer and leases	8/31/99	In process
4. Market or secure marina lease	8/31/99	In process
5. Prepare and certify an environmental impact report for Jack London Square	3/31/00	On hold pending completion of item 3
6. Further develop Jack London Square	3/30/01	In process
7. Implement the Estuary Plan	7/31/09	In process
8. Restructure the division	2/29/00	In process
9. Implement new operations systems and policies	4/28/00	On hold pending completion of item 3
10. Restructure and pay down debt	3/31/00	In process

Source: Real estate division's restructure and development plan and recommendations.

One item discussed in the 1998 study was the high cost of running and maintaining the land and buildings the real estate division manages. Over a period of three years, from fiscal years

1996–97 through 1998–99, the real estate division's maintenance cost averaged roughly $4 million, approximately 32 percent of its total operating expenses during each of those three fiscal years. To combat these high costs, the consultant performing the study recommended restructuring the real estate division and finding a lessee for the marina, noting that the operating expenses for private marinas tended to be about half what public marinas expend. According to the consultant, workforce improvements, such as personnel training and specialization, contribute to the greater profitability of private marinas. The consultant also recommended that the real estate division find a lessee to operate the facilities in Jack London Square.

In response to the first recommendation, the division received approval on August 7, 2001, from the board to send out a Request for Proposal for a management company to take over the marina. However, the division does not expect to complete this process until early next year. In fiscal year 1999–2000, the real estate division transferred its maintenance function to the engineering division's maintenance unit, thus redirecting some of its labor costs. While this action did not reduce the Port's overall operating expenses, it did have a positive effect on the real estate division's maintenance costs, which dropped from an average of 32 percent of its total operating costs to about 10 percent in fiscal year 1999–2000.

Finally, some of the real estate division's losses have been the result of business decisions that turned out badly. One of the key decisions involved Oakland Portside Associates (OPA), a limited partnership formed in 1987 to develop Jack London Square. Unfortunately, OPA lost its partner, which was supplying the necessary capital, shortly after the start of the development. At the time the OPA's partner withdrew, the Port had already started construction on various infrastructure improvements including parking facilities, roads, and utilities with an estimated cost of more than $30 million. Rather than walk away from its investment, the Port became a general and limited partner, and in August 1990, it in effect became the sole owner of the OPA. The OPA finished the project but has been operating at an annual loss averaging $2.4 million since fiscal year 1990–91. These losses, which are reflected in the operations of the real estate division, are included in the amounts shown in Figure 13 on page 45. Further, when it acquired the OPA, the Port wrote down the value of the OPA assets by almost $7 million in fiscal year 1990–91 to accurately reflect their value.

The Jack London Square project has been operating at an average annual loss of $2.4 million since the Port became the sole owner in 1990.

Another example of a business decision that turned out badly involved one of the real estate division's tenants that operated a hotel adjacent to the airport until August 1994. The real estate division took possession of the building as part of the tenant's bankruptcy settlement and attempted to run the hotel until it could locate a potential buyer. However, when it was unable to find a suitable prospect, it eventually demolished the building and cleared the land. During the period between fiscal years 1994–95 and 1996–97, the real estate division spent approximately $2.7 million more to operate the hotel than it received in revenues. It spent another $1.8 million to raze the site.

The Other Divisions Have Subsidized the Real Estate Division's Past Capital Improvement Projects

The real estate division has not generated enough revenue to cover its debt service costs for six of the last eight fiscal years.

The real estate division has only been able to minimally contribute revenue to pay for its past capital improvement projects because its expenses have generally exceeded its revenues. Specifically, the real estate division's debt service coverage ratio was negative for six of the eight fiscal years spanning 1992–93 through 1999–2000. A negative debt service coverage ratio means that the division's operations did not generate enough revenues to pay for both its operating costs and its long-term debt.[7] Thus, one or more of the other divisions has had to subsidize the real estate division's past capital improvement projects that, from January 1991 to May 2001, amounted to approximately $74 million.

The real estate division's two largest projects were a large parking garage that cost approximately $12.3 million and a new Amtrak station that cost about $10.5 million. Our attempt to determine the rate of return on the parking garage as an individual project was unsuccessful. The real estate division does not keep detailed accounting records, instead depending on the finance division of the Port for its accounting needs. As a result, the information that the real estate division provided us regarding the financial health of the parking garage did not contain the maintenance, utilities, and finance costs associated with the project. The finance division was also unable to provide us with the maintenance and utility costs because it does not record them on an individual project basis. Although the revenues and expenses reflected in the accounting records indicate that the parking

[7] It should be noted that the debt service coverage ratio presented to investors is based on the Port's activities taken as a whole. Therefore, as long as the Port's other two revenue divisions maintain debt service coverage ratios high enough to cover the real estate division's deficit, it should not preclude the Port from obtaining financing.

project is making a profit, any evaluation made of that data would be incomplete without inclusion of the maintenance and other operating expenses.

The cost to construct the Amtrak station was around $10.5 million, but the real estate division was only responsible for a part of this total. State and federal grants paid for approximately $8 million of the construction, while the real estate division paid the remaining $2.5 million. As mentioned earlier, the real estate division provides the land the station sits on for a lease of $1 a year. It does not receive any other revenues from this project.

The Division's Plans Should Not Increase the Port's Debt

The real estate division's projected debt service coverage ratios for the next nine fiscal years, from 2000–01 through 2008–09, appear to be well below the 1.25 required of the Port as a whole. However, these projections do not take into account a number of the division's current plans to reduce its losses. According to the division, these plans were not included when it projected its future revenues and expenses because it did not want to assume it could accomplish these tasks in the near future. According to the Port's chief financial officer, the real estate division's plans are not yet finalized and thus could not be considered in the capital improvement program contained in the feasibility study. This decision partially explains why the division's projections continue to show losses. Because the real estate division has struggled in the past to improve its operations, this appears to be a conservative and appropriate approach.

For its future capital projects, the division will act primarily as a landlord while developers bear the burden of financing capital development costs.

Some large developments that the real estate division is in the process of planning should not require the issuance of any additional debt. These projects, which include expanding Jack London Square and developing a large section in the waterfront area, are part of a bigger overall plan the Port and the city of Oakland have for the waterfront called the Estuary Plan. To finance its Estuary Plan projects, the division intends to have the developers bear the responsibility for the capital development costs while it acts primarily as a landlord. The division is also attempting to sell some properties around the airport and intends to use the proceeds from those sales to finance its portion of the developments. Currently, the division is in negotiations with developers for the second phase of the Jack London Square project and has issued a Request for Qualifications for the waterfront development.

RECOMMENDATIONS

To reduce the effect of its losses on the Port's overall operations, the real estate division should take the following actions:

- Complete the action plan approved by the board in 1999.
- Examine the feasibility of increasing below-market lease rates to cover its operational costs. It should also consider the impact of such an action on the Port's relationships with the community and the other municipalities.
- Continue to look for ways to increase revenues and decrease costs associated with managing its assets.

We conducted this review under the authority vested in the California State Auditor by Section 8543 et seq. of the California Government Code and according to generally accepted government auditing standards. We limited our review to those areas specified in the audit scope section of this report.

Respectfully submitted,

ELAINE M. HOWLE
State Auditor

Date: October 23, 2001

Staff: Doug Cordiner, Audit Principal
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Wesley Opp
Patrick Browning

APPENDIX

As discussed in the Scope and Methodology section of the Introduction, the Port of Oakland (Port) does not internally calculate the rate of return on its major capital and real estate investments but instead relies on the debt service coverage ratio as the key measure in determining the viability of its capital projects. We attempted to calculate the rate of return for each of the revenue divisions of the Port but were unable to do so because the Port does not maintain asset information segmented by division. Therefore, we calculated the rate of return for the Port as a whole by using information from the Port's annual audited financial statements for fiscal years 1990–91 through 1999–2000.

The rate-of-return-on-investment ratio measures an entity's income in relation to its total asset value. The Port's rate of return on investment ranged from -2.67 percent in fiscal year 1990–91 to a peak of 1.63 percent in fiscal year 1997–98. We were not able to compare the rate of return on investment to other ports because it is not a ratio that other ports use. Table 6 on the following pages show selected financial information, including the rate of return, for the Port covering the 10 fiscal year period 1990–91 through 1999–2000.

TABLE 6

Selected Information From the Port of Oakland's Annual Audited Financial Statements for Fiscal Years 1990–91 Through 1999–2000 (In Thousands)

Balance Sheet	1990–91	1991–92	1992–93	1993–94	1994–95	1995–96	1996–97	1997–98	1998–99	1999–2000
Assets										
Current assets	$ 47,598	$ 67,980	$ 60,689	$ 83,999	$106,642	$106,810	$ 108,012	$ 126,322	$ 136,583	$ 113,263
Restricted cash and investments	30,360	82,912	156,389	119,085	109,813	95,487	132,985	130,672	81,339	456,249
Property, plant, and equipment	622,409	672,534	706,802	782,248	827,063	879,949	914,707	943,954	951,134	994,946
Less accumulated depreciation	(158,229)	(177,465)	(198,616)	(217,754)	(241,348)	(269,671)	(298,906)	(327,450)	(343,653)	(374,620)
Land	108,262	98,693	132,725	115,928	123,269	138,158	165,746	198,653	340,713	475,266
Deferred charges and other assets	25,873	20,630	21,048	18,803	16,243	15,330	36,424	17,488	17,266	22,326
Total Assets	**$676,273**	**$765,284**	**$879,037**	**$902,309**	**$941,682**	**$966,063**	**$1,058,968**	**$1,089,639**	**$1,183,382**	**$1,687,430**
Liabilities and Equity										
Current liabilities	$ 32,615	$ 31,047	$ 35,017	$ 40,376	$ 47,034	$ 43,121	$ 39,599	$ 46,179	$ 77,848	$ 51,151
Current liabilities paid from restricted assets	42,272	46,652	9,405	17,295	18,776	22,752	21,951	20,654	23,900	69,971
Long-term liabilities	381,589	445,761	566,304	543,448	539,622	534,329	589,910	576,832	597,950	1,041,523
Equity	219,797	241,824	268,311	301,190	336,250	365,861	407,508	445,974	483,684	524,785
Total Liabilities and Equity	**$676,273**	**$765,284**	**$879,037**	**$902,309**	**$941,682**	**$966,063**	**$1,058,968**	**$1,089,639**	**$1,183,382**	**$1,687,430**

Source: Port of Oakland, consolidated audited financial statements for fiscal years 1990–91 through 1999–2000.

Operating Statement	1990–91	1991–92	1992–93	1993–94	1994–95	1995–96	1996–97	1997–98	1998–99	1999–2000
Operating revenue	$98,038	$107,389	$118,715	$120,805	$133,474	$143,860	$149,918	$157,838	$162,903	$172,725
Operating expenses	(72,499)	(55,920)	(58,310)	(67,693)	(71,486)	(76,476)	(79,121)	(84,094)	(93,109)	(90,830)
Depreciation and amortization	(21,172)	(21,700)	(23,211)	(23,892)	(30,242)	(31,046)	(32,199)	(33,225)	(34,227)	(34,900)
Operating Income	**$4,367**	**$29,769**	**$37,194**	**$29,220**	**$31,746**	**$36,338**	**$38,598**	**$40,519**	**$35,567**	**$46,995**
Nonoperating income (expenses)	(21,701)	(19,720)	(18,533)	(15,917)	(21,171)	(27,864)	(27,432)	(23,028)	(18,551)	(23,970)
Net Income Before Extraordinary Items	**(17,334)**	**10,049**	**18,661**	**13,303**	**10,575**	**8,474**	**11,166**	**17,491**	**17,016**	**23,025**
Extraordinary items	(839)	573	(5,552)	0	0	0	0	0	0	0
Net Income (Loss)	**$(18,173)**	**$10,622**	**$13,109**	**$13,303**	**$10,575**	**$8,474**	**$11,166**	**$17,491**	**$17,016**	**$23,025**
Rate of Return*	-2.67%	1.47%	1.59%	1.49%	1.15%	0.89%	1.10%	1.63%	1.50%	1.60%

Source: Port of Oakland, consolidated audited financial statements for fiscal years 1990–91 through 1999–2000.

* Auditor calculated rate of return by dividing net income by average total assets.

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Agency's comments provided as text only.

Port of Oakland
530 Water Street
Oakland, CA 94604-2064

October 10, 2001

Elaine Howle
California State Auditor
Bureau of State Audits
555 Capitol Mall, Suite 300
Sacramento, CA 95814

SUBJECT: PORT OF OAKLAND RESPONSE AND COMMENTS

Dear Ms. Howle:

The Port of Oakland is pleased to have an opportunity to respond to the findings of the audit conducted by the Bureau of State Audits. As the Port of Oakland experiences unprecedented growth and embarks on an aggressive expansion plan to meet those demands, it is critical that the State have an understanding of the Port, its operations, and economic impact. We trust that the audit provided the critical information needed by the State in its evaluation of the Port's significant value and impact. With respect to the State's findings and recommendations regarding the Commercial Real Estate Division, we offer the following comments:

1. Execution and implementation of the Restructure & Development Plan is well under way. All elements of the Plan are being aggressively executed.

2. Any perceived delays in execution and implementation of the Plan have been either a result of the challenges associated with managing a large and visible public agency with a diverse group of stakeholders and/or decisions made by the Port to address the goals and objectives of our Port-wide Mission and Strategic Plan. Examples of these decisions include the policy to lease real estate at below-market rates for public use and benefit as shown in the audit report Table 4 — Estimated Fair Market Value of the Real Estate Division's Below-Market Lease Properties.

We trust that these comments are responsive to your findings and hope that your audit of the Port of Oakland provides the State of California with the information necessary to evaluate and concur with our belief that the Port of Oakland plays a critical role in not just the San Francisco Bay Area economy, but also that of our entire State.

Sincerely,

(Signed by: Tay Yoshitani)

Tay Yoshitani
Executive Director

cc: Members of the Legislature
Office of the Lieutenant Governor
Milton Marks Commission on California State Government Organization and Economy
Department of Finance
Attorney General
State Controller
State Treasurer
Legislative Analyst
Senate Office of Research
California Research Bureau
Capitol Press