PORT OF OAKLAND

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

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Port of Oakland's response as of December 2002

Audit Highlights . . .

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.*

Overall, the Port of Oakland (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, its inability to control its high operating costs, and the Port's decision to lease certain real estate division holdings to public and nonprofit entities 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 had to revise its expansion plan to curb costs when updated construction cost projections proved higher than expected. In addition, an appellate court decision will require the Port to develop a supplemental environmental impact report that will result in added time and expense. Finally, the terrorist attacks of September 11, 2001, could result in costly changes to airport security.

Finding: The real estate division's consistent losses have been due to costly public services, high operational expenses, and some ill-fated business decisions.

Despite two studies and an action plan adopted by the Board of Port Commissioners (board), the real estate division has taken few steps to alleviate the financial drain it has had on the Port's overall operations. From fiscal year 1990–91 through 1999–2000 the real estate division lost between $4.3 million and $12.4 million, 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 value. The second relates to the high operational costs associated with 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.

We recommended that, 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 to improve revenues and reduce operating costs that was approved by the board in 1999.
- Examine the feasibility of increasing below-market lease rates to at least cover its operational costs without harming 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.

Port Action: Partial corrective action taken.

The Port reports that its real estate division has accomplished several items included in its 1999 action plan and is currently working towards completing several others. Specifically, the division has sold four buildings in Jack London Square and entered into a management agreement to transfer the management of the entire Jack London Square portfolio to a partnership group. The Port stated that this transaction should improve the operational efficiencies of the real estate division. The division is also moving forward with the phase II development of Jack London Square and recently released a request for proposal for a management company to take over managing the division's Marina portfolio of properties.

Further, the Port reports that its real estate division is not going to pursue any new "below market" transactions and will attempt to restructure its leases with the city of Oakland as opportunities arise for land being used for municipal services. However, the Port stated it does not feel that restructuring the below market leases related to public access and recreational benefits as a way to increase the division's revenue would be feasible. Finally, the real estate division reported land sales totaling $19.5 million in fiscal year 2001–02 and $5.6 million thus far in fiscal year 2002–03. The Port stated that the proceeds of all such sales would be used to fund the real estate division's capital improvement and infrastructure projects.