



Executive Director's
Report to the
Board of Harbor Commissioners

DATE: FEBRUARY 8, 2017

FROM: WATERFRONT & COMMERCIAL REAL ESTATE

SUBJECT: RESOLUTION NO. _____ - APPROVAL OF ANNUAL BUDGETS COVERING FISCAL YEARS 2014/2015, 2015/2016 AND 2016/2017 FOR WESTREC MARINA MANAGEMENT, INC. UNDER AGREEMENT NO. 13-3125

SUMMARY:

Staff requests approval of the annual budgets for Fiscal Years (FY) 2014/2015, 2015/2016 and 2016/2017 under Agreement No. 13-3125 (Agreement) between Westrec Marina Management, Inc. (Westrec) and the City of Los Angeles Harbor Department (Harbor Department). The Agreement provides for the operation, management, and maintenance of the Cabrillo Way Marina (CWM) and its structures/facilities located in San Pedro on behalf of the Harbor Department.

The Agreement has a five-year term (July 1, 2013 through June 30, 2018), with two five-year option periods to extend the term. Exhibit B: Scope of Work of the Agreement requires the Operator (Westrec), with input from the Harbor Department, to prepare an annual budget for operation of the marina for approval by the Harbor Department. The first proposed annual budget for FY 2013/2014 was approved at the Agreement's inception and was provided as an estimate of the proposed revenues and expenses. The initial expense and revenue budgets were produced as part of a competitive Request for Proposal (RFP) process in which Westrec was the successful proposer.

RECOMMENDATION:

It is recommended that the Board of Harbor Commissioners (Board):

1. Find that the proposed action is exempt from the requirements of the California Environmental Quality Act (CEQA) under Article II Section 2(f) of the Los Angeles City CEQA Guidelines as determined by the Director of Environmental Management;
2. Approve the Westrec Marina Management, Inc. annual budget for Fiscal Years 2014/2015, 2015/2016, and 2016/2017 under Agreement No. 13-3125; and
3. Adopt Resolution No. _____.

SUBJECT: APPROVAL OF ANNUAL BUDGETS FOR WESTREC MARINA MANAGEMENT, INC. UNDER AGREEMENT NO. 13-3125**DISCUSSION:**

Proposed Action – Staff requests Board approval of the annual budgets for FYs 2014/2015, 2015/2016 and 2016/2017. An analysis of future expenditures and revenues was conducted, and it was determined that the proposed annual budget is appropriate for CWM. CWM's first year's proposed budget for 2013/2014, as well as its actual expenses and revenue, are provided in Transmittal 1. This initial 2013/2014 budget was approved by the Board along with the Agreement with Westrec. The 2013/2014 budget was based on the proposal Westrec submitted during the 2010 competitive RFP process in which Westrec was selected as the successful proposer. Annual budgets thereafter were to be approved by the Board. CWM's proposed operating budget covering FYs 2014/2015, 2015/2016 and 2016/2017, as well as actuals for 2014/2015 and 2015/2016, are provided in Transmittal 2.

Budget Process Summary – Pursuant to the terms and conditions of the Agreement, Westrec is required to submit its proposed annual budget to the Harbor Department for approval by December 1st of each year. Although Westrec submitted its proposed budget annually for FYs 2014/2015, 2015/2016 and 2016/2017, the budgets were not presented to the Board for approval at either of those times. The delay was due to a misinterpretation of the approval process, as well as changes in the Real Estate Division's staffing. Additionally, gathering and reviewing the supporting documentation from Westrec for the 2014/2015, 2015/2016, and 2016/2017 budget periods has been a lengthy process that commenced in May 2016. Staff has since implemented an annual reminder notification procedure to ensure adequate time is allotted to meet the annual budget approval schedules.

Background – The Agreement was approved by the Board at its meeting on June 6, 2013, and allows Westrec to operate, manage, and maintain the Harbor Department's CWM, effective July 1, 2013 through June 30, 2018, with two five-year option periods to extend the term. Westrec manages CWM as a fee operator while passing through all expenses and revenue to the Harbor Department. CWM consists of approximately 64.14 acres of land and water in San Pedro, currently with 697 recreational berthing slips, 400 dry boat storage stalls, two cranes for boat hoisting, pump out stations, parking lots, promenades, boater facilities, and public restrooms. As part of a development project, CWM was constructed in an area that included an existing marina with existing slip tenants. All improvements are owned by the Harbor Department and maintained by Westrec.

Existing Slip Tenants – Pursuant to the terms and conditions of the Agreement, Westrec is required to annually phase in slip rate increases for the former slip tenants displaced during construction of the CWM to gradually bring those tenant's slip rates up to market. Boat slip tenants entering CWM after August 1, 2010 were charged market rates, including annual increases. The phasing of rental adjustments for the former boat tenants will be completed by June 2017, at which time all tenants will be charged the same slip rates. Slip and dry boat storage rates are based on the overall length of a vessel or slip, whichever is greater.

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Operating Expense and Revenue Summary – Annual operating expenses include, but are not limited to, a four percent monthly management fee of the gross slip and dry storage rents collected, staffing expenses, including salary, benefits, and the required annual living wage ordinance increases, sub-contracting, insurance, maintenance, and security. Annual revenues include slip rent, dry boat storage rent, guest slip fees, laundry machine coin collections, storage locker fees, vending machine income and interest income. Under the Agreement, Westrec submits monthly gross receipts reports, along with financial and bank statements. These reports include the monthly revenue received and monthly operating expenses.

Start-Up Budget - At the inception of the Agreement, Westrec was provided a start-up budget of \$364,000 to be allocated within the first two years of operation; \$244,000 in FY 2013/2014 and \$120,000 in FY 2014/2015. However, not all funds were expended within the first two-year period of operation due to delays in starting up the dry boat storage operations. Start-up funds were and are used for office equipment, dry boat storage start-up operations, storage sheds/containers, and a variety of materials, equipment, and supplies. Additionally, Westrec was required to complete construction projects that weren't completed at the time the marina was turned over to the Harbor Department. The remaining start-up budget funds are to be expended in years three and four. Westrec provided documentation supporting its start-up expenditures, which are outlined below.

Start Up Expenditures		
Year	Amount	
	\$ 364,000	Summary of Expenses
2013/2014	\$ 181,578	Office furniture/equipment, storage sheds/racks, dock carts, various parts and equipment
2014/2015	\$ 15,962	Dry boat storage electrical panels, storage containers, crane parts
2015/2016	\$ 91,280	40' containers, storage sheds, cement/masonry work
Total	\$ 288,820	
Balance	\$ 75,180	Remaining Balance to be expended in FY 2016/2017

Budget Review Process - Staff recently initiated and completed an extensive review and analysis of the past, current, and future year's budget and found the annual budgets to be satisfactory. Westrec provided documentation to support the proposed budgeted items, including detailed information when budget variances were noted. This review determined that expenses and revenues are in line with CWM's operational capacity.

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During staff's review of the proposed budget for 2016/2017, significant variations from the initial year's budget were noted in several budget line items which required additional justification and supporting documentation. Those line items include budget categories under the proposed operating expenses and proposed revenues. Regarding expense categories, Westrec provided adequate explanation for each line item in question, and it was determined that those budget allocations were justified. Additional justification for revenue budget projections are provided below.

PROPOSED OPERATING BUDGET				
2016/2017 JUSTIFICATION				
Description	Year 3 FY 2015/2016		Year 4 FY 2016/2017	Justification
	2015/2016 (Proposed)	2015/2016 (actuals)	Proposed	
Expenses				
Maintenance and Repairs:				
Equipment	\$ 28,275	\$ 16,516	\$100,000	Purchase/installation of a 3rd crane to accommodate the demand that can't be fulfilled with the 2 existing cranes.
Supplies	\$ 12,485	\$ 903	\$14,600	Purchase/installation of gangway circuit boards and to have an inventory on hand to replace when needed as they malfunction often
Lighting	\$ 1,912	\$ 1,510	\$135,000	Increase is based on an annual maintenance and replacement of bulbs/ballast as this service will now be assumed by Westrec instead of POLA's C&M
Filters	\$ -	\$ 1,470	\$13,482	Inspection and cleaning of the storm water filters throughout the marina. A complete cleaning/replacement is required every other year
Grounds	\$ 65,725	\$ 87,229	\$39,725	Maintenance of the promenade, including tables, benches and trash receptacles all of which deteriorate quickly due to exposure to the elements and the type of materials (wood railing); animal trapping
Office Supplies	\$ 22,260	\$ 64,942	\$77,419	Office supplies for the marina operations office, include credit card merchant fee, bad debts, uniforms, printing, stationery, postage, mileage, memberships, drug testing/background checks. The most expensive of the items is credit card merchant fees that have risen over the past year due to increased credit card use.
TOTAL EXPENSES	\$ 130,657	\$ 172,570	\$380,226	

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Operating Expense Percentage Ratio - The marina industry standard for operating expense percentage ratios, which includes both public and privately-owned marinas, is typically 56 percent of revenues received with a net income of 44 percent, excluding rent payments to municipal landlords. Although this standard is used as a general performance metric, actual performance of individual marinas will vary based on many factors including local market conditions, proximity to open water, land to water ratio, configuration, slip size mix, age and physical condition. In the CWM context, the marina is negatively affected by a general oversupply of slips in the market area, high land to water ratio and slip mix favoring larger slips. CWM is positively affected by its close proximity to open water, age, and physical condition.

For FY 2015/2016, CWM expenses were at 62 percent of revenues with a net income of 38 percent. Outside of the above unique marina characteristics, CWM's below industry standard ratio is due to the marina continuing through the initial stabilization period and associated occupancy of 57 percent, as well as approximately 150 slip tenants which initially transferred from the former marina paying lower rates than those slip tenants occupying slips after August 1, 2010. It is anticipated that after CWM achieves occupancy ratios in line with neighboring marinas, and all the reduced slip tenant rates are phased out in June 2017, percentage ratios will stabilize in line with industry standards.

Gross Revenue Performance and Projections - The variation between the proposed revenue and actual revenue over the initial three fiscal years is due to several factors that resulted in overestimation of expected gross revenue primarily from wet slips.

Following the economic recession of 2008, the pace of the projected recovery did not materialize as quickly as expected. The slower than expected recovery negatively affected gross revenue projections for wet slip occupancy within CWM as discretionary income spent on recreational boating did not rebound as anticipated. Westrec relied on both published market trend projections and surveys of boat brokers to make a reasonable projection of revenue growth over the first three years of the Agreement. Westrec relied on this information to determine that the market for larger boats was improving both for the 2014/2015 and 2015/2016 annual budgets. The pre-recession market trend for marina slip demand also favored larger boats, which was mirrored in the CWM design which includes 50 percent of all wet slips being 45 feet or larger. However, the market for larger boats was slow to improve while the market for smaller boats improved unexpectedly faster as indicated by the dry boat storage facility reaching full occupancy by June 30, 2016, which was two years faster than expected. The assumptions regarding stronger demand favoring larger slips and a slower general economic recovery resulted in significant overestimations of gross revenues for wet slips in both the 2014/2015 and 2015/2016 proposed budgets. The 2016/2017 budget proposal benefits from three full years of actual absorption history. This fiscal year's revenue projection has taken into account the slower recovery and shift in market demand and as a result is expected to be more accurate than past year's projections.

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The Agreement also mandated that Westrec, over a five-year period, bring boaters carried over from the previous marina up to market rental rates. The year over year rate increases varied from 10 to 17 percent annually depending on slip size. Westrec underestimated the amount of existing slip tenants that would vacate as a result of these annual increases in both 2014/2015 and 2015/2016. Westrec expected approximately 10 percent attrition to occur over the course of the first four years, however, the actual attrition rates for this group of slip tenants has been 60 percent with 90 of 150 slip tenants from the old marina leaving up to the present date. The variance between projections and actual results occurred due to an underestimation in boater sensitivity towards the automatic rate increases that was compounded with neighboring Marina's having the flexibility to competitively set pricing to attract this group of boaters as well as others.

The rate increases for CWM for both slip tenants of the previous marina and new wet and dry slip occupants are strictly prescribed in the contract. Westrec does not have the ability to alter these annual rate adjustments, which has also affected annual gross revenue projections that included an assumption that competing marinas would also implement annual rate increases.

Summary of Financial Performance - Total annual revenue is expected to average \$3,687,501 over the three fiscal year periods, and expenses are expected to average \$2,254,143 (actuals for 2014/2015 & 2015/2016 and proposed for 2016/2017), with an annual operating income to the Harbor Department averaging \$1,433,358. As mentioned above, operating expense percentage ratios are expected to achieve market standards following stabilization of CWM which should occur by the close of FY 2017/2018 within the first five years of full operations. Despite overestimated revenue projections, Westrec has been successful in substantially increasing net operating income to the Harbor Department on a year over year basis with net operating income increasing by 45 percent in FY 2015/2016 and projected to increase 26 percent in FY 2016/2017.

Current Operator Compensation – On a monthly basis, Westrec deducts its four percent management fee as an operating expense from the revenue generated from slip and dry boat storage rents collected, which on average is approximately \$147,351 per year over the past three-year budget periods.

ENVIRONMENTAL ASSESSMENT:

The proposed action is approval of the annual budgets under the Agreement between Westrec and the Harbor Department for the operation, management, and maintenance of CWM. As an administrative activity, the Director of Environmental Management has determined that the proposed action is exempt from the requirements of CEQA under Article II Section 2(f) of the Los Angeles City CEQA Guidelines.

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FINANCIAL IMPACT:

Based on the proposed budget and actuals for the periods of 2014/2015 and 2015/2016, the Harbor Department had a realized operating income of \$2,460,188 for that two-year period and is expected to net \$1,839,887 for FY 2016/2017 based on the estimated revenue and the proposed 2016/2017 budget. These calculations are outlined below:

Budget Year	Revenue	Expenses*	Operating Income to POLA
2014/2015	\$2,744,033	\$1,739,183	\$1,004,850
2015/2016	\$3,825,625	\$2,370,287	\$1,455,338
2016/2017 (Estimated & Proposed)	\$4,492,845	\$2,652,958	\$1,839,887
Total	\$11,062,503	\$6,762,428	\$4,300,075

*Includes Westrec's four percent management fee

CITY ATTORNEY:

The Office of the City Attorney has reviewed this Board report and has no legal issues at this time.


TRANSMITTALS:

1. Proposed Budget FY 13/14 vs. Actuals
2. Proposed Budget FY 14/15, FY 15/16 vs. Actuals; Proposed Budget FY 16/17




MICHAEL J. GALVIN
Director of Waterfront & Commercial Real Estate

FIS Approval: ML (Initials)
CA Approval: MB (Initials)



FOR MICHAEL DiBERNARDO
Deputy Executive Director

APPROVED:



FOR EUGENE D. SEROKA
Executive Director