

PORT OF SEATTLE
MEMORANDUM

COMMISSION AGENDA
ACTION ITEM

Item No. 6a
Date of Meeting May 24, 2016

DATE: May 15, 2016
TO: Ted Fick, Chief Executive Officer
FROM: Paula Edelstein, Senior Director, Human Resources
Tammy Woodard, Assistant HR Director – Total Rewards
SUBJECT: Second Reading and Final Passage, Resolution 3720, Amending Resolution 3712 as amended, 2016 Salary and Benefits Resolution

ACTION REQUESTED

Request Second Reading and Final Passage of Resolution No. 3720: A resolution of the Port Commission of the Port of Seattle amending Resolution No. 3712 as amended, the 2016 Salary and Benefits Resolution, to modify the Pay for Performance program to add a lump sum incentive pay plan component to the existing base pay increase component.

SYNOPSIS

Port staff is proposing an Incentive Pay Plan for non-represented employees. This plan will be in addition to the existing Pay for Performance plan that rewards employees based on their performance review ratings with base pay increases. The plan will be effective June 1, 2016.

The proposed plan will support Port employees working together as One Port for the benefit of the region, it will be self-funding and not add to fixed salary costs, will be socially responsible, and will include non-financial goals that are results oriented, values driven, and Century Agenda focused. The non-financial goals will also provide opportunities for employees across the Port to have an impact. Importantly, the plan will reward results, not efforts toward results.

The proposed Incentive Pay Plan will also support the Port's attraction and retention efforts by adding a component to the pay program that is very common in private industry where 93% of employers offer something similar. This plan will also create a competitive advantage for the Port among public sector employers. Nationally, about half the government employers responding to an incentive pay survey reported offering some sort of plan while about 25% of airports offer this type of plan and about 22% of ports offer a similar plan. The proposed plan will particularly distinguish the Port among local public employers where these types of plans are uncommon.

The amendment to the 2016 Salary and Benefits Resolution will specify that the Pay for Performance program has two components, the base pay increase component and the new lump

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sum Incentive Pay Plan component. The amendment will also include the plan's non-financial goals for 2016 and will specify a maximum Incentive Pay Plan payout for the 2016 plan year.

BACKGROUND

Business Case

The business case for the proposed Incentive Pay Plan is compelling; when the Port achieves exceptional performance our community wins through job creation, economic development, and environment and sustainability improvements. Incentive pay plans provide an opportunity for employers to directly link business outcomes and employee performance. These plans provide rewards to employees that are usually financial, cash, and paid as a lump sum based on the organization achieving and surpassing predetermined goals. The awards these plans pay are determined each year and do not carry forward from one year to the next. As such, they are self-funding and do not add to fixed payroll costs.

These type of pay plans are a competitive practice among both private and public employers. By offering an Incentive Pay Plan the Port will be better able to compete with private industry employers for skilled employees with the talents essential to achieving the Century Agenda and meet other key Port goals. This is important as the Port attracts job applicants from both public and private sector employers. In 2015 about 75% of our new hire employees came from private industry employers. While an Incentive Pay Plan will help the Port compete with these private employers for employee talent, it will also differentiate us among public sector employers where these types of plans are less common than among private sector employers. The following table illustrates the prevalence of incentive pay plans on a national level.

PREVALENCE OF INCENTIVE PAY PLANS		
Industry	Percent of Employers Offering	Data Source
All Industry	93%	Aon Hewitt book of business
Public Sector	55%	WorldatWork, 2016 Survey
Airports	25%	ACI 2015/2016 Survey
Seaports	22%	AAPA 2015 Survey

Among local government employers incentive pay plans are rare. Several local government employers have implemented them only to eliminate them after several years. Currently, a plan at the Wastewater Division of King County that is being phased out is the only plan we were able to identify.

Goals and Incentive Pay Plan Funding

Financial and non-financial goals are the basis for incenting the organization to deliver exceptional performance. The plan defines performance through a socially responsible lens by rewarding employees for achieving financial and non-financial goals.

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Non-Financial Goals

The Incentive Pay Plan included in the proposed Salary and Benefits Resolution Amendment will support a balanced approach to goals. Non-financial goals will be values driven, results oriented strategically important and Century Agenda focused to support employees working together as One Port for the benefit of our community. These goals will also be stretch goals that are realistic and measurable, yet they will require focused effort to achieve them. A very important consideration of the non-financial goals is that employees across the Port will have opportunities to impact them. The resolution states that CEO shall report to Port Commission the progress toward incentive pay plan goals in August.

We are proposing three non-financial goals each year, and achieving at least two of them together with the financial goal is required for an Incentive Pay Plan payout to be earned. We are proposing first year non-financial goals in the following areas:

1. **Small Business and WMBE Participation**

This goal will build on existing contracting efforts and elevate the importance and visibility of this goal to all employees.

2. **Customer Satisfaction and Public Engagement**

This goal will bring a Port-wide, One Port, focus to customer satisfaction.

3. **Environmental Stewardship**

This goal will focus on a One Port approach to reducing the Port's environmental footprint print.

The proposed specific goals are as follows:

Goal 1 – Small Business and WMBE Participation

- a. Increase small business contracting participation Port-wide, as defined by the U.S. Small Business Administration guidelines to 35%, including the sub-goal of a 50% increase (over 2015) of certified Washington State Office of Minority and Woman's Business Enterprises to 5.1%.
- b. By November 1, 2016, assess all Port efforts geared to promoting small and WMBE business participation and provide a report to the Commission rating the effectiveness of each and providing specific recommendations for improvements for Commission consideration.

Goal 2 – Customer Satisfaction and Public Engagement

- a. Quantitatively and qualitatively assess customer satisfaction of all segments of non-aviation customers to measure satisfaction with Port services and facilities; and identify specific areas for improvement.
- b. Improve aviation customer overall satisfaction, as measured by the Airport Service Quality (ASQ), from 4.07 to 4.13.
- c. Assess within our jurisdiction public and other local government understanding of the Port and our role in the regional and local economy.
- d. By November 1, 2016, provide a report to the Commission that includes:
 - i. Benchmarks for future goal setting to improve satisfaction with Port services and facilities.

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- ii. Strategies to improve the ASQ.
- iii. High impact actions and programs to improve public and other local government understanding of the Port and our role in the regional and local economy.

Goal 3 – Environmental Stewardship

- a. Develop and ensure Port-wide implementation of an environmental scorecard that measures the Port’s environmental footprint and that will serve to guide and monitor reduction efforts in all Port operating and non-operating divisions.
- b. By November 1, 2016, assess potential opportunities for increasing the use of renewable energy and reducing greenhouse gas emissions at Port owned facilities and report findings and recommendations to the Commission for consideration.

Financial Goal and Plan Funding

In addition to the non-financial goals, the plan will have a financial goal. The financial goal will be to achieve positive budget variances in total Port adjusted revenues (as defined below) and reduce Port-wide expenses sufficient to fund at least the minimum level Incentive Pay Plan payout. Using the 2016 approved budget and an estimated 2016 payroll for incentive eligible employees, Port staff modeled the funding necessary to pay an Incentive Pay Plan award at minimum payout. This level payout is estimated to require a payout pool of \$1.0 million and are an adjusted total positive variance of \$2.0 million. **Both the financial goal and at least two of the non-financial goals must be met for any payout to be earned.**

Adjusted revenues are derived by subtracting Aeronautical revenues from Total Port revenues. Aeronautical revenues are excluded because they are determined on a ‘cost recovery’ basis. In other words, the revenues are set to fully recover Aeronautical costs so as costs increase or decrease so do the associated revenues. Actual adjusted revenues less budgeted adjusted revenues yields the adjusted revenue variance.

Total actual Port expenses are then compared to total budgeted Port expenses. The difference is the total expense variance which is added to the adjusted revenue variance to determine the adjusted total budget variance. Half the total variance is retained by the Port and the other half funds the incentive payout pool. When the payout pool is sufficient to pay the minimum, or threshold, incentive plan award the financial goal is met. As the payout pool grows larger additional award levels may be achieved as described more fully below.

The financial goal formula is illustrated below.

	2016 Budget	2016 Actual*	Variance
Total Revenue	\$584.5m		
Less Aeronautical Revenue	\$257.4 m		
<i>Equals</i> Adjusted Revenue	\$327.1m	\$337.3 m	\$10.2 m
Total Port Expense	\$336.1m	\$324.7m	+ 11.4 m
Total Variance			= \$21.6m
<i>Half</i> Funds the Payout Pool			\$10.8m

*Note – 2016 Actuals are for illustrative purposes only

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There are a small number of expenditure categories that may be excluded from the Incentive Pay Plan variance calculations. These include unpredictable and non-controllable expenses such as reserves established for lawsuits and environmental remediation, non-cash expensing of prior year costs that had been capitalized when projects are cancelled, and major variances due to accounting rule changes. Also included in this small group of exclusions are significant cost savings due to major budgeted initiatives being cancelled or deferred. To provide transparency items subject to exclusion will be identified and noted during the annual budget development process. For 2016 these items will be identified and communicated when the plan is implemented.

Determining Individual Incentive Pay Plan Payouts

When the Incentive Pay Plan has been funded the payout pool needs to be distributed to employees. The plan is designed to have individual payout levels based on the size of the payout pool. The minimum, or threshold, funding level is the amount necessary to pay an earned award of 1% of employees' eligible earnings for employees receiving a *Strong* performance rating. The maximum, level 5, funding level is the amount necessary to pay an earned award of 10% of employees' eligible earnings for employees receiving a *Strong* performance rating. Regardless of funding level, employees' performance review ratings will inform the award each employee will receive. There are 3 additional funding levels between the minimum and maximum funding levels.

In addition, individual payouts will be determined for two groups, members of the Executive Leadership Team (ELT) and other eligible non-represented employees. The payout will first be set at the minimum step for employees. If there is sufficient funding in the payout pool to pay employees at Step 1 the payout step will increase. If there is still sufficient funding in the payout pool to pay members of the ELT at Step 1, that step will fund. If funds remain in the payout pool sufficient to pay employees at step 2 funding will increase, and if funds still remain ELT will receive Step 2 payouts. This pattern will continue until either insufficient funds remain in the payout pool to fund the next step or the maximum payout for all eligible employees is reached.

The following table illustrates how performance review ratings impact individual awards as well as what the awards would be at the minimum and maximum funding levels.

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Performance Rating	Guided Rating Distribution	Payout Factor	Minimum Payout	Step 1	Step 2	Step 3	Step 4	Maximum, Level 5, Payout
Unsatisfactory	0%	no payout	no payout	no payout	no payout	no payout	no payout	no payout
Contributing	0% -- 5%	1 X Payout	0.5%	1%	2%	3%	4%	5%
Strong	65% -- 70%	2 X Payout	1.0%	2%	4%	6%	8%	10%
Highly Effective	15% -- 20%	3 X Payout	1.5%	3%	6%	9%	12%	15%
Exceptional	5% -- 10%	4 X Payout	2.0%	4%	8%	12%	16%	20%

With the guided rating distribution included with PerformanceLink, the performance goal setting and review process, most employees are expected to earn a *Strong* performance rating. The performance rating distribution will be reviewed across the organization before it is finalized. The actual rating distribution vs. the guided distribution will be reported to the Commission, along with the Port's financial results, estimated Incentive Pay Plan awards before any incentive pay plan awards will be paid.

Implementation

Port staff is recommending June 1, 2016 as the implementation date for the Incentive Pay Plan. This will require adjusting 2016 year-end financial results to reflect the partial year the plan will be in effect. With the recommended June 1, 2016 implementation date 7/12 of the total year-end results will be eligible to determine payout pool. The following table illustrates how the 2016 pro-rating will work, using a \$21.6M adjusted total positive variance as an example. The actual adjusted total positive variance over the past 5 years has ranged from \$14.0M to \$31.0M so the example below is possible, but in the upper range of possibilities.

Possible 2016 year-end adjusted total positive variance	\$21.6 M
7/12 pro-rating applied to actual 2016 results	~58%
Variance eligible for Incentive Pay Plan calculations	\$12.6M
50% to the payout pool	\$6.3M
Estimated Incentive Pay Plan Funding Step	2.1
Estimated Incentive Pay Plan Payouts	0% to 8% for employees and executives

2016 Payout Pool Cap

In addition to pro-rating the adjusted total positive variance to reflect the partial year that the Incentive Pay Plan will be in effect for 2016, the payout pool will be capped at \$5.0 million for the 2016 plan year. Port staff is estimating the \$5.0 million cap will fund at step 2.1 or 4% for employees earning a *Strong* performance rating and a range of 0% to 8%.

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ALTERNATIVES AND IMPLICATIONS CONSIDERED

Alternative 1 – Support employee attraction and retention by increasing base pay ranges and actual employee pay levels.

Cost Implications: This alternative would add to fixed payroll cost rather than rewarding employees when the Port's financial performance produces sufficient funding to pay the rewards.

Pros:

- (1) This option will address the gap in total pay between the Port's pay program and programs of other, particularly private sector, employers that include an incentive pay plan.
- (2) Increasing base pay ranges and rates will help the Port attract and retain skilled and knowledgeable employees with the talents necessary to accomplish the Century Agenda and achieve other Port of Seattle goals.
- (3) Port staff conducted a survey in late January asking employees what form of award they would most prefer for contributing to the Port meeting or exceeding both financial and non-financial goals. Some employees indicated a preference for base pay increases over lump sum cash payments.

Cons:

- (1) Increasing base pay will also lead to increased benefits costs for benefits related to pay. Life insurance, disability insurance, Social Security taxes and PERS contributions are all benefits where Port costs are a percentage of pay.
- (2) Increasing base pay will add to the Port's fixed costs whereas an incentive pay plan that is self-funding and rewards results by paying awards only when financial and non-financial goals are met will not.

This is not the recommended alternative.

Alternative 2 – Move forward with the plan to implement the Incentive Pay Plan but postpone implementation to January 1, 2017.

Cost Implications: This alternative will have no financial impact for 2016 and will fund incentive awards in future years from positive variances against the Port budget.

Pros:

- (1) Postponing implementation of the Incentive Pay Plan would provide more time to educate employees about the plan, prepare ongoing communication plan, and establish the administrative systems and processes that will assist Port staff in administering the plan. While additional time to accomplish a task is always appreciated, it is not needed or even particularly beneficial in this case.

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- (2) Implementing at the beginning of the year would eliminate the need to pro-rate the Port's financial performance thus simplifying the first year's plan administration somewhat.

Cons:

- (1) Postponing implementation to 2017 could result in loss of employee engagement and confidence in the Incentive Pay Plan. Employees expressed excitement and interest in the plan through the Employee Feedback mail box last fall, attendance at the information sessions in January and participation in the 'form of award' survey in late January. Efforts already undertaken will need to be increased, and likely repeated, late in 2016 if the plan is not implemented until 2017.
- (2) The Port will continue to have a pay program that is not as competitive with private sector employers as it could be. Letting prospective employees know that we plan to implement an Incentive Pay Plan will not have the same immediate positive impact on recruiting and retention that being able to communicate an approved and ready to implement plan will.

This is not the recommended alternative.

Alternative 3 – Adopt the Incentive Pay Plan with a June 1, 2016 effective date by approving an amended 2016 Salary and Benefits Resolution authorizing the plan.

Cost Implications: Costs associated with this alternative will be funded with total positive variances against the Port budget.

Pros:

- (1) Implementing the Incentive Pay Plan June 1, 2016 will permit the Port to communicate the plan, how it will be funded and how pay outs can be earned immediately. This will increase the value of the Port's Total Rewards Package for both current and prospective employees.
- (2) Implementing the plan now, following the communication and outreach to employees that has taken place over the past several months will permit the Port to build on the excitement and engagement around the plan and increase the likelihood of achieving all the 2016 goals of the plan.
- (3) Implementing the plan now will help immediately focus employees on the financial and non-financial goals in a new way.

This is the recommended alternative.

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ATTACHMENTS TO THIS REQUEST

- Draft Resolution No. 3720 amending Resolution No. 3712, 2016 Salary and Benefits Resolution.
- Computer slide presentation

PREVIOUS COMMISSION ACTIONS OR BRIEFINGS

- April 12, 2016 – The Commission received a briefing on a proposed Incentive Pay Plan for 2016.
- December 8, 2015 – The Commission adopted Resolution No. 3712, the 2016 Salary and Benefits Resolution, as amended to include a section for one-time special pay.
- November 24, 2015 – Resolution No. 3712 was laid on the table prior to obtaining Second Reading.
- November 10, 2015 – The Commission passed Resolution No. 3712, the 2016 Salary and Benefit Resolution, on First Reading.