Item No. 9a
Meeting Date: October 22, 2019

Financial Policy Update

October 22, 2019

Port of Seattle

Overview

Background

- Motion 2018-14
- Purpose of Financial Policies
- Financial Policy Process

1. Capital Investment Program (CIP) Reserves
2. Non-Airport Debt Service Coverage

Motion 2018-14 Section 6

- Identify financial policies to be reviewed and updated
- Review management of capital contingencies and reserves
- 2020 Budget document to include a policy on capital contingencies and reserves

Purpose of Financial Policies

- The primary purpose is prudent financial management
  – Provides for financial sustainability to achieve Port’s objectives
  – Promotes stewardship of public resources
  – Provides flexibility to withstand adverse circumstances
  – Manages risk
- A secondary purpose is to maintain the Port’s access to credit
  – Policies support the Port’s strong credit ratings
  – Enables the Port to get competitive rates on debt (lower costs)

Financial Policy Process

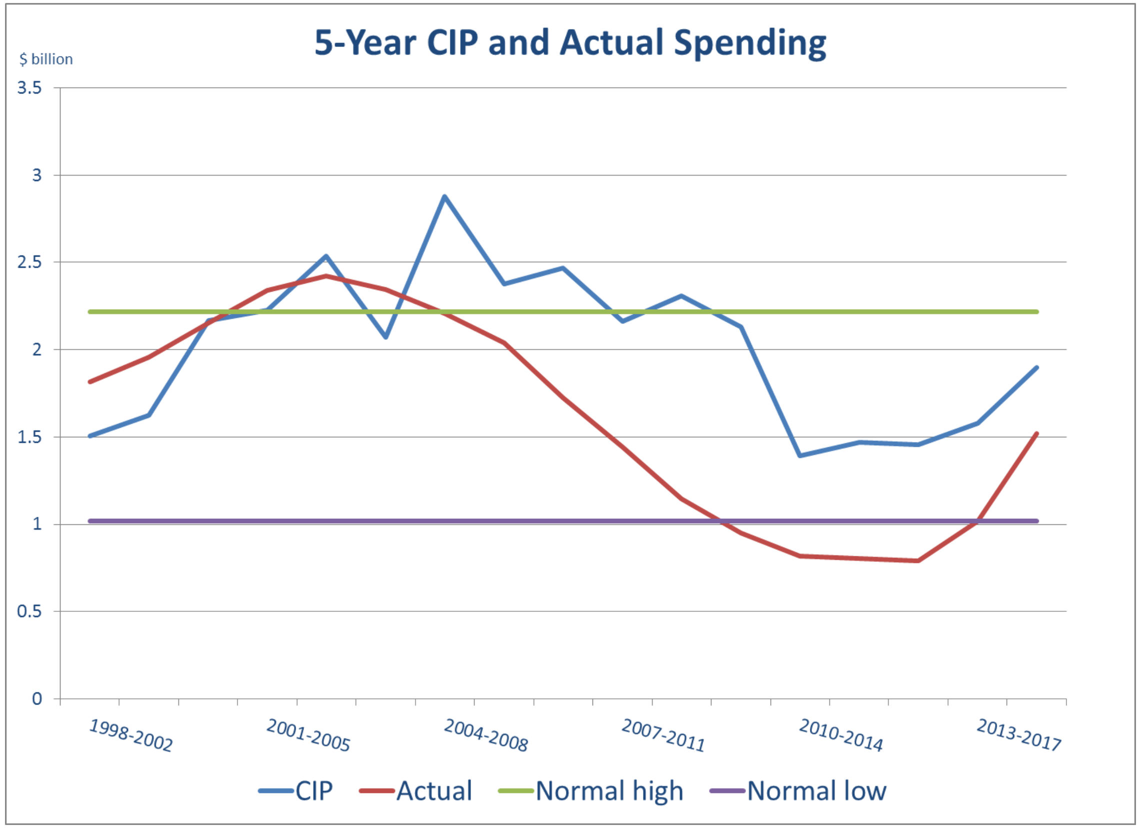
- Port develops financial policies and tools based on holistic approach
  - Best practices
    - Government Finance Officers Association (GFOA) develops and publishes best practices and guidelines
    - Other industry groups: ACI, AAPA, AICPA, GASB
    - General financial management theory from academia and industry associations like Association of Financial Professionals
  - Peer review
    - Survey finance colleagues at other airports and seaports
    - Outreach to other large local governments
  - Port specifics
    - Analyze Port data trends
    - Consult with outside experts, e.g. financial advisor, external consultants
    - Adapt as appropriate to best ensure Port financial sustainability

1. CIP Reserves

- Best Practices and Peer Review insights
  - Recommended as part of a conservative budget process
  - No standard approach
  - Provides flexibility to manage the unknown
  - Use to smooth cash flows within five-year CIP
- Internal Analysis
  - Port staff reviewed twenty years of historical CIP data
  - Insights help inform development of a CIP Reserve

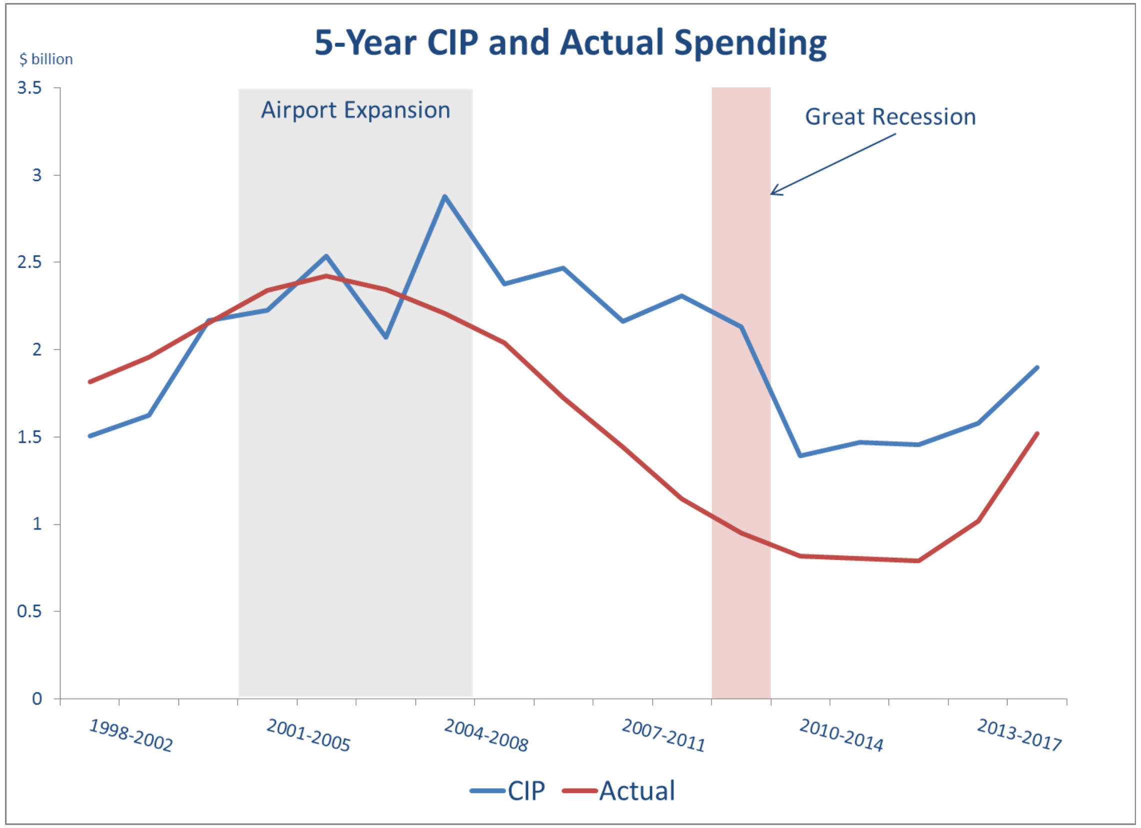
Capital Spending Trends

Normal range (1) has varied by $1.2 billion
Average spending has been 80% of CIP

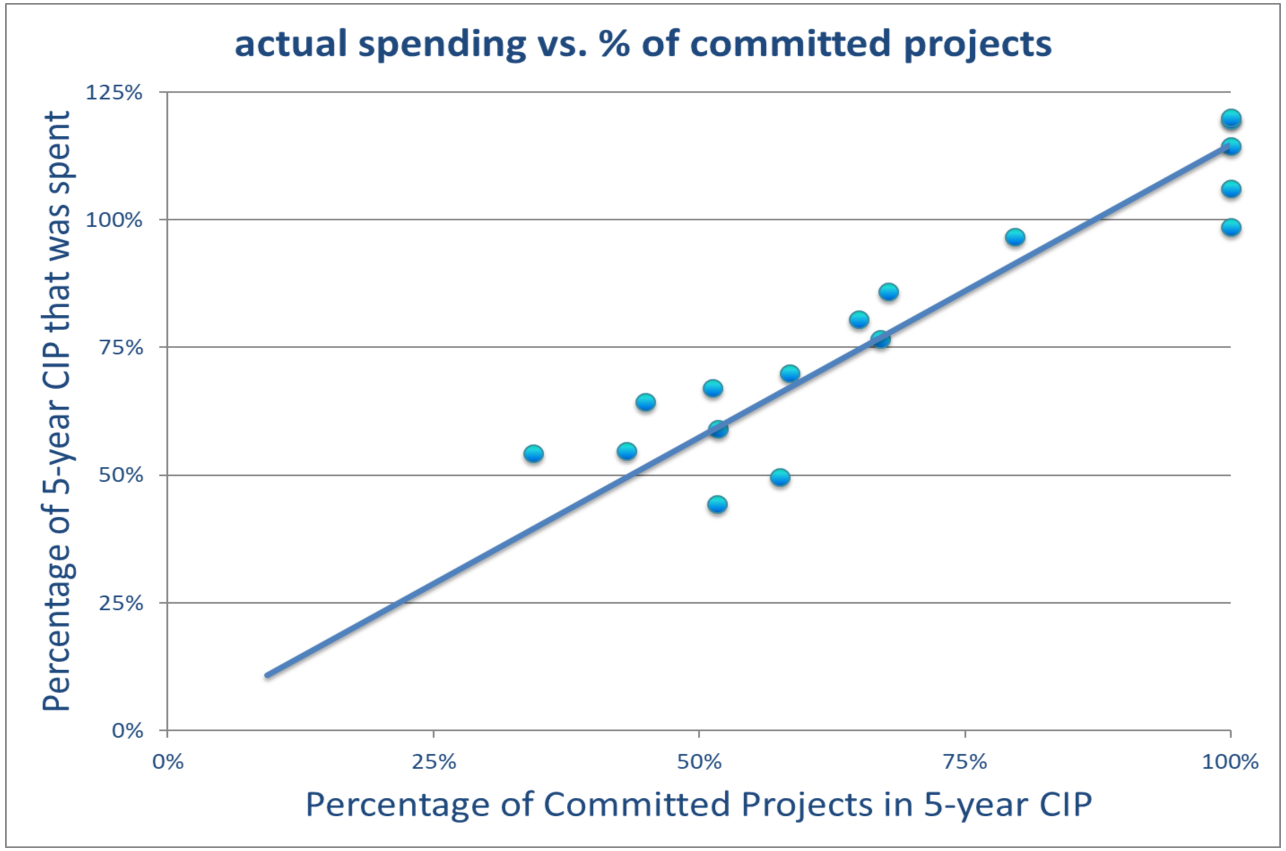


(1) Within one standard deviation

Spending fluctuates depending on capital cycle and unknowns



Correlation: The More "Committed" Projects in a CIP, the More Accurate the CIP Forecast



Each dot represents a 5-year CIP

- During the planning periods of the capital cycle fewer projects have a "Committed" status
- A higher percentage of "Business Plan Prospective" projects in a CIP, the more opportunity for course correction

Business Plan Prospective = Status 2
Committed = Status 3-5

Reserve Development Practice

- Staff will take the trend analysis into account to develop CIP reserves
  - This may include a cash flow adjustment to better reflect more achievable levels of capital spending
  - This year's CIPs will incorporate this practice
- In addition to CIP Reserves, individual projects will continue to include project contingencies
  - Established by project management based on best practices
  - No change recommended at this time

CIP Reserve Policy Applied

Central Services CIP ($ million)						
Original CIP - Presented Sept. 24	**2020**	**2021**	**2022**	**2023**	**2024**	**TOTAL**
Projects	20.0	5.9	4.4	4.8	5.0	40.2
CIP Reserve	-	3.5	5.0	5.0	5.0	18.5
Total CIP	20.0	9.4	9.4	9.8	10.0	58.7
Revised CIP						
Projects	20.0	5.9	4.4	4.8	5.0	40.2
CIP Reserve	-	-	1.0	1.0	1.0	3.0
CIP Cash Flow Adjustment	(5.0)	2.0	1.0	1.0	1.0	-
Total CIP	15.0	7.9	6.4	6.8	7.0	43.2

Trend and project status analysis resulted in both a reduction in CIP Reserve amount and a cash flow adjustment

Staff Recommendation

- Add the following policy to the 2020 Preliminary Budget:

"Capital Improvement Plan (CIP) Reserve: The Capital Improvement Plan may include one or more CIP reserves to ensure funding capacity for unspecified projects (e.g. renewal and replacement), new initiatives and unforeseen needs. However, CIP reserves are not intended to anticipate all potential future spending and amounts will be determined by considering the data on historical capital trends, existing asset conditions, the status (level of certainty) of CIP forecasts, and any contingent risks that may require funding. The use of CIP reserves will be reviewed with the Commission annually during the budget process."

2. Non-Airport Debt Service Coverage

- Review conducted in 2018
- Management coverage targets last revised in 2005
  - Measure of net income divided by revenue bond debt service
  - Airport: 1.25x
  - Non-Airport: 1.50x
  - Difference reflects the relative business risk
- **Management target is not the Port legal requirement promised to investors**

Best Practices and Peer Review

- Debt service coverage is a significant measure of financial resiliency
- Important to investors and credit rating agencies
- Survey of other seaports:
  - Targets generally range from 1.8 – 2.0x
  - Port of Tacoma uses 2.0x

Seaport Business Risk Has Increased Since 2005

- Changes in the container terminal business have put pressure on net income
- Trend analysis shows that net income for non-Airport businesses has fluctuated in recent years from
  – A low of $50 million in 2013 to
  – A high of $69 million in 2016
- **A higher coverage target would provide stronger cash flow to withstand adverse conditions and better manage risk**

Staff Recommendation

- Change Non-Airport revenue bond debt service coverage from 1.50x to 1.80x
  - Consistent with large peer ports
  - Shifts available funding from debt to cash
  - Reduces funding capacity in the short term; increases it in the long term
  - No funding impact until 2023, first year of capacity for new bonds
- No recommended change to Airport coverage at this time
- Change will be included in the 2020 Preliminary Budget