Highlights Version – This version of the document highlights significant changes from prior versions – there is a non-highlighted version available.

Consultant Peer Review Report on the

Fort Worden State Park

Business and Management Plan

Submitted by the
Fort Worden Port Development Authority
(Version Dated October 8, 2012)

Authored by Rick McPherson

for the Washington State Parks and Recreation Commission

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Comments or Questions on this report should be addressed to the Washington State Parks and Recreation Commission for transmittal to the author.

Consultant Peer Review Report of the Fort Worden State Park Business and Management Plan

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Description of Analysis Assignment:

This analysis is being provided as a Peer Review of the "Fort Worden State Park Business and Management Plan" dated 10/8/2012. This Plan was developed by the Fort Warden Public Development Authority (PDA) and its Consultant, ProsConsulting. This Peer Review is being provided at the request of the Washington State Parks and Recreation Commission (Commission). It should be noted that the scope of this work specifically is addressing the reasonableness of the PDA's plan, not to evaluate various other options for the Commission.

The analysis is based on the following activities completed by me:

a) Review of the "Fort Worden State Park Business & Management Plan" Working Draft dated 8/23/12
b) Attending a portion of the Public Development Authority meeting on August 28, 2012
c) A tour of the Fort Worden facility on August 28, 2012
d) Review of the "Fort Worden State Park Business & Management Plan" Working Draft dated 9/17/2012
e) Review of the "October 2012 Fort Worden State Park Business & Management Plan" with Highlighted Changes dated 10/8/2012 (10/8 Plan)

This document specifically addresses the Plan for the 100 acres that includes the current Fort Warden Campus facilities that are used for the Lifelong Learning Center, Conferences, Conference Housing, Vacation Housing and miscellaneous events and performances. These 100 acres are identified on page 32 of the 10/8 Plan and will be referred to as the "Campus" throughout this document.

It should be noted that I provided two prior analyses on the 8/23 and 9/17 Working Drafts to the PDA, ProsConsulting and the Commission and many of the concerns and questions that I raised in those analyses have been addressed in the final 10/8 version of the Plan.

Executive Summary of Analysis:

Overall the 10/8 Plan is a good description of most of the issues facing the Fort Worden State Park Campus area and creates a solid description of what the proposed responsibilities (and costs) for each of the two parties (PDA and Commission) will be, under PDA Management of the Campus. The plan identifies many opportunities for the PDA and Commission to improve the utilization of the Fort Worden State Park while creating some cost avoidance for the State over time. The Plan takes a realistic approach to the transition, has mostly reasonable pro forma financials (with some significant upside) and has an expectation to create solid measurements and a co-management process. The PDA has identified that it will raise and invest $550,000 to cover transition costs, increased marketing and establish a reserve to cover cash flow gaps and potential operating losses (page 3).

As with any change and any forecast, there are risks that will be enumerated in this document. Most of these risks are relatively minor in the overall scope of the opportunities for the Commission, PDA and the City of Port Townsend. Many of these risks are present regardless of who manages the Campus (such as decreased profit margins from lower than expected revenues or higher costs; losses of major Partner tenants; State funding cuts; and confusion about who is responsible for an expenditure between landlords and tenants). This version of the Plan does specify the level of financial risk that the PDA will commit to regarding transition costs and operating losses of $550,000 (pages 3 and 59) and establishes that if the PDA's losses exceed this amount, the Campus area would be returned to the Commission for management. The 10/8 Plan identifies that there will be a Co-Management Board in place to identify potential operational and financial problems along the way so that all parties are aware of the potential of a failure and can take remedial actions together or prepare for the transfer back to the Commission for management (Pages 4 and 59).

This Plan will be the baseline document to decide if this management transition to PDA should go forward and, if it should, then this Plan will serve as a guideline for negotiating a formal Management Agreement (and other associated agreements such as a master lease). There are a few of the issues identified below that are considered more significant and should be addressed before detailed negotiations begin such as:

1) As indicated in the 10/8 Plan, there needs to be a definitive understanding of the duties and fiscal responsibilities of each party on several functions that are identified in the plan as "support, joint or shared" (pages 35 and 48). This is especially true in refining the expected State capital funds commitment as stated in the plan as "… with the state retaining $8 to $15 million in capital funding responsibilities at the site over the next ten years…"(page 4).

2) While this was not expected to be covered in the PDA's Plan – the State will need to have a clear understanding of the approximate financial impact to the State given the proposed agreement regarding operations income/losses, capital expenditures, maintenance costs, building improvements, campground revenues and employee impacts. I understand that this assessment is currently being worked on by the Commission, and will require refinement as specific responsibilities are more defined as stated in #1 above.

3) A better understanding of how and when the $550,000 is expected to be raised by the PDA for the mobilization costs and cash flow cushion. Fort Worden is currently in a state of "limbo" awaiting the Campus management decision and if approved, the Commission, State Employees, Partners and others will be best served if the implementation begins in a timely manner, which requires that the start-up funds be raised quickly. Business experience indicates that implementation with long time frames create uncertainty for customers and decreased morale for existing employees who then provide poor service or choose to leave before the transition occurs, creating short term job vacancies and service issues for the existing organization.

4) As indicated in the 10/8 Plan, there will need to be a clear understanding that the facilities and infrastructure will be maintained in certain condition by the parties responsible for each, with resolution processes if commitments are not met.

Opportunities:

The 10/8 Plan identifies many overarching opportunities for the transfer of management and marketing duties for the Campus to the PDA which are identified on page 58. I agree that the opportunities identified there are reasonable and have a very good chance of meeting the apparent overarching goals of:

A) Increased Use: The marketing and customer service actions listed in the Plan, plus the $300,000 of transition and marketing investment by the PDA should increase use of the Fort Worden Facilities by individuals and organizations from the State of Washington and the Pacific Northwest area. These opportunities include:
   a. Increased and focused marketing efforts for Increased group usage for conferences and events
   b. Increased and focused marketing efforts to bring Lifelong Learning Center partners as tenants in the Campus
   c. Increased and focused marketing efforts and pricing actions to increase utilization during the shoulder seasons.
   d. Planned tenant improvements (typically interior upgrades and reconfigurations) that the State would probably not be able to fund to raise occupancy levels, stay lengths and in certain cases raise prices for higher quality facilities, by accessing different avenues of funding that the State does not have access to as outlined on pages 54 to 58 of the 10/8 Plan.

B) Operating Cost Avoidance for the State Budget: Comparing the "Actual 2011" Reported Revenues and Expenses column on page 37 for annual expenses, eventually this Plan should achieve a cost avoidance in the "subsidization" of the Campus area by the Commission/State of an estimated $163,438 in annual operating losses based on this 2011 data. Note however, that as I read the report (Page 37), in the first three years of the agreement, the Plan has the PDA collecting $250,000 per year from campground revenues. So, according to the numbers presented in the Plan, the state will actually increase its subsidization by roughly $86,000 per year for the first 3 years (plus any transition costs such as employee relocation or severance payments). At year 4 the cost avoidance for operating expenses does eliminate the $163, 438 operating cost subsidization for each year into the future. This is based on 2011 numbers, so the actual subsidy in 2012 could be larger or smaller.

C) Capital Cost Avoidance for the State Budget: There should also be cost avoidances of a significant portion of the Capital Improvements as responsibilities shift to the PDA and Partner organizations as described in the Plan:

a. The Commission staff estimates $50 million in identified capital needs over the next 8-10 years (page 7). The Commission has spent an average of $1.3 million per year (page 48) over the past few years which according to the information presented in the Plan, is not enough for basic upkeep and has resulted in significant deferred maintenance as a penalty for the lack of funding.

b. The PDA estimates capital needs of $89M (page 48 and detailed on pages 48-53). In this same section, the PDA plan states that the Commission's responsibility for this list of capital expenditures will be $8 to $15 million over the next 11 years for infrastructure, major structural repairs and historical preservation (similar or less than current funding). At the same time the PDA Plan states it will be responsible for $15 to $25 million in capital improvements and the Partner organizations will be responsible for $35 to $50 million in capital improvements (these would often be considered "tenant improvements"). This represents a pretty good "deal" for the Facilities and visitors of Fort Worden – the state burden will be the same or less of current funding while the quality of the facilities and maintenance will be increased according to this Plan.

D) Embracing Entrepreneurism: As identified on page 10 of the Plan, "…State Parks has been directed by the Governor and the Legislature to embrace a more entrepreneurial model of operation". This kind of a co-management Plan appears to be a good step forward in this direction.

Net impact, after the first three years of increased subsidization, the State should see an operating cost avoidance (depending on Discovery Pass exclusions) while the use and conditions of the facilities improve through capital investments from the PDA and Partner organizations.

Some other Opportunities that are included in the plan include:

A. Conservative Estimates: The Plan and Pro-Forma financials are based on an "as-is" operation with increased marketing efforts and with minimal changes or upgrades to the facilities which makes this a conservative plan with upside potential. The Capital Plan beginning on Page 48, identifies many opportunities to improve the facilities which should increase usage and revenues through both occupancy rates and higher prices for upgraded facilities. As identified in the Strategic Initiatives (page 61), there will be a market opportunity and cost/benefit analysis conducted for these additions, which is entirely appropriate.

B. Accountability and Metrics: The Plan identifies several metrics that will/could be negotiated and put in place in the final Management Agreement (page 59). Having strong performance metrics to which the PDA and the Commission will be held accountable is an excellent way to create an environment focused on managing and improving performance by all involved.

C. Realistic Phased Approach: The Phased approach that properly sets expectations of activities shown on page 61 of the Plan provides a reasonable roadmap for the Campus. As the PDA Campus management team comes up to speed, there is probably an opportunity to accelerate these initiatives to create more revenue sooner. A key issue is that a longer time frame often loses steam as time passes by, with original sponsors of the program moving on to other interests and community awareness fading, so a more aggressive schedule should be a consideration to keep up the momentum.

D. Recognition of a Mobilization Period: The 10/8 Plan has included the costs and actions needed to mobilize and manage the transition and begin the increased marketing and outreach efforts.

Potential Risks:

With the above opportunities in mind, here are some specific concerns on the 10/8 Working Draft document:

a) Responsibility for Operating Losses: The 10/8 Plan includes $250,000 in working capital to be raised by the PDA as a cushion against operating losses and to cover monthly cash shortages. The Plan also specifies this is the upper limit commitment to losses from the PDA. Monthly fluctuations of net funds could easily deplete the majority of this fund (see page 39, $143,402 is projected to be needed in May of the first year based on the Pro Forma projections). This leaves only $107,000 in cushion to absorb unplanned operating losses at this point in a year and could be quickly eroded if annual profits are not as expected. $107,000 represents only 4% of the annual revenues projected in the first year. With the assignment of the Partner leases, the PDA is also assuming the risk of partner organizations that may choose to leave the Campus or go out of business. To mitigate this risk the PDA Plan does invest $300,000 in Mobilization costs to improve operations and to jump start marketing, provides for the monitoring of performance by the Co-Management Board and provides for the return of the management of the Campus to the Commission if the $250,000 losses threshold is reached. The Commission will then need to decide how to best proceed – continue some level of subsidization of the Campus in support of the PDA's efforts, transition the management back to the Commission, or some other action.

b) Reasonableness of Financial Assumptions:

- The revenue growth projections for conferences, housing and other current operations for Year 1 on page 37 shows 4.5% increase over 2011 in the "start up" year (this excludes the $250,000 campground revenue and lodging/sales tax rebate increases shown to the PDA). If the slide of revenues continued into 2012, then the year over year increase would be even greater. As a first year management change, this may be an overly optimistic growth projection and needs to be carefully reviewed, looking at the 2012 Year-to date revenue comparisons to 2011 and making sure to understand where revenues will truly be able to be impacted in the first year given the lead time on conference and vacation planning. The Mobilization period before Year 1 could help to mitigate this issue, but it should be carefully understood.
- The 10/8 version of the Plan sounds an alarm on page 8 regarding the future success of Partners and the PDA citing that the Discovery Pass has sharply cut into park visitation "by as much as 55%" (this is somewhat overstated – see footnote on the same page). The resolution of the Discovery Pass exceptions and a better understanding of this impact should be undertaken quickly.
- The cash flow projections on page 38 should include the minimum PDA capital expenditures required for basic capital replacement for the areas that the PDA is responsible for managing. Note that these could also be shown in the Income Statement but GAAP accounting practices would classify these items as capital and place them on the cash flow and balance sheets of an organization.
- It is unclear how the current plans for the conversion of Building 202 into classrooms is being funded and how the increased revenues are reflected in the Pro Forma financials. Page 4 of the plan identifies the PDA role as "assist in the fundraising" for this project and is also exploring the use of tax credits to fund some of the project (page 56).
- The monthly cash flow on page 39 does not show any variability in salaries and wages for the seasonality of the Campus area. Intuitively one would expect that labor costs would be higher in the summer months where the revenue stream is almost 3 times the revenues in November through February.

c) Capital Investment Commitments: The 10/8 Plan makes good progress on identifying responsibilities for maintenance (page 31) and capital expenses (page 48-49). While these are good general definitions of who is responsible for these expenditures, as shown on page 31, there will need to be more specific definitions of the responsibilities for each party in the Management Agreement, similar to what is seen in commercial leases. A helpful exercise early in the Management Agreement negotiations would be to take each of the capital projects identified on pages 49 to 52 and identify the expected source of funding for each project by entity so there becomes a clear understanding of what will be expected from each party using projected costs and real projects. The Plan does identify that there will be an annual review of "capital requests" – this should include both the PDA and State funded capital requests and review of the expected Capital Commitments (pages 49-53 or as updated and approved) for each year versus what is actually going to be accomplished, and establishing a corrective actions process if expectations are not met.

d) PDA Accountability for Partner organizations: It should be understood that since the PDA will have overall management responsibilities for the Campus, they will need to manage the risk of becoming responsible for the Partners' projects, payments and operations. Sub-leases and new construction project documents will need to be written so that it is clear what risks the PDA is taking being the manager of all of the Partner agreements on the Campus.

e) Maintenance Standards for Facilities: As noted in the 10/8 Plan, the Final Management Agreement will need to specify the condition that facilities and equipment are expected to be maintained and improved for both parties (Commission and PDA). Inspection processes and remedies should be clearly spelled out in the Management Agreement. The risk to the Commission is that if this Management Agreement is not successful, the Commission may "re-inherit" facilities in worse shape and a brand image that is damaged.

f) State Funding Issues: The 10/8 Plan identifies the need for $8 to $15 million from the State for infrastructure and major repairs, which raises a reasonable question - what happens if the Commission/State does not have the funds available to do the defined capital maintenance projects identified on page 49 that then affects the PDA's forecast of revenues or costs? For example - a specific facility may not have adequate major maintenance being done on heating systems making the space too cold for the enjoyment of the guests paying for the space (and therefore impacts customer satisfaction and referrals and therefore future revenues). As noted in the 10/8 Plan, the Management Agreement needs to address the remedies available to the PDA (and indirectly to Partners) if this occurs.

g) Approval of PDA sub-leases and other key agreements: The Governance model does not list the process and approvals for leases or concession agreements among its duties (but does address tenant improvements). Page 28 identifies that the Co-Management Board may be asked to approve certain leases – this should be a requirement in the Management Agreement. It is appropriate that leases over 5 years or 10 years or with unusual terms and conditions (such as below market rent) be approved by the Co-Management Board. For example, a lease for 40 years that the Commission then takes over if the PDA management process fails, may be very undesirable. The Co-Management Board should also approve a standard terms and conditions lease form that must be used with exceptions approved by the Operations Committee or the Co-Management Board.

h) Conflict of Interest and Code of Ethics: As management entities, the PDA Campus management team, the PDA Board, the Operations Committee and the Co-management Board should have a code of ethics regarding decision making when conflicts of interest exist and establishing appropriate behaviors in general. The 10/8 Plan addresses this issue on page 65 and because many of the various leadership organizations have volunteers, they should be reminded annually of the code of ethics to be followed and acknowledge that they understand the expectations.

i) Clarity of Responsibilities: As identified in the 10/8 version of the Plan, the Management Plan will need to better define the management, fiscal and operational responsibilities between the PDA and the State Park for the Campus. Good progress has been made in this version of the Plan for general maintenance (page 38) and capital expenses (pages 48-49), however there remains 13 (46%) of the other areas identified on page 35 as "support, joint or shared" including key financial and customer impacting areas such as marketing and sales, training, community outreach, etc. There needs to be a more specific definition of the role of the two organizations in managing each of these functions including decision making, quality and fiscal responsibility.

j) Clarification of Use of Surplus Operating funds (defined as Net Revenues in the Plan): Page 39 of the Pro-forma financials identifies that 60% of the "margin over expenses" will be utilized for the purposes of facility and infrastructure improvements and investments. With the division of the capital needs provided on page 49, it should be clarified which entity will get this "building reserve fund" to pay for their share of capital requirements.

k) Leadership and Marketing Qualifications: It is unclear that the organizational staffing (page 44) will have strong enough leadership in place to manage the Campus day-to-day operations while also:

- coordinating the outsourced marketing initiatives,
- coordinating with the Fort Worden Conservancy to aggressively pursue fundraising for capital projects,
- pursuing other funding alternatives not pursued through the Conservancy,
- attracting new events
- attracting new Partner organizations.

In earlier correspondence it was identified that the salary is the same for the Manager position as the existing salary for the current Fort Worden Park Manager as justification that this salary is reasonable for the skills and experiences required for success. It needs to be noted that significant job duties are being added to this job in the areas identified above, and that coordination across multiple organizations with divergent goals requires a level of leadership finesse that is typically seen in higher paid leaders than the proposed Manager position. It appears that the Manager position has been renamed as an Executive Director, with no change in salary (page 44). Page 68 identifies that the PDA Manager will report to the PDA Board of Directors, therefore a recommendation could be that the PDA Board identify one member who will serve in a direct leadership position over the PDA Manager, or possibly that the PDA Manager should report to the existing Executive Director of the PDA (currently Dave Robison) to lead these coordination efforts and provide leadership support to the PDA Manager and the other organizations.

l) Fort Worden Conservancy Role in Fundraising Capabilities: The 10/8 Plan identifies that the Fort Worden Conservancy will serve in a key role for the fundraising (Pages 44 and 54). While the Conservancy has been successful in raising some funding in the past ($80,000 listed on page 54), the scale of fundraising needed for the PDA portion of the Capital Improvements is $15 to $25 million over the next 11 years (page 48). This is a significant change in scope for the Conservancy.

m) Impact of Changes to Discover Pass Revenues: Page 26 of the plan suggests that the exemptions to the $10 Discover Pass fee be widened to include additional classifications of visitors to the park that are using Campus facilities or with Partner organizations. There should be a calculation about how this will impact the State Park revenues on the Discover Pass before the agreement proceeds further as it could be a significant negotiation point that should be agreed to in advance.

Impacts to the State Parks and Recreation Commission: The Fort Warden PDA Business and Management Plan does not address, by agreement, the impacts to the State Parks and Recreation Commission and specifically to the Fort Worden State Park. Some things the Park should consider from their perspective could be:

a. The impact to the Park's net annual costs by transferring this management to the PDA needs to be totaled up. This includes:
   - the elimination of the current operating deficit,
   - the loss of some campground revenues,
   - the rebate of lodging/sales taxes
   - the potential reduction of Discovery Pass revenues
   - the transfer of "tenant improvement" related expenses to the PDA and Partners
   - the expected "infrastructure, major repairs and historical restoration" capital expenses (increase or decrease)
   - impacts to current state employees from severance or transfer costs

b. Will there be a loss of any economies of scale with this segmentation of responsibilities and how will those be managed going forward (such things as administrative support for rangers and staff, IT support and infrastructure, meeting rooms and office spaces, etc.).

c. If the PDA Campus Management plan is approved by the Commission (and others at the State), then every effort should be made to implement the change quickly in negotiating the Management Agreement and building a transition plan with the PDA. This is dependent upon the fundraising speed for the $550,000 by the PDA, so that fundraising plan and expected timeline becomes a key issue for the State to understand.

d. The park staff should brainstorm what other positive and negative impacts can occur for the Commission.