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Phase 2 Analysis of the Fort Worden Public Development Authority Plan – 9/17/2012 Draft Review
Authored by Rick McPherson on 9/26/2012

This analysis is being provided as a Peer Review of the "Fort Worden State Park Business and Management Plan" Working Draft dated 9/17/12. This Plan was developed by the Fort Warden Public Development Authority (PDA) and its Consultant ProsConsultng. 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:

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 (9/17 Plan)

This document is specifically addressing 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. This 100 acres are identified on page 30 of the 9/17 Plan and will be referred to as the "Campus" throughout this document.

It should be noted that I provided a Phase 1 analysis of the 8/23 Working Draft to the PDA, ProsConsulting and the Commission and many of the concerns and questions that I raised in that analysis have been addressed in the 9/17 Working Draft.

Executive Summary of Analysis:
Overall the 9/17 Plan is a good description of most of the issues and plans facing the Fort Worden State Park Campus area and creates a solid description of what the two parties (PDA and Commission) can generally understand as their proposed responsibilities and costs will be under PDA Management of the Campus. The plan identifies many opportunities for the 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.

As with any change and any forecast, there are risks that have been enumerated below. 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 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 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. There are a few of the risks identified below that are considered more significant and should be addressed before detailed negotiations begin such as:

1) What happens if the financial forecasts from the PDA included in the Plan do not come true and there are significant losses at the Campus? Who will become responsible to cover those losses and any outstanding liabilities?
2) 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.
3) 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.
4) A clearer understanding of the duties and fiscal responsibilities of each party on several functions that are identified in the plan as "support, joint or shared".

Opportunities:
The 9/17 Plan identifies many overarching opportunities for the transfer of management and marketing duties for the Campus to the PDA which are identified on page 55. I agree that the opportunities identified there are reasonable and has a very good chance of meeting the apparent overarching goals of:

A) <u>Increased Use:</u> The marketing and customer service actions listed in the Plan 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 on 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 51 to 54 of the 9/17 Plan.

B) Operating Cost Avoidance for the State Budget: Eventually this Plan should achieve a cost avoidance in the "subsidization" of the Campus area by the Commission/State of an estimated $166,000 in operating income in 2011 (page 35 Pro Forma). Note however that as I read the report (Page 35), 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 $84,000 per year. At year 4 the cost avoidance for operating expenses does eliminate the subsidization and begins to provide cost avoidances, increasing dramatically by Year 7.

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 average of $1.3 Million per year (page 45) over the past few years which 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 45 and detailed on pages 46-50). 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 at 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.

Net impact, the state could see an operating cost avoidance within 3 years (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 43 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 on page 58, 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 56). 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 57 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: This version of the 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 9/17 Working Draft document:

a) Responsibility for Operating Losses: The 9/17 Plan includes $250,000 in working capital as a cushion against operating losses and to cover monthly cash shortages. Monthly fluctuations of net funds could easily deplete the majority of this fund (see page 36, $143,000 will 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. With the assignment of the Partner leases, the PDA is also assuming the risk of partner organizations who may choose to leave the Campus or go out of business. There should be a clear understanding, before negotiating the Management Agreement, of what occurs if cumulative operating losses exceed the $250,000 cash cushion and the obligations to any outstanding unfulfilled agreements (to employees, service providers and capital project contractors). Could the PDA declare bankruptcy or would the operating losses be absorbed by the City of Port Townsend or by the State Parks Commission, or somewhere else?

b) Reasonableness of Financial Assumptions:
   a. Year 1 Growth projections: The Revenues growth projections for conferences , housing and other current operations for Year 1 on page 35 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.
   b. The employee benefits cost increases of 2.5% to 3% seems very low given the expected rises in healthcare costs (page 35) in most forecasts. The miscellaneous contingency could cover some of this exposure.
   c. The cash flow projections on page 35 should include the minimum PDA capital expenditures required for basic capital repairs for the areas that the PDA is responsible for managing.
   d. 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.
   e. The monthly cash flow on page 36 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 9/17 Plan makes good progress on identifying responsibilities for maintenance (page 28) and capital expenses (page 45-46). While these are good general definitions of who is responsible for these expenditures, 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 would be to take each of the capital projects identified on pages 46 to 50 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 real data and projects.

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: The Final Management Agreement will need to specify the condition that facilities and equipment is expected to be maintained 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: With this version of the plan identifying the need for $8 to $15 Million from the State for infrastructure and major repairs, it 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 46 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). 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 26 puts all lease negotiations in the hands of the PDA, for leases up to 50 years. It may be more appropriate that leases over 5 years or 10 years or with unusual terms and conditions (such as below market rent) be approved by the Operations Committee or 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 s of Interest: 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 (e.g. that members must recuse themselves from the decision making process).

i) Clarity of Responsibilities: 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 28) and capital expenses (pages 45-46), however there remains 13 (46%) of the other areas identified on page 33 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) Construction Management by PDA: Page 33 and page 61 seem to be in conflict or at least confusing regarding construction management and administration. This area and specific responsibilities of each party on various projects (State funded projects vs. PDA/Partner funded projects) should be clarified and delineated.

k) Clarification of Use of Surplus Operating funds (defined as Net Revenues in the Plan): Page 36 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 pages 45-46, it should be clarified which entity will get this “building reserve fund” to pay for their share of capital requirements.

l) Leadership and Marketing Qualifications: It is unclear that the organizational staffing will have adequate leadership in place to both manage the day-to-day operations while also leading the aggressive marketing and customer service improvement initiatives, aggressively performing fund raising for capital projects, attracting new events and expanding Partner organizations. In earlier correspondence it was identified that the salary is the same 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. There is also some confusion in the Plan as the Staffing section (page 41) identifies the leader as “Manager” while page 57 identifies an Executive Director. It may be that the current PDA Executive Director and Staff will be an incremental resource to the Campus management team identified within this plan which would reduce these concerns.

m) Impact of Changes to Discover Pass Revenues: Page 25 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 Park: 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:
   a. the elimination of the current operating deficit,
   b. the loss of some campground revenues,
   c. the rebate of lodging/sales taxes
   d. the potential reduction of Discovery Pass revenues
   e. the transfer of “tenant improvement” related expenses to the PDA and Partners
   f. the expected “infrastructure, major repairs and historical restoration” capital expenses (increase or decrease)
   g. 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. The park staff should brainstorm what other negative impacts can occur for the Commission?