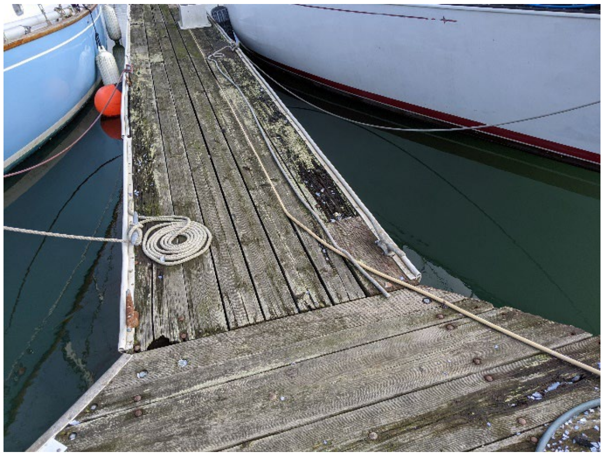
BERKELEY MARINA LOAN FEASIBILITY REPORT UPDATE SUMMARY



Dock D

Dock E

City of Berkeley

$5,500,000 Loan

SUMMARY

The Department of Parks and Recreation, Division of Boating and Waterways (DBW) asks the Boating and Waterways Commission (Commission) to provide advice and comment on amending conditions that the Commission previously advised DBW to require for a $5.5 million loan from the Harbors and Watercraft Revolving Fund (HWRF) to the City of Berkeley (City) for demolition and replacement of Docks D and E at Berkeley Marina. DBW previously presented this project to the Commission for advice and comment on February 14, 2020. Since then, the City has not met three of the four conditions that the Commission advised DBW to include in the loan agreement. These conditions can be found in the full Feasibility Report Update.

The subject loan would fund design and construction of new docks, concrete piles, utilities, and necessary related infrastructure for these two docks.

There are no engineering, permitting, stakeholder or public access issues associated with this project. However, the Marina Fund, responsible for repaying the proposed loan, has a structural deficit which the City has annually supplemented with the City's General Fund.

Since DBW made its last loan to the City for the Marina in 2005, expenses have outpaced revenues. Although boating-specific revenues appear to be sufficient to offset boating expenses, overall waterfront revenues are consistently below overall waterfront expenses and are not projected to improve under the current framework.

DBW seeks Commission advice and comment on this existing $5,500,000 loan to the City of Berkeley in light of the ongoing issues described in the June 23, 2023 Feasibility Report Update to the February 14, 2020 Feasibility Report.

Cost Estimate

Based on the March 2023 engineer's cost estimate, the estimated total project cost has increased from $5.9 million in 2020 to $7.9 million today. This total project cost includes construction, escalation, construction contingency, engineering, construction management, and inspection. The City believes it has identified additional funding sources to pay for this funding gap.

The Marina Fund

Over the years, the Marina Fund's resources have become strained as land adjacent to the marina has been developed for parks, other non-boating recreation, and special events. Marina Fund resources have been used to bear these expenses, which cities typically pay for with general funds or special assessments. Marina Fund revenues have not kept up with the added expenses and a significant proportion of the Marina Fund's revenues support non-revenue-generating activities. This is not how enterprise funds are typically used. Generally accepted accounting principles require state and local governments to use enterprise funds to account for "business-type activities" – activities similar to those found in the private sector. Business-type activities include services primarily funded through user fees.

Recent Support from General Fund

The City's General Fund has historically been financially stable, and in recent years it has transferred funds to the Marina Fund to offset annual structural imbalances. However, these transfers are discretionary. The City recently transferred American Rescue Plan funds to the Marina Fund in 2022 (amount of $1.45 million) and 2023 (amount of $1.1 million) to address operating deficits in that fund.

Because this practice is discretionary and not guaranteed for future years, DBW's financial analysis cannot assume the City will continue to provide General Fund resources to the Marina Fund. According to City staff, General Fund transfers and other one-time solutions have been providing similar support to the Marina Fund for the last several years. The City is not legally obligated to do this, and if other budgetary priorities were to become higher, the Marina Fund could fall further into deficit, putting loan repayments and marina maintenance in jeopardy.

Existing Conditions to the Loan

In February 2020, the Commission advised DBW to include the four conditions of the original loan agreement. Three of the four conditions have not been met. Two of the three conditions included the Marina Fund reaching financial ratios that proved its solvency. The third condition related to permitting which has been delayed, in part, because of the ongoing financial issues. Condition Four (4) in the existing loan agreement states:

- The Berkeley City Council shall adopt a resolution accepting the loan funds. The language of the resolution shall acknowledge the Marina Fund does not currently meet the income/expense ratio required by DBW and is not forecasted to do so, and the language of the resolution must further state that in the event the Marina Fund cannot fulfill its repayment obligation for this loan in any fiscal year, the City shall supplement that year's repayment from any legally available source, for every year until the loan is fully repaid. This condition may be withdrawn if and when the City demonstrates meeting the required income/expense ratio and debt service coverage ratio for five consecutive years.

This condition has been met. However, the available source that would be used to repay the loan has not been disclosed.

Revenue

DBW forecasts Marina Fund revenues of $7.3 million in 2026, the first full year after construction of the new docks, if the City raises slip fees now and if occupancy rates for the new slips meet DBW's expectations.

Expenses

DBW estimates the Marina Fund's operational expenses in 2026 will be $7.7 million, before debt service is factored in.

DBW estimates that the annual debt service for the proposed $5.5 million loan will be approximately $342,000. The interest rate will be 4.5%, compounded continuously. The final payment on a prior DBW loan is expected to be due on August 1, 2044. Total debt service each year, including both this loan and a prior DBW loan, to the Marina will be $828,000.

Together, using DBW's adjustments to the City's original forecast, operating expenses and debt service are projected to be $8.6 million in 2026, which is $1.2 million more than operating revenues.

FINANCIAL MEASURES

Income Expense Ratio

Since 2009, in consultation with and upon recommendation of the Boating and Waterways Commission, it has been DBW's practice to require a 1.2:1 income to expense ratio. Income/expense ratio is the operating revenue divided by operating expenses. In 2020, the Commission advised DBW to waive this requirement if the conditions noted earlier were met. To date, those conditions have not been met.

This project would have an income/expense ratio of 0.95 in 2026, the first year after construction is complete. This ratio stays throughout the loan repayment period, based on the assumption that total operating revenues and expenses will grow at approximately the same rate (which the City's original projections included).

Because the income expense ratio is below 1.2, it does not meet the Commission's minimum requirement.

Debt Service Coverage Ratio

The debt service coverage ratio (DSCR) is a measure of an entity's capacity to not only maintain operations, but also to afford debt. DSCR is the net operating income divided by total debt service. The minimum DSCR established by the Commission at its May 2009 meeting was 1.25 for public marina loans. The DSCR for this loan is negative.

Alternative analysis: Separating Boating Activities from Non-Boating Activities

During preparation of this report, the City gave DBW a list of current year Marina Fund expenses, and estimated the percentage of each expense category that is related to boating operations at the Marina. Based on DBW's analysis, operating expenses specific to boating represent about 45% of all operating expenses coming out of the Marina Fund this year. Other operating expenses go to various activities like park maintenance, building maintenance, and non-boating-related personnel expenses.

After receiving this data, DBW conducted a second financial analysis that excluded all non-boating revenue (such as waterfront leases and special event fees) and all non-boating expenses. Using this approach, the income/expense ratio is above 1.2 throughout the loan payback period, and the DSCR goes above 1.25 in 2025 and continues to increase throughout the payback period.

While this analysis is more encouraging, it also highlights the magnitude of the City's reliance on the Marina Fund to support non-boating activities. The boating/non-boating expense breakdown the City shared was an informal report prepared at DBW's request, which the City Council has not had an opportunity to review and potentially shift non-boating expenses to strengthen the Marina Fund. Classifications of the expenses are imprecise since some expenses are not strictly boating or non-boating. For example, some City staff work on both boating and non-boating activities, while some staff work on site at the Marina and others elsewhere, so personnel expenses and their related overhead can only be allocated between boating and non-boating activities by using estimated workloads.

Based on the expense breakdown the City reported, and with DBW staff's historic experience with marinas and borrowers across the state, DBW believes the Berkeley Marina generates more than sufficient revenue from boating activities to cover the projected debt service for this loan. However, because the City uses a significant proportion of Marina Fund resources for non-boating activities throughout the waterfront, there would be a perpetual and sustained liability on the Marina Fund, and potential liability on the City's General Fund or other applicable special funds. As DBW has seen in previous loans that had developed similar imbalances, this could degrade investments in marina maintenance and operations, which may cause the marina loan repayments to be subject to a delinquent status.

CONCLUSION

DBW's analysis indicates that this project is feasible from engineering, permitting, stakeholder, and public access perspectives. However, the Marina Fund responsible for repaying this loan cannot sustain repayment as currently structured. Further, the City has not restructured revenues and expenses to ensure the Fund is sustainable for the term of this loan.

ADVICE AND COMMENT

DBW seeks Commission's advice and comment on the potential alternatives for addressing the current challenges associated with this loan. Prior to loan disbursement:

A. Formalize a City financial process whereby a subaccount within the Marina Fund is established solely for the purpose of repaying all outstanding DBW loans. This subaccount must be fully funded with $2 million. Funding within the subaccount must only be used by the City for DBW loan repayments and the subaccount must be fully refreshed within 30 days of each loan payment. The subaccount must be fully funded each fiscal year before Marina Fund revenues are used for any other purpose. The subaccount shall remain fully funded until either this loan is fully repaid or until the City demonstrates to DBW for twelve (12) consecutive months that the Marina Fund has achieved the income/expense ratio and the debt service coverage ratio that DBW normally requires. The City agrees to maintain these ratios in the Marina Fund for the life of the loan. In the event of default, the subaccount may be utilized by DBW for loan payments and to cure any deficiencies in maintenance or operation.

B. Formalize a City financial process whereby non-boating-related waterfront expenses will be paid from a specified source other than the Marina Fund, or establish an alternate revenue source (or sources) within the Marina Fund, not to include boating related revenues, to off-set all non-boating-related expenses. Loan funds would be made available after this process is implemented and once the City demonstrates to DBW for twelve (12) consecutive months that the Marina Fund has achieved the income/expense ratio and the debt service coverage ratio that DBW normally require. The City agrees to maintain these ratios in the Marina Fund for the life of the loan. ***Note***: The Loan agreement will not be extended beyond the funding availability, which currently expires June 30, 2026. To meet this deadline, the conditions noted above must be met, and loan funding requested no later than February 1, 2026.

C. As a substitute for meeting the loan ratio conditions DBW normally requires, no later than March 31, 2024, the City shall establish an escrow account funded with $2 million in City funds. The funds in this account shall be held in reserve to ensure payment of debt service on both the DBW loan currently in repayment and this new loan. The escrow account shall remain fully funded until either the loan is fully repaid or when the City demonstrates to DBW for twelve (12) consecutive months that the Marina Fund has achieved the income/expense ratio and the debt service coverage ratio that DBW normally requires. The City agrees to maintain these ratios in the Marina Fund for the life of the loan.

D. As a substitute for meeting the loan ratio conditions DBW normally requires, no later than March 31, 2024, the City shall obtain a surety bond naming DBW as its beneficiary. The City shall bear all expenses and other obligations associated with obtaining and maintaining the surety bond. The surety bond shall be in the amount of the outstanding principal and shall remain fully funded until either the loan is fully repaid or until the City demonstrates to DBW for twelve (12) consecutive months that the Marina Fund has achieved the income/expense ratio and the debt service coverage ratio that DBW normally requires. The City agrees to maintain these ratios in the Marina Fund for the life of the loan.

E. Cancel existing loan due to the City’s inability to meet previous conditions.

Before any alternative listed above can be incorporated into the loan agreement, City staff must seek approval from the City Council. City staff has expressed a desire to give the Council multiple alternatives from the above list to consider. All of the alternatives above would protect State interests, and providing flexibility would help the City identify an effective solution that it would be likely to implement.

DBW recommends that the loan be approved to move forward using any solution from alternatives A, B, C, and D listed above.

COMMISSION ADVICE AND COMMENT

DBW seeks Commission advice and comment on this existing $5,500,000 loan to the City of Berkeley in light of the ongoing issues described in the June 23, 2023 Feasibility Report Update to the February 14, 2020 Feasibility Report.