

Patrick Higgins

*Humboldt Bay Harbor, Recreation and Conservation District Commissioner
Fifth Division Representative
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McKinleyville, CA 95519*

June 12, 2008

Mr. Dennis Hunter, Commission President
Humboldt Bay Harbor, Recreation and Conservation District Commission
601 Startare Drive
Eureka, CA 95502

Re: Summary of Humboldt Bay Harbor, Recreation and Conservation District 2008-2009
Budget, Recent Budget Trends and Need for Adjustments

Dear Dennis,

I very much appreciate the time allowed for analysis of this year's Humboldt Bay Harbor, Recreation and Conservation District (District) budget due to its complexity. The staff has also been very helpful in providing additional clarification and information as necessary. I have used charting tools to summarize budget trends to help focus the discussion of the Commission as we approach budget approval. I am not an accountant or financial analyst, but I do have expertise in analyzing data trends and a background in business.

In summary, data indicate that our enterprise has negative cash flow and that we are depleting our cash reserves. The operating loss of nearly \$500,000 is not sustainable and I believe we need to run projections for the next several years to see when cash flow is anticipated to be positive. If revenue from shipping ventures does not materialize within five years, I am concerned about our future solvency. I do not see our large scale marine ventures as likely to come to fruition in that time and, therefore, believe we need to reassess our fiscal direction.

Income/Expense Summary: The District's projected revenue for 2008-09 is robust, with over \$3 million from general operation and Woodley Island Marina (Marina) but the combined operating expenses, including debt payments, result in a net operating loss of a projected at \$491,796 (Figure 1). When the Redwood Dock study becomes available, our Commission needs to project revenue and expenses forward several years to calculate when port related fees would change our cash flow to positive.

District Budget History (Surplus/Deficit 1993-2007): The trends in surplus or deficits in the District's budget from 1993 to 2007 (Figure 2) show a major increase in projected and actual annual deficits since 2000, when the District expended over \$2.6 million for deep dredging (50 feet) of the harbor entrance and carried forward some debt. It appears that debt service on money borrowed to pay for the deepening project continues to drive the District into the red.

Recent Cash Balance Trends 1996-2007: In order to offset negative cash flow, the District has tapped its cash reserves from various funds intended for facility improvement, dredging or recreation and conservation enhancement (Figure 3). Annual cash balance trends as of June 30

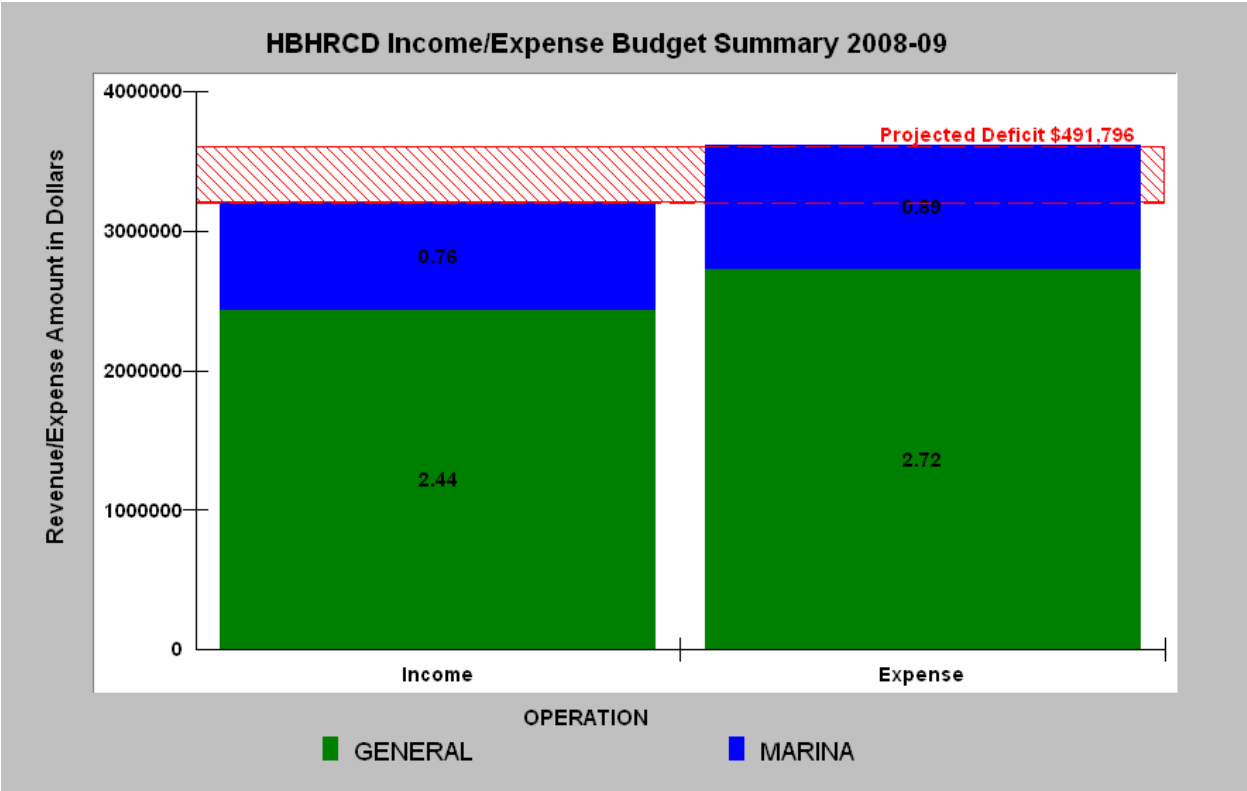


Figure 1. District revenue is over \$3 million, but operating expenses and debt and capital expenditures amount to over \$3.5 million, leaving a deficit of \$491,796. Data as of 5/22/08.

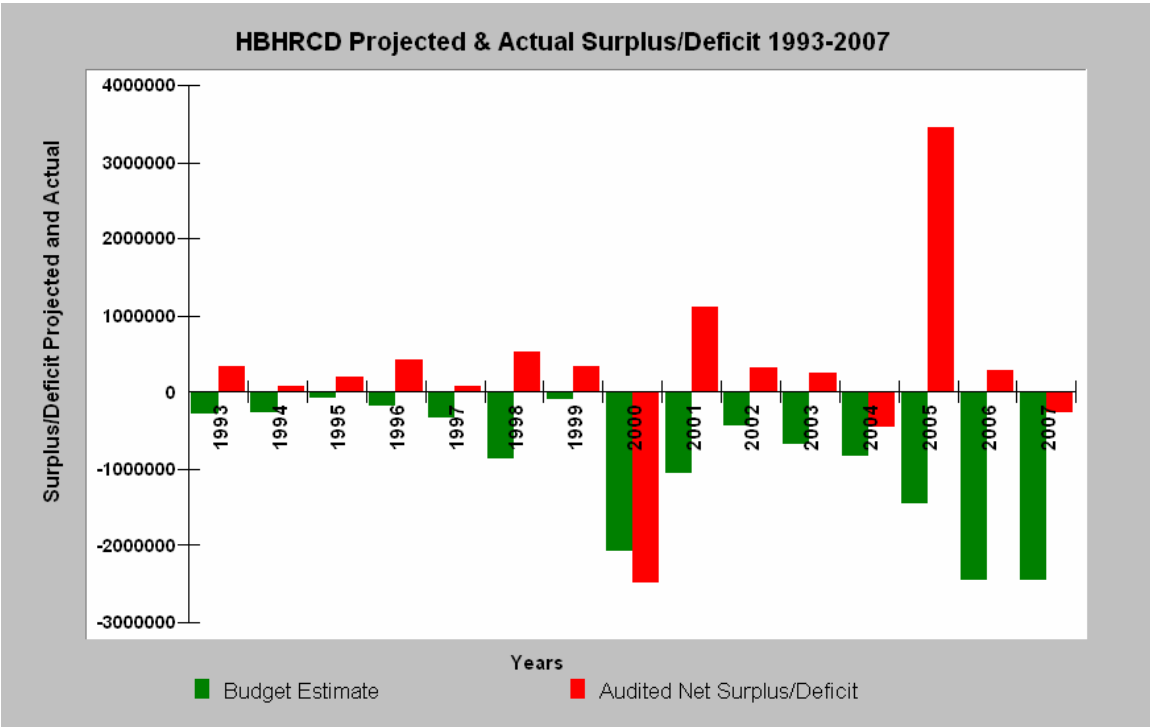


Figure 2. The District’s budget estimate of surplus or deficit for all years from 1993 to 2007 is displayed in green and contrasted with the actual net revenue balance in red. Recent projected budget deficits have been offset in part by tapping cash reserves.

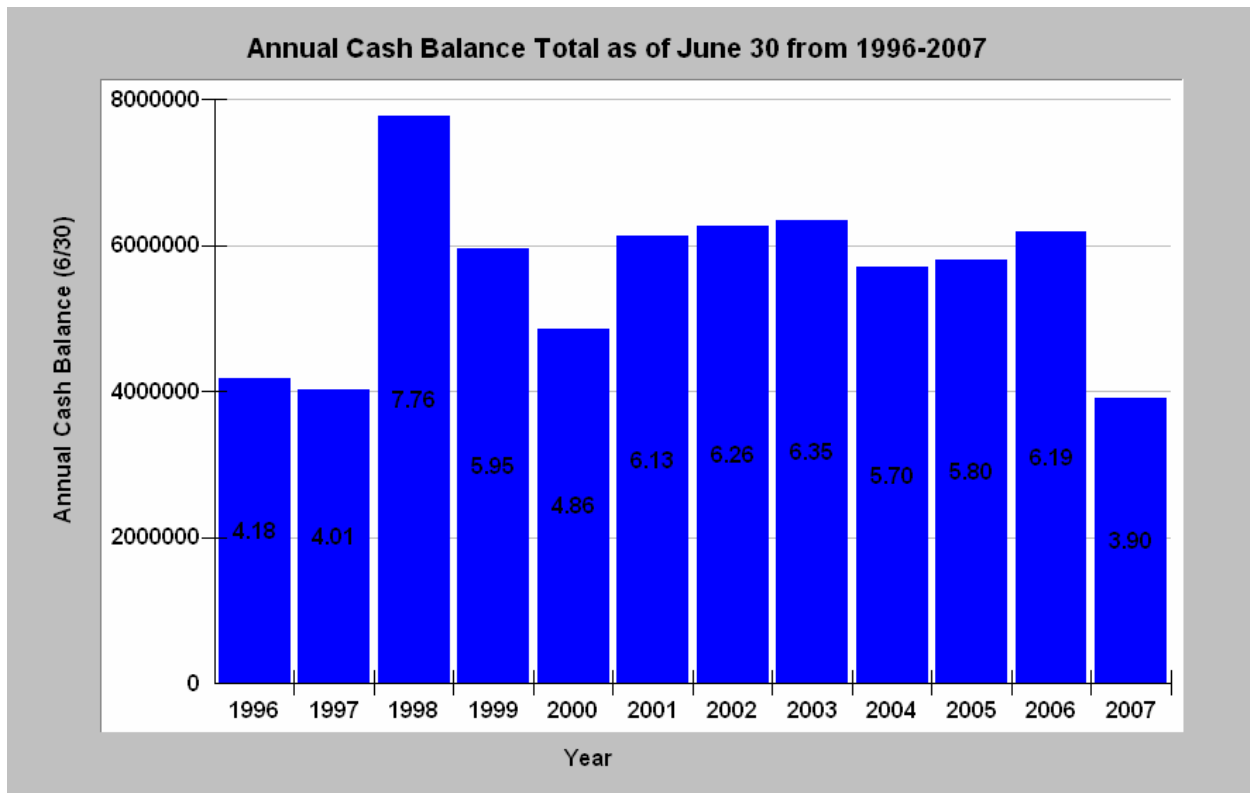


Figure 3. The total cash balance in all District fund reserves at the end of the fiscal year (June 30) is shown above for the years 1996 to 2007. We have the lowest fund reserve in more than a decade, which is due in part to our using money from reserves to cover budget deficits.

from 1996 to 2007 have declined to their lowest point in more than a decade. We can't continue to draw down our reserves at this rate indefinitely, and tapping into these funds saps our ability to accomplish parts of our mission. At our present rate, fund reserves would be depleted in seven years.

Fund Reserve Balance Changes in 2007-08: Figure 4 shows the summary of changes in various District fund reserves. All fund balances were decreased to help offset the budget deficit except for the Emergency fund, which was augmented by \$100,000.

District Projected 2008-09 Expenses: A District budget expense summary (Figure 5) shows that personnel costs are the largest expense with combined payroll, payroll taxes and benefits projected to be \$1,329,711 for fiscal year 2008-09. This may not be sustainable.

Three Year Trends in Top Seven Budget Expense Categories (2006-2009): The three year trend in the top seven budget expense categories from 2006-2008 (Figure 6) show the sharpest increase in salaries and payroll burden. Our payroll has increased by over 50% in three years and it is obviously contributing to the District's negative cash flow problems. Although staff is the engine that drives District activities and accomplishments, at some point we need to balance revenue and expense or risk fiscal insolvency.

Projected Revenue (2008-09): Figure 7 shows a pie chart of projected revenue for the District by category with recreation grants (\$750 K), tax base support (\$720 K), and slip rents (\$359 K)

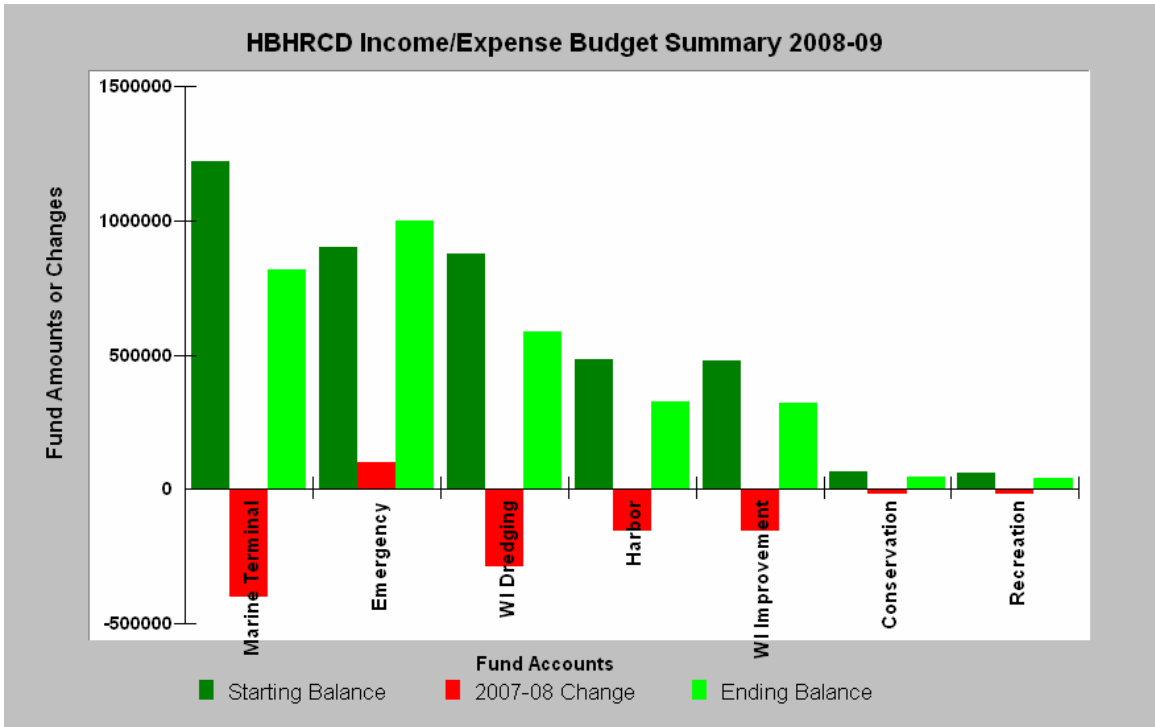


Figure 4. This summary chart shows fund balance changes in 2007-08 with most decreased to help offset budget deficits, except for the Emergency fund that was augmented by \$100,000. WI = Woodley Island.

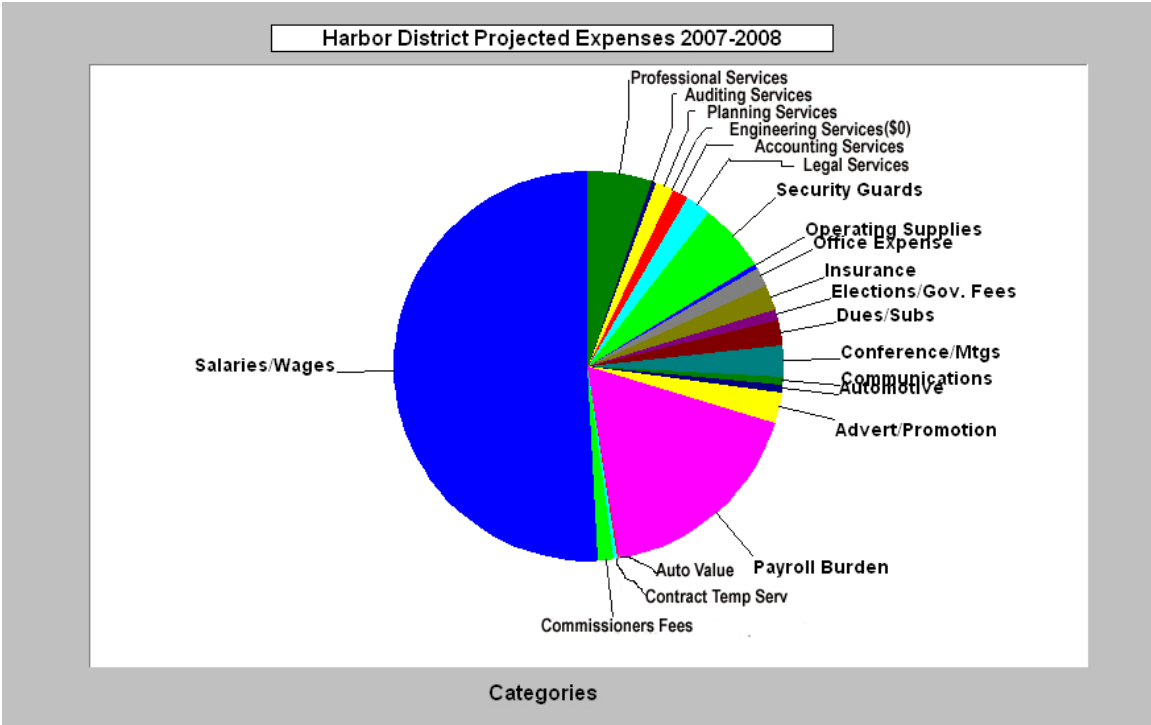


Figure 5. Projected expenses for the District show that personnel costs along with associated taxes and benefits make up more than 60% of the total costs with security guards and professional services the next largest expense.

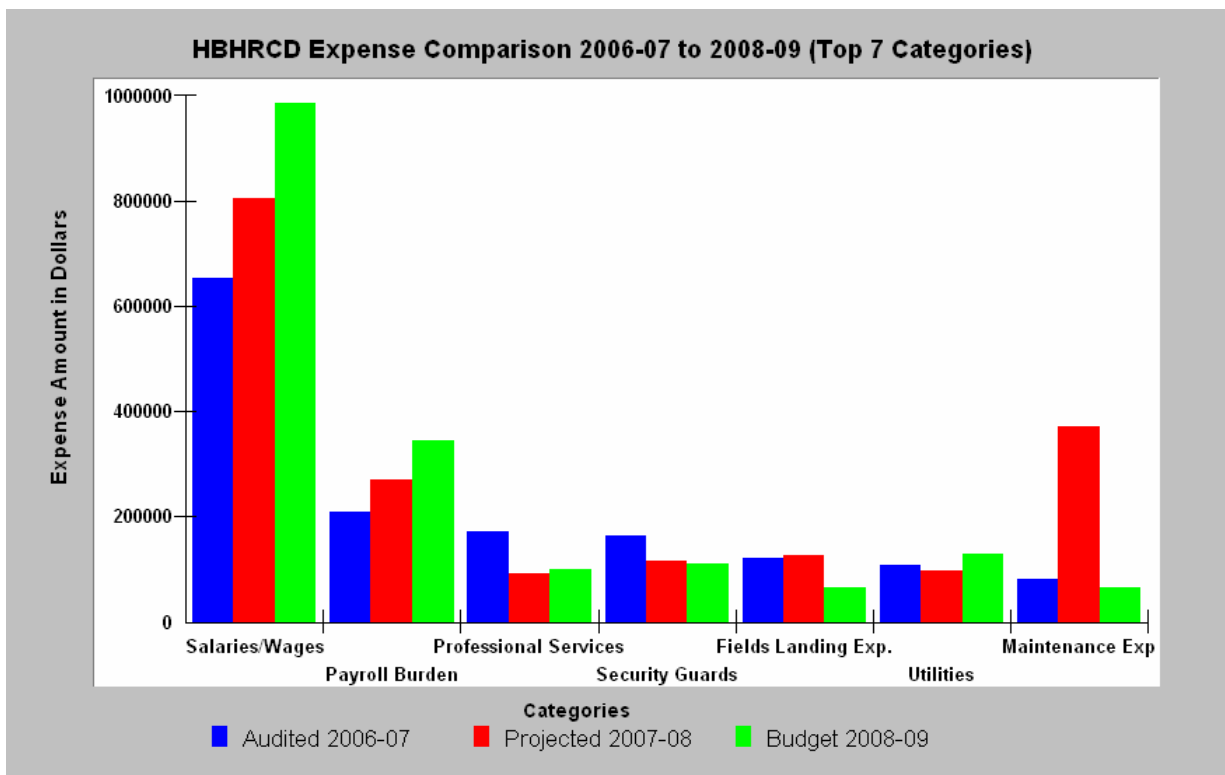


Figure 6. Three year trends in the top seven budget expense categories from 2006-2008 show the sharpest increase in salaries and payroll burden, which is taxes and employee benefits.

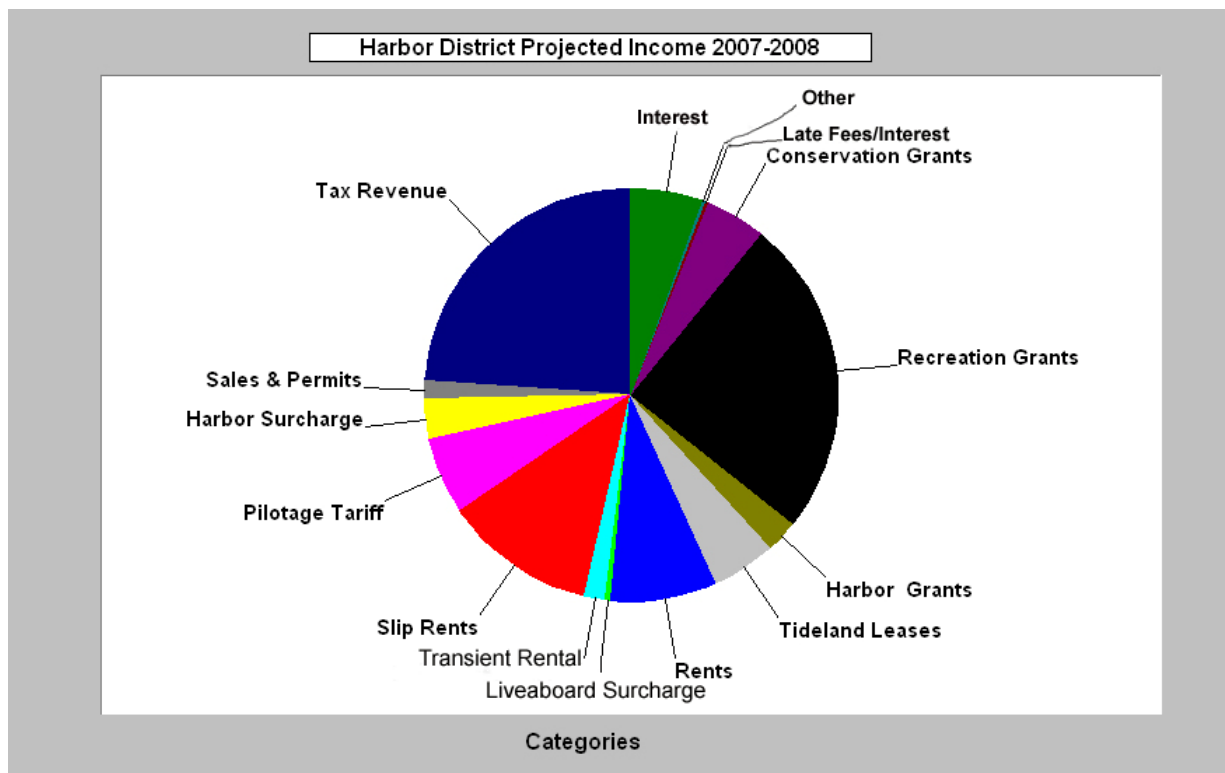


Figure 7. District projected income for 2008-09 is displayed above with recreation grants, tax revenue and slip rents the highest three categories.

comprising the highest three sources. Shipping tariffs and fees do not come close to offsetting expense of marine shipping related staff.

I believe there is room for substantial growth in revenue associated with the District's recreation and conservation missions. It is also my opinion that we can bring the Woodley Island Marina operation out of the red with improved management. Our shipping enterprises, however, are not producing revenue to offset expenses. I realize that our Commission and District staff have been investing capital in expectation of substantial pay back when a large scale shipping enterprise begins operation. However, if construction and operation of a large scale shipping facility does not come about (or is too long in gestation); at some point the District will have depleted its capital resources and will face bankruptcy.

I am looking forward to the Redwood Dock Business Plan report from TranSystems that should give clear projections of cash flow for the next several years so that our Commission can estimate if or when we are expecting shipping revenues to increase. Although we have interest and enthusiasm from the Goldman-Sachs for marketing the Port of Humboldt and the Northwest Pacific Railroad, their representative made it clear that there would have to be completed and approved environmental impact statements for both enterprises before any auction could take place. In just preliminary consideration, I see the District encumbering at least \$1 million for this environmental review over the next five years. This will further contribute to our deficit and may accelerate the rate of reserve depletion.

I hope this analysis is helpful and can generate focused discussion so that we can ultimately balance our budget and structure an enterprise that is more fiscally sound.

Sincerely,

A handwritten signature in black ink, appearing to read 'Patrick Higgins', with a large, stylized flourish extending from the end of the signature.

Patrick Higgins