# CITY AND COUNTY OF SAN FRANCISCO

## BOARD OF SUPERVISORS

### BUDGET AND LEGISLATIVE ANALYST

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**TO:** Budget and Finance Committee

**FROM:** Budget and Legislative Analyst

**SUBJECT:** May 3, 2023 Budget and Finance Committee Meeting

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## EXECUTIVE SUMMARY

### Legislative Objectives

- The proposed ordinance would amend the Administrative Code to modify the waivers of specified contract-related requirements in the Administrative and Environment Codes for electricity and related product transactions, authorize binding arbitration for contracts with investor-owned utilities, and increase the annual expenditure limit for energy procurements from $150 million to $200 million.

### Key Points

- In July 2022, the Board of Supervisors approved an ordinance to add Chapter 21.43 to the Administrative Code, which approves form electricity purchase and sale contracts for the SFPUC, grants Administrative and Environment Code waivers for these contracts, and delegates authority to the SFPUC General Manager under Charter Section 9.118 to execute certain contracts with terms in excess of 10 years, or requiring expenditures of $10 million or more, or having anticipated revenues of at least $1 million, for a period of three years through June 30, 2025.
- Due to rapid increases in wholesale energy market prices, SFPUC believes that the $150 million annual expenditure limit is no longer sufficient to purchase the electricity products needed for Hetch Hetchy Power and CleanPowerSF and is requesting that the limit be increased to $200 million. The proposed ordinance would also waive additional provisions of the Administrative and Environment Codes, which are not included in form energy contracts used by SFPUC, as well as authorize binding arbitration in Resource Adequacy and related products and services contracts with investor-owned utilities, which is a standard provision in these contracts.

### Fiscal Impact

- The authority delegated by the proposed ordinance would be used to enter into contracts with total annual expenditures of up to $200 million, an increase of $50 million from the existing authority. Contracts may have a total term length of up to 25 years. Therefore, a total of $5 billion in contract expenditures may be authorized by the proposed ordinance. This is an increase of $1.25 billion over the existing total authorized expenditures of $3.75 billion allowed through the $150 million annual limit.

### Recommendation

- Because the proposed ordinance waives (1) additional standard contracting provisions required by the City's municipal codes, and (2) the Board of Supervisors' authority under Charter Section 9.118, authorizing the SFPUC to enter into contracts longer than 10 years or in an amount of $10 million or more without further Board of Supervisors approval, approval of the proposed ordinance is a policy matter for the Board of Supervisors.

## MANDATE STATEMENT

City Charter Section 9.118(b) states that any contract entered into by a department, board or commission that (1) has a term of more than ten years, (2) requires expenditures of $10 million or more, or (3) requires a modification of more than $500,000 is subject to Board of Supervisors approval.

City Charter Section 2.105 states that all legislative acts shall be by ordinance, approved by a majority of the members of the Board of Supervisors.

## BACKGROUND

In July 2022, the Board of Supervisors approved an ordinance to add Chapter 21.43 of the Administrative Code, which approves form electricity purchase and sale contracts for the San Francisco Public Utilities Commission (SFPUC), grants Administrative and Environment Code waivers for these contracts, and delegates the SFPUC General Manager authority under Charter Section 9.118 to execute certain contracts with terms in excess of 10 years or requiring expenditures of $10 million or more or having anticipated revenues of at least $1 million, for a period of three years through June 30, 2025 (File 22-0652).

SFPUC requested the ordinance because CleanPowerSF and Hetch Hetchy Power must enter into contracts for electricity products under compressed timelines to comply with state law and California Public Utilities Commission (CPUC), California Energy Commission (CEC), and California Independent System Operator (CAISO) rules and regulations, such as Resource Adequacy requirements.[1] The energy market is highly volatile and increasingly competitive, with six Investor-Owned Utilities, 71 Publicly Owned Electric Utilities, 24 Community Choice Aggregation (CCA) programs, and 19 Energy Service Providers supplying wholesale customers and retail customers (as of July 2022). The time-limited pricing typically offered in the industry cause the SFPUC to size commitments to the authority of the General Manager to secure power supplies on market timelines, even when the SFPUC is aware that a larger purchase commitment may have produced more favorable outcomes for ratepayers were the SFPUC able to execute a contract within the time-limited window. As such, SFPUC staff believes the Board of Supervisors approval is not always feasible or convenient.

Additionally, the ordinance authorized SFPUC to use two widely used industry standard agreements (the Western Systems Power Pool Agreement and Edison Electric Institute Master Agreement), the SFPUC's purchase, storage, and sale agreements, and form contracts developed by California Community Power (CC Power).[2] The form agreements do not include provisions required under the City's Administrative Code, such as: (1) non-discrimination in contracts (Chapter 12B); (2) MacBride Principles (Chapter 12F); (3) local business enterprise utilization and non-discrimination in contracting (Chapter 14B); (4) consideration of criminal history in hiring (Chapter 12T); (5) consideration of salary history in hiring (Chapter 12K); (6) prohibition on

[1] State law requires all electric service providers, including CleanPowerSF and Hetch Hetchy Power, to maintain certain quantities of Resource Adequacy (RA) to ensure sufficient electric generation resources to meet unusually high levels of consumer demand.

[2] CC Power is a Joint Powers Authority comprised of nine California CCA programs, including CleanPowerSF.

contracting in certain states (Chapter 12X); (7) first source hiring (Chapter 83); (8) competitive bidding requirements (Section 21.1); and (9) tropical hardwood and virgin redwood ban (Environment Code Chapter 8). These requirements were waived under the ordinance.

SFPUC reports that wholesale energy market prices have increased faster than anticipated due to supply chain delays, Russia's invasion of Ukraine, heat waves, and drought conditions (prior to December 2022) impacting hydroelectric energy outputs. We noted these impacts in a March 2023 amendment to SFPUC's scheduling coordinator services contract with APX Inc. (File 23-0091).[3] SFPUC's contract originally had an amount not to exceed $134,742,800 over a five-year term, or approximately $27 million per year in projected expenditures. Due to rising costs, and after consulting trade industry projections, SFPUC requested an amendment less than one year later to increase the not-to-exceed amount to $895,742,800 over the same five-year term, or approximately $179 million per year, a 565 percent increase. As such, the SFPUC Power Enterprise no longer believes that the annual expenditure authority of $150 million is sufficient to meet operational needs and requests that this limit be increased to $200 million.

## DETAILS OF PROPOSED LEGISLATION

The proposed ordinance would amend the Chapter 21.43 of Administrative Code to modify the waivers of specified contract-related requirements in the Administrative and Environment Codes for electricity and related product transactions, authorize binding arbitration for contracts with investor-owned utilities, and increase the annual expenditure limit for energy procurements from $150 million to $200 million.

### Waiver of Administrative and Environment Code Requirements

As noted above, the previous ordinance (File 22-0652) authorized SFPUC to waive several Administrative and Environment Code provisions that are not included in power purchasing form contracts used by SFPUC. The proposed ordinance would expand these waivers to include the following: (1) Minimum Compensation Ordinance (Administrative Code Chapter 12P); (2) Health Care Accountability Ordinance (Administrative Code Chapter 12Q); (3) public access to meetings and records of non-profit organizations (Administrative Code Section 12L.2); (4) sweatfree contracting (Administrative Code Section 12U.4); and (5) food service waste reduction (Environment Code Section 1605).

### Binding Arbitration

The proposed ordinance would authorize SFPUC to enter into contracts for resource adequacy and related products and services from California investor-owned utilities with binding arbitration provisions. Under binding arbitration, a dispute between two parties is decided by a neutral arbitrator rather than in court before a judge or jury, and parties signing a binding arbitration agreement forfeit their rights to go to court or appeal an arbitrator's decision. According to Michael Hyams, SFPUC Deputy Assistant General Manager of Power, SFPUC is

[3] The SFPUC does not meet the CAISO requirement for a "scheduling coordinator," an entity that is authorized to complete power transactions on the CAISO network and as able to make payments to CAISO for power transactions, so SFPUC has contracted for these services.

requesting this authority because binding arbitration is a standard provision in form contracts with investor-owned utilities.[4]

**Increase of Expenditure Authority**

The proposed ordinance would increase the annual expenditure limit for energy procurements under authority delegated to SFPUC from $150 million to $200 million. As noted above, this is due to rapid increases in wholesale energy market prices and SFPUC's belief that the $150 million annual expenditure limit is no longer sufficient to purchase the electricity products needed for Hetch Hetchy Power and CleanPowerSF. The ordinance would retain its requirement that SFPUC provide quarterly reports to the Board of Supervisors with the duration, product purchased, and cost of contracts entered into under the delegated authority, as well as annual reports with program costs, the rates charged to CleanPowerSF customers to recover those costs, and a comparison of those rates to PG&E rates.

## FISCAL IMPACT

The authority delegated by the proposed ordinance would be used to enter into contracts with total annual expenditures of up to $200 million, an increase of $50 million from the existing authority. Contracts may have a total term length of up to 25 years. Therefore, a total of $5 billion in contract expenditures may be authorized by the proposed ordinance. This is an increase of $1.25 billion over the existing total authorized expenditures of $3.75 billion allowed through the $150 million annual limit.

According to Deputy Assistant General Manager Hyams, SFPUC has entered into nine contracts under the existing authority with total expenditures of up to $830 million. SFPUC projects total FY 2022-23 power contract expenditures of $276.7 million for CleanPowerSF and $19 million for Hetch Hetchy Power, for total expenditures of approximately $295.7 million. For FY 2023-24, the SFPUC projects total contract expenditures of approximately $321.6 million for CleanPowerSF and $30 million for Hetch Hetchy Power, for total expenditures of approximately $351.6 million.

## POLICY CONSIDERATIONS

**Waiver of Administrative and Environment Code Requirements**

As noted above, the proposed ordinance would delegate authority to the SFPUC General Manager to waive additional standard contract and City code provisions. According to SFPUC, the City's standard contract terms identified in the proposed ordinance are not standard electric industry terms and many energy sellers reject such terms or will mark up the cost of energy to account for what they may consider a non-market condition and liability.

**Increase of Expenditure Authority**

The proposed ordinance would increase the annual expenditure limit for energy procurements under authority delegated to SFPUC from $150 million to $200 million. Since the SFPUC

[4] In 2018, the Board of Supervisors authorized SFPUC to enter into power contracts with binding arbitration (File 18-0708). Binding arbitration was also included in recent SFPUC power contracts with PG&E (File 19-0997) and Southern California Edison (File 20-1280).

Commission has also delegated its approval authority to the General Manager, the terms of power purchase and sale agreements executed under this authority may not be publicly visible prior to the SFPUC entering into the agreements. As noted above, the ordinance would retain its requirement that SFPUC provide quarterly reports to the Board of Supervisors with the duration, product purchased, and cost of contracts entered into under the delegated authority, as well as annual reports with program costs, the rates charged to CleanPowerSF customers to recover those costs, and a comparison of those rates to PG&E rates. Since the Board of Supervisors approved the ordinance adding Chapter 21.43, the SFPUC has submitted three quarterly reports. Additionally, the SFPUC transmitted the most recent CleanPowerSF annual report to the Clerk of the Board on March 6, 2023.

Because the proposed ordinance waives (1) additional standard contracting provisions required by the City's municipal codes, and (2) the Board of Supervisors' authority under Charter Section 9.118, authorizing the SFPUC to enter into contracts longer than 10 years or in an amount of $10 million or more without further Board of Supervisors approval, approval of the proposed ordinance is a policy matter for the Board of Supervisors.

## RECOMMENDATION

Approval of the proposed ordinance is a policy matter for the Board of Supervisors.

| **Item 2**<br>**File 23-0405** | **Department:**<br>Office of the Treasurer-Tax Collector (TTX) |
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**EXECUTIVE SUMMARY**

**Legislative Objectives**

- The proposed resolution would approve the 12th Amendment to the online tax filing system contract between the Office of the Treasurer and Tax Collector (TTX) and 21 Tech, LLC, extending the term by 10 years through May 2033, and increasing the not-to-exceed amount by $10,000,000, for a total not to exceed $18,200,000.

**Key Points**

- In 2011, TTX issued a Request for Proposals (RFP) to replace its business tax system. TTX selected a joint proposal between XTech JV, a joint venture between 21 Tech LLC and Eaton and Associates, and Manatron, Inc. After the business tax system was implemented, Manatron provided 21 Tech the source code to its proprietary software. In 2013, TTX received a sole-source waiver from the Office of Contract Administration (OCA) to award a contract to 21 Tech to continue supporting the system and build online tax filing and payment portals. 21 Tech's contract has been amended 11 times, with the term extended through May 2023 for a total amount not to exceed $8,150,713. TTX has requested a sole-source waiver from the OCA to extend the contract for an additional 10 years.
- Under the contract, 21 Tech develops and supports online tax filing and payment forms it has built for TTX, including the Business Tax Payment Portal and filing forms for New Business Registration, Business Registration Renewal, Gross Receipts Tax, Homelessness Gross Receipts Tax, Commercial Rents Tax, Commercial Vacancy Tax, Overpaid Executive Tax, and Administrative Office Tax.
- The proposed contract has a not to exceed amount of $18,150,173, which is less than the $18,200,000 in the proposed resolution.

**Fiscal Impact**

- Over the 10-year extension term, TTX projects annual expenditures of $1,000,000. Average actual expenditures on the existing contract have been approximately $815,000, however the proposed not to exceed amount assumes $250,000 in annual spending for tax modifications and new taxes.
- The contract is primarily funded by revenues from the various taxes collected, as well as through interdepartmental workorders.

**Recommendations**

- Amend the resolution to correct the not-to-exceed amount of the contract to $18,150,173.
- Approve the resolution, as amended.

## MANDATE STATEMENT

City Charter Section 9.118(b) states that any contract entered into by a department, board or commission that (1) has a term of more than ten years, (2) requires expenditures of $10 million or more, or (3) requires a modification of more than $500,000 is subject to Board of Supervisors approval.

## BACKGROUND

In 2011, the Office of the Treasurer-Tax Collector (TTX) issued a Request for Proposals (RFP) to replace its business tax system, which was at the end of its useful life. TTX selected a joint proposal between XTech JV, a joint venture between 21 Tech LLC and Eaton and Associates, and Manatron, Inc. After the business tax system was implemented, Manatron provided 21 Tech the source code to its proprietary software. TTX received a sole-source waiver from the Office of Contract Administration (OCA) to award a contract to 21 Tech to continue supporting the system. In 2013, TTX executed a contract with 21 Tech to develop online tax filing portals, which integrate with the business tax system. The contract had a term of five years and one month, from June 2013 through June 2018, and an amount not to exceed $1,787,120. The contract has been amended 11 times, with the term extended by five years through May 2023, and the not-to-exceed amount increased by $6,363,593, for a total not to exceed $8,150,713.[1] According to Amanda Kahn Fried, TTX Chief of Policy and Communications, the Department has expended or encumbered the full $8,150,173 current contract not-to-exceed amount.

TTX and 21 Tech have agreed to extend the contract for an additional 10 years. According to Eric Manke, TTX Policy and Communications Manager, TTX has requested a sole-source waiver from the OCA to extend the contract beyond the current 10-year term to align with the approved contract extension with Manatron, Inc. for the Aumentum software.[2]

## DETAILS OF PROPOSED LEGISLATION

The proposed resolution would approve the 12th Amendment to the contract between TTX and 21 Tech, extending the term by 10 years through May 2033, and increasing the not-to-exceed amount by $10,000,000, for a total not to exceed $18,200,000. However, the proposed contract has a not-to-exceed amount of $18,150,173, which is less than the $18,200,000 in the proposed resolution. The Budget and Legislative Analyst recommends amending the resolution to correct the not-to-exceed amount from $18,200,000, as stated in the resolution, to $18,150,173, consistent with the proposed 12th Amendment.

### Services

Under the contract, 21 Tech supports online tax filing and payment forms it has built for TTX, including the Business Tax Payment Portal and filing forms for New Business Registration,

[1] The original contract and 11 amendments did not require Board of Supervisors approval because the contract has not exceeded 10 years or $10 million.

[2] Because the contract is sole-sourced, Administrative Code Section 21.9's total contract term limitation of 10 years does not apply.

Business Registration Renewal, Gross Receipts Tax, Homelessness Gross Receipts Tax, Commercial Rents Tax, Commercial Vacancy Tax, Overpaid Executive Tax, and Administrative Office Tax. According to Policy and Communications Manager Manke, the online tax forms built and supported by 21 Tech have enabled over 350,000 tax filings in the past three years, providing over $2.4 billion in revenue, and accounting for 95 percent of the City's business tax filings.

**Performance**

According to Policy and Communications Manager Manke, TTX does not formally document contractor performance. The Department informally assesses 21 Tech's performance regarding responsiveness to inquiries or issues, timeliness of deliverables, quality of work, ability to meet project deadlines and goals, ability to work collaboratively with TTX, adherence to contract terms and conditions, weekly meetings, documentation for all projects, and training sessions. Each project contains a set of deliverables with associated milestone payments. According to Policy and Communications Manager Manke, 21 Tech consistently meets or exceeds these standards and TTX is pleased with 21 Tech's performance.

## FISCAL IMPACT

Over the 10-year extension term, TTX projects annual expenditures of $1,000,000. Average actual expenditures on the existing contract have been approximately $815,000, however the proposed not to exceed amount assumes $250,000 in annual spending for tax modifications and new taxes. Projected annual expenditures by tax and fee type are shown in Exhibit 1 below.

**Exhibit 1: Projected Annual Expenditures by Tax and Fee Type**

| Business Tax/Fee Type | Annual Expenditures | Total Expenditures (10 Years) |
|---|---|---|
| Gross Receipts Tax | $94,049 | $940,493 |
| Homelessness Gross Receipts Tax | 39,695 | 396,950 |
| Commercial Rents Tax | 57,632 | 576,317 |
| Business Registration Fee | 173,835 | 1,738,350 |
| Homelessness Administrative Office Tax | 39,423 | 394,230 |
| Administrative Office Tax | 39,423 | 394,230 |
| Payroll Expense Tax | 28,603 | 286,030 |
| Commercial Vacancy Tax | 200,000 | 2,000,000 |
| Overpaid Executive Tax | 38,005 | 380,050 |
| Cannabis Tax | 39,335 | 393,350 |
| Tax Modifications and New Legislation | 250,000 | 2,500,000 |
| **Total** | **$1,000,000** | **$10,000,000** |

Source: TTX

Consistent with the current contract, under the proposed amendment, 21 Tech would charge hourly billing rates up to $240 for the first year of the contract extension, with annual increases up to three percent, based on the inflation rate.

The contract is primarily funded by revenues from the various taxes collected. TTX also receives annual workorders of $39,695 from the General City Responsibility budget unit for the Homelessness Gross Receipts Tax, $39,695 from the Department of Early Care and Education

(DEC) for the Commercial Rents Tax, and $75,000 from the Office of Economic and Workforce Development (OEWD) for the Commercial Vacancy Tax.

## RECOMMENDATIONS

1. Amend the resolution to correct the contract not-to-exceed amount to $18,150,173, consistent with the contract.
2. Approve the resolution as amended.

| **Item 3**<br>**File 23-0315** | **Department:**<br>San Francisco Public Library (SFPL) |
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**EXECUTIVE SUMMARY**

**Legislative Objectives**

- The proposed resolution would approve the Director of Public Works' emergency declaration under Administrative Code, Section 6.60 for remediation work and repairs at the San Francisco Main Public Library for an estimated total cost of approximately $550,000.

**Key Points**

- On January 20, 2023, a sewer overflow occurred on the fourth floor of the San Francisco Main Library due to foreign objects being flushed down a toilet, impacting floors one through three in the northwest corner of the building. Space used by both staff and the public were affected, including access to services in the Talking Books and Braille Center, Audio-Visual Room, and Genre Room.
- The Library declared a state of emergency in a letter to Public Works on January 31, 2023. Public Works declared a state of emergency and issued a contract to Belfor Property Restoration Services (Belfor) on February 17, 2023. Public Works introduced a resolution declaring a state of emergency to the Board of Supervisors on March 21, 2023, which falls within the 60-day requirement of Administrative Code Sec. 6.60(d).
- Because immediate remediation services were needed given the nature of the sewer overflow event, Library staff contacted Belfor to begin the repair and remediation services the evening of the event. Belfor is a registered City vendor and has been utilized as an emergency damage remediation vendor previously on both insured and self-insured losses at City facilities.
- The contract's scope of work includes remediation services for sewer overflow impacting the first through third floors of the Library; the removal and repair of damaged materials, including furniture; containment and reconstruction of the impacted areas; and reconstruction of flooring, sheetrock, insulation, cubicles, and paint, and other elements.

**Fiscal Impact**

- The San Francisco Public Main Library facility is insured for property loss under an insurance program administered through the Risk Management Division of the City Administrator's Office. Consequently, the $550,000 in estimated costs (minus a $10,000 deductible) will be paid by insurers and the $10,000 deductible will be paid from the Library Preservation Fund.
- Repair costs in excesses of $550,000 would require Board of Supervisors' approval.

**Recommendation**

- Approve the proposed resolution.

## MANDATE STATEMENT

Administrative Code Section 6.60 provides that City contracts entered into for emergency work may be executed in the most expeditious manner. However, declarations of emergencies where the repair work is anticipated to be $250,000 or more are subject to Board of Supervisors approval. Section 6.60(d) also states that if the emergency does not permit Board of Supervisors approval of the emergency before work is commenced or the contract(s) entered into, such approvals from the Board of Supervisors shall be obtained as soon as possible, with the proposed resolution approving the emergency determination submitted to the Board of Supervisors within 60 days of the department head's emergency declaration.

## BACKGROUND

**Main Library Damage**

On January 20, 2023, a sewer overflow occurred on the fourth floor of the San Francisco Main Library due to foreign objects being flushed down a toilet, impacting floors one through three in the northwest corner of the building. Space used by both staff and the public were affected, including access to services in the Talking Books and Braille Center, Audio-Visual Room, and Genre Room. According to the library, space occupied by a total of 23 staff (12 staff on the second floor and 11 staff on the first floor) was impacted by the sewer overflow. Consequently, San Francisco Public Library (Library) staff states that immediate remediation services were required given the sudden and unforeseeable nature and damage of the sewer overflow, which created a health hazard, and emergency repair was needed to safeguard the City's property and reopen the public spaces for use.

**Emergency Declaration**

The Chief Operating Officer of the San Francisco Public Library declared a state of emergency in a letter to the Public Works Interim Director on January 31, 2023. The Department of Public Works (Public Works) declared a state of emergency and issued a contract to Belfor Property Restoration Services (Belfor) on February 17, 2023. Public Works introduced a resolution declaring a state of emergency to the Board of Supervisors on March 21, 2023, which falls within the 60-day requirement of Administrative Code Sec. 6.60(d). The declaration of emergency allows the Department to contract without undergoing a competitive solicitation.

**Vendor Selection**

According to the Library, because immediate remediation services were needed given the nature of the sewer overflow event, the Department contacted a contractor, Belfor Property Restoration Services (Belfor), to begin the repair and remediation services the evening of the event. According to Library staff, Belfor is a registered City vendor and has been utilized as an emergency damage remediation vendor previously on both insured and self-insured losses at City facilities. In addition, Belfor has agreed-upon fee schedules with the City's insurers. The Library chose to retain Belfor for the continued remediation and repair work after the immediate response work was completed for continuity and because the majority of the costs are being paid from insurance proceeds.

## DETAILS OF PROPOSED LEGISLATION

The proposed resolution would approve the Director of Public Works' emergency declaration under Administrative Code, Section 6.60 for remediation work and repairs at the San Francisco Main Public Library for an estimated total cost of approximately $550,000. Emergency repairs costs in excess of $550,000 authorized in the proposed resolution would require Board of Supervisors' approval.

### Contract

The contract between the City and Belfor provides for a not-to-exceed amount of $550,000 and requires the work to be completed within 30 calendar days of the official Notice to Proceed.[1] The scope of work includes remediation services for sewer overflow impacting the first through third floors of the Library; the removal and repair of damaged materials, including furniture; containment and reconstruction of the impacted areas; and reconstruction of flooring, sheetrock, insulation, cubicles, paint, and other elements. Library staff state that almost all components of the impacted areas were damaged or contaminated, including ceilings, ductwork, wallboard (such as painted surfaces), insulation, cubicles, and floor coverings.

### Timeline

According to Library staff, remediation work (e.g., cleanup, disinfection, removal of damaged materials) began on January 20, 2023 and was completed February 9, 2023. Reconstruction and repair work began on approximately February 13, 2023, and most of the work has been completed, except for reconstruction of elements with long lead order timelines (including flooring and cubicles). Two large components that still need to be completed on the first floor, include: (1) replacing the flooring throughout the Genre Room as it was contaminated with black water;[2] and (2) replacing the cubicles in the Info Services office area as they were also contaminated with black water. The completion date of the work is to be determined. According to the Library, the timeline is dependent on the final scope of work and final cost of repair agreement between Belfor, the City, and its insurers. Library staff state that a timeline has been requested, as well as the current status on progress towards completion.

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[1] According to Library staff, the remediation work was completed within 30 days. Belfor was given the official Notice to Proceed with reconstruction on February 13, 2023, and most of the work has been completed, except for reconstruction of flooring and cubicles, which have long lead order timelines.

[2] Black water is wastewater from toilets.

## FISCAL IMPACT

The San Francisco Public Main Library facility is insured for property loss under an insurance program[3] administered through the Risk Management Division of the City Administrator's Office on behalf of various City departments and enterprise agencies. Consequently, the $550,000 in estimated costs (minus a $10,000 deductible) will be paid by insurers[4] and the $10,000 deductible will be paid from the Library Preservation Fund. Repair costs in excess of $550,000 would require Board of Supervisors' approval.

According to the Library, the estimated total cost of $550,000 is based on Belfor's initial estimates, which include $200,000 for remediation services and $350,000 for the removal of damaged materials, repair, and reconstruction including furnishing replacements. The contractor will be paid based on pre-agreed and filed rates with the insurer, and the contractor has agreed to comply with the City's prevailing wage requirements. Invoices for the remediation and repair work are being audited by insurers and likely will not be available until the restoration has been accepted, billed, and audited. Consequently, according to Library staff, a line-item budget of total costs is not available and actual expenditures to date are unknown as bill submission goes directly to insurer.

## RECOMMENDATION

Approve the proposed resolution.

[3] Alliant Property Insurance Program. Alliant is the broker leading the insurance program and Lexington Insurance Company is the lead insurer, with which Belfor as agreed-upon rates.
[4] According to staff from the Risk Management Division of the City Administrator's Office, the insurer is paying the vendor directly, except for the Library's deductible.

| **Items 5 & 6**<br>**Files 23-0204 & 23-0342**<br>*(Continued from 4/19/23 meeting)* | **Department:**<br>Airport |
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## EXECUTIVE SUMMARY

### Legislative Objectives

- **File 23-0204** is a resolution that would approve the 2023 Lease and Use agreement between the City and 29 airlines to conduct flight operations at the Airport for a 10-year term from July 1, 2023 through June 30, 2033.
- **File 23-0342** is a resolution that would approve the 2023 Lease and Use agreement between the City and an additional 11 airlines to conduct flight operations at the Airport for a 10-year term from July 1, 2023 through June 30, 2033.

### Key Points

- According to Airport staff, there are currently 60 airlines operating at the Airport. Of the 60 airlines, 40 signatory airlines are under the Airport's 2011 Lease and Use Agreement and 20 are "non-signatory airlines" operating under month-to-month Airline Operating Permits and Terminal Space and Use Permits. Non-signatory airlines pay a 25 percent premium on landing fees and a higher security deposit compared to signatory airlines.
- The original term of the 2011 Lease was July 1, 2011 through June 30, 2021, later extended to June 30, 2023 due to COVID.
- Rental rates, landing fees, and related fees are adjusted annually according to the Airport's "residual rate setting methodology (breakeven policy)" such that the total amount of airline revenues received by the Airport together with non-airline revenues received by the Airport, including concession and parking revenues, is equal to total Airport costs, including debt service and operating costs.
- The proposed lease creates a new Operating Revenue and Capital Improvement Fund (ORCIF) totaling $800 million over the 10-year term and increases annually to account for inflation, among other changes. According to the proposed lease, ORCIF funds "may be used for any lawful purpose for which Airport Revenues may be used."

### Fiscal Impact

- The proposed new lease and use agreement with the 40 signatory airlines are estimated by Airport staff to provide approximately $6.1 billion in revenues to the Airport, over the 10-year lease term, including $3.4 billion in airline rents and $2.6 billion in landing fees.

### Recommendation

- Approve the proposed resolutions.

## MANDATE STATEMENT

Section 2A.173 of the City's Administrative Code authorizes the Airport to negotiate and execute leases of Airport lands and space in Airport buildings without undergoing a competitive bid process, as long as the original term of the lease does not exceed 50 years.

City Charter Section 9.118(a) states that contracts entered into by a department, board, or commission that (i) have anticipated revenues of $1 million or more, or (ii) have anticipated revenues of $1 million or more and require modifications, are subject to Board of Supervisors approval.

## BACKGROUND

**2011 Airport Lease & Use Agreement**

According to Airport staff, there are currently 60 airlines operating at the Airport. Of the 60 airlines, 40 signatory airlines are under the Airport's 2011 Lease and Use Agreement and 20 are "non-signatory airlines" operating under month-to-month Airline Operating Permits and Terminal Space and Use Permits. The airline lease and use agreement set the rate making methodology, legal and business terms for the operation of airlines at the airport, and gate allocation and operating procedures. Non-signatory airlines pay a 25 percent premium on landing fees and a higher security deposit compared to signatory airlines.

The original term of the 2011 Lease was July 1, 2011 through June 30, 2021. According to a February 7, 2023 memorandum from the Airport Director to the Airport Commission on the award of the 2023 Lease and Use Agreement (2023 Airport Lease Award Memo), airport staff and signatory airlines suspended negotiations of a new lease due to the impact of the COVID-19 pandemic on airport operations, and the Airport Commission approved a two-year extension of the term for the 2011 Lease for a new expiration date of June 30, 2023, which was approved by the Board of Supervisors in May 2021 (File 21-0335). The Airport and signatory airlines later resumed negotiations of a new lease and have agreed to the terms of the 2023 proposed lease.

**Residual Rate Setting Methodology**

The rent and landing fees, which are charged by the Airport to the airlines, are determined by the Airport's "residual rate setting methodology (breakeven policy)" set forth in the 2011 Lease. Under such methodology, the rental rates, landing fees, and related fees are adjusted annually such that the total amount of airline revenues received by the Airport together with non-airline revenues received by the Airport, including concession and parking revenues, is equal to total Airport costs, including debt service and operating costs.

According to Exhibit O of the 2023 proposed lease, each airline's terminal area rentals are calculated by multiplying the terminal area rental rate by the airline's leased terminal space (in square feet). Terminal area rental rates are based on net terminal area expenses and gross terminal space and vary according to five categories of terminal space (i.e., the rental rates for check-in counters are different than the rental rates for baggage claim lobbies). Landing fees are calculated by multiplying net airfield area expenses by the airline's projected share of total landed weight (in thousands of pounds). In addition, each airline pays a surcharge (which is applied to both terminal area rentals and landing fees) to cover the expenses of public space in the terminal. The Pro Forma for FY 2023-24 from Exhibit O of the 2023 proposed lease showing the calculation of terminal area rentals, rental rate structure, and calculation of landing fees is provided in Attachment 1.

**Airport Economic Recovery**

According to traffic and non-airline revenue performance data presented to the Airport Commission on January 17, 2023, the number of enplaned passengers for both domestic and international air travel was 82 percent of 2019 levels in November 2022, and non-airline revenues were 104 percent of 2019 levels due to strong parking, ground transportation, and car rental revenues according to the meeting minutes. Although air traffic has not fully recovered, Airport staff report that airline revenues continue to be sufficient together with non-airline revenues to cover the Airport's costs due to the breakeven policy.

## DETAILS OF PROPOSED LEGISLATION

**File 23-0204** is a resolution that would approve the 2023 Lease and Use agreement between the City and 29 airlines to conduct flight operations at the Airport for a 10-year term from July 1, 2023 through June 30, 2033.

**File 23-0342** is a resolution that would approve the 2023 Lease and Use agreement between the City and an additional 11 airlines to conduct flight operations at the Airport for a 10-year term from July 1, 2023 through June 30, 2033.

The proposed resolutions would also affirm the Planning Department's determination under the California Environmental Quality Act and authorize the Airport Director to enter into immaterial modifications to the lease.

**Signatory Airlines**

All signatory airlines execute the same form of the lease with slight differences reflecting the specific airline's allocation of space. To date, the Airport Commission has awarded the proposed 2023 lease to 40 airlines. The Airport Commission awarded the proposed 2023 lease to the following 29 signatory airlines on February 7, 2023:

1. ABX Air, Inc.
2. Aerovias de Mexico S.A. de C.V. dba Aeromexico
3. Air China Limited
4. Air India Limited
5. Air New Zealand Limited
6. Air Transport International, Inc.
7. Alaska Airlines, Inc.
8. All Nippon Airways Co, Limited
9. Asiana Airlines Inc.
10. China Eastern Airlines Co. Ltd
11. Condor Flugdienst GMBH
12. Delta Air Lines, Inc.
13. Deutsche Lufthansa AG dba Lufthansa German Airlines
14. Emirates
15. EVA Airways Corporation
16. Federal Express Corporation
17. Japan Airlines Co., Ltd.
18. Kalitta Air LLC
19. Koninklijke Luchtvaart Maatschappij N. V. dba KLM Royal Dutch Airlines
20. Korean Air Lines Co., Ltd
21. Nippon Cargo Airlines, Inc.
22. Scandinavian Airlines of North America Inc dba Scandinavian Airlines SAS
23. Singapore Airlines Limited
24. Societe Air France dba Air France
25. Southwest Airlines Co.
26. Sun Country, Inc.
27. Turk Hava Yollaria A.O. dba Turkish Airlines
28. United Airlines, Inc.
29. Virgin Atlantic Airways Limited

In addition, the Airport Commission awarded the proposed 2023 lease to the following 11 airlines on March 21, 2023:

30. Air Canada
31. American Airlines, Inc.
32. British Airways, PLC
33. Cathay Pacific Airways, Ltd.
34. China Airlines, Ltd.
35. China Southern Airlines Company Limited
36. Frontier Airlines, Inc.
37. Philippine Airlines, Inc.
38. Swiss International Air Lines, Ltd.
39. TACA International Airlines, S.A. (TACA dba Avianca)
40. WestJet

File 23-0204 would approve leases between the City and airlines one through 29 above, and File 23-0342 would approve leases between the City and airlines 30 through 40. According to the 2023 Airport Lease Award Memo, the proposed 2023 lease has been offered to all airlines operating at the Airport and will continue to be offered to all other airlines, including new entrants, through the remainder of its term.[1]

**Key Lease Terms**

Key lease terms are summarized in Exhibit 1 below, based on the 2023 Airport Lease Award Memo.

[1] According to Airport staff, there were fewer signatory airlines initially under the proposed lease (29) compared to the existing lease (40) because some airlines could not get the necessary corporate approval within the timeframe or may elect not to sign the 2023 lease.

**Exhibit 1: Proposed 2023 Airport Lease and Use Agreement Terms**

| | |
|---|---|
| Term | July 1, 2023 through June 30, 2033 (10 years) |
| Rate-Making Methodology | Existing residual rate setting methodology (described above) is maintained. Signatory airlines pay terminal area rentals, landing fees, and other usage fees, which are adjusted annually by the Commission to ensure that total airline and non-airline revenues are equal to total airport costs, including debt service. |
| Annual Service Payment | Existing Airport Annual Service Payment to the City's General Fund is maintained at the greater of $5 million or 15% of Airport concession revenues. |
| Operating Reserve and Capital Improvement Fund | Establishes an operating reserve and capital improvement fund totaling $800 million over the 10-year term and adjusted annually for inflation. |
| Shared Use Equipment | Expands rights of the Airport Commission to install shared use equipment throughout the Airport, including in exclusive use spaces of airlines, to enhance operational efficiency. |
| Preferential Use Gate Allocation | Expands review period of airline seat capacity to allocate preferential use gates to encourage consistent use of preferential use gates throughout the year. |
| Gate Accommodations | Enhances rights of the City to accommodate flights at preferential use gates of signatory airlines to maximize the use of a gate and capacity and efficiency of the Airport. |
| Sustainable Aviation Fuel Working Group | Establishes a Sustainable Aviation Fuel Working Group of Airport staff and signatory airlines that would determine how the parties can cooperate to increase the uptake of sustainable aviation fuel at the Airport. The working group will be chaired by the Airport Director. |
| Ground Service Equipment Electrification | Establishes a mutual goal to achieve 100% electric-powered ground service equipment at the Airport. |
| Airline Relocation Costs | Clarifies financial liability for airline relocations. If an airline initiates its relocation within the Airport, that airline is financially responsible for the move and for any required secondary relocations of other airlines. If the Airport initiates relocation of an airline, the Airport is financially responsible, subject to rate recovery under the lease. |
| Digital Information Working Group | Establishes a Digital Information Working Group chaired by the Airport Director and consisting of Airport staff and signatory airlines that will identify data on airport infrastructure and airline operations that could be exchanged to enhance Airport operations and improve the experience of Airport guests. |
| Commercialization of Digital Assets | Acknowledgement that the Airport has the sole and exclusive right to control, manage, and utilize all Airport Proprietary Content. |

Source: 2023 Airport Lease Award Memo

**Operating Revenue and Capital Improvement Fund**

As shown in Exhibit 1 above, the proposed lease creates a new Operating Revenue and Capital Improvement Fund (ORCIF) totaling $800 million over the 10-year term and increases annually to account for inflation. According to the proposed lease, ORCIF funds "may be used for any lawful purpose for which Airport Revenues may be used." Expenditures on capital improvements from the fund are subject to the lease's review process for capital improvements. The proposed lease establishes a minimum and a maximum annual ORCIF deposit for each year and states that no deposit shall be made to the fund in any year when the unencumbered and unallocated balance of the fund exceeds $650 million. Deposits to the fund will be funded by airline revenues.

## FISCAL IMPACT

As shown in Exhibit 2 below, the proposed new lease and use agreement with the 40 signatory airlines are estimated by the Airport to provide approximately $6.1 billion in revenues to the Airport, over the 10-year lease term.[2] In FY 2023-24, total airline rents are budgeted at $371.5 million, of which $283.1 million is provided by the Lease and Use Agreement for the 40 airlines, with the remaining $88.4 million in rental revenues coming from non-signatory airlines. Total landing fees are budgeted at $300.4 million in FY 2023-24, of which $217.4 million is provided by the Lease and Use Agreement, with the remaining $83.0 million in landing fees coming from non-signatory airlines.

**Exhibit 2: Estimated Total Annual Lease Revenues**

| Fiscal Year | Terminal Area Rental Revenue | Landing Fees | Total Lease Revenue | Annual Percent Change |
|---|---|---|---|---|
| FY 2023-24 | $283,070,971 | $217,443,856 | $500,514,827 | |
| FY 2024-25 | 297,856,096 | 230,664,442 | 528,520,538 | 6% |
| FY 2025-26 | 312,526,623 | 242,336,064 | 554,862,687 | 5% |
| FY 2026-27 | 327,807,755 | 252,126,441 | 579,934,196 | 5% |
| FY 2027-28 | 339,703,578 | 262,312,349 | 602,015,927 | 4% |
| FY 2028-29 | 349,946,602 | 270,234,181 | 620,180,784 | 3% |
| FY 2029-30 | 360,455,258 | 278,395,254 | 638,850,513 | 3% |
| FY 2030-31 | 371,279,173 | 286,802,790 | 658,081,963 | 3% |
| FY 2031-32 | 382,427,805 | 295,464,235 | 677,892,040 | 3% |
| FY 2032-33 | 393,910,897 | 304,387,256 | 698,298,154 | 3% |
| **Total** | **$3,418,984,758** | **$2,640,166,870** | **$6,059,151,628** | |

Source: Airport

[2] File 23-0204 would generate an estimated $5.1 billion in revenues over the 10-year term from 29 signatory airlines, and File 23-0342 would generate an estimated $1.0 billion in revenues over the 10-year term from 11 additional signatory airlines.

The estimated revenue is based on: (a) projected terminal use and landed weight of the 40 airlines through FY 2027-28; (b) proforma terminal area rental rates from the proposed lease, increased annually by three percent per year; and (c) proforma landing fee rates from the proposed lease, increased annually by two percent per year.

As discussed above, the revenues generated by the proposed leases are calculated by the Airport's residual rate setting methodology (breakeven policy), such that the proposed new leases would continue to result in the Airport's budget being fully balanced by the revenues paid by the airlines to the Airport after considering the Airport's budgeted expenditures and all non-airline revenues. Changes to Airport expenses, including debt service, and non-airline revenues will result in changes in airline revenues.

## RECOMMENDATION

Approve the proposed resolutions.

**Attachment 1: FY 2023-24 Pro Forma for Terminal Rentals and Landing Fees from Exhibit O of Proposed ABX Air, Inc. Lease**

**Attachment 3**

**CALCULATION OF TERMINAL AREA RENTALS AND RENTAL SURCHARGE**
**(BASIC RENTAL ADJUSTMENT)**
**SAN FRANCISCO INTERNATIONAL AIRPORT**
Fiscal Year 2023/24
(dollars in thousands, except for rates)

| | | Pro Forma 2024 |
|---|---|---|
| **Terminal Area Expenses** | | |
| Operation and Maintenance Expenses | | $ 390,267 |
| Debt Service | | 453,436 |
| Small Capital Outlays | | 2,699 |
| Equipment | | 1,185 |
| Annual Service Payment | | 45,773 |
| Annual ORCIF Deposit | | 196,844 |
| Deferred Aviation Revenue | | (196,844) |
| | | $ 893,360 |
| ÷ 'Gross Terminal Space (square feet) | | 5,916 |
| = Basic Rate | | $151.02 |
| x Airline Leased Space (square feet) | | 1,742 |
| **= Basic Rentals** | [A] | $ 263,048 |
| **Rental Surcharge (Basic Rental Adjustment)** | | |
| Basic Rate | | $151.02 |
| x Public Space | | 4,174 |
| = Cost of Public Space | | $630,312 |
| - Non-airline revenues | | (175,077) |
| - PFCs Classified as Revenues | | (150,000) |
| + Net Expense - GT and Parking Area | | - |
| Rental Surcharge | | $ 305,236 |
| **Allocation of Rental Surcharge (Basic Rental Adjustment)** | | |
| Terminal Area Rental Surcharge | [B] | $ 152,618 |
| Landing Fee Surcharge | | 152,618 |
| | | 305,236 |
| **Terminal Area Rentals** | | |
| Basic Rentals | [A] | $ 263,048 |
| Terminal Area Rental Surcharge | [B] | 152,618 |
| | | $ 415,666 |
| **Effective Average Rental Rate** | | |
| Basic Rate | | $151.02 |
| Rental Surcharge Rate | | 87.62 |
| | | $238.63 |

Note: Amounts may not add due to rounding.

2023-2033 Lease and Use Agreement
ABX Air, Inc.
Exhibit O, Page 12

**Attachment 4**

**DERIVATION OF REQUIRED AIRLINE RENTAL RATE STRUCTURE**

**SAN FRANCISCO INTERNATIONAL AIRPORT**

Fiscal Year 2023/24

(dollars in thousands, except for rates)

| | Relative value | Pro Forma 2024 |
|---|---|---|
| **Airline Leased Space (square feet)** | | |
| Category I | | 321 |
| Category II | | 552 |
| Category III | | 195 |
| Category IV | | 633 |
| Category V | | 40 |
| | | 1,742 |
| **Equivalent Category I (square feet)** | | |
| Category I | 1.00 | 321 |
| Category II | 0.75 | 414 |
| Category III | 0.50 | 98 |
| Category IV | 0.25 | 158 |
| Category V | 0.10 | 4 |
| | | 995 |
| **Required Category I** | | |
| Terminal Area Rentals | | $ 415,666 |
| Divided by Equivalent Category I space (square feet) | | 995 |
| Required Category I Rate (per square foot) | | $417.58 |

| **Terminal Rental Rates** | Relative value | |
|---|---|---|
| Category I | 1.00 | $417.58 |
| Category II | 0.75 | 313.19 |
| Category III | 0.50 | 208.79 |
| Category IV | 0.25 | 104.40 |
| Category V | 0.10 | 41.76 |

Note: Amounts may not add due to rounding.

2023-2033 Lease and Use Agreement
ABX Air, Inc.

Exhibit O, Page 13

**Attachment 5**

**CALCULATION OF LANDING FEES AND LANDING FEE RATE**

**SAN FRANCISCO INTERNATIONAL AIRPORT**

Fiscal Year 2023/24

(dollars in thousands, except for rates)

| | Pro Forma 2024 |
|---|---|
| **BASIC LANDING FEES** | |
| Operation and Maintenance Expenses | $105,388 |
| Debt Service | 43,403 |
| Small Capital Outlays | 460 |
| Equipment | 671 |
| Annual ORCIF Deposit | 53,156 |
| | $203,077 |
| Non-airline revenues | (4,616) |
| PFCs Classified as Revenues | (1,000) |
| Deferred Aviation Revenue deficit (surplus) | (53,156) |
| Net expense (revenue) - Other Leased Areas | 3,115 |
| Net expense (revenue) - West of Bayshore Area | 2,471 |
| **Airfield Area Net Expense** | $149,891 |
| ÷ Composite landed weight forecast (in 1,000 lbs units) | 36,050 |
| = Basic Rate (per 1,000 lbs.) | $4.16 |
| | |
| **LANDING FEE SURCHARGE** | |
| Landing Fee Surcharge | $ 152,618 |
| Net revenue - GT and Parking Area | (52,048) |
| | $ 100,570 |
| ÷ Composite landed weight forecast (in 1,000 lbs units) | 36,050 |
| = Landing Fee Surcharge Rate (per 1,000 lbs.) | $2.79 |

| | |
|---|---|
| **Landing Fees** | |
| Basic Landing Fees | $ 149,891 |
| Landing Fee Surcharge | 100,570 |
| | $ 250,461 |
| | |
| **Landing Fee Rate** | |
| Basic Rate | $4.16 |
| Surcharge Rate | 2.79 |
| | $6.95 |

Note: Amounts may not add due to rounding.

2023-2033 Lease and Use Agreement Exhibit O, Page 14
ABX Air, Inc.