

**CITY AND COUNTY OF SAN FRANCISCO**  
**BOARD OF SUPERVISORS**  
**BUDGET AND LEGISLATIVE ANALYST**

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March 6, 2015

**TO:** Budget and Finance Sub-Committee

**FROM:** Budget and Legislative Analyst



**SUBJECT:** March 11, 2015 Budget and Finance Sub-Committee Meeting

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**Item 3**  
**File 14-1208**

**Department:**  
Department of Technology

### EXECUTIVE SUMMARY

#### Legislative Objectives

- The proposed ordinance would approve the second amendment to the master contract between the City and AT&T to (1) Retroactively extend the end date of the master contract by 19 months from September 1, 2014 to March 1, 2016, (2) Increase the contract amount by \$26,433,700, from \$75,000,000 to \$101,433,700 and (3) Allow the Department of Technology to use AT&T's Calnet 3 rates (discussed below).

#### Key Points

- In May 2010, the Board of Supervisors approved a not-to-exceed \$75,000,000 contract between the Department of Technology (DT) and AT&T from March 1, 2010 to August 31, 2014 for the purchase of telecommunications services and equipment (File 10-0251). Based on this contract, the City's rates for telecommunication services rely primarily on California's rate agreement with AT&T, Calnet 2, and other rate agreements negotiated by other public entities.
- The State of California completed a competitive bid for a new telecommunications agreement in 2014, Calnet 3. While AT&T is the sole service provider for Calnet 2, the State's competitive bid process for Calnet 3 allowed more service providers to compete with AT&T, resulting in lower rates for the majority of services.

#### Fiscal Impact

- The proposed ordinance would extend the City's contract with AT&T on a sole source basis to March 1, 2016 and allow the City to take advantage AT&T's cheaper rates offered in Calnet 3. DT expects to migrate the City to AT&T's Calnet 3 rates by July 29, 2015. Based on an analysis conducted by AT&T, the City will save an estimated \$48,287 per month after migrating to AT&T's Calnet 3 rates. However, the analysis does not estimate cost savings to the City if the City were to select a Calnet 3 provider other than AT&T.

#### Recommendations

- Request the City Administrator to work with the Controller's City Services Auditor to evaluate the best possible Calnet 3 rates and providers by type of service, and report back to the Board of Supervisors prior to October 15, 2015 on recommended service providers by type of service.
- Amend the proposed ordinance to extend the existing master contract between AT&T and the City to December 31, 2015 rather than the proposed end date of March 1, 2016.
- Amend the proposed ordinance to reduce the contract not-to-exceed amount by \$3,480,000 from \$101,433,700 to \$97,953,700.
- Approve the proposed ordinance as amended.

**MANDATE STATEMENT / BACKGROUND****Mandate Statement**

City Charter Section 9.118(b) states that a 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 with a \$500,000 impact or more is subject to Board of Supervisors approval.

City Administrative Code Section 21.16 allows the Purchaser to use the competitive procurement process of any other public agency to purchase commodities or services for the City under the terms established in that agency's competitive procurement process upon making a determination that (1) the other agency's procurement process was competitive or the result of a sole source award, and (2) the use of the other agency's procurement would be in the City's best interests.

**Background**

In May 2010, the Board of Supervisors passed an ordinance approving a not-to-exceed \$75,000,000 contract between the Department of Technology (DT) and AT&T from March 1, 2010 to August 31, 2014 for the purchase of telecommunications services and equipment (File 10-0251). The contract combined all existing and proposed AT&T services and equipment under one citywide master contract as part of DT's effort to consolidate information technology procurement and contracting on a citywide basis.

The master contract allows the City to purchase telecommunications services and equipment from AT&T under the best pricing provided by AT&T to other public entities, including (1) the State of California's Integrated Information Network agreement (Calnet 2), (2) the Western States Contracting Alliance agreement, (3) the San Francisco Airport Sonet agreement, and (4) the Merced County agreement. California's Calnet 2 rate agreement with AT&T is the most widely used pricing schedule in this master contract. The California Department of Technology, Office of Technology Services selected AT&T to provide Calnet 2 services through a competitive process in 2005. The City did not conduct its own competitive solicitation for similar services in 2010 and instead relied on the State's competitive 2005 competitive solicitation process in accordance with Administrative Code Section 21.16.

The Department of Technology entered into an amendment to the master contract in April 2013 to address administrative changes. According to Ms. Fan-Wa Wong, DT Administrative Analyst, this amendment was not subject to Board of Supervisors approval because it did not increase the contract amount or term.

**Reporting to Board of Supervisors**

At the recommendation of the Budget and Legislative Analyst, the ordinance approving the original contract was amended to require that the Department of Technology report to the Board of Supervisors on approximately September 1, 2013 on (a) the specific Local Business Enterprises retained and the amount of the proposed agreement awarded to each LBE under

the subject AT&T agreement and (b) the expenditures incurred by each City department each year under the subject AT&T agreement, and for the City as a whole. On August 1, 2013, the Department of Technology reported to the Board of Supervisors (a) that no Local Business Enterprises had been retained as part of the AT&T master agreement and (b) during FY 09-13 the City had spent \$34,375,705 on purchase orders under the agreement. As recommended by the Budget and Legislative Analyst, a breakdown of spending by department was included in the memo.

## DETAILS OF PROPOSED LEGISLATION

The proposed ordinance would approve the second amendment to the master contract between the City and AT&T to:

1. Extend the end date of the master contract by 18 months retroactively to September 1, 2014 to March 1, 2016.
2. Increase the contract amount by \$26,433,700, from \$75,000,000 to \$101,433,700.
3. Allow the Department of Technology to use AT&T's less costly Calnet 3 rates.

### **The Original Contract with AT&T Expired August 31, 2014**

According to Ms. Wong, DT proposes to extend the existing contract with AT&T rather than select a new vendor through a competitive solicitation process because DT staff resignations resulted in delays in planning for a new competitive solicitation process. Although DT began planning for the termination of the AT&T contract in early 2014, DT's contract manager for the AT&T contract went on leave in June 2014 and subsequently resigned and DT's director resigned in July 2014 and a new director was not officially appointed until December 2014.<sup>1</sup>

As noted above, the existing contract between the City and AT&T expired on August 31, 2014. According to Ms. Wong, because the contract with AT&T has expired, AT&T may revert to charging the City market rates for services at any moment, which are higher, on average, than the current rates under the master agreement.

The State's Calnet 2 rates were originally set to expire on January 30, 2016, and be replaced by new Calnet 3 rates. Therefore, DT originally proposed to extend the existing contract with AT&T by 19 months through March 1, 2016, which allowed for a one-month close-out period after expiration of the Calnet 2 rates. However, on December 23, 2014 AT&T informed DT that Calnet 2 rates, for which there is comparable service in Calnet 3, would be phased out no later than July 29, 2015, approximately six months earlier than DT's anticipated Calnet 2 end date of January 30, 2016. During January 2015 DT researched the new rate structure available within Calnet 3 and plans to transition to Calnet 3 prior to the expiration of the Calnet 2 rates.

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<sup>1</sup> On December 8, 2014, the Mayor's Office announced the appointment of Miguel Gamiño as the Executive Director of the Department of Technology.

**FISCAL IMPACT**

City departments spent or encumbered \$62,672,070 of the \$75,000,000 AT&T contract amount through December 29, 2014 with a remaining contract amount of \$12,327,930, as shown in Table 1 below. Of the remaining \$12,327,930, the Department of Emergency Services has been allocated \$50,000 to make changes to the City's 9-1-1 system. Of the remaining \$12,277,930, \$8,754,625 has been reallocated to the Department of Technology's Citywide Reserve for Professional Services in anticipation of 1) professional services for the Public Safety Building, 2) reserve for the new San Francisco General Hospital, and 3) contingency for professional services for other city departments.

**Table 1: AT&T Contract Expenditures, March 1 2010 – December 29, 2014**

Program	Allocation	Amount Spent or Encumbered as of December 29, 2014	Remaining Contract Authority	Reallocation of Remaining Authority	Remaining Contract Authority after Reallocation
Department of Technology	\$49,978,914	\$44,547,096	\$5,431,818	\$3,322,807	\$8,754,625
Airport	10,906,349	9,016,067	1,890,282	0	1,890,282
SF General Hospital	7,951,001	7,662,300	288,701	0	288,701
Laguna Honda Hospital	942,201	942,201	0	0	0
Public Library	3,005,751	240,974	2,764,777	(2,584,777)	180,000
Police	1,388,535	224,213	1,164,322	0	1,164,322
Public Utilities Commission	707,249	0	707,249	(707,249)	0
Children, Youth and Their Families	90,000	27,051	62,949	(62,949)	0
Hetch Hetchy Water	30,000	12,168	17,832	(17,832)	0
Department of Emergency Management	0	0	0	50,000	50,000
<b>Total</b>	<b>\$75,000,000</b>	<b>\$62,672,070</b>	<b>\$12,327,930</b>	<b>(\$0)</b>	<b>\$12,327,930</b>

Source: Department of Technology

The proposed ordinance would increase the AT&T contract amount by \$26,433,700, from \$75,000,000 to \$101,433,700. According to Ms. Wong, the increase of \$26,433,700 is necessary to provide monthly telecommunications services to City departments, and new services for the new Public Safety Building and San Francisco General Hospital, Library internet services, and Airport wifi improvements through June 30, 2016, as shown in Table 2 below. According to Ms. Wong, DT estimated the cost of these services through June 30, 2016, rather than the expiration date of the proposed second amendment of March 1, 2016, because these costs are based on City departments' FY 2015-16 budgets. Of the additional requested \$26,433,700, DT has budgeted \$14,360,000 for the City's monthly AT&T service charges, which were approximately \$680,000 per month in 2014.

**Table 2: Uses of Funds Remaining from Prior Contract and Additional Proposed Not-To-Exceed Amount**

Program	Remaining Contract Authority after Reallocation	Requested Amount through June 30, 2016	Total Available Contract Authority	Uses
Department of Technology	\$8,754,625	\$14,360,000	\$23,114,625	Monthly Services; IT for Public Safety Building; General Hospital Seismic Retrofit; Contingency for Professional Services
Airport	1,890,282	10,299,800	12,190,082	Wifi improvement and updates, Help Desk
SF General Hospital	288,701	1,563,900	1,852,601	Building upgrades and services
Public Library	180,000		180,000	Internet Service Provider (ISP) Services
Police	1,164,322		1,164,322	Communication upgrades
Department of Emergency Management	50,000		50,000	Updates to the 9-1-1 System
Moscone Center	N/A	210,000	210,000	Phone/internet
<b>Total</b>	<b>\$12,327,930</b>	<b>\$26,433,700</b>	<b>\$38,761,630</b>	

Source: Department of Technology

## POLICY CONSIDERATION

### The State's Competitive Bid Process

The State of California competitively bid for Calnet 3 services, which include telephone, fiber based data connection, data networking services, and professional consulting services. While AT&T is the sole service provider for Calnet 2, the State's competitive bid process for Calnet 3 rates allowed more service providers to compete with AT&T. The Calnet 3 providers are shown below in Table 3. As shown in Table 3, AT&T's Calnet 3 rates are lower than AT&T's Calnet 2 rates for all services except for legacy services, for which AT&T remains the sole provider.<sup>2</sup>

Administrative Code Section 21.16 allows the City to rely upon the competitive bidding processes of other public agencies. According to Mr. Kenneth Bukowski, Deputy City Administrator, utilizing Calnet 3 rates negotiated by the State most likely represents the lowest cost option for the City's internet and telephone needs. Mr. Bukowski does not believe that City would be able to secure lower service rates if it went through its own competitive bid process.

### Comparison of AT&T's Calnet 2 and Calnet 3 Rates

Under the proposed second amendment to the master contract between the City and AT&T, the City could continue to purchase telecommunications services from AT&T under the Calnet 2 rates through July 29, 2015. The proposed second amendment also allows the City to purchase telecommunications services from AT&T under the Calnet 3 rates, which became available between January 2014 to August 2014, as shown in Table 3 below.

<sup>2</sup> "Legacy services" are business access lines connected to AT&T's central office over standard telephone wiring. In San Francisco, only the Department of Public Health (DPH) uses legacy services.

**Table 3: Summary of Calnet 3**

Service Category	Service Providers	AT&T Rate Change: Calnet 2 to Calnet 3	AT&T Calnet 3 Start Date	AT&T Calnet 3 End Date	1 Year Optional Extensions
1.1 Dedicated Transport <sup>a</sup>	AT&T Verizon	Decreased	Jan. 2014	June 2018	2
1.2 MPLS VPN and Converged VoIP <sup>b</sup>	AT&T Integra Jive NWN Verizon	Decreased	Feb. 2014	June 2018	2
1.3 Standalone VoIP	AT&T Integra Jive Verizon	Decreased	Jan. 2014	June 2018	2
1.4 Long Distance	AT&T CenturyLink	Decreased	Jan. 2014	June 2018	2
1.5 Toll Free	AT&T CenturyLink Verizon	Decreased	Jan. 2014	June 2018	2
1.6 Legacy <sup>c</sup>	AT&T	Increased	Jan. 2014	June 2017	3
2 Web Conferencing	AT&T CenturyLink NWN	Decreased	June 2014	June 2018	2
3 Metropolitan Area Network (MAN) Ethernet <sup>d</sup>	AT&T CenturyLink Integra	Decreased	June 2014	June 2018	2
4.1 SONET Ring	Integra Verizon	Decreased	June 2014	June 2018	2
4.2 SONET Point-to-Point <sup>e</sup>	AT&T Integra Verizon	Decreased	June 2014	June 2018	2
5 Managed Internet <sup>f</sup>	AT&T Integra	Decreased	June 2014	June 2018	2
6.1 Hosted IVR-ACD <sup>g</sup>	AT&T NWN	Decreased	Aug. 2014	June 2018	2
7 Network Based Managed Security	AT&T CenturyLink Verizon	Decreased	June 2014	June 2018	2

Source: Department of Technology; AT&T

<sup>a</sup> Dedicated transport is dedicated digital line service providing data transport.

<sup>b</sup> MPLS (multiprotocol label switching) is a network based VPN (virtual private network) solution, enabling customers to build an application VPN to link locations and efficiently transmit data over a single connection. VoIP (voice over internet protocol) provides internet- based telephone services.

<sup>c</sup> Legacy services are Business Access Lines that connect directly with AT&T's central office over standard telephone wiring.

<sup>d</sup> Metropolitan Area Network Ethernet is an Ethernet transport service using fiber and copper access technology and a switched Ethernet core network. This service provides data transport between the customer's premises and AT&T's central office, allowing data ports to be interconnected in a variety of ways in the core network.

<sup>e</sup> SONET point to point is a data transport service that connects customer premises in a point-to-point linear configuration (transporting voice, data, video, imaging, internet and other advanced broadband applications).

<sup>f</sup> Managed internet service is a dedicated high-speed internet access service.

<sup>g</sup> Hosted IVR (interactive voice response) is a technology that allows a computer to interact with humans through the use of voice commands; and ACD (automatic call distributor) is an automatic call distribution system.

### AT&T's Estimates of Savings to the City under Calnet 3

AT&T retained a consultant composed of former AT&T employees to estimate the City's savings of migrating from AT&T's Calnet 2 rates to AT&T's Calnet 3 rates.<sup>3</sup> As shown in Table 4 below, based on this analysis the City would save an estimated \$48,287 or 8.5 percent each month once the migration to Calnet 3 rates from Calnet 2 rates is complete. However, the analysis does not estimate cost savings to the City if the City were to select a Calnet 3 provider other than AT&T.

**Table 4: Estimated AT&T Monthly Saving, Calnet 3 Rates vs. Calnet 2 Rates**

Calnet Service Category	AT&T Spend Calnet 2	AT&T Estimated Spend Calnet 3	AT&T Estimated Change C2 to C3	% Change C3 vs. C2
1.1 Dedicated Transport	\$219,764	\$210,964	(\$8,800)	(4.0%)
1.2 MPLS VPN and Converged VoIP	\$6,587	\$1,231	(\$5,356)	(81.3%)
1.3 Standalone VoIP	\$0	\$0	\$0	0.0%
1.4 Long Distance	\$26,076	\$13,107	(\$12,969)	(49.7%)
1.5 Toll Free	\$1,424	\$1,053	(\$371)	(26.1%)
1.6 Legacy Telecommunication	\$179,913	\$193,130	\$13,217	7.3%
<b>Subtotal 1.1 - 1.6</b>	<b>\$433,764</b>	<b>\$419,485</b>	<b>(\$14,279)</b>	<b>(3.3%)</b>
2 Web Conferencing	\$0	\$0	\$0	0.0%
3 Metropolitan Area Network (MAN) Ethernet	\$102,980	\$80,264	(\$22,716)	(22.1%)
4.2 SONET Point-to-Point	\$0	\$0	\$0	0.0%
5 Managed Internet	\$30,409	\$19,117	(\$11,292)	(37.1%)
6.1 Hosted IVR-ACD	\$718	\$718	\$0	0.0%
7 Network Based Managed Security	\$0	\$0	\$0	0.0%
<b>Subtotal 2 - 7</b>	<b>\$134,107</b>	<b>\$100,099</b>	<b>(\$34,008)</b>	<b>(25.4%)</b>
<b>Total</b>	<b>\$567,871</b>	<b>\$519,584</b>	<b>(\$48,287)</b>	<b>(8.5%)</b>

Source: Department of Technology; AT&T

<sup>3</sup> The Budget and Legislative Analyst interviewed AT&T and its consultant to understand AT&T's methodology. The consultant completed its rate analysis in two phases. For service categories 1.1 – 1.6, the consultant reviewed the City's Calnet 2 bill from January 2014 and then used Calnet 3 prices to determine the estimated savings. The analysis for service categories 1.1 – 1.6 was completed in April 2014. Once bids were awarded for service categories 2 – 6, the consultant reviewed the City's October 2014 bill and again applied Calnet 3 rates to estimate the City's savings. The analysis for service categories 2 – 6 was completed in January 2015. For each estimate, the consultant used the most recent month's bill available for review. AT&T's estimate of the City's monthly costs of \$567,871 differs from the City's estimate of \$680,000 due to differences in the time periods under examination.



Calnet 3 provides a price ceiling for phone and internet services which can then be negotiated down by customers. The Department of Technology intends to negotiate with AT&T to lower the rates charged by AT&T under Calnet 3 for use of legacy services, potentially increasing the City's monthly savings estimated in Table 4. AT&T did not bid for the SONET Ring Connectivity (category 4.1 above in Table 3 above) business and as such is not a service provider to that line of business within the Calnet 3 agreement. The Airport is the only City department to use SONET services. The Airport will still have access to SONET services from AT&T and preferred rates through the SONET pricing schedule referenced in the original contract between AT&T and the City.

### **Calnet 3 Providers and Rates**

Under the proposed second amendment to the master contract between the City and AT&T, the City would continue to use AT&T as a service provider under Calnet 3 rates. According to Ms. Wong, DT intends to move to Calnet 3 services provided by AT&T as soon as possible. AT&T estimates that it will take 45 – 60 days to move all services to Calnet 3 once the transition begins.

However, the City has the option to use Calnet 3 service providers other than AT&T (shown in Table 3 above), either by contracting directly with the service provider or submitting a work authorization to the State to use the service provider. DT has not evaluated if the City could potentially receive more cost-effective services from Calnet 3 service providers other than AT&T.

The Board of Supervisors should request the City Administrator to work with the Controller's City Services Auditor Performance Management Unit to evaluate the Calnet 3 rates and services, and recommend the most cost-effective service providers by type of service. According to Mr. Bukowski, the process to evaluate Calnet 3 services, obtain Board of Supervisors approval as required by the Administrative Code, and implement new agreements will take approximately ten months. Therefore, the proposed ordinance should be amended to extend the existing master contract between AT&T and the City to December 31, 2015 rather than the proposed end date of March 1, 2016.

Under the proposed ordinance, the contract not-to-exceed amount would increase by \$26,433,700, from \$75,000,000 to \$101,433,700. The proposed ordinance should be amended to decrease the proposed contract not-to-exceed amount by \$3,480,000, from \$101,433,700 to \$97,953,700, which is sufficient to pay for the City's monthly telecommunications costs, and City's departments' costs for new telecommunications services and projects, discussed above.

## **RECOMMENDATIONS**

1. Request the City Administrator to work with the City Services Auditor to evaluate the best possible Calnet 3 rates and providers by type of service, and report back to the Board of Supervisors prior to October 15, 2015 on recommended service providers by type of service.
2. Amend the proposed ordinance to extend the existing master contract between AT&T and the City to December 31, 2015 rather than the proposed end date of March 1, 2016.

3. Amend the proposed ordinance to reduce the contract not-to-exceed amount by \$3,480,000 from \$101,433,700 to \$97,953,700.
4. Approve the proposed ordinance as amended.

**Items 4 and 5**  
**Files 15-0078 and 150079**

**Department:**  
 Public Utilities Commission (PUC)

## EXECUTIVE SUMMARY

### Legislative Objectives

- File 15-0078: Ordinance amending the Administrative Code to add Chapter 43, Article XIV, Sections 43.14.1 through 43.14.9, to provide procedures for the issuance of Power Revenue Bonds by the San Francisco Public Utilities Commission (SFPUC).
- File 15-0079: Ordinance approving the issuance and sale of revenue bonds by the SFPUC in an amount not to exceed \$48,000,000 to finance various capital projects pursuant to Charter Section 9.107(6) and Section 9.107(8); approving certain documents/agreements; making California Environmental Quality Act determinations and other actions.

### Key Points

- On February 10, 2015, the SFPUC approved a 10-year Capital Plan which includes \$760 million for power projects, including \$550,000,000 of funding from power revenue bonds. On June 24, 2014, the Board of Supervisors approved the SFPUC's capital budget for FY 2014-15 and FY 2015-16 and authorized the SFPUC to issue up to \$112,346,843 of power revenue bonds. To date the SFPUC has not issued any SFPUC Power revenue bonds.

### Fiscal Impact

- Total estimated debt service over the 30-year term of the bonds at 4.2% annual interest is \$87,072,605, consisting of \$48,000,000 in principal and \$39,072,605 in interest. The estimated average annual debt service payment is approximately \$2,900,000.
- Debt service payments will be covered by Power Enterprise revenues from the sale of electricity. The City's General Fund departments currently pay a subsidized rate of \$.0575/kWH, which will increase by \$.01/kWH in FY 2015-16. All SFPUC's power rates are projected to increase to cover the actual costs of service, including debt service for power revenue bonds. In FY 2014-15, SFPUC estimated the City's General Fund departments received \$20 million of subsidized electric power rates.

### Policy Consideration

- File 15-0078 authorizes the SFPUC to refund bonds by resolution of the SFPUC, without Board of Supervisors approval, provided the refunding bonds achieve debt service savings.

### Recommendations

- Except for the provisions to authorize the SFPUC refunding bonds without further approval by the Board of Supervisors, which the Budget and Legislative Analyst considers to be a policy decision, approve the proposed ordinances.
- Approval of Section 43.14.6 in File 15-0078 to allow the SFPUC to authorize bonds to be refunded without approval of the Board of Supervisors is a policy decision for the Board of Supervisors. If the Board of Supervisors wants to delegate such authority to the SFPUC, the proposed ordinance should be amended to specify a net present value debt service savings threshold of at least 3% of the refunded bonds, consistent with City debt policy.

**MANDATE STATEMENT / BACKGROUND**

According to Charter Section 9.107(6) and 9.107(8), the Board of Supervisors is authorized to provide for the issuance of revenue bonds without voter approval if:

Issued for the purpose of the reconstruction or replacement of existing water facilities or electric power facilities or combinations of water and electric power facilities under the jurisdiction of the Public Utilities Commission, when authorized by resolution adopted by a three-fourths affirmative vote of the Board of Supervisors; and/or

Issued for the purpose of acquisition, construction, installation, equipping, improvement or rehabilitation of equipment or facilities for renewable energy and energy conservation.

Charter Section 5A.31(d) states that 1/20th of one percent from the proceeds of each issuance or sale of public utility revenue bonds must be set aside for use by the Public Utilities Commission Revenue Bond Oversight Committee to cover the costs of Committee activities.

Charter Appendix F1.113 states that 0.2 percent of the bond expenditures net of bond financing and auditing costs be allocated to support the Controller's Audit Fund.

**Background**

Since the construction of the Hetch Hetchy Project in 1918, the San Francisco Public Utilities Commission (SFPUC) has been responsible for providing water and electricity to Bay Area and San Francisco customers and the Modesto and Turlock Irrigation Districts<sup>1</sup>. Currently, the Hetch Hetchy Project delivers water to approximately 2.6 million Bay Area residents and generates an average of 1.6 million megawatts (MWh) of clean renewable electricity annually.

In 2005, the SFPUC reorganized and created a Power Enterprise, functionally and financially separate from the SFPUC's existing Water Enterprise and Wastewater Enterprise. The Power Enterprise is responsible for generating, scheduling, purchasing, selling, transmitting and distributing electricity to meet the needs of approximately 2,416 retail and wholesale customers. SFPUC Power Enterprise customers include: (a) all City municipal departments, including City Hall, police and fire stations, City hospitals, Moscone Convention Center, MUNI, the Airport, public housing, and all City streetlights and traffic signals; (b) tenants in City-owned properties, including the Port and Airport; and (c) tenants in the Hunters Point Shipyard Phase I redevelopment project, Treasure Island and Transbay Transit Center.

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<sup>1</sup> The PUC has provided electricity to these two State irrigation districts since the 1920s in accordance with the terms of the Federal Raker Act, which granted the City rights of way over federal lands in Yosemite National Park, Stanislaus National Forest and other public lands to construct and operate the Hetch Hetchy Project, to provide water to the Bay Area and generate hydroelectricity as part of the City's water delivery operations.

Electricity is generated through three large hydroelectric powerhouses located in Tuolumne County: (1) Holm Powerhouse, (2) Kirkwood Powerhouse and (3) Moccasin Powerhouse and then delivered through distribution and transmission lines and switchyards and substations. Most of the SFPUC's existing powerhouses, and electrical distribution and transmission systems have been in operation since the 1960s or earlier and are nearing the end of their useful lives, requiring significant capital investment, rebuild and improvements to maintain ongoing operations. The SFPUC's electric power sales must generate sufficient revenues to fund the Power Enterprise's operating expenses while funding capital investments.

To fund these long term capital improvements, on May 13, 2014, the SFPUC approved a 10-year Capital Plan which included \$748 million for power capital projects. On February 10, 2015, the SFPUC approved an updated 10-year Capital Plan (FY 2015-16 through FY 2024-25) which calls for \$760 million for power capital projects. Of the currently identified \$760 million for power capital projects, the current 10-year Capital Plan identifies \$198 million of annual ongoing power revenues, \$12 million from Cap and Trade Auction revenues and \$550 million from debt funding through the issuance of power revenue bonds.

On June 24, 2014, the Board of Supervisors approved the SFPUC's capital budget for FY 2014-15 and FY 2015-16 with the following two ordinances:

- File 14-0482: ordinance authorizing the issuance and sale of SFPUC power revenue bonds for up to \$112,346,843 to finance various SFPUC Power Enterprise capital projects; and
- File 14-0480: supplemental ordinance appropriating \$217,478,836 of Hetch Hetchy revenues, Cap and Trade allowances and Power and Water Revenue Bonds for the SFPUC's Hetch Hetchy Capital Improvement Program, including \$105,878,198 in FY 2014-15 and \$111,600,638 in FY 2015-16, and placing \$173,755,378 of bond funded proceeds on Controller's reserve by project, subject to SFPUC and Board of Supervisors' approval of the California Environmental Quality Act (CEQA) requirements and receipt of proceeds of indebtedness and loan funds.

Although the ordinance under File 14-0482 authorized the SFPUC to issue and sell up to \$112,346,843 of power revenue bonds and the supplemental appropriation ordinance (File 14-0480) specified \$43,004,314 of Power Enterprise revenue bonds and \$15,099,665 of reappropriated Hetchy Power revenue bonds as sources of funding, to date the SFPUC has not issued any SFPUC Power revenue bonds.

## DETAILS OF PROPOSED LEGISLATION

**File 15-0078:** The proposed ordinance amends the Administrative Code to add Chapter 43, Article XIV, Sections 43.14.1 through 43.14.9 to provide procedures for the issuance of Power Revenue Bonds by the SFPUC.

**File 15-0079:** The proposed ordinance approves the issuance and sale of power revenue bonds by the SFPUC in an aggregate principal amount not to exceed \$48,000,000 to finance various capital projects consisting of reconstruction or replacement of existing water and/or electric power facilities pursuant to Charter Section 9.107(6) and the acquisition, construction, installation, equipping, improvement or rehabilitation of equipment or facilities for renewable energy and energy conservation pursuant to Charter Section 9.107(8); approving the execution of certain documents and agreements; confirming and making certain California Environmental Quality Act (CEQA) determinations and approving other actions and matters in connection therewith, as defined herein.

**Amendments to the Administrative Code (File 15-0078)**

Under the proposed ordinance, the City's Administrative Code would be amended to specify the procedures for the SFPUC to separately issue and sell power revenue bonds payable from and secured by the SFPUC's Power Enterprise revenues. Specifically, the proposed ordinance identifies the definitions, procedures for issuance, financing and refinancing of capital improvements, repairs, improvements and replacements for the SFPUC's Power Enterprise. The interest rates on SFPUC Power Enterprise bonds could be fixed or variable, sold through competitive or negotiated sale, with other terms, methods of sale, reserves, debt service coverage and credit agreements and validity of bond actions, to be authorized by future SFPUC Commission determination. The SFPUC could also authorize refunding bonds, without further Board of Supervisors approval, provided such refunding bonds achieve debt service savings as provided in City Administrative Code Article VI, Chapter 43 (see Policy Consideration below).

The proposed ordinance specifies that such power revenue bonds would be limited obligations of the SFPUC and would not constitute general indebtedness to the City subject to repayment by the City's taxing power or through the City's General Fund. Under the proposed ordinance, the SFPUC's Power Enterprise would be defined as the City's electric utility system which provides electric power and related services to the City and its departments, including that portion of the Hetch Hetchy Project that is allocated to power generation, transmission and distribution facilities and related facilities. The SFPUC's Power Enterprise Revenues, which would be obligated for the repayments of the power revenue bonds, would specifically mean the revenues, rates and charges received and accrued by the SFPUC for electric power and energy services. Therefore, this ordinance commits the SFPUC to set sufficient rates and charges for electricity to repay the debt service on the power revenue bonds, including appropriate reserves and debt service coverage and requirements.

**Issuance and Sale of up to \$48,000,000 of Power Revenue Bonds (File 15-0079)**

Under the proposed ordinance, the SFPUC would be authorized to issue the first Power Enterprise Revenue Bonds for up to \$48,000,000 to finance various capital projects that specifically benefit the SFPUC's Power Enterprise in accordance with Charter Section 9.107(6) and 9.107(8). This ordinance limits these power revenue bonds to a maximum 12% annual interest rate, specifies the funding of a debt service reserve account, payment of capitalized interest and the costs of issuance and related costs. This ordinance also approves the security and disclosure documents, including the Master Trust Indenture, First Supplemental Trust Indenture, Bond Purchase Contract, preliminary Official Statement and the Continuing

Disclosure Certificate. In addition, this ordinance confirms the CEQA determinations for the specified projects to be funded with the bond proceeds.

### **Descriptions of Nine Capital Projects**

The SFPUC is proposing to fund the following nine capital projects with the proceeds from the up to \$48,000,000 of Power Revenue bonds, including the first three projects through construction and the following six projects through detailed feasibility and planning studies:

1. Moccasin Hydropower Generator Project – Units 1 and 2 of Moccasin Powerhouse, the hydroelectric generating units, are almost 40 years old and have exceeded their useful life. This project will fund a comprehensive evaluation of the existing conditions, preparation of design specifications, technical assistance, manufacture and installation of components, construction and construction management oversight.
2. Transmission Lines/Distribution System: Moccasin to Warnerville (Don Pedro Reservoir Crossing) – Rehabilitation of transmission and distribution lines and facilities used for hydroelectric power to improve reliability and address the North American Electric Reliability Corporation (NERC) requirements. Transmission projects will include replacement of insulators, switches, towers, groundings, and protective and regulatory requirements. Distribution projects will include over 50 miles of lines, related equipment, substations, disconnect switches, breakers and metering.
3. Hydropower Powerhouse Control Upgrade – Replace existing power control and monitoring system with an upgraded multifunctional digital solution which meets current regulatory requirements and provides diagnostic functions and reduced maintenance requirements.
4. Other Hydropower Powerhouse Projects – Conduct feasibility and planning study for powerhouse upgrades, renewal and replacement, specifically at Holm Powerhouse Generator Unit 2.
5. Switchyard/Substation Rehabilitation (Warnerville Switchyard Phase 1) – Conduct feasibility and planning study at Warnerville Switchyard for renewal and replacement of switchyard and substation components for hydropower transmission, including regulatory grading, fencing and grounding protection.
6. Oil Containment Upgrade at Holm and Kirkwood Powerhouses – Conduct feasibility and planning study to upgrade oil separation systems in the Holm and Kirkwood Powerhouses to prevent oil discharges.
7. Moccasin Generator Step Up Transformers and Oil Containment – Conduct feasibility and planning study for replacement of transformers in Moccasin Powerhouse to improve efficiency and increase power generation.
8. Refurbish Kirkwood Powerhouse and Replace two Turbine Shutoff Valves – Conduct feasibility and planning study to rehabilitate Kirkwood Powerhouse hydroelectric facilities to increase their life expectancy.
9. Moccasin Hydropower Switchyard Upgrade – Conduct feasibility and planning study for renewal and replacement of switchyard and substation components at Moccasin Switchyard for hydropower transmission.

In November 2014, the Planning Department determined that the three construction projects noted above are categorically exempt and the six feasibility and planning studies noted above are statutorily exempt under the California Environmental Quality Act (CEQA), as specified in the subject ordinance (File 15-0079).

### **Details on the Requested up to \$48 Million Issuance**

According to Mr. Michael Brown of the SFPUC's Financial Services Division, the entire requested up to \$48,000,000 bond issuance is anticipated in the spring of 2015 and would be a negotiated, rather than a competitive bid sale. Mr. Brown advises that the SFPUC is recommending a negotiated sale because the proposed power revenue bonds would be the first bond sale for the Power Enterprise, which requires additional outreach and marketing to bond investors unfamiliar with this new issuer. Mr. Brown advises that if these power bonds were sold on a competitive basis, the SFPUC would not expect to obtain the lowest cost.

A portion of the proposed 2015 SFPUC power revenue bonds may be designated and sold as "Green Bonds" a new bond market designation that identifies these bonds as funding projects that result in 100% greenhouse gas-free electricity, and that are environmentally beneficial projects to interested investors. Mr. Brown advises that of the total not-to-exceed \$48,000,000 power revenue bonds, approximately \$30 million would be tax-exempt Green Bonds and the remaining \$18 million would be tax-exempt conventional bonds.

Mr. Brown reports that to select a bond underwriter, the SFPUC sent a Request for Proposal (RFP) to the Controller's Office of Public Finance pre-qualified pool of 25 underwriter firms, to which nine firms responded. The SFPUC and its financial advisors evaluated the nine proposals. Based on the proposals, the SFPUC has selected Wells Fargo Securities as the underwriter for this transaction, as noted in the proposed \$48,000,000 issuance ordinance (File 15-0079).

### **FISCAL IMPACT**

Table 1 below shows estimated total project costs of \$37,300,000 for the nine capital power projects summarized above.

**Table 1: Estimated Nine SFPUC Power Project Costs**

<b><u>Projects</u></b>	<b><u>Cost</u></b>
Moccasin Hydropower Generator Rewind Project	\$24,000,000
Transmission Lines/Distribution System: Moccasin to Warnerville	5,000,000
Hydropower Powerhouse Control Upgrade	1,700,000
Other Hydropower Powerhouse Projects	1,000,000
Switchyard/Substation Rehabilitation	1,500,000
Oil Containment Upgrade at Holm and Kirkwood	1,000,000
Moccasin Generator Step Up Transformers and Oil Containment	1,000,000
Refurbish Kirkwood Powerhouse & Replace Turbine Shutoff Valves	1,500,000
Moccasin Hydropower Switchyard Upgrade	600,000
<b>Total Estimated Project Costs</b>	<b>\$37,300,000</b>



Pursuant to Charter Appendix F1.113, 0.2% of the expenditure budget net of bond financing and audit costs is to be allocated and available to support the Controller's Audit Fund. In accordance with Proposition P approved by San Francisco voters in November 2002, 1/20<sup>th</sup> of 1% (.05%) of the bonds' gross proceeds will be expended for the Revenue Bond Oversight Committee activities. Table 2 below shows the total estimated SFPUC Power Project Costs of \$37,300,000 and the related bond financing, City Services Auditor and the Revenue Bond Oversight Committee costs including a contingency that result in the total estimated \$48,000,000 revenue bond cost.

**Table 2: Total Up to \$48,000,000 Estimated Bond Costs**

Total Project Costs	\$37,300,000
Capitalized Interest	6,000,000
Debt Service Reserve	3,200,000
Bond disclosure counsel & financial advisors	800,000
Contingency	628,000
City Services Auditor Fee	48,000
Revenue Bond Oversight Fee	24,000
<b>Total Estimated Costs</b>	<b>\$48,000,000</b>

### **Estimated Debt Service**

According to Mr. Brown, the estimated annual interest rate for the bond payments will be 4.2%. Total estimated debt service over the 30-year term of the bonds at 4.2% annual interest is \$87,072,605, consisting of \$48,000,000 in principal and \$39,072,605 in interest to fund the above-noted \$37,300,000 in project costs. The estimated average annual debt service payment is approximately \$2,900,000.

### **Electricity Rate Increases Needed to Cover Debt Service**

Debt service payments will be covered by SFPUC's Power Enterprise revenues from the sale of electricity. The electricity rate charged to the City's enterprise departments and other non-General Fund agencies is currently \$.1449/kWH, which is equivalent to the Pacific Gas and Electric (PG&E) power rates. This rate is scheduled to increase by 3% annually starting in FY 2015-16 based on the projected changes to PG&E's rates.

Most of the City's General Fund departments currently pay a subsidized rate of \$.0575/kWH, which will increase by \$.01/kWH in FY 2015-16, and is currently projected to increase by \$.005/kWH annually thereafter. Other City agencies, including the hospitals, libraries, Moscone Convention Center, public buildings and street-lights pay various higher and lower electric rates to the SFPUC, based on prior negotiations with the Mayor's Office. Table 3 below shows the different rates paid by various City departments.

**Table 3: FY 2014-15 and FY 2015-16 City Electric Rates Charged by the SFPUC**

	<b>FY 2014-15 Adopted Rates<sup>(1)</sup></b>	<b>FY 2015-16 Adopted Rates<sup>(1)</sup></b>
General Fund Departments and Related Customers	5.75 ¢/kWh	6.75 ¢/kWh
Public Libraries	9.13 ¢/kWh	10.13 ¢/kWh
Moscone Convention Center Facilities	7.78 ¢/kWh	8.80 ¢/kWh
San Francisco General Hospital	2.70 ¢/kWh	3.70 ¢/kWh
Laguna Honda Hospital	3.49 ¢/kWh	4.49 ¢/kWh
Public Buildings & City Street Lights	2.00 ¢/kWh	3.00 ¢/kWh
Enterprise Departments (tied to PG&E rates)	14.49 ¢/kWh	15.50 ¢/kWh

<sup>(1)</sup> Adopted by the SFPUC.

As noted above, the proposed ordinance (File 15-0078) commits the SFPUC to set sufficient rates and charges for electricity to repay the debt service, including those rates and charges paid by City departments through the City's annual budget process. According to Mr. Brown, all of the City's power rates are projected to gradually rise to cover the actual costs of service, including debt service for the SFPUC's power revenue bonds and required reserve accounts, in accordance with the SFPUC's 10-year financial plan. For FY 2014-15, the SFPUC estimated that the City's General Fund would incur approximately \$20 million of additional costs to fully fund the City's subsidized electric power rates.

In accordance with Charter Section 8B.125, the SFPUC is responsible for setting the rates, fees and other charges for the sale of electricity. The SFPUC's action on all rates, fees and charges is subject to rejection, within 30 days of submission, by resolution of the Board of Supervisors. If the Board of Supervisors does not act within 30 days, the SFPUC proposed rates become effective without further Board of Supervisors action.

#### **Prior Board of Supervisors Authorization for SFPUC Power Revenue Bonds**

As discussed above, in 2014, the Board of Supervisors authorized the issuance and sale of SFPUC power revenue bonds for up to \$112,346,843 to finance various SFPUC Power Enterprise capital projects (File 14-0482). If the Board of Supervisors approves the proposed ordinance (File 15-0079) to issue and sell up to \$48,000,000 of SFPUC power revenue bonds, the SFPUC would have a remaining authorization to issue and sell up to \$64,346,843 of SFPUC power revenue bonds.

## POLICY CONSIDERATION

As noted above, under the proposed ordinance (File 15-0078), the SFPUC could authorize SFPUC refunding bonds, by resolution approved by the SFPUC, without further Board of Supervisors approval, provided such refunding bonds achieve debt service savings as provided in City Administrative Code Article VI, Chapter 43. These provisions would be codified as a new Section 43.14.6 in the City's Administrative Code. Currently, the SFPUC cannot authorize the refunding of Water or Wastewater revenue bonds, without approval of the Board of Supervisors.

Section 43.8.4 of the City's Administrative Code currently specifies that the Board of Supervisors is only authorized to provide for the issuance of refunding general obligation, revenue or lease revenue bonds which provide net debt service savings to the City on a present value basis calculated in provisions of general State law or by other ordinance of the Board of Supervisors. Net debt service savings are calculated by comparing the present value of the aggregate debt service on the refunding bonds to that of the refunded bonds as of the date of the refunding bonds using an assumed rate of interest equal to the yield on the refunding bonds. According to Ms. Nadia Sesay, the Director of the Controller's Office of Public Finance, the City's standard debt policy currently defines such net debt service savings as a minimum of 3%. However, the subject ordinance does not specify a net debt service savings that must be achieved by the SFPUC for such refunding.

Therefore, approval of this provision to allow the SFPUC to authorize revenue bonds to be refunded, without subsequent approval of the Board of Supervisors is a policy decision for the Board of Supervisors. If the Board of Supervisors wants to delegate such authority to the SFPUC, without subsequent approval by the Board of Supervisors, the proposed ordinance should be amended to specify a net present value savings threshold of at least 3% of debt service on the refunded bonds, consistent with existing City debt policy.

## RECOMMENDATIONS

1. Except for the provisions to authorize the SFPUC refunding bonds without further approval by the Board of Supervisors, which the Budget and Legislative Analyst considers to be a policy decision, approve the proposed ordinances.
2. Approval of Section 43.14.6 in File 15-0078 to allow the SFPUC to authorize bonds to be refunded without approval of the Board of Supervisors is a policy decision for the Board of Supervisors. If the Board of Supervisors wants to delegate such authority to the SFPUC, the proposed ordinance should be amended to specify a net present value debt service savings threshold of at least 3% of the refunded bonds, consistent with City debt policy.