

CITY AND COUNTY OF SAN FRANCISCO

BOARD OF SUPERVISORS

BUDGET AND LEGISLATIVE ANALYST

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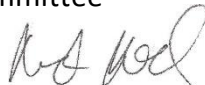
TO: Budget and Appropriations Committee
FROM: Budget and Legislative Analyst 
SUBJECT: June 5, 2024 Budget and Appropriations Committee Meeting

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<p>Item 1 File 24-0455</p>	<p>Department: Public Utilities Commission (PUC)</p>
<p>EXECUTIVE SUMMARY</p>	
<p style="text-align: center;">Legislative Objectives</p> <p>File 24-0455: is an ordinance authorizing \$1,040,007,350 in Water Revenue Bonds.</p> <p style="text-align: center;">Key Points</p> <ul style="list-style-type: none"> • The proposed ordinance is component of the PUC’s FY 2024-25 – FY 2025-26 two-year capital budget, which includes Wastewater and Power Bond authorizations (24-0453, 24-0454) and an appropriation of all PUC capital spending (24-0452). • At its May 22, 2024 meeting, the Budget & Appropriations Committee approved the Wastewater and Power bond authorizations, the capital budget appropriation, and a \$5 million increase to the Water bond authorization to account for emergency water main repair in Pine Lake Park. The amendment to the Water Bond ordinance was deemed substantive and therefore requires consideration at another public meeting. <p style="text-align: center;">Fiscal Impact</p> <ul style="list-style-type: none"> • The average annual debt service for the PUC’s \$3.05 billion in Water, Wastewater, and Power bonds over 30 years is approximately \$221.5 million, or \$6.6 billion in total debt service, excluding any capitalized interest for interim financing. Actual debt service costs may be lower due to bond refunding and access to state and federal lending. • The PUC projects that each division will have sufficient net revenues and unrestricted fund balance to maintain debt service coverage ratios in compliance with its financial policies. <p style="text-align: center;">Policy Consideration</p> <ul style="list-style-type: none"> • The proposed capital budget funds water main replacement at 12 miles per year, which is below the program goal of 15 miles per year. Water main failures require emergency work and may damage residences and businesses. This report provides options to improve water main replacements. • Addressing new and ongoing regulatory actions may require changes to the scale and pace of the Wastewater Enterprise’s capital budget. The cost of the largest capital project, the Biosolids Digester, increased by \$300 million (or 13 percent) since last year, from \$2.37 billion to \$2.67 billion, due to the low number of bids received in recent solicitations. <p style="text-align: center;">Recommendation</p> <p>Approve the proposed ordinance (File 24-0455).</p>	

MANDATE STATEMENT

Charter Section 8B.124 states that the Public Utilities Commission is authorized to issue revenue bonds and other forms of indebtedness, when authorized by two-thirds vote of the Board of Supervisors.

Charter Section F1.113 states that 0.2 percent of the City’s budget, excluding bond debt, must be set-aside for the Controller’s audit fund.

Administrative Code Section 5A.31(d) states that one-twentieth of one percent (0.05%) 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.

BACKGROUND

May 22, 2024 Budget & Appropriations Meeting

The proposed ordinance (File 24-0455) is component of the PUC’s FY 2024-25 – FY 2025-26 two-year capital budget, which includes Wastewater and Power Bond authorizations (24-0453, 24-0454) and an appropriation of all PUC capital spending (24-0452).

At its May 22, 2024 meeting, the Budget & Appropriations Committee approved the Wastewater and Power bond authorizations, the capital budget appropriation, and a \$5 million increase to the Water bond authorization to account for emergency water main repair in Pine Lake Park. The amendment to the Water Bond ordinance was deemed substantive and therefore requires consideration at another public meeting.

The remainder of this report pertains to the entire PUC capital budget for FY 2024-25 – FY 2025-26.

PUC Capital Plan

The Public Utilities Commission (PUC) plans its capital spending over two, ten, and twenty year time frames. The two-year capital budget accompanies the PUC’s two-year operating budget and both two-year spending plans are subject to Board of Supervisors approval.

Wastewater Enterprise Capital Improvement Plan

The Wastewater Enterprise has four major capital improvement programs totaling \$6.0 billion over the ten-year period FY 2024-25 to FY 2033-34.

1. **Sewer System Improvement Program (SSIP):** This program consists of multiple projects that include addressing aging infrastructure, the existing wastewater collection and treatment facilities, and seismic deficiencies, managing stormwater in the City’s eight urban watersheds, and upgrading the existing wastewater system **(\$4.0 billion)**.
2. **Treasure Island Program:** consists of new sewer and stormwater infrastructure on Treasure Island, consistent with the ongoing redevelopment of the area. **(40.9 million)**

3. **Renewal and Replacement Program (R&R):** This program addresses (1) deficiencies in the sewer collection system to ensure they continue to function at proper capacity and meet regulatory standards, and (2) the extension of the useful life of treatment facilities throughout the City by helping to maintain their treatment capacity and performance and maintain regulatory compliance (**\$1.7 billion**).
4. **Facilities and Infrastructure Program (F&I):** consists of capital projects intended to provide for necessary upgrades to aging facilities not included in the SSIP and the R&R Program. These projects include the Southeast Outfall Condition Assessment & Rehabilitation, Ocean Beach Climate Change Adaptation Project, Collection Division Consolidation (WWE Facilities Plan), Southeast Community Center at 1550 Evans, Southeast Bay Outfall Islais Creek Crossing Replacement, and Southwest Ocean Outfall (SWOO) (**\$258.9 million**).

The Wastewater Enterprise's \$6.0 billion ten-year capital improvement plan is an increase from last year's \$4.9 billion ten-year capital plan for Wastewater. The PUC increased the ten-year capital budget by \$1.2 billion, primarily due to the inclusion of the Southeast Plant Nutrients Reduction Project, a new project to reduce nitrogen discharges into the Bay that contribute to algae blooms.

Water Enterprise Capital Improvement Program

The Water Enterprise provides both regional water conveyance and local (in-city) water distribution. The regional water system includes the New Irvington Tunnel conveying water from the Hetch Hetchy Reservoir, the San Antonio and Calaveras Reservoirs in Alameda County, and the San Andreas and Crystal Springs Reservoirs on the Peninsula. The in-city distribution system is a series of pipelines that distributes water from the regional water system to residences and businesses in San Francisco. The Water Enterprise's FY 2024-25 to FY 2033-34 Ten Year Capital Plan includes \$1.6 billion for regional systems and \$1.3 billion for the local system, totaling \$2.9 billion.

Hetch Hetchy Water and Power Capital Improvement Program

The Hetch Hetchy Enterprise is composed of Hetch Hetchy Water and Hetch Hetchy Power. Hetch Hetchy Water manages the water system in and around the Hetch Hetchy Reservoir and throughout the Sierras and is responsible for power generation. Because power is generated hydroelectrically, some capital projects benefit both Hetch Hetchy Water and Hetch Hetchy Power operations. Hetch Hetchy Power primarily provides electricity to local City agencies, government-affiliated entities, as well as redevelopment areas and low-income housing. Hetch Hetchy Water's FY 2024-25 to FY 2033-34 Ten Year Capital Plan includes \$237.3 million for Water Infrastructure, 290.8 million for Power, and \$1.0 billion for joint Water and Power projects. Hetch Hetchy Power's Plan includes \$1.2 billion for local power projects. The total ten-year capital plan is \$2.8 billion.

CleanPowerSF Capital Improvement Program

CleanPowerSF, which provides renewable electricity to residential and commercial customers in San Francisco, is also part of the Hetch Hetchy Enterprise. The FY 2024-25 to FY 2033-34 Ten Year

Capital Plan for CleanPowerSF totals \$48.5 million, all of which is revenue-funded and for the Local Energy Renewable Program, which funds new solar and battery storage projects.

DETAILS OF PROPOSED LEGISLATION

File 24-0453: is an ordinance (a) authorizing the issuance and sale of tax-exempt or taxable Wastewater Revenue Bonds and other forms of indebtedness by the San Francisco Public Utilities Commission (SFPUC) in an aggregate principal amount not to exceed \$1,715,671,086 to finance the costs of Wastewater Enterprise capital projects; (b) authorizing the issuance of Wastewater Revenue Refunding Bonds and the retirement of outstanding Wastewater Enterprise Commercial Paper; (c) declaring the intent of SFPUC to reimburse itself with one or more issues of tax-exempt or taxable bonds or other forms of indebtedness; and (d) ratifying previous actions taken in connection with the issuance of the bonds.

File 24-0455: is an ordinance (a) authorizing the issuance and sale of tax-exempt or taxable Water Revenue Bonds by the San Francisco Public Utilities Commission (SFPUC) in an aggregate principal amount not to exceed \$1,040,007,350 to finance the costs of Water Enterprise capital projects; (b) authorizing the issuance of Water Revenue Refunding Bonds and the retirement of outstanding Water Enterprise Commercial Paper; (c) declaring the intent of SFPUC to reimburse itself with one or more issues of tax-exempt bonds or other forms of indebtedness; and (d) ratifying previous actions taken in connection with the issuance of the bonds.

The ordinance originally authorized \$1,035,007,350 in Water Bonds, however SFPUC requested an amendment to the Water Bond authorization to increase the amount by \$5 million to account for an increase in water main project spending, following emergency repair work on a water main break in Pine Lake Park (File 24-0343). The funding is included in the proposed appropriation ordinance.

File 24-0454: is an ordinance authorizing (a) the issuance and sale of tax-exempt or taxable Power Revenue Bonds and other forms of indebtedness (as described below) by the San Francisco Public Utilities Commission (SFPUC) in an aggregate principal amount not to exceed \$292,825,860 to finance the costs of various Hetch Hetchy Power Enterprise capital projects; (b) the issuance of Power Revenue Refunding Bonds and the retirement of outstanding Power Enterprise Commercial Paper; (c) declaring the intent of SFPUC to reimburse itself with one or more issues of tax-exempt or taxable bonds or other forms of indebtedness; and (d) ratifying previous actions taken for purpose of issuing the bonds.

File 24-0452: is an ordinance appropriating:

- (a) \$1,972,783,704 of proceeds from Wastewater Revenue Bonds, Wastewater revenues, and Wastewater capacity fees for the San Francisco Public Utilities Commission (SFPUC) Wastewater Enterprise's Capital Improvement Program for FY 2024-25 and FY 2025-26.
- (b) \$1,065,096,228 of proceeds from Water Revenue Bonds, Water revenues, and Water capacity fees for the San Francisco Public Utilities Commission (SFPUC) Water Enterprise's Capital Improvement Program for FY 2024-25 and FY 2025-26.

- (c) \$541,717,157, consisting of Power Revenue Bonds, Water Revenue Bonds, Hetch Hetchy revenues, and Cap and Trade revenues for the San Francisco Public Utilities Commission (SFPUC) Hetch Hetchy Water & Power Enterprise's Capital Improvement Program for FY 2024-25 and FY 2025-26.
- (d) \$1,098,690 in CleanPowerSF customer revenues for the Local Renewable Energy Program in FY 2024-25 and FY 2025-26.

In addition to Revenue Bond proceeds, the sources of funds may also include loans and grants from State or Federal entities, when available.

File 24-0452 also places \$1,551,317,002 in FY 2024-25 and \$1,510,767,748 in FY 2025-26 of funding on Controller's Reserve pending Controller certification of the availability of funds.

Projects funded by the appropriated funds are subject to final approval of the California Environmental Quality Act (CEQA) findings by the SFPUC and the Board of Supervisors.

Revenue Bond Issuance

At the February 13, 2024, Commission meeting, the SFPUC approved the issuance of new Wastewater, Water, and Power Revenue Bonds to finance capital projects. The proposed ordinances allow the issuance of commercial paper or other interim debt to finance the projects prior to the issuance of the revenue bonds and provide for SFPUC to access California Water Resources Control Board revolving loan funds or grant funds.

The SFPUC may issue taxable or tax-exempt bonds in one or more series through either a negotiated or competitive sale. Each bond authorization ordinance requires the SFPUC to report to the Board of Supervisors within 30 days of the bond issuance: (i) the principal amount sold and method of sale, (ii) true interest cost, (iii) final maturity, (iv) the facilities constructed and/or improved, and (v) a statement about the remaining bonding authorization.

In addition, the SFPUC may issue refunding bonds to repay outstanding Revenue Bond debt if the issuance of the refunding bonds results in net present value debt service savings of 3 percent and does not extend the maturity date. If the SFPUC issues refunding bonds, then the SFPUC needs to submit to the Board of Supervisors the final official statement for the refunding bonds and a statement from the financial advisor on the 3 percent net present value debt service savings. The Commission may also authorize refunding bonds if other benefits accrue. The authorization to issue refunding bonds extends through June 2029.

Wastewater Capital Budget

The proposed appropriation ordinance appropriates \$1.97 billion of Wastewater bond proceeds, Wastewater revenues, and Wastewater capacity fees to various SSIP and Wastewater projects, as shown in Exhibit 1 below.

Exhibit 1: Wastewater Appropriation

Sources	FY 2024-25	FY 2025-26	Total
Wastewater Bond Proceeds (File 24-0453)	911,508,795	804,162,291	1,715,671,086
Wastewater Revenue	112,415,407	133,891,216	246,306,623
Wastewater Capacity Fees	5,323,150	5,482,845	10,805,995
Total Sources	1,029,247,352	943,536,352	1,972,783,704
Uses	FY 2024-25	FY 2025-26	Total
Sewer System Improvement Project (SSIP)			
Program Management	16,000,000	12,996,970	28,996,970
Biosolids/Digester Project	378,512,525	188,532,739	567,045,264
Treatment Plant Improvements - Southeast	83,860,148	113,581,087	197,441,235
Treatment Plant Improvements - Other	54,491,438	57,913,311	112,404,749
Collection System Improvements	15,587,483	44,773,049	60,360,532
Stormwater Management/Green	7,677,412	17,951,320	25,628,732
Flood Resilience/Hydraulic Improvements	82,267,176	158,669,505	240,936,681
Total, SSIP	638,396,182	594,417,981	1,232,814,163
Other Wastewater Programs			
Renewal & Replacement-Collection System	128,538,826	142,124,003	270,662,829
Renewal & Replacement-Treatment Facilities	24,000,000	25,000,000	49,000,000
Treasure Island	36,624,859	4,272,611	40,897,470
Wastewater Facilities and Infrastructure	64,961,166	57,097,413	122,058,579
Total, Other Wastewater Programs	254,124,851	228,494,027	482,618,878
Financing Costs	136,726,319	120,624,344	257,350,663
Total Uses of Funds (File 24-0452)	1,029,247,352	943,536,352	1,972,783,704

Source: Appropriation Ordinance

Financing costs include the costs of interim, short-term funding for projects by the Commercial Paper Program, such as accrued interest and credit bank and dealer fees associated with outstanding commercial notes as well as capitalized interest and other issuance costs. It also includes the funding for the Controller's Audit Fund and PUC Revenue Bond Oversight Committee, as required by the City Charter.

Water Capital Budget

The proposed appropriation ordinance appropriates \$1.06 billion of Water Revenue bond proceeds, water revenues, and water capacity fees to various water projects, as shown in Exhibit 2 below.

Exhibit 2: Water Appropriation

Sources of Funds	FY 2024-25	FY 2025-26	Total
Water Bond Proceeds (File 24-0455)	418,099,747	432,635,062	850,734,809
Water Enterprise Revenues	99,977,942	104,353,430	204,331,372
Water Capacity Fees	4,940,910	5,089,137	10,030,047
Total Funding Sources	523,018,599	542,077,629	1,065,096,228
Uses of Funds			
Regional Water			
Reg Water Facilities and Infrastructure	203,597,839	122,663,166	326,261,005
Watersheds & Right of Way	8,870,044	9,694,978	18,565,022
Regional Alternative Water Supplies	6,240,441	7,449,609	13,690,050
Total Regional Water Uses	218,708,324	139,807,753	358,516,077
Local Water			
Local Water Facilities and Infrastructure	232,398,679	319,859,530	552,258,209
Local Water Resources	9,946,634	17,515,087	27,461,721
Total Local Water Uses	242,345,313	337,374,617	579,719,930
Financing Costs	61,964,962	64,895,259	126,860,221
Total Use of Funds (File 24-0452)	523,018,599	542,077,629	1,065,096,228

Source: Appropriation Ordinance

Financing costs include the costs of interim, short-term funding for projects by the Commercial Paper Program, such as accrued interest and credit bank and dealer fees associated with outstanding commercial notes as well as capitalized interest and other issuance costs. It also includes the funding for the Controller's Audit Fund and PUC Revenue Bond Oversight Committee, as required by the City Charter.

Hetch Hetchy Water & Power Capital Budget

The proposed appropriation ordinance appropriates \$543.4 million of Power Revenue Bonds, Water Revenue Bonds, Hetch Hetchy revenues, and Cap and Trade revenues for Water, Power, and joint Water/Power projects, as shown in Exhibit 3 below.

Exhibit 3: Hetch Hetchy Water & Power Appropriation

Sources of Funds	FY 2024-25	FY 2025-26	Total
Power Bond Proceeds (File 24-0454)	115,630,709	177,195,151	292,825,860
Water Bond Proceeds (File 24-0455)	99,396,533	89,876,008	189,272,541
Hetch Hetchy Revenue Funds (Power/Water)	20,222,482	37,238,254	57,460,736
Cap and Trade Revenue	1,006,901	1,151,119	2,158,020
Total Sources of Funds	236,256,625	305,460,532	541,717,157
Uses of Funds	FY 2024-25	FY 2025-26	Total
Water Infrastructure Projects	56,049,054	57,052,901	113,101,955
Power Infrastructure Projects	25,730,244	61,113,838	86,844,082
Joint Water/Power Projects	70,995,489	62,598,926	133,594,415
Total Water Uses	152,774,787	180,765,665	333,540,452
Distribution Services Retail	30,167,789	54,810,971	84,978,760
Distribution Services Retail - Treasure Island	638,000	10,362,000	11,000,000
Distribution Services Retail - Grid Connections	8,050,000	8,350,000	16,400,000
Streetlights	3,615,000	3,615,000	7,230,000
Small Renewables	192,062	0	192,062
Cap and Trade Projects	1,006,901	1,151,222	2,158,123
Public Power Expansion	7,558,000	6,345,000	13,903,000
Total Power Uses	51,227,752	84,634,193	135,861,945
Financing Cost, Power	17,344,606	26,579,273	43,923,879
Financing Cost, Water	14,909,480	13,481,401	28,390,881
Total Financing Costs	32,254,086	40,060,674	72,314,760
Uses of Funds (File 24-0452)	236,256,625	305,460,532	541,717,157

Source: Appropriation Ordinance

Financing costs include the costs of interim, short-term funding for projects by the Commercial Paper Program, such as accrued interest and credit bank and dealer fees associated with outstanding commercial notes as well as capitalized interest and other issuance costs. It also includes the funding for the Controller's Audit Fund and PUC Revenue Bond Oversight Committee, as required by the City Charter.

CleanPowerSF Capital Budget

Finally, the proposed appropriation ordinance appropriates \$1.1 million of CleanPowerSF customer revenue for the Local Renewable Energy Program.

Proposition E Bond Funds

San Francisco voters approved Proposition E in 2002 and Proposition A in 2018, providing for the Board of Supervisors to authorize issuance of Water, Power, Wastewater Revenue Bonds and other forms of debt with two-thirds approval of the Board members. As shown below in Exhibit 4, the Board has authorized \$12,191,403,124, of which \$9,087,293,110 has been issued and \$3,104,110,014 is authorized but not issued.

Exhibit 4: Proposition E & A Bond Authorizations

PUC Division	Authorized	Issued	Unissued	Proposed	New Total Authorized
Wastewater	6,336,935,567	4,482,180,128	1,854,755,439	1,715,671,086	8,052,606,653
Water	5,117,502,961	4,317,652,982	799,849,979	1,040,007,350	6,157,510,311
Power	736,964,596	287,460,000	449,504,596	292,825,860	1,029,790,456
Total	12,191,403,124	9,087,293,110	3,104,110,014	3,048,504,296	15,239,907,420

Source: SFPUC

Approval of the proposed bond authorization ordinances would increase the amount of bonds authorized in accordance with Propositions E and A to \$15,239,907,420. The SFPUC plans to issue approximately \$11.11 billion in revenue bonds between FY 2024-25 to FY 2033-24, as per their 10-year Financial Plan (amounts are preliminary are subject to change due to market conditions and actual project spending).

FISCAL IMPACT

Debt Service

SFPUC’s Ten-Year Financial Plan assumes Revenue Bonds will have a 6 percent interest rate and a thirty-year term. This is an increase from the 5 percent interest assumed in last year’s Financial Plan and consistent with the Controller’s Office of Public Finance’s assumptions for other City debt. The average annual debt service for the proposed \$3.05 billion in Water, Wastewater, and Power bonds over 30 years is approximately \$221.5 million, or \$6.6 billion in total debt service, excluding any capitalized interest for interim financing. Actual debt service costs may be lower due to bond refunding and access to state and federal lending and other capital revenues.

Financial Policies

The SFPUC FY 2024-25 – FY 2033-34 10-Year Financial Plan projects that the Water, Wastewater, and Hetch Hetchy Water and Power Enterprises will have sufficient net revenues and unrestricted fund balance to maintain debt service coverage ratios in compliance with the Department’s financial policies.

Water, Wastewater, and Power are in compliance with the Department’s Capital Financing policy, which requires operating revenues to fund between 15 and 30 percent of capital spending. The purpose of this policy is to manage the impact of debt service on utility charges.

In November 2023, the Public Utilities Commission adopted a new Affordability Policy, which establishes a non-binding affordability target that the average residential combined water and sewer bill should be no more than three percent of typical household income.¹ According to the

¹ Typical household income is defined as the 40th percentile of household income in San Francisco, as measured in the U.S. Census Bureau’s more recent Five-Year American Community Survey, or \$92,915 in 2021. The Affordability

FY 2024-25 – FY 2033-34 Ten Year Financial Plan, the combined water and sewer bill will be 1.8 percent of typical household income in FY 2024-25, rising to 2.7 percent in FY 2033-34 and therefore in compliance with the new Affordability Policy.² A target for Hetch Hetchy and CleanPowerSF bills has not been established, however the Financial Plan projects that the rates for each will be between 1.1 and 1.3 percent of average income.

Customer Rates

Exhibit 5 below shows the projected rate increases for each utility service for the next five fiscal years, based on the 10-Year Financial Plan. These are subject to change prior to adoption. Rates for service pay for operating and capital expenditures.

Exhibit 5: Utility Rate Increases (Red = higher than last year, Blue = lower than last year)

Utility	FY 2025	FY 2026	FY 2027	FY 2028	FY 2029
Retail Water	5.0%	5.0%	5.00%	5.00%	4.00%
Wholesale Water	7.70%	4.50%	2.60%	8.20%	3.10%
Wastewater	9.0%	9.0%	12.00%	12.00%	11.00%
Hetch Hetchy Power	12.00%	10.00%	9.00%	9.00%	5.00%
CleanPowerSF Generation	8.50%	1.00%	0.00%	0.00%	0.00%
Municipal Hetchy Power Customers subject to General Use Rate (being phased out)	18.90%	15.90%	13.70%	12.10%	10.80%

Source: FY 2024-25 – FY 2033-34 Ten Year Financial Plan

Notes: Red highlighting indicates higher increases than projected in last year’s financial plan, typically an increase of one percentage point. Blue highlighting indicates lower increases than projected in the financial plan, typically a decrease of one percentage point. CleanPowerSF FY 2024-25 generation rates are increasing by 8.5% rather than 0% projected last year.

Retail Water and Wastewater rates were adopted by the SFPUC in May 2023 through FY 2025-26 and deemed approved by the Board of Supervisors.

Wholesale Water rates are based on contracts with wholesale customers.

Wastewater rates are increasing starting in FY 2026-27 due to higher interest rates, cost increases for existing capital projects, and new capital projects, as discussed in the Policy Consideration section below.

Policy also sets planning targets such that the combined water and sewer bill be no more than seven percent of the 20th percentile of San Francisco income, which was \$38,376 in 2021.

² According to the FY 2024-25 to FY 2033-34 Ten Year Financial Plan, the combined water and sewer bill rises to 2.9 percent of typical customer income but does not breach the three percent policy maximum.

Hetch Hetchy Power and CleanPowerSF rates will be adopted annually, given recent volatility in energy markets. The driver of these rate increases is the increasing costs of power purchase and distribution. The Public Utilities Commission approved new FY2024-25 Hetch Hetchy retail and CleanPowerSF rates at its May 14, 2024 meeting. A Power rate study is planned for Spring 2026.

San Francisco government customer rates are being increased by \$0.03/kWh per year, pursuant to a 2022 agreement between the SFPUC and Mayor's Office, to align San Francisco government customer rates with the cost of service.

POLICY CONSIDERATION

Debt Service Coverage Policy

One of the PUC's financial policies is the Debt Service Coverage Policy. The Policy includes two formulas: (1) for maintaining sufficient net revenues and fund balance to exceed debt service coverage requirements in bond indentures and (2) for maintaining sufficient net revenues to exceed debt service. The Indenture Coverage formula explicitly includes enterprise fund balance. The Current Coverage ratio does not explicitly include fund balance, which is consistent with how credit rating agencies and some PUC creditors evaluate debt service coverage.³ However, according to the FY 2024-25 – FY 2023-34 Ten Year Capital Plan, on advice of bond counsel, the PUC may include appropriated fund balance in the calculation a PUC Enterprise's Current Coverage, as it is a funding source for operating costs.⁴

All utility enterprises comply with the PUC's debt service coverage policies. The Debt Service Coverage Policy has not been updated since 2017. BLA has discussed this with SFPUC and the Department is in the process of updating its financial policies. All PUC Policy updates remain subject to Commission consideration and approval.

Water Main Replacement

The Water Enterprise's Local Water Conveyance/Distribution System Program has a goal of replacing 15 miles of water mains per year. The purpose of this goal is to ensure ongoing renewal of the City's 1,230 miles of water mains, many of which are near the end or beyond their useful life. Since FY 2019-20, the PUC has replaced an average of 7.7 miles of water main pipeline per

³ As calculated in SFPUC's Debt Service Coverage Policy: The Indenture Coverage formula is: $((\text{Annual Revenues} - \text{Operating Expenses}) + \text{Unappropriated Fund Balance}) / \text{Annual Debt Service}$. The Current Coverage formula is: $(\text{Annual Revenues} - \text{Operating Expenses}) / \text{Annual Debt Service}$. The Indenture Coverage must be at least 1.35x debt service and the Current Coverage must 1.10x debt service.

⁴ In FY 2024-25 and FY 2025-26, the Power Enterprise's Current Coverage will be met by a combination of operating revenues and fund balance. According to PUC financial staff, the approach was communicated to ratings agencies in late 2023 ahead of the most recent Power bond sale, who affirmed the enterprise's ratings with Stable outlooks despite the use of fund balances. The enterprise's revenue bonds are rated AA and AA-by S&P Global Ratings and Fitch Ratings, respectively. According to SFPUC's 10-year Financial Plan, the Power Enterprise next plans to issue revenue bond debt in Fiscal Year 2025-26.

year. According to PUC staff, this pace is largely due to internal capacity constraints, the slow pace of joint agency trenching projects, and unforeseeable site conditions underground rather than funding constraints.

In September 2023, a water main failed at Fillmore and Green Streets in San Francisco, requiring at least \$5 million in emergency repair work (File 23-1001) and damaging residents and businesses. Another water main failed near Pine Lake Park in April 2024, though the cause is still under investigation.

The proposed capital budget funds water main replacement at 12 miles per year, which is below the program goal of 15 miles per year. The proposed 12 miles per year is an increase from last year's capital budget, which provided for 7.5 to 9 miles of main replacement per year, accomplished by reallocating water main replacement funding along the Better Market Street project area, for which work has been suspended.

According to PUC capital project data, replacing one mile of water main pipeline cost \$6.1 million, on average. This would require a 3.5 percent funding increase in the proposed two-year \$1.06 billion Water Enterprise capital budget or reallocation of existing funding among projects. Increasing the proposed two-year capital budget would increase utility rates starting in FY 2028-29 and would likely push the combined water and sewer bill above the Commission's Affordability Policy in the mid-2030s.

The Board of Supervisors has several options to help the PUC increase its water main replacement delivery. It could: (1) approve existing or new positions related to water main replacement in the Water Enterprise operating budget, (2) request the PUC reevaluate the prioritization of water main replacement, which was last assessed in 2017, to include soil conditions and other factors that are not currently included in the PUC's water main replacement strategy, and (3) work with the PUC to reallocate capital project funding from less essential projects.

Wastewater

On May 1, 2024, the U.S. Department of Justice, on behalf of the U.S. Environmental Protection Agency filed a complaint in the Northern District of California District Court alleging the SFPUC violated the Clean Water Act and similar State regulations (Case 3.24-cv-02594). In particular, the complaint alleges that the Wastewater Enterprise's level of untreated sewage discharges into the ocean exceeds federal and state regulations. Resolving this complaint may require changes to the scale and pace of the Wastewater Enterprise's capital budget.

Separately, the California Regional Water Quality Control Board will adopt new regulations to reduce nutrient discharges into San Francisco Bay in 2024. In anticipation of this regulatory action, the SFPUC has modified the capital plan for the Wastewater Enterprise by adding a Southeast Plant Nutrients Reduction project. This project aims to reduce the amount of nutrients discharged by the Southeast Treatment Plant on the bayside of the City's sewer system. The

Nutrient Reduction project is expected to cost \$1.5 billion, including \$16.8 million in planning costs over FY 2024-25 and FY 2025-26 and \$1.1 billion through FY 2033-24. The project is expected to be completed in 2039.

Other projects may be required to be added to the Wastewater capital plan to meet federal and state regulations. Funding for new projects would require an increase in Wastewater rates, defunding planned projects, and/or reducing the costs of planned capital projects. Wastewater rate increases over the next ten years average 9.7 percent per year and assume Wastewater operates with net negative revenues and uses fund balance to pay for operating costs and debt service costs through FY 2029-30, without which annual rate increases would be higher. There is little room to increase Wastewater rates within the confines of the Affordability Policy; the Ten-Year Financial Plan forecasts combined water and sewer rates will reach 2.9 percent of typical household income (just below the 3.0 percent policy goal) within the next twenty years. Therefore, successfully delivering all planned capital projects requires ongoing cost management.

The PUC's largest capital project is the Wastewater Biosolids Digester, a component of the Southeast Treatment Plant. The cost of that project has increased by \$300 million (or 13 percent) since last year, from \$2.37 billion to \$2.67 billion, due to the low number of bids received in recent solicitations. This is a perennial problem for the PUC and other City Departments. If these cost escalation trends continue, the PUC may not be able to deliver all planned capital projects within currently estimated timeframes, risking further regulatory action. Aside from the ongoing Government Operations Initiative to improve Citywide contracting processes, there is no specific plan to reign in capital project costs at the Public Utilities Commission.

The Board of Supervisors should consider holding a hearing on the PUC's strategy to manage capital project cost escalations or request a report from the PUC and other Chapter 6 Departments on this topic by June 2026. The report should include recommendations on any legislative action the Board should take to reform the City's procurement regulations.

Revenue Bond Oversight Committee

In 2002, voters approved Proposition P, which created the PUC Revenue Bond Oversight Committee to oversee PUC revenue bond spending.⁵ The Committee is allocated 0.05 percent of revenue bond gross proceeds for its oversight work, which includes overseeing the appropriate use of bond proceeds. The current sunset date for this committee is January 1, 2025, though the Board of Supervisors may extend it through an ordinance amending Administrative Code Chapter

⁵ The committee consists of seven members, two appointed by the Mayor, two appointed by the Board of Supervisors, one appointed by the Controller, one appointed by the Bay Area Water Users Association, and one seat for the Budget & Legislative Analyst.

5A. The original sunset date for the Committee was January 1, 2013, which the Board has since extended.

In addition, Charter Section F1.113 states that 0.2 percent of the City's budget, excluding bond debt, must be set-aside for the Controller's audit fund.

The proposed appropriation ordinance includes \$3 million in FY 2024-25 and in FY 2025-26 for the Controller's audit fund and \$772,318 in FY 2024-25 and \$751,934 in FY 2025-26 to the Revenue Bond Oversight Committee.

RECOMMENDATION

Approve the proposed ordinance (File 24-0455).