CITY AND COUNTY OF SAN FRANCISCO

BOARD OF SUPERVISORS

BUDGET AND LEGISLATIVE ANALYST

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February 7, 2020

TO: Budget and Finance Committee

FROM: Budget and Legislative Analyst

SUBJECT: February 12, 2020 Budget and Finance Committee Meeting

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EXECUTIVE SUMMARY

Legislative Objectives

- The proposed resolution would approve the first modification to the Airport's contract with SITA Information Networking Computing USA, Inc. (SITA) to increase the not-to-exceed amount by $5,928,253 from $9,966,543 to $15,894,796. The five-year term of the contract from January 2019 through December 2023 would remain the same.

Key Points

- The Airport selected SITA following a competitive solicitation to support the Airport's existing Passenger Processing and Information Display System in the International Terminal and selected locations within Domestic Terminals. These systems include: check-in and boarding systems, common use self-service kiosks, baggage messaging system, baggage reconciliation system, resource management system, airport operational data base, passport control systems, and public information systems. The RFP defined support for these systems as hardware maintenance, system administration, and 24/7 monitoring of system and hardware performance.
- The proposed increase in the contract amount will be used to support additional equipment coming online as additional gates and other passenger and processing facilities become operational in Terminal 1. According to the Airport's Director of Terminal Systems, the additional equipment needed for the new gates and facilities in Terminal 1 were not included in the original contract because the Airport did not finalize the total number of equipment to be installed until after the January 2018 when the Airport authorized the solicitation for the contract services.

Fiscal Impact

- The original base contract budget over the five year term from 2019 through 2023 is $9,626,078 for salaries, other contract services, and profit, increasing by $2,676,401 or 27.8 percent to $12,302,479 under the contract modification. Contract staffing will increase in the second contract year (beginning in March 2020) from 15.5 positions to 21.5 positions.
- The original contract budget for paper, supplies, shipping, and as-needed services over the five year term is $340,463, increasing nine-fold to $3,251,852 under the contract modification. The increase for paper and supplies is due to underestimation of the actual need over the five year term. The increase is as-needed services is for additional staff to support additional equipment to be activated in Terminal 1 in May 2021 and March 2023.
- According to the Airport's Director of Terminal Systems, sufficient funding is available in the Airport's Operating Budget to cover the increased contract costs.

Recommendation

- Approve the proposed resolution.

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 January 2018, the Airport released a Request for Proposals (RFP) to select a vendor to support the Airport's existing Passenger Processing and Information Display System in the International Terminal and selected locations within Domestic Terminals. These systems include: check-in and boarding systems, common use self-service kiosks, baggage messaging system, baggage reconciliation system, resource management system, airport operational data base, passport control systems, and public information systems. The RFP defined support for these systems as hardware maintenance, system administration, and 24/7 monitoring of system and hardware performance. The RFP did not include the Passenger Processing equipment since that was going to be procured under the Terminal 1 construction project. The final equipment count was under negotiation with the airlines during the time of the RFP.

The Airport received three proposals, of which two were deemed responsive. The proposal from SITA Information Networking Computing USA, Inc. (SITA) received the higher score from the review panel consisting of Vice President and Station Manager for Japan Airlines; Manager, Facility Maintenance Operations for United Airlines; Terminal Systems Manager, Operations and Security, for the Airport; and Senior Information Systems Engineer, Information Technology and Telecommunications, for the Airport. . On November 2018, the Airport Commission approved a contract with SITA for a five year term, January 2019 through December 2023, and a not-to-exceed amount of $9,966,543. Because the contract was below $10 million and had a term of less than ten years, it did not require Board of Supervisors' approval.

DETAILS OF PROPOSED LEGISLATION

The proposed resolution would approve the first modification to the Airport's contract with SITA to increase the not-to-exceed amount by $5,928,253 from $9,966,543 to $15,894,796. The term of the contract would remain the same. The increase in the contract amount will be used to support additional equipment coming online as additional gates and other passenger and processing facilities become operational in Terminal 1. According to the Airport's Director of Terminal Systems, the additional equipment needed for the new gates and facilities in Terminal 1 were not included in the original contract because the Airport did not finalize the total volume of equipment to be installed until after the January 2018 issuance of the RFP.

Table 1 below shows the increase in equipment to be installed and supported under the contract with SITA for Terminal 1.

Table 1: Supported Equipment in Terminal 1

Terminal 1	Oct. 2018	March 2020	May 2021	March 2023	5 Year Increase
Passenger Processing Equipment	34	533	643	729	695
Information Displays	125	447	486	492	367
Total Equipment	**159**	**980**	**1,129**	**1,221**	**1,062**

Source: Airport

As shown above, the total equipment in Terminal 1 to be supported by SITA staff is expected to increase by 1,062 devices over the term of the contract.

FISCAL IMPACT

The original base contract budget over the five year term from 2019 through 2023 is $9,626,078 for salaries, other contract services, and profit, increasing by $2,676,401 or 27.8 percent to $12,302,479 under the contract modification. The original contract budget for paper, supplies, shipping, and as needed services over the five year term is $340,463, increasing nine-fold to $3,251,852 under the contract modification, as shown in Table 2 below.

Table 2: Original and Proposed SITA Contract Budget

	Original Contract	Proposed Modification	Increase
Contract Budget			
Labor, profit, and services	$9,626,078	$12,302,479	$2,676,401
Other Contract Expenses			
Supplies (non-paper)	134,587	339,655	205,068
Paper	155,027	1,053,060	898,033
Shipping Costs	8,850	208,907	200,057
As-Needed Services	42,000	84,000	42,000
Flexible Staffing	0	1,906,694	1,906,694
Subtotal	$340,463	$3,592,316	$3,251,852
Total	**$9,966,542**	**$15,894,795**	**$5,928,253**

Source: Original Amounts taken from Appendix B of January 2019 SITA Contract and Proposed Amounts provided by Airport staff.

Note: Original contract budget is less than not-to-exceed amount approved by the Airport Commission by $1.

Contract increases totaling $5,928,253 include:

- $2,676,401 in labor, services, and profit expenditures over the remaining four years of the contract to support passenger processing and information display equipment in as a result of the Terminal 1 expansion project.[1]

[1] Total contract positions in Year 1 were 15.5, including technicians, lead technicians, supervisors, and managers. Contract positions increased to 21.5 in Year 2: technician positions increased by five, from five to ten; and supervisor positions increased by one, from five to six.

- $1,906,694 for flexible staffing to pay for labor to support additional equipment in Terminal 1 to be activated in May 2021 and March 2023. According to Airport staff, prior to the activation dates, the Airport and SITA will mutually agree on appropriate staffing levels and associated costs to support the additional equipment.
- $898,033 and $205,068 for paper and supplies respectively, which were underestimated in the original contract for the passenger processing equipment. The increase in the contract modification takes into account actual expenditures in the first year for supplies and paper, and the additional passenger processing equipment being installed in Terminal 1.[2]
- $42,000 for increased as-needed labor due to unanticipated installation, and replacement or activation of new equipment.

Contract Spending

The contract budget for the first year of the contract from January 2019 through December 2019 was $2,089,179, and actual expenditures were $2,154,678 which includes $2,028,646 for labor expenditures plus $38,621 for supplies and $87,412 for paper.

According to the Airport's Director of Terminal Systems, sufficient funding is available in the Airport's Operating Budget to cover the increased contract costs.

RECOMMENDATION

Approve the proposed resolution.

[2] According to Airport staff, the original contract allocated only $155,027 for paper and $134,587 for supplies for the entire five-year contract period; actual expenditures in the first year of the five-year contract (January-December 2019) for paper expenditures were $87,412 and supplies were $38,621.

Item 2 **Files 20-0046**	**Department:** San Francisco Public Works

EXECUTIVE SUMMARY

Legislative Objectives

- The proposed resolution would (1) authorize Public Works to accept and expend a grant of $15,000,000 from the United States Department of Transportation for the FY 2018 Better Utilizing Investments to Leverage Development Transportation Discretionary (BUILD) Grant to fund the construction of the Public Works' Better Market Street Phase 1 project for the period of June 2020 to June 2025, and (2) confirm that grant is consistent with the City's General Plan.

Key Points

- Better Market Street is intended to reconstruct 2.2 miles of Market Street from Octavia Boulevard to the Embarcadero. Improvements include new water and sewer lines, broadband conduit installation, ADA-accessible curb ramps and streetcar access ramps, roadway resurfacing, streetcar track replacement, replacement and upgrade of traffic signals, and a new F-line streetcar turnaround loop at McAllister and Charles J. Brenham Streets.
- Phase 1 of the project will focus solely on the construction phase of the portion of Market Street between Fifth and Eighth Streets (the Central Market and Civic Center sections of Market Street). Construction is expected to extend from February 2021 to August 2023.

Fiscal Impact

- The total construction budget for the Better Market Street Phase 1 is $176,759,600. Of the approximate $176.8 million, $161.8 million (91.5%) are City funds and $15 million (8.5%) are federal funds. The grant budget, which is included in the $176.8 million project budget is $27.5 million, including the $15 million BUILD grant and local matching funds. Local matching funds come from Proposition K Sales Tax revenues and Proposition A General Obligation Bond proceeds.

Recommendation

- Approve the proposed resolution.

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.

Administrative Code Section 10.170-1 requires Board of Supervisors approval for the acceptance and expenditure of federal, State, or other grant funds in the amount of $100,000 or more.

BACKGROUND

Public Works Better Market Street Project

San Francisco Public Works ("Public Works") requests authorization to accept and expend $15,000,000 in Better Utilizing Investments to Leverage Development (BUILD) Transportation Discretionary Grant funding from the U.S. Department of Transportation to pay construction and other costs for Better Market Street Phase 1. Better Market Street is intended to reconstruct 2.2 miles of Market Street from Octavia Boulevard to the Embarcadero. Improvements include new water and sewer lines, broadband conduit installation, ADA-accessible[1] curb ramps and streetcar access ramps, roadway resurfacing, streetcar track replacement, replacement and upgrade of traffic signals, and a new F-line streetcar turnaround loop at McAllister and Charles J. Brenham Streets.

The project scope conforms to several City policies including Transit First, Vision Zero, the SF Bicycle Plan and the Better Streets plan by restricting private vehicles between Steuart and Gough Streets, increasing efficiency of the 14 surface Muni bus lines that run on Market, and conducting significant roadway and other infrastructure improvements[2]. The plan includes building transit's core capacity along Market street in order to accommodate new growth, increase safety and decrease conflicts of bicyclists with transit and pedestrians. Construction for the first phase of the project will begin on February 26, 2021 and is estimated to reach substantial completion on August 30, 2023. Better Market Streets Phase 1B will be delivered through a separate contract and the schedule has not been finalized.

[1] American with Disabilities Act

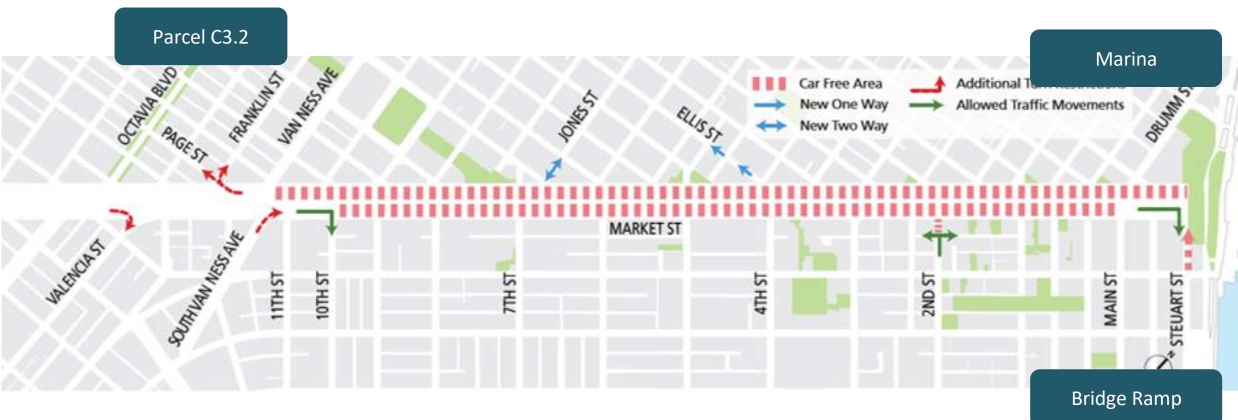
[2] Charter Section 8A.115 defines the City's Transit First policy to be incorporated into the City's General Plan. Vision Zero outlines all actions the City has taken to eliminate traffic fatalities. The SF Bicycle Plan presents guidelines for developing bike-friendly infrastructure. The Better Streets Plan was adopted by the Board of Supervisors in 2010 to create a unified set of standards, guidelines, and implementation strategies to govern how the City designs, builds, and maintains its pedestrian environment.

Better Market Street Project Readiness

The Better Market Street planning and review process began in 2011 and is ongoing. The San Francisco Planning Commission certified the California Environmental Quality Act (CEQA) Environmental Impact Report on October 10, 2019 (Motion No. 20538). On October 15, 2019, San Francisco Public Works approved the project and adopted the CEQA Findings, Statement of Overriding Considerations, and Mitigation Measures and Monitoring Report (MMRP) (Public Works Order No. 202018), and the San Francisco Municipal Transportation Agency (SFMTA) Board of Directors approved aspects of the project under SFMTA jurisdiction and adopted the CEQA Findings (Resolution No. 191015-131). The project is currently in the National Environmental Policy Act (NEPA) review process.

The San Francisco County Transportation Authority (SFCTA) and San Francisco Planning Department conducted the initial feasibility study and conceptual planning. During this period, Public Works led outreach efforts to incorporate transit passengers, bicyclists and pedestrians, as well as merchants and property owners along Market Street into the planning process. Four rounds of outreach and project scoping meetings have been held since 2011, and the concluding round resulted in a final agreement on the construction phasing and the preferred project configuration.

Exhibit 1: Better Market Street Project



Source: SF MTA "Better Market Street Project"

Better Market Streets Phase 1

The Better Market Street program will be implemented in phases. Phase 1 improvements will focus solely on the construction phase of the portion of Market Street between Fifth and Eighth Streets (the Central Market and Civic Center sections of Market Street). Beginning in September 2009, the City implemented a trial demonstration of some of the project elements to ensure that these changes would not negatively impact existing transportation services. Some of these "early start" projects include:

- Turn prohibitions requiring right turns for cars going eastbound on Market Street between 6th, 8th and 10th streets.
- Elimination of all turns for cars from side streets onto Market between 3rd and 8th.
- A raised cycle track built along 8 blocks of Masonic Avenue from Geary to Fell streets.

The initial anticipated completion date for the design phase was December 2019; however, it has since been delayed to May 2020 due to the additional city block (5th Street) that has been added to the scope of the project, according to Principal Capital Finance Analyst for the Department of Public Works Mr. Oscar Quintanilla. Phase 1 construction will now begin in February 2021 and is estimated to reach substantial completion on August 2023. See Exhibit 2 below.

Exhibit 2: Better Market Street Phase 1 Project Delivery Milestones

Phase	Start (Month/Year)	End (Month/Year)
Planning/Conceptual Engineering (typically 30% design)	1/1/2011	1/18/2019
Environmental Studies (CEQA/NEPA)	1/1/2015	5/15/2020
Design Engineering (PS&E)	1/21/2019	5/29/2020
Bid and Award	7/1/2020	2/1/2021
Construction (substantial completion)	2/26/2021	8/30/2023

DETAILS OF PROPOSED LEGISLATION

The proposed resolution would (1) authorize Public Works to accept and expend a grant of $15,000,000 from the United States Department of Transportation for the FY 2018 Better Utilizing Investments to Leverage Development Transportation Discretionary (BUILD) Grant to fund the construction of the Public Works' Better Market Street Phase 1 project for the period of June 2020 through June 2025, and (2) confirm that grant is consistent with the City's General Plan. The purpose of this grant is to finance the construction of the Better Market Street Phase 1 project.

Background

On April 27, 2018, the U.S. Office of the Secretary of Transportation released a Notice of Funding Opportunity (NOFA) for the FY 2018 BUILD Grant program funded under the Consolidated Appropriations Act, 2018. The Consolidated Appropriations Act of 2018 appropriated a total of $1.5 billion to be awarded for National Infrastructure Investments.

On July 18, 2018, Public Works submitted a 2018 BUILD grant application for Better Market Street Phase 1. In December 2018, the U.S. Department of Transportation awarded $15,000,000 to the Better Market Street Phase 1 project for construction phase expenditures. According to Mr. Quintanilla, , although the grant was awarded in December 2018, Public Works submitted the resolution to accept and expend the grant funds to the Board of Supervisors in January 2020, or 13 months after the grant award, because it was unclear which federal agency (the Federal Highway Administration or the Federal Transit Administration) would manage the grant at the federal level. In October 2019, the U.S. Department of Transportation decided that the Federal Highway Administration would manage the grant.

FISCAL IMPACT

According to Ms. Elizabeth Ramos, Capital Finance Analyst for the Department of Public Works, the construction cost estimate for Better Market Streets Phase I increased from the cost estimate at the time of the grant application (2018) of $71.5 million to the current budget in 2020 of $176.8 million due to additional scope of work added to the project, including the addition of another city block (starting at 5th Street rather than 6th) and changes to the design as a result of transit operations requirements.

Better Market Street Phase 1 Construction

The total construction budget for the Better Market Street Phase 1 is $176,759,600, as shown in Exhibit 3 below. Of the approximate $176.8 million, $161.8 million (91.5%) are City funds and $15 million (8.5%) are federal funds.

The total Phase 1 Construction Budget amount is shown in Exhibit 3 below.

Exhibit 3: Better Market Street Phase 1 Construction Budget

Fund Source	Amount
FY 2018 BUILD Transportation Discretionary Grant	$15,000,000
Prop A General Obligation Bond	$72,123,000
BART (8th/Grove/Hyde/Market)	$410,000
One Bay Area Grant (OBAG)	$3,366,000
Prop K	$10,534,000
PUC Sewer and Water Funds	$36,500,000
TBD (e.g., Prop A GO Bond, LPP Competitive Grant, AHSC Grant)	$38,826,600
Construction Total	**$176,759,600**

Source: Public Works

Sources of local funds for the proposed Better Market Street Phase 1 construction budget include:

- $72,123,000 in Proposition A General Obligation Bonds,
- $410,000 from Bay Area Rapid Transit (BART),
- $10,534,000 in Proposition K funding[3], and
- $36,500,000 in San Francisco Public Utilities Commission (SFPUC) Sewer and Water funds.

Sources of federal funding for the proposed Better Market Street Phase 1 construction budget include:

- $15,000,000 in federal BUILD grant (subject of File 20-0046), and
- $3,366,000 in One Bay Area Grant (OBAG) funding[4].

[3] Prop K is San Francisco's voter-approved half-cent sales tax and generates approximately $100 million annually for transportation improvements.

[4] The Metropolitan Transportation Commission distributes One Bay Area Grant (OBAG) funds to county Congestion Management Agencies (CMAs) in each of the nine Bay Area counties.

Public Works has not yet secured $38,826,600, but states that these funds could potentially come from Proposition A GO Bonds, California Senate Bill Local Partnership Program Grant, or California Department of Housing and Community Development Affordable Housing and Sustainable Communities Program funds. According to Mr. Quintanilla, Public Works would work with SFMTA to secure additional Proposition A General Obligation bond funds if the Department is unable to secure the additional $38.8 million needed to complete the project.

BUILD Transportation Discretionary Grant Construction Budget

The federal BUILD grant of $15 million requires matching funds of at least 20 percent, or $3 million. According to Ms. Ramos, BUILD grant funds will be combined with Proposition K funds and Proposition A GO Bonds to complete key elements of Better Market Street Phase 1 on Market Street from 5th to 8th Streets. The cost share will be finalized after the project reaches 100% design. The overall cost estimate was prepared by Public Works Streets & Highways engineers based on the unit price and quantities of each bid line item. BUILD Grant funds of $15 million will be used only for construction costs[5] as shown below:

- Approximately $5 million (33% of the total grant amount) will be used towards the construction of .5 miles of roadway,
- $3 million (20%) will be used towards the replacement of .5 miles of track,
- $4 million (27%) will be used for replacing or upgrading an estimated 62 pedestrian crossing signals, and an estimated 125 traffic, bicycle and transit signals for all four intersections, and
- $3 million (20%) will be used towards the construction of F-Loop Phase 1A[6].

Exhibit 4: BUILD Transportation Discretionary Grant Cost Estimate

Fund Source	BUILD	Prop K/ Prop A GO Bond	Total
Roadway	$5,000,000	$1,000,000	$6,000,000
Track Replacement	$3,000,000	$2,000,000	$5,000,000
Traffic Signals Replacement and Upgrade	$4,000,000	$5,500,000	$9,500,000
F-Loop Phase 1A	$3,000,000	$4,000,000	$7,000,000
Construction Total	$15,000,000	$12,500,000	$27,500,000

Source: San Francisco Public Works

[5] According to Ms. Ramos, the BUILD grant will only go towards funding "hard costs," of which City agency personnel labor is not included. Until the contractor is selected and the construction contract is finalized, exact uses of funds cannot be determined.

[6] According to Ms. Ramos, roadway work is curb-to-curb and may include asphalt concrete, concrete base, concrete curb, pavement markings, etc. Track replacement work may include streetcar track, track drainage, track concrete and pavement, etc. Traffic Signals Replacement and Upgrade may include vehicle signals and mountings, pedestrian signals and mountings, poles, pull boxes, conduits, intersection controllers, etc. The F-Loop Phase 1A refers to the new rail, track switches, and OCS within the Phase 1A project limits that will connect the F-line to the F-Loop. The track along McAllister and Charles J. Brenham will be installed through Phase 1B, which is not funded by BUILD. F-Loop Phase 1A may include new rail, track switches, and overhead contact system work.

According to Mr. Quintanilla, the total grant budget of $27.5 million, including grant and matching funds, will likely change as the project is scoped in more detail during the design phase. If the project budget increases, other sources of funds will need to be identified, including Proposition A GO Bonds or Proposition K Transportation Sales Tax funds.

RECOMMENDATION

Approve the proposed resolution.

Items 3 and 4 **Files 20-0062 & 20-0063**	**Department:** Public Utilities Commission (PUC)

EXECUTIVE SUMMARY

Legislative Objectives

- The proposed resolutions would approve the San Francisco Public Utilities Commission (SFPUC) dam and reservoir planning, design, and engineering service contracts with (i) HDR Engineering, Inc. (File 20-0062) and (ii) AECOM Technical Services, Inc. (File 20-0063), for amounts not to exceed $11,000,000 per contract. Each contract would have an anticipated term from April 16, 2020 through April 15, 2031.

Key Points

- In 2017, then-Governor Jerry Brown ordered the California Division of Safety of Dams to identify high-hazard dam spillways that could pose significant risk to the public if a spillway incident were to occur, similar to the 2017 Oroville Dam spillway failure. The Division of Safety of Dams ordered SFPUC to conduct condition assessments of the spillways under Division of Safety of Dams jurisdiction. SFPUC has developed a 10-year capital plan to address the Division of Safety of Dams orders.
- In September 2019, SFPUC issued a Request for Proposals (RFP) to select up to three consulting firms to provide specialized dam and reservoir design services. The RFP stipulated that contracts would each have a term not to exceed 11 years and an amount not to exceed $11,000,000. Based on the proposal review, AECOM and HDR were awarded contracts.
- Under the proposed contracts, HDR would provide dam and reservoir planning and engineering services for the Mocassin and O-Shaughnessy Dams. AECOM would provide dam and reservoir planning and engineering services for reservoirs in San Francisco, and for regional dams and upgrades**.**

Fiscal Impact

- The proposed contracts would each have an amount not to exceed $11,000,000 over the 11 year term of each contract. Sufficient funding is available in the SFPUC Hetch Hetchy and Water Enterprise budgets.

Recommendation

- Approve the proposed resolutions.

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 2017, then-Governor Jerry Brown ordered the California Division of Safety of Dams to identify high-hazard dam spillways that could pose significant risk to the public if a spillway incident were to occur, similar to the 2017 Oroville Dam spillway failure. The Division of Safety of Dams ordered the San Francisco Public Utilities Commission (SFPUC) to conduct condition assessments of the spillways under the Division's jurisdiction. SFPUC has developed a 10-year capital plan to address the Division's orders.

In September 2019, SFPUC issued a Request for Proposals (RFP) to select up to three consulting firms to provide specialized dam and reservoir design services. The RFP stipulated that contracts would each have a term not to exceed 11 years and an amount not to exceed $11,000,000. SFPUC received four proposals, and an evaluation panel[1] reviewed the proposals and scored them, as shown in Table 1 below.

Table 1: Proposals and Scores from RFP

Proposer	Written Proposal Score (out of 875)	Oral Interview Score (out of 500)	Overhead and Profit Schedule Score (out of 125)	Total Score (out of 1500)
AECOM Technical Services, Inc.	765.11	410.05	125.00	1300.16
GEI Consultants, Inc.	736.58	424.80	75.00	1236.38
HDR Engineering, Inc.	751.05	418.78	62.50	1232.33
Stantec Consulting Services, Inc.	702.82	395.68	125.00	1223.50

AECOM Technical Services, GEI Consultants, and HDR Engineering were deemed the three highest scoring responsive and responsible proposers. However, Stantec Consulting Services filed a protest against GEI, and SFPUC is reviewing the merits of the protest before awarding GEI a contract. On January 14, 2020, the SFPUC Commission approved contracts with AECOM and HDR.

DETAILS OF PROPOSED LEGISLATION

The proposed resolutions would approve SFPUC dam and reservoir planning, design, and engineering service contracts with (i) HDR Engineering, Inc. (File 20-0062) and (ii) AECOM Technical Services, Inc. (File 20-0063), for terms not to exceed 11 years and amounts not to

[1] The evaluation panel consisted of an SFPUC Infrastructure Division Project Manager IV, an SFPUC City Distribution Division Principal Engineer, an East Bay Municipal Utility District Manager, and a San Francisco International Airport Project Manager III.

exceed $11,000,000 per contract. Each contract would have an anticipated term from April 16, 2020 through April 15, 2031.

Under the proposed contracts, HDR and AECOM would provide dam and reservoir planning and engineering services for projects identified in the SFPUC Hetch Hetchy and Water Enterprise Capital Improvement Programs. The scope of services includes civil engineering, electrical engineering, mechanical engineering, structural engineering, pipeline engineering, geotechnical and geologic engineering, tunnel engineering, cost estimating, utilities mapping and coordination, photogrammetry and surveys, materials testing and inspections, quality assurance review, peer review and independent technical review, potential failure modes analysis and risk assessments, possible engineering support during bid and award if the projects are approved, possible engineering support during construction, start-up, and closeout if the projects are approved, and training and technology transfer.

HDR would be assigned to the Mocassin Dam and Reservoir, O'Shaughnessy Dam Outlet Works, and O'Shaughnessy Dam Access and Drainage Improvements projects. AEECOM would be assigned to the Regional Dam Safety Upgrades, Pilarcitos Dam and Reservoir Improvements, San Andreas Dam Facility Improvements, Turner Dam and Reservoir Improvements, Local (San Francisco) Tanks and Reservoir Improvements, College Hill Reservoir Outlet, Merced Manor Reservoir Facilities Repairs, Stanford Heights Reservoir, Summit Reservoir, Sunset South Basin, and University Mound South Basin projects.

FISCAL IMPACT

The proposed contracts would each have a not-to-exceed amount of $11,000,000. According to Mr. John Scarpulla, SFPUC Policy and Government Affairs, the contract budgets by project are shown in Table 2 below.[2]

[2] According to Mr. Scarpulla, the projects that would be conducted under the third contract, which is pending protest review, are the Cherry Valley Dam Spillway, Early Intake Dam Rehabilitation, Eleanor Dam Rehabilitation, Eleanor Dam Bridge Rehabilitation, and Priest Condition Assessment and Monitoring projects.

Table 2: HDR and AECOM Contract Budgets

HDR (File 20-0062)

Project Name	Amount
Moccasin Dam and Reservoir	$1,200,000
O'Shaughnessy Dam Outlet Works Phase I	1,500,000
O'Shaughnessy Dam Outlet Works Phase II	7,900,000
O'Shaughnessy Dam Access & Drainage Improvements	400,000
Total	**$11,000,000**

AECOM (File 20-0063)

Project Name	Amount
Regional Dam Safety Upgrades	$2,600,000
Pilarcitos Dam and Reservoir Improvements	2,500,000
San Andreas Dam Facility Improvements	2,000,000
Turner Dam and Reservoir Improvement	900,000
Local (San Francisco) Tanks/Reservoir Improvements	300,000
College Hill Reservoir Outlet	600,000
Merced Manor Reservoir Facilities Repairs	1,200,000
Stanford Heights Reservoir	150,000
Summit Reservoir	150,000
Sunset South Basin	400,000
University Mound South Basin	200,000
Total	**$11,000,000**

Sufficient funding for the contracts is available in the Hetch Hetchy and Water Enterprise 10-Year Capital Improvement Programs budgets.

RECOMMENDATION

Approve the proposed resolutions.

Item 5 **File 20-0043**	**Department:** Department of Homelessness and Supportive Housing Real Estate Division

EXECUTIVE SUMMARY

Legislative Objectives

- The proposed resolution would approve a lease between the City and TC II 888 Post, LLC for property located at 888 Post Street for an initial term of 20 years with one 10-year one option to extend, for a total 20 year lease. The resolution (a)authorizes the Director of Property to negotiate and enter into future subleases, including with Goodwill Industries as a subtenant; (b) finds the proposed transaction is in conformance with the General Plan, and the eight priority policies of Planning Code, Section 101.1; and (c) adopts findings under the California Environmental Quality Act.

Key Points

- The property at 888 Polk Street would serve as a 75 bed Navigation Center for Transitional Age Youth. In July 2019, the Board of Supervisors approved a resolution urging the Department of Real Estate to pursue a financially feasible option to lease or purchase 888 Post Street for use as a Navigation Center and/or workforce development and multi-use service center serving homeless and/or formerly homeless individuals (File 19-0738).

Fiscal Impact

- The proposed lease provides an annual base rent of $1,500,000 for the first year, increasing by 3 percent per year. Total estimated rent, taxes, and insurance over the initial 20-year lease term are $49,041,565. Operating costs for the proposed Navigation Center with approximately 75-beds are $3,764,663 per year.
- The City would also make an initial contribution of $5,000,000 toward capital and tenant improvements.

Policy Consideration

- The proposed resolution authorizes the Director of Property and Director of the Department of Homelessness and Supportive Housing to exercise the extension option without further Board of Supervisors approval. The Budget and Legislative Analyst recommends amending the proposed resolution to delete this provision; the intent of this recommendation is for the exercise of the lease extension to be submitted to the Board of Supervisors for approval, consistent with Board of Supervisors practice.
- The rent payments paid by the City (rent payments not anticipated due until December 2020) over the initial 20 year term of $40 million exceed the purchase price of $29 million.

Recommendations

- Amend the proposed resolution to delete the provision that allows the Director of Property and the Director of the Department of Homelessness and Supportive Housing to exercise the option to extend the lease by ten years at the end of the initial 20 year term.
- Amend the proposed resolution to request the Department of Homelessness and Supportive Housing, subject to the availability of funding, to submit a plan to the Board of Supervisors prior to August 2021 to purchase 888 Post Street.
- Approve the proposed resolution, as amended.

MANDATE STATEMENT

Administrative Code Section 23.27 requires Board of Supervisors approval of leases of one year or more in which the City is the tenant.

BACKGROUND

The Navigation Center model was first piloted in March 2015 to provide a low-barrier, service-rich alternative to traditional homeless shelters, with the goal of transitioning people off the streets and into longer-term solutions. As of January 2020, seven Navigation Centers have been opened in three out of the eleven Supervisorial Districts (District 6, District 9, and District 10).

In July 2019, the Board of Supervisors approved a resolution urging the Department of Real Estate to pursue a financially feasible option to lease or purchase Assessor's Parcel Block No. 0300, Lot No. 009, at 888 Post Street, for use as a Navigation Center and/or workforce development and multi-use service center serving homeless and/or formerly homeless individuals (File 19-0738).

DETAILS OF PROPOSED LEGISLATION

The proposed resolution would (1) approve a lease between the City and TC II 888 Post, LLC for property located at 888 Post Street for an initial term of 20 years at a base rent of $1,500,000 per year that increases at 3 percent per year and includes one option to extend the lease for a period of ten years; (2) authorize the City's contribution of up to $5,000,000 towards the cost of landlord improvements; (3) authorize the Director of Property, under certain conditions, to negotiate and enter into future subleases, including with Goodwill Industries of San Francisco, San Mateo and Marin Counties, Inc. as a subtenant; (4) authorize the Director of Property to execute documents, make certain modifications and take certain actions in furtherance of the lease and this proposed resolution, including allowing the City to increase its contribution towards the cost of the landlord improvements, subject to future appropriation of funds; (5) finding the proposed transaction is in conformance with the General Plan, and the eight priority policies of Planning Code, Section 101.1; and (6) adopting findings under the California Environmental Quality Act.

According to Ms. Dylan Rose Schneider, Manager of Policy and Legislative Affairs at the Department of Homelessness and Supportive Housing, the site at 888 Post Street will primarily be used for a Navigation Center with approximately 75-beds for transitional-aged youth (TAY) between the ages of 18-24 who are experiencing homelessness. Ms. Schneider also states that the City is negotiating with Goodwill Industries to sublease the ground level of the building as a donation/drop-off center with training opportunities. Other additional subtenants that provide complementary services will also be considered to fully utilize the building.

Table 1 below lists the terms of the proposed lease.

Table 1. Proposed Lease Terms for 888 Post Street

Landlord	TC II 888 Post, LLC
Tenant	City
Area	33,970 square feet
Rent (monthly and annual)	• $125,000 (monthly) • $1,500,000 (annually) • Rent abatement for the first two months after the commencement date of lease
Rent adjustments	• 3 percent annual increase • If, before the rent commencement date, the tenant makes any supplemental contributions then the base rent will be reduced by $0.09 per annum for each $1.00 of supplemental contributions[1].
Term	20 years. Anticipated Commencement Date on or around October 1, 2020 with an expiration date of approximately September 30, 2040.
Options to extend	One additional 10-year option, exercisable by the City by notice to landlord given not less than 12 months in advance, with rent determined to be the greater of 95 percent of prevailing market rate or 103 percent of the Base Rent payable at the time the extension option is exercised.
Services and Utilities	• City to provide and pay for services and utilities. • City is responsible for purchasing furniture, fixtures and equipment, assisting with moving services, and performing other work and services outside the landlord improvements
Tenant, Leasehold and Capital Improvements	City to contribute capped amount of $5 million towards landlord costs of Tenant Improvements, Leasehold Improvements and/or Capital Improvements. Additionally, at its option, the City may contribute up to an additional $2,000,000 to the City Contribution. Landlord is responsible for all tenant, leasehold and/or capital improvement costs above the $5 million capped amount from the City.
Taxes and Insurance	City to reimburse landlord for real estate taxes and landlord's insurance.
Purchase Option	City has an option to purchase the property for $29 million from the landlord at any time prior to August 1, 2022.

[1] For example, if the City makes $500,000 in supplemental contributions, then the annual base rent payable would be reduced by $45,000. The City and landlord will confirm the reduction in base rent in writing before the commencement date, which, upon execution by the landlord and the City, will be considered a part of the proposed lease.

Option to Purchase Property from Landlord

Under the proposed lease, the City has an option to purchase the property for $29 million from the landlord at any time prior to August 1, 2022 ("Purchase Option"). Under the proposed lease, the exercise of the Purchase Option will be subject to a future, separate approval action by the Board of Supervisors. According to Mr. Josh Keene, Special Projects and Transactions Manager at the Real Estate Division, the $29 million purchase price was proposed by the landlord, exercisable any time before August 1, 2022. Mr. Keene states that to check the reasonableness of the proposed $29 million purchase amount absent an appraisal, the City used an income approach to estimate the value of the lease[2]. Given the long term and low risk tenant (the City) and the current market, the Real Estate Division used a 5 percent capitalization rate. As previously mentioned, approval of the purchase option is subject to future Board approval action either at a maximum $29 million purchase price if the City intends to exercise this in the future, as well as available funding. Mr. Keene states that an appraisal and review would then be obtained to confirm the appropriateness of the proposed purchase price.

City Contribution of $5 Million

According to Mr. Keene with consultation through San Francisco Public Works, major building systems and seismic upgrades are necessary throughout the building. The scope of work has not been finalized yet, but examples of the landlord improvements include electrical upgrades, elevator and elevator equipment, structural elements such as the roof, heating and air circulation/ventilation, light fixtures, plumbing, meeting disabled accessibility standards, and exterior improvement work. Under the proposed lease, the City will contribute up to $5 million towards the cost of landlord leasehold, capital and/or tenant improvements. Additionally, at its option, the City may contribute up to an additional $2 million for a total City contribution of $7 million. According to Mr. Keene, the purpose of this clause is to allow the City to reduce its base rent obligation if the City elects to contribute additional capital beyond the $5 million. Under the proposed lease, if the City makes any supplemental contributions, then the base rent will be reduced by $0.09 per annum for each $1.00 of supplemental contributions. According to Mr. Keene, the City would likely only consider evoking this clause if it elects to not purchase the building. The landlord is responsible for all leasehold, capital and/or tenant improvement costs above the $5,000,000 contribution amount from the City. In addition, under the proposed lease, the City is responsible for purchasing its own furniture, fixtures and equipment, assisting with moving services and other one-time costs estimated at $500,000, according to Mr. Keene with consultation through San Francisco Public Works.

In addition, per the proposed lease, if the City intends to seek Board of Supervisors approval to exercise its Purchase Option, the City will be allowed to increase the City's contribution towards the landlord costs for capital, tenant and leasehold improvements if there is an applicable

[2] According to Mr. Keene, the Real Estate Division used the following equation to help determine an approximate price point for the value of the property: $1,500,000 (first year revenue) divided by the 5 percent capitalization rate, which equals $30 million dollars. The estimated 5 percent capitalization rate is based on current market conditions and considers the strong credit worthiness of the City's Lease. According to CBRE Research published in summer 2019, Class A & B office space cap rates range between 4.5 – 6.0%.

appropriation of additional funds. According to Mr. Keene, the purpose of the clause is to allow the possibility to negotiate a possible reduced purchase price by increasing the City contribution towards the landlord costs for capital, tenant and leasehold improvements.

Sub-Lease with Goodwill Industries and Other Subtenants

Under the proposed lease, the City intends to negotiate and enter into subleases with other subtenants, preferably nonprofit organizations with similar goals and uses consistent with the services offered at the proposed Navigation Center. The City is currently negotiating a sublease with Goodwill Industries of San Francisco, San Mateo and Marin Counties (Goodwill) to sublease the ground floor of the property, which is approximately one-third of the premises. The sublease with Goodwill will be on the same terms and conditions of the Master Lease (as per the current proposed resolution) but adjusted for Goodwill's percentage occupancy. For example, if Goodwill occupies one-third of the building, the organization will pay one-third of the base rent under the proposed lease for 888 Post Street. The purpose of the subleases is to help offset the cost of the City's obligations under the proposed lease or as a future owner of the property that is proportionate to the space occupied by the subtenants.

According to the proposed resolution, the Board of Supervisors authorizes the Director of Property and Director of the Department of Homelessness and Supportive Housing to enter into any additions, amendments, or modifications to the lease (including entering into subleases and exercising the extension option) that the Directors determine are in the best interests of the City, do not materially decrease the benefits to the City and do not materially increase the obligations or liabilities of the City. A sublease would require subsequent Board action if there was a material deviation, such as the subtenant is paying less rent per square feet than the City is.

FISCAL IMPACT

The proposed lease provides an annual base rent of $1,500,000 (or $125,000 per month) for the first year. Annual rent adjustments will be 3 percent thereafter on each anniversary of the proposed lease's commencement date. Rent abatement of $250,000 for the first two months will occur after the proposed lease's commencement date. In addition, as previously mentioned, if the City makes any supplemental contributions up to an additional $2 million beyond the $5 million City contribution then the base rent will be reduced by $0.09 per annum for each $1.00 of supplemental contributions[3], which could result in approximately $4.8 million in savings over the 20 years if the maximum $2 million is contributed. Table 2 below summarizes the leasing costs of the initial 20-year term of the proposed lease. Total estimated leasing costs over the initial 20-year lease term for 888 Post Street is $49,041,565.

[3] For example, if the City makes $500,000 in supplemental contributions, then the annual base rent payable would be reduced by $45,000.

Table 2. Total Estimated Leasing Costs Under Proposed Lease for 888 Post Street

Year	Base Rent (Per Square Feet)	Square Feet	Total Rent Payments	Taxes and Insurance[4]	Total Leasing Costs
1[5]	$44.16	33,970	$1,500,000	$271,760	1,521,760
2	45.48	33,970	1,545,000	285,348	1,830,348
3	46.85	33,970	1,591,350	299,615	1,890,965
4	48.25	33,970	1,639,091	314,596	1,953,687
5	49.70	33,970	1,688,263	330,326	2,018,589
6	51.19	33,970	1,738,911	346,842	2,085,753
7	52.73	33,970	1,791,078	364,184	2,155,263
8	54.31	33,970	1,844,811	382,394	2,227,204
9	55.94	33,970	1,900,155	401,513	2,301,668
10	57.61	33,970	1,957,160	421,589	2,378,749
11	59.34	33,970	2,015,875	442,668	2,458,543
12	61.12	33,970	2,076,351	464,802	2,541,153
13	62.96	33,970	2,138,641	488,042	2,626,683
14	64.85	33,970	2,202,801	512,444	2,715,245
15	66.79	33,970	2,268,885	538,066	2,806,951
16	68.79	33,970	2,336,951	564,970	2,901,921
17	70.86	33,970	2,407,060	593,218	3,000,278
18	72.98	33,970	2,479,271	622,879	3,102,150
19	75.17	33,970	2,553,650	654,023	3,207,672
20	77.43	33,970	2,630,259	686,724	3,316,983
20-Year Subtotal			**$40,305,562**	**$8,986,004**	**$49,041,565**

According to Mr. Keene, the current rent for a comparable site in size (30,163 square feet) and location (555 Post) is $48 per square foot per year. Mr. Keene states that the fair market rental rates for available property in the area range from $48.00 to $68.82 per square foot per year[6]. According to Mr. Keene, the negotiated base rent of $44.16 per square foot per year of the proposed lease is at or below the fair market rental value estimate. In addition, the proposed base rent does not meet the independent appraisal requirement threshold of $45 per square foot per year as stipulated under Section 23.27 of the Administrative Code[7] .

[4] According to Mr. Keene, this is an estimate of $8.00 per square foot per year at 5 percent growth per year.

[5] Year 1 includes 2 months of rent abatement ($250,000 credit removed from Year 1 Total Leasing Costs).

[6] According to Mr. Keene, the following comparable properties were used to determine the base rental rate: $58 per square foot for 14,730 square feet, $68.82 per square foot for 11,472 square feet, $48.00 per square foot for 30,163, $58 per square foot for 11,772 square feet, and $58 per square foot for 14,642 square feet. The average of all comparable properties is $58.16 per square foot per year.

[7] Per City Administrative Code Section 23.27, the Director of Property shall determine the Market Rent of such lease based on a review of available and relevant data. If the Market Rent of the lease is more than $45 per square foot per year as base rent, the Director of Property shall obtain an appraisal for such Lease

Proposed Operating Costs of Navigation Center

In addition to leasing costs, as noted above in Table 2, the proposed lease requires the City to pay for utilities, services, routine maintenance and repair and other operating expenses. These costs have been incorporated into the operating costs for the proposed Navigation Center at the site. According to Ms. Schneider, the proposed annual operating costs for a Navigation Center with approximately 75-beds will be $3,764,663, as shown in Table 3 below[8].

Table 3. Proposed Annual Operating Costs for 75-Bed Navigation Center at 888 Post Street

Operating Costs	Amount
Salaries and Benefits[9]	$2,381,482
Operating Expense[10]	892,138
Indirect Cost	491,043
Total Costs	**$3,764,663**

Source of Funds

According to Ms. Schneider, the Department of Homelessness and Supportive Housing plans to utilize the $27,671,628 in State Homeless Emergency Aid Program (HEAP) funding received in February 2019 to fund the proposed lease and Navigation Center operating costs for the first two years. Tenant improvement costs, not to exceed $5 million, would be funded by the department's FY 2019-20 General Fund appropriation for new Navigation Centers. After the first two years of the proposed lease, the department has not identified sources of funding and is currently exploring various options, such as the Homeless Housing and Assistance Program (HHAP) State grant or purchasing the building.

POLICY CONSIDERATION

Option to Extend the Lease

If the City exercises its option to extend the initial lease term, the rent would be the greater of 95 percent of the prevailing market rate or 103 percent of the base rent payable at the time the extension option is exercised. As previously mentioned, according to the proposed resolution, the Board of Supervisors authorizes the Director of Property and Director of the Department of Homelessness and Supportive Housing to enter into any additions, amendments, or modifications to the lease (including entering into subleases and exercising the extension option) that the Directors determine are in the best interests of the City, do not materially

[8] The nonprofit operator has not been selected yet.

[9] This includes staffing costs for a Site Manager, Assistant Site Manager, Shift Supervisor, Monitors, Maintenance Manager, Janitors/Maintenance Staff, Case Management Supervisor, Case Managers, laundry staff (client laundry) and miscellaneous part-time positions.

[10] This includes costs such as utilities, trash, building maintenance supplies and repair, cleaning/janitorial supplies, office supplies, cable, linen laundry, client supplies, and rental of equipment.

decrease the benefits to the City and do not materially increase the obligations or liabilities of the City.

The Budget and Legislative Analyst recommends amending the proposed resolution to delete the provision that allows the Director of Property and the Director of the Department of Homelessness and Supportive Housing to exercise the option to extend the lease by ten years at the end of the initial 20 year term. The intent of this recommendation is for the exercise of the lease extension to be submitted to the Board of Supervisors for approval, consistent with Board of Supervisors practice.

Option to Purchase the Property

The proposed lease grants the City the exclusive option to purchase the property for $29 million at any time on or before August 1, 2022. According to Mr. Keene, independent of whether funding is available today or not, the Real Estate Division is utilizing a lease with an option to purchase rather than an outright purchase of 888 Polk Street, because the lease provides that the owner (not the City) make the tenant and capital improvements at the owner's cost, subject only to the City's contribution of $5 million. Whether the City is to buy today or buy in 2021, the price is still $29 million. The rent payments paid by the City (rent payments not anticipated due until December 2020) over the initial 20 year term of $40 million exceed the purchase price of $29 million. If the City were to purchase today rather than lease the property first, the owner would not be required to make the tenant and capital improvements.

RECOMMENDATIONS

- Amend the proposed resolution to delete the provision that allows the Director of Property and the Director of the Department of Homelessness and Supportive Housing to exercise the option to extend the lease by ten years at the end of the initial 20 year term.
- Amend the proposed resolution to request the Department of Homelessness and Supportive Housing, subject to the availability of funding, to submit a plan to the Board of Supervisors prior to August 2021 to purchase 888 Post Street.
- Approve the proposed resolution, as amended.

Items 14 and 15 **Files 20-0088 and 20-0089**	**Department:** Office of Public Finance

EXECUTIVE SUMMARY

Legislative Objectives

- **File 20-0089** is a resolution approving the City's Debt Policy, as recommended by the Controller's Office of Public Finance.
- **File 20-0088** is a resolution authorizing the issuance of up to $1,482,995,000 in refunding bonds to refund outstanding general obligation bonds. The refunding bonds would be sold in series, with the first series to be sold in 2020 in the amount of $255,000,000.

Key Points

- File 20-0089 revises the City's Debt Policy to conform to Security and Exchange Commission (SEC) Rule 15c2-12, regarding a municipality's disclosure policies to bond holders and potential investors. The changes specifically pertain to the Disclosure Practice Working Group, and the City's requirements to disclose (1) certain events that could impact credit rating, credit quality, and default probability; (2) changes in financial and economic circumstances that affect repayment capacity; and (3) any changes in the rights of bond holders that could expose owners to increased risk and financial liability.
- File 20-0088 authorizes the Office of Public Finance to issue refunding bonds of up to $1,482,995,000 to refund outstanding general obligation bonds. The refunding bonds could be issued in multiple series through June 30, 2025; the first series authorized by the proposed resolution would be $225,000,000 to be sold in the spring of 2020. Future issuances would be subject to Board of Supervisors approval.

Fiscal Impact

- Estimated debt service savings from the issuance of $255,000,000 in refunding bonds is $31.64 million.

Recommendations

- Amend Resolution 20-0089 to state: "The Controller or the Director of the Office of Public Finance, in consultation with the City Attorney, is hereby authorized and directed to take into account changes in law, ~~changes in best practices, or as otherwise recommended by the City's municipal advisors as are necessary or desirable~~; provided that such changes shall be filed with the Clerk of the Board within 30 days of any such change with a brief memorandum explaining the nature of the change."
- Amend File 20-0088, Section 4(c)(i) to state: "The City's current policy, based on GFOA recommended standards, is that the present value of the savings on debt service of each series of refunding bonds will be 3 percent or greater in total than the present value of the par of the bonds to be refunded. The discount rate to calculate present value should be either (a) true interest cost of the series of the refunding bonds, or (b) the discount rate that equates future debt service costs to the series of refunding bonds to their purchase price."
- Amend File 20-0088, Section 4(c)(ii) to add: "The Series of Bonds shall not have a true interest cost in excess of twelve percent (12%), <u>as is mandated by Title 5, Article 4.5, Section 53508(d) of the California Government Code</u>".
- Approve File 20-0088 as amended and File 20-0089 as amended.

MANDATE STATEMENT

File 20-0089: California Code Section 8855 requires that local governments certify 30 days prior to the sale of any bonds that it has adopted debt policies.

File 20-0088: City Charter Section 9.109 authorizes the Board of Supervisors to approve the refunding or general obligation bonds which are expected to result in net debt service savings.

BACKGROUND

The City's Debt Policy

California Senate Bill (SB) 1029 provides for the issuer of state or local government debt, no later than 30 days prior to the issuance of debt, to certify that the issuer has adopted local debt polices and that the issuance is consistent with the debt policies. The Board of Supervisors previously approved the City's Debt Policy as recommended by the Controller's Office of Public Finance in January 2019 (File 18-1227).

DETAILS OF PROPOSED LEGISLATION

File 20-0089: The proposed resolution approves the City's Debt Policy, as recommended by the Controller's Office of Public Finance. The proposed changes to the City's Debt Policy include:

Change to Negotiated Sales Provision

Currently, the Debt Policy authorizes the Director of Public Finance in consultation with the Controller to determine if new money and refunding bonds may be issued through a negotiated rather than a competitive sale under the following conditions: (1) deterioration in the City's credit rating or outlook; (2) market disruptions outside of the City's control, including new or proposed changes in taxation or sector risks; and (3) transactions consisting of variable rate debt, commercial paper, non-traditional debt structure, or public/private partnerships.

Under the proposed Debt Policy, the City's municipal advisor(s) would also be included in the consultation of when new or refunding bonds may be issued through a negotiated sale. In addition, "complex refunding" would be added as a transaction that may be issued through a negotiated sale.

Changes to Disclosure Provisions

Appendix I of the Debt Policy details the City's Municipal Finance Disclosure Policies and Procedures. The changes to Appendix I are required to conform with recent changes to Security and Exchange Commission (SEC) Rule 15c2-12, regarding a municipality's disclosure policies to bond holders and potential investors. The changes pertain primarily to the Disclosure Practice Working Group, and outline in specific detail the City's procedures and guidelines surrounding its obligation to disclose (1) certain listed events that could impact credit rating, credit quality, and default probability; (2) changes in financial and economic circumstances that affect repayment capacity; and (3) any changes in the rights of bond holders that could expose owners to increased risk and financial liability. Such events or changes will need to be disclosed electronically within 10 business days and made public to investors through a disclosure announcement that will be posted on the Municipal Securities Rulemaking Board Electronic Municipal Market Access system.

Other proposed changes to Appendix I include:

- Providing for the Office of Public Finance to develop additional disclosures for bonds issued by Community Facilities Districts or Infrastructure Financing Districts or Special Assessment Districts, and for Green Bonds, unrelated to federal and state security laws; and
- Provisions (1) for disclosure documents for issuers of conduit financing (such as multi-family revenue bonds) to indemnify the City against untrue statements in the disclosure documents; and (2) for offering statements to contain disclaimers that the information supplied by the City is limited.

File 20-0088: The proposed resolution authorizes the issuance of up to $1,482,995,000 in refunding bonds to refund outstanding general obligation bonds. The refunding bonds would be sold in series, with the first series to be sold in 2020 in the not-to-exceed amount of $255,000,000.

The proposed resolution approves actions and documents (including modifications) for the issuance of the refunding bonds, including:

- The form and terms of the refunding bonds; and execution, authentication, and registration of the refunding bonds;
- Appointment of depositories, verification agents, and other agents for the refunding bonds;
- The property tax levy for repayment of the refunding bonds;
- Procedures for the competitive or negotiated sales, including the forms of the Official Notice of Sale and Notice of Intention to Sale, and the selection of underwriters and the execution and delivery of bond purchase contracts;
- The execution, delivery, or distribution of continuing disclosure certificates, escrow agreements relating to the prior general obligation bonds, and Preliminary Official Statement and Official Statement for sale of refunding bonds in an amount not-to-exceed $255 million; and
- Payment of costs of issuance.

Terms of Refunding Bonds

As noted above, the proposed resolution would authorize the sale of the first series of refunding bonds in 2020 in an amount not-to-exceed $255 million. Future sales would be subject to Board of Supervisors approval. The terms for the sale of refunding bonds include:

- Debt service on the refunding bonds should result in present value savings of 3 percent of the outstanding principal amount on the prior general obligation bonds;

- True interest cost of the refunding bonds should not exceed 12 percent;[1]
- The maturity date of the refunding bonds is no later than the maturity date of the prior general obligation bonds;
- Costs of issuance of the refunding bonds does not exceed 2 percent of the principal amount of the bonds;
- The purchase price of the refunding bonds is not less than the par amount of the bonds;
- If the refunding bonds are sold through a negotiated sale, the underwriter's discount[2] cannot exceed 1 percent; and
- If the refunding bonds are sold using credit enhancements (such as bond insurance or letters of credit), the present value savings of using the credit enhancements must exceed the cost of the credit enhancements.

Under the proposed resolution, the Director of Public Finance determines the amount, date, and other provisions for the future sale of refunding bonds, up to the authorized amount of $1,482,995,000. As noted above, future sales of refunding bonds would be subject to Board of Supervisors approval.

In order to clarify the intent of the proposed resolution (File 20-0088):

- Section 4(c)(i), which provides for present value savings of 3 percent of the outstanding principal amount on the prior general obligation bonds, should be revised to state: "The City's current policy, based on GFOA recommended standards, is that the present value of the savings on debt service of each series of refunding bonds will be 3 percent or greater in total than the present value of the par of the bonds to be refunded. The discount rate to calculate present value should be either (a) true interest cost of the series of the refunding bonds, or (b) the discount rate that equates future debt service costs to the series of refunding bonds to their purchase price."
- Section 4(c)(ii), which provides for the true interest cost of the refunding bonds, should be revised to add: "as is mandated by Title 5, Article 4.5, Section 53508(d) of the California Government Code."

Outstanding General Obligation Bonds

The City previously issued series of general obligation bonds totaling $3,125,290,000 between 2008 and 2018 which contain principal maturities that are currently outstanding and could be optionally redeemed before June 15, 2025, as authorized by File 20-0088, of which $1,842,405,000 is outstanding, as shown in the Attachment. The proposed ordinance would authorize refunding of $1,482,995,000 of the outstanding balance of $1,842,405,000.

[1] "True interest cost" is the rate that sets the present value of principal and interest payments equal to the net proceeds from the bond issuance.

[2] The "underwriter's discount" is the difference between the price paid to the issuer of the bonds and the price at which the bonds are offered for sale to investors.

FISCAL IMPACT

The Office of Public Finance has identified $233,095,000 in outstanding general obligation bonds to be refunded by a maximum par of $255,000,000 in refunding bonds to be sold in 2020, as shown in Exhibit 1 below.

Exhibit 1: Series 2020-R1 General Obligation Refunding Candidates

Prior Bonds	Original Par Amount	Refundable Par Amount
Refunding Series 2008-R1	$232,075,000	$3,480,000
Series 2010 E (Earthquake Safety and Emergency Response, 2010)	79,520,000	35,730,000
Series 2012A (Earthquake Safety and Emergency Response, 2010)	183,330,000	108,025,000
Series 2012B (Clean & Safe Neighborhood Parks, 2008)	73,355,000	42,425,000
Series 2012C (Road Repaving & Street Safety, 2011)	74,295,000	43,435,000
Total	**$642,575,000**	**$233,095,000**

Source: Office of Public Finance

The amount of the bonds to be refunded is estimated to be $236,800,136, including the outstanding balance and accrued interest at the time of the refunding, as shown in Exhibit 2 below.

Exhibit 2: Estimated Source & Uses of 2020 Refunding Bonds

Sources	
Refunding Bond Proceeds	
Par Amount	$198,925,000
Premium	39,099,597
Total Sources	**$238,024,597**
Uses	
Refunding Escrow	$236,800,136
Delivery Date Expenses	
Cost of Issuance	905,805
Underwriter's Discount	318,656
Subtotal Delivery Date Expenses	1,224,416
Total Uses	**$238,024,597**
Reserve for Market Uncertainty	16,975,403
Not-to-Exceed Par Amount	**$255,000,000**

Source: Office of Public Finance, Montague DeRose and Associates, LLC

Debt Service Savings

According to the Office of Public Finance, based on bond market conditions as of January 24, 2020, the City could issue Series 2020-R1 tax-exempt refunding bonds in the Spring of 2020 in order to realize savings. Based on current market conditions, the Office of Public Finance estimates that the Series 2020-R1 refunding bonds will be sold at an interest rate of 2.19 percent and result in $31.64 million in total debt service savings.

The proposed resolution requires refunding bonds to achieve 3 percent present value savings of the par value of the refunded bonds. The net present value of the debt service savings of the proposed refunding bonds is estimated to be $26.83 million, equal to 11.51 percent of the par value of the refunded bonds[3], well above the 3 percent minimum present value savings threshold.

Debt Issuance Costs

The proposed resolution requires the costs of issuance to not exceed 2 percent, and for a negotiated sale, the underwriter's discount to not exceed 1 percent of the principal amount of the refunding bonds. The combined cost of issuance and underwriters discount is estimated at $1,224,461, which is less than 1 percent of the principal amount, below the threshold in the proposed resolution. The Office of Public Finance proposes allowing for a negotiated sale of the refunding bonds because of the series to be refunded includes multiple separate series with different initial origination dates, and multiple interest rates payable over time on each of the refunded series.

Debt Limit

The City Charter imposes a limit on general obligation bond debt of 3 percent of the assessed value of property in the City.[4] As of January 1, 2020, the City has approximately $2.39 billion in aggregate principal amount of general obligation bonds outstanding, equal to approximately 0.85 percent of the net assessed value in FY 2019-20.[5]

POLICY CONSIDERATION

Board of Supervisors Approval of the City's Debt Policy

The proposed resolution approving changes to the Debt Policy (File 20-0089) authorizes the Controller or the Director of the Office of Public Finance, in consultation with the City Attorney, to make changes to the Debt Policy to take into account changes in law or best practices, or that are recommended by the City's financial advisors. These changes would be filed with the Clerk of the Board with a brief memorandum explaining the nature of the change. The Budget and Legislative Analyst recommends amending the language of File 20-0089 to retain the Board of Supervisors practice of approving all aspects of the City's Debt Policy over which the City has local discretion, including changes in best practices or recommendations of the City's financial advisors.

3 According to the Office of Public Finance's calculations, the present value of debt service savings of $26,826,167 is equal to 11.15 percent of the refunded par amount of $233,095,000 (Exhibit 1 above).

[4] Net of non-reimbursable expenses and homeowner exemptions.

[5] According to Table A-26 in the Preliminary Official Statement, the total outstanding general obligation bond principal is $2,389,312,972. As noted in the Attachment to this report, of the $2,389,312,972 in outstanding general obligation bond debt, $1,842,405,000 could be refunded through June 30, 2025.

RECOMMENDATIONS

- Amend Resolution 20-0089 to state: “The Controller or the Director of the Office of Public Finance, in consultation with the City Attorney, is hereby authorized and directed to take into account changes in law, ~~changes in best practices, or as otherwise recommended by the City’s municipal advisors as are necessary or desirable~~; provided that such changes shall be filed with the Clerk of the Board within 30 days of any such change with a brief memorandum explaining the nature of the change.”
- Amend File 20-0088, Section 4(c)(i) to state: “The City’s current policy, based on GFOA recommended standards, is that the present value of the savings on debt service of each series of refunding bonds will be 3 percent or greater in total than the present value of the par of the bonds to be refunded. The discount rate to calculate present value should be either (a) true interest cost of the series of the refunding bonds, or (b) the discount rate that equates future debt service costs to the series of refunding bonds to their purchase price.”
- Amend File 20-0088, Section 4(c)(ii) to add: “The Series of Bonds shall not have a true interest cost in excess of twelve percent (12%), as is mandated by Title 5, Article 4.5, Section 53508(d) of the California Government Code”.
- Approve File 20-0088 as amended and File 20-0089 as amended.

Attachment: Current General Obligation Refunding Candidates

Prior Bonds	Original Par Amount	Outstanding Par Amount	Refundable Par Amount
2020 GO Refunding Candidates *(Callable on or before June 15, 2020)*			
Refunding Series 2008-R1	$232,075,000	$3,480,000	$3,480,000
Series 2010E (Earthquake Safety & Emergency Response, 2010)	$79,520,000	$38,335,000	$35,730,000
Series 2012A (Earthquake Safety & Emergency Response, 2010)	$183,330,000	$114,990,000	$108,025,000
Series 2012B (Clean & Safe Neighborhood Parks, 2008)	$73,355,000	$45,285,000	$42,425,000
Series 2012C (Road Repaving & Street Safety, 2011)	$74,295,000	$46,360,000	$43,435,000
Subtotal 2020 GO Refunding Candidates	$642,575,000	$248,450,000	$233,095,000
2021 GO Refunding Candidates *(Callable on June 15, 2021 or December 15, 2021)*			
Series 2013A (Clean & Safe Neighborhood Parks, 2012)	$71,970,000	$38,780,000	$34,690,000
Series 2013B (Earthquake Safety & Emergency Response, 2010)	$31,020,000	$16,720,000	$14,955,000
Series 2013C (Road Repaving & Street Safety, 2011)	$129,560,000	$69,785,000	$62,425,000
Refunding Series 2011-R1	$339,475,000	$149,240,000	$94,125,000
Subtotal 2021 GO Refunding Candidates	$572,025,000	$274,525,000	$206,195,000
2022 GO Refunding Candidates *(Callable on June 15, 2022)*			
Series 2012D (SFGH & Trauma Center Earthquake Safety, 2008)	$251,100,000	$147,770,000	$121,115,000
Series 2014A (SFGH & Trauma Center Earthquake Safety, 2008)	$209,955,000	$154,035,000	$128,575,000
Series 2012E (Earthquake Safety & Emergency Response, 2010)	$38,265,000	$28,380,000	$23,260,000
Series 2014C (Earthquake Safety & Emergency Response, 2010)	$54,950,000	$40,095,000	$34,045,000
Series 2014D (Earthquake Safety & Emergency Response, 2014)	$100,670,000	$73,435,000	$62,355,000
Subtotal 2022 GO Refunding Candidates	$654,940,000	$443,715,000	$369,350,000
2023 GO Refunding Candidates *(Callable on June 15, 2023)*			
Series 2015B (Transportation & Road Improvement Bonds, 2014)	$67,005,000	$41,870,000	$33,740,000
Refunding Series 2015-R1	$293,910,000	$234,310,000	$164,190,000
Series 2016A (Clean & Safe Neighborhood Parks, 2008)	$8,695,000	$7,195,000	$5,735,000
Series 2016B (Clean & Safe Neighborhood Parks, 2012)	$43,220,000	$23,355,000	$18,620,000
Series 2016C (Earthquake Safety & Emergency Response, 2010)	$25,215,000	$21,435,000	$17,190,000
Series 2016D (Earthquake Safety & Emergency Response, 2014)	$109,595,000	$72,305,000	$58,000,000
Series 2016E (Road Repaving & Street Safety, 2011)	$44,145,000	$37,515,000	$30,095,000
Subtotal 2023 GO Refunding Candidates	$591,785,000	$437,985,000	$327,570,000
2024 GO Refunding Candidates *(Callable on June 15, 2024)*			
Series 2017A (Public Health & Safety, 2016)	$173,120,000	$116,925,000	$90,670,000
Series 2018E (Public Health & Safety, 2016)	$49,955,000	$36,370,000	$29,475,000
Series 2018A (Clean & Safe Neighborhood Parks, 2012)	$76,710,000	$44,855,000	$35,400,000
Series 2018B (Transportation & Road Improvement Bonds, 2014)	$174,445,000	$102,010,000	$80,505,000
Series 2018C (Earthquake Safety & Emergency Response, 2014)	$189,735,000	$137,570,000	$110,735,000
Subtotal 2024 GO Refunding Candidates	$663,965,000	$437,730,000	$346,785,000
Total GO Refunding Candidates Callable 2020 - 2024 [1]	$3,125,290,000	$1,842,405,000	$1,482,995,000

[1] Note that there are no GO Bonds callable 6/15/2025.

Source: Memorandum provided by the Office of Public Finance

Items 15 and 16 Files 20-0012 & 20-0013	Department: Public Health

EXECUTIVE SUMMARY

Legislative Objectives

- **File 20-0012** is a resolution approving an agreement between McKesson Corporation and the Department of Public Health (DPH) for the purchase of pharmaceuticals for a total amount not to exceed $381,382,991 over a term of five years—from February 1, 2020 through January 31, 2024.
- **File 20-0013** is a resolution approving an agreement between McKesson Plasma and Biologics, LLC—a subsidiary of McKesson Corporation—and DPH for the purchase of pharmaceutical products, biologics, and specialty drugs for a total amount not to exceed $295,934,790 over a term of five years—from February 1, 2020 through January 31, 2024.

Key Points

- The City's Administrative Code authorizes the Department of Public Health to join a group purchasing organization (GPO). An ordinance approved by the Board of Supervisors on first reading at the February 4, 2020 Board meeting would allow DPH to join any healthcare GPO to continue its practice of obtaining healthcare goods and services from GPO vendors without going through a competitive solicitation. Through its membership in the Vizient GPO, DPH selected McKesson to provide pharmaceutical products based on its ability to comply with Administrative Code contracting requirements to do business with the City; pricing and volume discounts; ability to deliver products in a timely manner; and reporting and analytics capabilities.

Fiscal Impact

- The cumulative amount for both agreements over the five-year term is $677,317,781, which will be paid from DPH's General Fund budget. The costs will be partially offset from health insurance payors, including Medi-Cal, Medicare, and private insurance.
- Discounts that DPH receives under the respective purchasing agreements are monitored by the DPH Finance Unit. DPH Pharmacy staff will also review purchases to ensure that discounts are properly applied. The Chief Pharmacy Officer also reported that inventory controls are also in place to ensure that invoices match items and quantities received and that items received are added to the pharmacy inventory tracking systems.

Recommendations

- Request the Director of Health to (a) provide the February 25, 2020 Board of Supervisors meeting with the date by which the Department will submit the five-year evaluation of the GPO membership to the Health Commission, as required by Administrative Code Section 21A.2; and (b) include in the five-year evaluation an assessment of the Department's monitoring of the GPO prices and discounts, including how the Department ensures that all GPO discounts are provided to the Department.
- Approve the proposed resolutions, as amended, contingent on the Department of Public Health submitting the five-year evaluation of the GPO membership to the Health Commission, as required by Administrative Code Section 21A.2.

MANDATE STATEMENT

City Charter Section 9.118(b) requires that the Board of Supervisors approve by resolution all City agreements in excess of $10 million and/or that have a term of 10 years or more.

BACKGROUND

A Group Purchasing Organization (GPO) is an entity that is created to enable member organizations interested in buying similar products to combine their purchasing power for the purpose of procuring discounts on goods and services and to reduce the administrative burden associated with the procurement process for large organizations. GPOs are found in various industries, such as government and healthcare. In return, suppliers gain increased market share and access to decision-makers at customer organizations.

The City first authorized the Department of Public Health (DPH) to join a GPO in 1997. Originally, Administrative Code Section 21A.2 only authorized DPH to be a member of the healthcare GPO known as University HealthSystem Consortium (UHC),[1] which limited DPH's ability to compare costs against other GPOs in order to determine whether the Department was procuring healthcare goods and services for the best value. In 2015, Section 21A.2 was amended to clarify that DPH could procure information technology products and services through a number of GPOs. The Administrative Code also required DPH to evaluate its GPO memberships every five years beginning in 2020 and provide the Health Commission with an evaluation report no later than January 31, 2020 in order to determine "which GPO memberships offer DPH the best value." The evaluation report was not available as of the writing of this report.

The Board of Supervisors approved an ordinance on first reading at the February 4, 2020 Board of Supervisors meeting (File 19-1237), which would amend Chapter 21 of the Administrative Code to enable DPH to join any healthcare GPO and continue its practice of obtaining healthcare goods and services from GPO vendors without going through a competitive solicitation.

Selection of Vendor

Pursuant to the pending ordinance (File 19-1237), which was calendared at the February 11, 2020 Board of Supervisors meeting for the second and final reading, Administrative Code Section 21.1 would be amended to allow DPH to become a member of any healthcare GPO and continue to purchase products from GPO vendors without undergoing a competitive solicitation. As a result of DPH's membership in the Vizient GPO, the Department has access to three pharmaceutical vendors—McKesson Corporation, Cardinal Health, and AmerisourceBergen Corporation. The DPH's Chief Pharmacy Officer reported that a preliminary analysis of the three pharmaceutical vendors indicated that McKesson would provide the best value in terms of the following factors: (1) its ability to comply with Administrative Code

[1] In 2015, the University HealthSystem Consortium merged with two other healthcare networks, VHA Inc. and Novation, and later with MedAssets to form one of the nation's largest healthcare GPOs—known as Vizient, of which DPH is currently a member.

contracting requirements to do business with the City and County of San Francisco, (2) pricing including volume-based discounts, (3) ability to deliver products in a timely and accurate manner given DPH's substantial purchasing volume and distribution requirements, and (4) reporting and analytics capabilities related to the use of drugs across DPH's departmental units.

DETAILS OF PROPOSED LEGISLATION

File 20-0012: The proposed resolution would approve an agreement between McKesson Corporation and DPH for the purchase of pharmaceuticals for a total amount not to exceed $381,382,991 over a term of five years—from February 1, 2020 through January 31, 2024.

Under the proposed agreement, DPH is required to purchase 90 percent of its pharmaceutical supply from McKesson in order to receive discount pricing for bulk purchases. McKesson is a wholesale distributor of pharmaceuticals, meaning that it obtains drugs from a number of manufacturers and delivers them to DPH.

File 20-0013: The proposed resolution would approve an agreement between McKesson Plasma and Biologics, LLC—a subsidiary of McKesson Corporation—and DPH for the purchase of pharmaceutical products, biologics[2], and specialty drugs for a total amount not to exceed $295,934,790 over a term of five years—from February 1, 2020 through January 31, 2024. Like the agreement with McKesson Corporation, DPH is required to purchase 90 percent of its pharmaceutical products, biologics, and specialty drugs from McKesson in order to receive discount pricing for bulk purchases.

FISCAL IMPACT

Impact of Purchasing Agreement Discounts

The appendices to the respective agreements detail the discount values that DPH will receive based on the volume of purchases, invoice payment schedules, rebates and discounts, and other cost provisions; these discount values were redacted in the public documents. According to the City Attorney's Office, discount values in the respective purchasing agreements are considered confidential because the vendors are competing in the market place. While the specific financial terms of the agreements are redacted, our office has had an opportunity to confidentially review the financial terms of the agreements.

According to DPH's Director of Supply Chain and Chief Pharmacy Officer, discounts that DPH receives under the respective agreements are monitored by the DPH Finance Unit. DPH Pharmacy staff will also review purchases to ensure that discounts are properly applied. The Chief Pharmacy Officer also reported that inventory controls are in place to ensure that invoices match items and quantities received and that items received are added to the pharmacy inventory tracking systems.

[2] Biologic drugs are drugs synthesized from organic sources (animals, plants, microorganisms) or made up of components such as sugars, proteins, DNA, cells or tissues. Examples of biologics are (1) a long acting form of human insulin, (2) monoclonal antibodies used to treat rheumatoid arthritis and other auto-immune diseases, and (3) monoclonal antibodies used to treat certain forms of cancer.

Purchasing Agreement Budget

Table 1 below shows the spending plan for the proposed agreement with McKesson (File 20-0012). According to DPH's Chief Pharmacy Officer, the budget is based on recent historical spending and consideration of upcoming treatment trends, such as treatment of the hepatitis C virus in jails. The budget also includes an annual inflation factor of 11 percent for all departmental units to account for anticipated drug cost increases based on the average increase for pharmaceuticals that DPH has experienced in recent years.

Table 1: Proposed Budget for McKesson Agreement (File 20-0012)

	FY 2019-20 (2/1/2020-6/30/2020)	FY 2020-21	FY 2021-22	FY 2022-23	FY 2023-24 (7/1/2023-1/31/2024)	Subtotal
Zuckerberg San Francisco General Hospital	$8,635,585	$23,005,207	$25,535,779	$28,344,714	$18,353,202	$103,874,487
Laguna Honda Hospital	$5,281,070	$14,068,777	$15,616,342	$17,334,139	$11,223,855	$63,524,183
Jail Health Services	$1,352,565	$3,603,242	$3,999,598	$4,439,553	$2,874,610	$16,269,568
Primary Care	$872,945	$2,325,537	$2,581,346	$2,865,294	$1,855,278	$10,500,400
Community Behavioral Health	$3,091,665	$8,236,200	$9,142,182	$10,147,822	$6,570,715	$37,188,584
Public Health Division	$266,665	$710,400	$788,544	$875,283	$566,746	$3,207,638
Subtotal	**$19,500,495**	**$51,949,363**	**$57,663,791**	**$64,006,805**	**$41,444,406**	**$234,564,860**
					FY 2020-21 Pharmaceutical Innovation Initiatives[1]	$34,395,955
					Subtotal of all pharmaceuticals	$268,960,815
					Taxes[2]	$150,000
					Subtotal	$269,110,815
					Contingency (11%)	$30,535,486
					Total	**$299,646,301**
					Holdover Amount[3]	$81,736,690
					Guaranteed Maximum Cost	**$381,382,991**

[1] Emerging specialty drugs for hepatitis C virus treatment in Jail Health are expected to be available over the course of the agreement term. However, because the final drug costs are not known at this time, the values are not budgeted on an annual basis.

[2] Only over-the-counter drugs are taxable.

[3] A holdover amount to enable continuation of the agreement for up to 12 months after it expires on January 31, 2024—from February 1, 2024 to January 31, 2025—is calculated based on the last 12 months of the agreement plus a 20 percent inflation factor. This would allow time for DPH to determine whether it wants to extend its agreement with McKesson or pursue a different pharmaceutical vendor.

As shown in Table 1 above, the spending plan for the proposed agreement with McKesson shows the annual breakdown of $234.6 million in spending expected in six DPH divisions through January 2024. In addition, the spending plan includes $34.4 million for "specialty" drugs that are expected to be available during the agreement term, but for which annual spending amounts are unknown at this time. In addition, the spending plan has an 11 percent contingency of $30.5 million as well as a “Holdover Amount” of $81.7 million to allow the agreement to extend one year beyond the agreement end date of January 31, 2024. This amount is based on the expected spending on the final 12 months of the agreement escalated by 20 percent. Section 2.2 of the proposed agreement allows the agreement to extend in holdover status for up to 12 months beyond the end of the term.

Table 2 shows the spending plan for the agreement with McKesson Plasma and Biologics for specialty and gene therapy drugs. The budget includes an annual inflation factor of 40 percent to reflect the escalating cost of specialty and gene therapy drugs.

Table 2: Proposed Budget for McKesson Plasma and Biologics, LLC (File 20-0013)

	FY 2019- 20 (2/1/2020-6/30/2020)	FY 2020-21	FY 2021- 22	FY 2022-23	FY 2023-24 (7/1/2023-1/31/2024)	Subtotal
Specialty / Gene Therapy Drugs	$7,083,333	$23,800,000	$33,320,000	$46,648,000	$38,095,867	**$148,947,200**
					Specialty Drugs / Gene Therapy Innovation Initiatives[1]	$53,691,688
					Subtotal of all pharmaceuticals	$202,638,888
					Contingency (12%)	$24,256,862
					Total	**$226,895,750**
					Holdover Amount[2]	$69,039,040
					Guaranteed Maximum Cost	**$ 295,934,790**

[1] Emerging pharmaceuticals in the field of specialty drugs and gene therapy are expected to be available over the course of the agreement term. The amount here is derived by taking 14 percent of the subtotal for pharmaceuticals in Table 1 of $234.6 million ($32.8 million) plus 14 percent of the subtotal for specialty / gene therapy drugs of $148.9 million ($20.8 million) to arrive at a total of $53.7 million.

[2] A holdover amount to enable continuation of the agreement for up to 12 months after it expires on January 31, 2024—from February 1, 2024 to January 31, 2025—is calculated based on the last 12 months of the agreement plus a 20 percent inflation factor. This would allow time for DPH to determine whether it wants to continue with McKesson Plasma and Biologics or pursue a different vendor.

As with the spending plan for the McKesson agreement in Table 1, the spending plan in Table 2 includes $53.7 million for “specialty” drugs that are expected to be available during the agreement term, but for which annual spending amounts are unknown at this time. In addition, the spending plan has a 12 percent contingency of $24.2 million as well as a “Holdover Amount” of $69 million to allow the agreement to extend one year beyond the agreement end date of January 31, 2024. This amount is based on the expected spending on the final 12 months of the agreement escalated by 20 percent. Section 2.2 of the proposed agreement allows the agreement to extend in holdover status for up to 12 months beyond the end of the term.

The cumulative amount for both agreements over the five-year term is $677,317,781, which will be paid from DPH’s General Fund budget. The costs will be partially offset from health insurance payors, including Medi-Cal, Medicare, and private insurance. The Department reported the following patient mix: 60 percent Medi-Cal, 30 percent Medicare, 7 percent uninsured, and 3 percent private insurance. Uninsured patients may benefit from patient assistance programs in which pharmaceuticals are provided for free by the manufacturer, according to DPH.

Annual Cost Increases

As noted above, the agreements with McKesson and McKesson Plasma and Biologics have annual cost increases of 11 percent and 40 percent, respectively. The DPH Chief Pharmacy Officer reported that advances in the treatment of certain conditions, such as for HIV/AIDS, rheumatologic conditions, cancer, and hepatitis, are leading to rapidly growing costs for these specialty drugs. The DPH reports that these specialty drugs represent a small fraction of drug purchases, but almost 50 percent of drug expenditures; they are expected to continue to see 15 to 20 percent annual cost growth. Gene therapies for genetic disorders, such as hemophilia, sometimes cost $2 to $3 million per dose, according to the Department.

RECOMMENDATIONS

- Request the Director of Health to (a) provide the February 25, 2020 Board of Supervisors meeting with the date by which the Department will submit the five-year evaluation of the GPO membership to the Health Commission, as required by Administrative Code Section 21A.2; and (b) include in the five-year evaluation an assessment of the Department's monitoring of the GPO prices and discounts, including how the Department ensures that all GPO discounts are provided to the Department.
- Approve the proposed resolutions, as amended, contingent on the Department of Public Health submitting the five-year evaluation of the GPO membership to the Health Commission, as required by Administrative Code Section 21A.2.