CITY AND COUNTY OF SAN FRANCISCO

BOARD OF SUPERVISORS

BUDGET AND LEGISLATIVE ANALYST

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June 11, 2025

TO: Budget and Appropriations Committee

FROM: Budget and Legislative Analyst

SUBJECT: June 13, 2025 Special Budget and Appropriations Committee Meeting

TABLE OF CONTENTS

Items 6, 7, 8 **Files 25-0600, 25-0601, 25-0602**	**Department:** Public Utilities Commission

EXECUTIVE SUMMARY

Legislative Objectives

- **File 25-0600** is an ordinance that de-appropriates $86,916 from PUC's capital budget in FY 2025-26, with no change to capital project expenditure budgets; **File 25-0602** is an ordinance that de-appropriates $12,990,064 from PUC's operating budget in FY 2025-26.
- **File 25-0601** is an ordinance authorizing $1,054,138,857 in Water Revenue Bonds.

Key Points

- According to the PUC's 10-Year Financial Plan for FY 2025-26 – FY 2034-35, ratings agencies expressed concern about the forecast of debt service coverage in the Water and Wastewater Enterprises. As a result, the PUC plans to raise projected rates in the Water, Wastewater, and Power Enterprises to enhance debt service coverage and reserves.
- The PUC is proposing to offset approximately $14.1 million in revenue funding in its FY 2025-26 capital budget for additional bond funding for the Water and Hetch Hetchy Water Enterprises and conversely to offset approximately $5.2 million in bond funding for revenue funding for the Hetch Hetchy Power Enterprise to optimize for financial policy goals regarding rate changes, debt service coverage and reserve levels.
- According to PUC staff, the proposed ordinance authorizing bonds updates the amount of the 2024 authorization ($1.04 billion) to $1.054 billion, an increase of $14.1 million.

Fiscal Impact

- The average annual debt service for the proposed $14.1 million in Water bonds is approximately $1.2 million, or $34 million in total debt service over the life of the bond, excluding interim financing costs. Actual debt service costs may be lower due to market conditions, bond refunding, and access to state and federal lending.
- The PUC projects that each division will have sufficient net revenues and unrestricted fund balance to maintain debt service coverage ratios in compliance with its financial policies.

Policy Consideration

- The PUC updated the financial plan to target a higher current coverage ratio (1.25x) compared to its Debt Service Coverage Policy (1.10x) to address concerns of rating agencies. PUC will propose updates to its financial policies in FY 2025-26 and we have recommended certain changes to them to clarify their policies.

Recommendations

- Amend File 25-0601 to clarify that the proposed authorization increases the aggregate principal amount of water revenue bonds by $14,131,507
- Approve File 25-0600, File 25-0602, and File 25-0601 as amended.

MANDATE STATEMENT

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

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

City Charter Section 9.101 provides for two-year budgets and authorizes the Board of Supervisors to determine by resolution which budgets are on a two-year fixed budget. Section 9.101(g) provides for the Mayor to submit an ordinance to the Board of Supervisors, amending the second-year budgets of City departments with fixed two-year budgets, if the Controller projects that the City will experience significant increases or decreases in revenues or expenditures during the second year of such budgetary cycle.

File 23-1196 approved fixed two-year budgets for the Airport, Port, and Public Utilities Commission for FY 2024-25 and FY 2025-26 and defined "significant" budget changes as a five percent or more change in revenues or expenditures in non-General Fund funds and 2.5 percent change in General Fund funds.

City Charter Section 9.105 states that amendments to the Annual Appropriations Ordinance, after the Controller certifies the availability of funds, are subject to Board of Supervisors approval by ordinance.

BACKGROUND

The Public Utilities Commission (PUC) plans its capital spending over two- and ten-year time frames. The two-year capital budget accompanies the PUC's two-year operating budget and both two-year spending plans are subject to Board of Supervisors approval. In June 2024, the Board of Supervisors approved the SFPUC two-year FY 2024-25 and FY 2025-26 capital budget (File 24-0452). PUC capital projects are primarily funded by revenue bonds and operating revenue. Exhibit 1 below shows the PUC approved 10-year capital plan for each enterprise.

Exhibit 1: PUC 10 Year Capital Plan

Enterprise	FY 2026-35
Wastewater	$5,889,029,154
Water	2,418,252,433
Hetch Hetchy Water	1,430,124,584
Hetch Hetchy Power	1,276,666,217
CleanPowerSF	48,448,303
Total	**$11,062,520,691**

Source: PUC

10-Year Financial Plan

According to the PUC's 10-Year Financial Plan for FY 2025-26 – FY 2034-35, ratings agencies expressed concern about the forecast of debt service coverage in the Water and Wastewater Enterprises, and the potential depletion of reserves. According to PUC staff, the projected decrease in debt service coverage was still in compliance with the agency's financial policies. In 2024, S&P Global Ratings affirmed the Wastewater Enterprise's AA rating but lowered the outlook of the Wastewater Enterprise bonds from "stable" to "negative". Maintaining high bond ratings allows the PUC to access lower interest rates on revenue bonds, lowering borrowing costs and annual debt service. Additionally, PUC is required by charter section 8B.125 to "Establish rates, fees and charges at levels sufficient to improve or maintain financial condition and bond ratings at or above levels equivalent to highly rated utilities of each enterprise".

As a result of the ratings concerns, and as a result of lower volume forecasts, the PUC made changes to its 10-Year Financial Plan and plans to raise projected rates in the Water, Wastewater, and Power Enterprises to enhance forecasted debt service coverage and reserves. The PUC is also proposing to make changes to the funding sources for its two-year capital budget for the Water Enterprise. Specifically, the PUC is proposing to offset approximately $14 million in revenue funding for water capital projects with debt through the issuance of additional corresponding Water Revenue Bonds in order to optimize debt service coverage in the budget and in future years.

Rating agencies affirmed the Water Enterprise's credit rating and stable outlook in March 2025, subsequent to the adoption of the 10-Year Financial Plan.

DETAILS OF PROPOSED LEGISLATION

File 25-0600 is an ordinance that appropriates and de-appropriates funding for the SFPUC's capital projects budget for a net de-appropriation of $86,916, with no change to capital project expenditure budgets.

File 25-0602 is an ordinance that de-appropriates $12,990,064 from SFPUC's operating budget in FY 2025-26.

File 25-0601 is an ordinance (a) authorizing the issuance and sale of tax-exempt or taxable Water Revenue Bonds by the San Francisco Public Utilities Commission (SFPUC) in an aggregate principal amount not to exceed $1,054,138,857 to finance the costs of Water Enterprise capital projects; (b) authorizing the issuance of Water Revenue Refunding Bonds and the retirement of outstanding Water Enterprise Commercial Paper; (c) declaring the intent of SFPUC to reimburse itself with one or more issues of tax-exempt bonds or other forms of indebtedness; and (d) ratifying previous actions taken in connection with the issuance.

Capital Budget Sources Appropriation Changes (File 25-0600)

As mentioned above, the PUC is proposing changes to its capital budget to change the mix of revenue and debt funding sources for projects in order to optimize for financial policy goals regarding rate changes, debt service coverage and reserve levels. There are no changes to the adopted capital project expenditure budget. As shown below, the overall change in funding is a reduction in $86,916, which is not material across a $1.8 billion budget. The PUC is proposing to offset approximately $14.1 million in revenue funding for additional bond funding for the Water and Hetch Hetchy Water Enterprises and conversely to offset approximately $5.2 million in bond funding for revenue funding for the Hetch Hetchy Power Enterprise.

Despite the proposed increase in debt funding in FY 2025-26, over the 10 Year Financial Planning period, PUC is overall decreasing its reliance on debt funding as part of its efforts to enhance its financial sustainability policy metrics over time. The latest plan projects 29 percent revenue funding vs. 22 percent in the prior version of the 10-year plan, exceeding the PUC's minimum policy target of 15 percent according to PUC staff.

Exhibit 2: Capital Budget Sources De-Appropriation and Appropriation Changes

Enterprise	FY 2025-26 Approved	FY 2025-26 Proposed	Proposed Change
Bond Funded			
Wastewater	$804,162,291	$804,157,905	($4,386)
Water	432,635,062	445,404,669	12,769,607
Hetch Hetchy Water	89,876,008	91,364,909	1,488,901
Hetch Hetchy Power	177,195,151	171,660,126	(5,535,025)
CleanPowerSF	0	0	0
Subtotal, Bond Funded	*1,503,868,512*	*1,512,587,609*	*8,719,097*
Revenue & Fee Funded			
Wastewater	139,374,061	139,378,447	4,386
Water	109,442,567	96,799,961	(12,642,606)
Hetch Hetchy Water	8,772,339	7,338,910	(1,433,429)
Hetch Hetchy Power	29,617,034	34,882,670	5,265,636
CleanPowerSF	516,430	516,430	0
Subtotal, Revenue & Fee Funded	*287,722,431*	*278,916,418*	*(8,806,013)*
Total Sources			
Wastewater	943,536,352	943,536,352	0
Water	542,077,629	542,204,630	127,001
Hetch Hetchy Water	98,648,347	98,703,819	55,472
Hetch Hetchy Power	206,812,185	206,542,796	(269,389)
CleanPowerSF	516,430	516,430	0
Total Sources	**$1,791,590,943**	**$1,791,504,027**	**($86,916)**

Source: PUC

Water Enterprise and Hetch Hetchy Water

As part of the PUC's 10-Year Financial Plan for FY 2025-26 – FY 2034-35, the PUC revised water and wastewater volume forecasts down, mainly due to slower post-pandemic and drought recovery. In addition, as explained above, due to rating agency concerns about weak financial metrics, PUC built in an additional buffer in revenue projections to improve debt service coverage and reserves metrics. Lastly, the mix of debt vs. revenue funding for capital projects was adjusted across the 10 year forecast window to optimize for annual rate changes, debt service coverage and reserve levels in each year. This optimization of debt vs. revenue funding resulted in a reduction in the revenue contribution for capital projects of $12.6 million in the Water Enterprise and $1.5 million in the Hetch Hetchy Water Enterprise, for a total reduction of $14.1 million in water revenues going to capital in FY 2025-26. The PUC is proposing to offset this reduction in revenue funding with additional water revenue bond funding for capital projects in these enterprises, including an increase of $12.8 million in the Water Enterprise and an increase of $1.5 million in Hetch Hetchy Water.

The Water Enterprise provides both regional water conveyance and local (in-city) water distribution.[1] The changes in funding for local water capital projects are offsetting changes in funding for regional water capital projects. Revenue funding for regional water projects is increasing by $15.0 million (and is being offset by lower bond funding) due to the same reason as above. The PUC made changes in the 10-year financial plan to optimize for annual rate changes, debt service coverage and reserve levels in each year. Revenue funding for local water projects is decreasing by $27.6 million (and is being offset by increased bond funding).

Power Enterprise

According to PUC staff, PUC is proposing to increase appropriations for power revenues for Hetch Hetchy Power Enterprise capital projects by $5.3 million, again to optimize for debt vs. revenue funding for capital projects. This increase in revenue funding is offset by a proposed reduction in power revenue bond funding of $5.5 million.

Operating Budget Appropriation Changes (File 25-0602)

The proposed ordinance that de-appropriates approximately $13 million from the PUC's FY 2025-26 operating budget reflects the proposed changes to the capital budget. The proposed ordinance includes reductions in transfers of water revenues to capital projects.

Water Revenue Bond Issuance (File 25-0601)

In June 2024, the Board of Supervisors approved the issuance of $1,040,007,350 of new Water Revenue Bonds to finance capital projects in the two-year capital budget (File 24-0455). According to PUC staff, the proposed ordinance updates the amount of the prior authorization to $1,054,138,857, an increase of $14.1 million, rather than authorizing an additional $1.054 billion in water revenue bonds. However, this is not clearly stated in the ordinance. We recommend that the Board of Supervisors amend the proposed ordinance to clarify that the proposed authorization increases the aggregate principal amount of water revenue bonds by $14,131,507.

[1] The regional water system includes the New Irvington Tunnel conveying water from the Hetch Hetchy Reservoir, the San Antonio and Calaveras Reservoirs in Alameda County, and the San Andreas and Crystal Springs Reservoirs on the Peninsula. The in-city distribution system is a series of pipelines that distributes water from the regional water system to residences and businesses in San Francisco

The PUC is proposing to increase the amount of water revenue bonds to offset a reduction in revenue funding for Water capital projects, as discussed above. File 25-0600 appropriates the proposed increase in water revenue bonds for water capital projects.

The proposed ordinance allows the issuance of commercial paper or other interim debt to finance the projects prior to the issuance of the revenue bonds and provide for SFPUC to access California Water Resources Control Board revolving loan funds or grant funds.

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

In addition, the SFPUC may issue refunding bonds to repay outstanding Revenue Bond debt if the issuance of the refunding bonds results in net present value debt service savings of 3 percent and does not extend the maturity date. If the SFPUC issues refunding bonds, then the SFPUC needs to submit to the Board of Supervisors the final official statement for the refunding bonds and a statement from the financial advisor on the 3 percent net present value debt service savings. The Commission may also authorize refunding bonds if other benefits accrue. The authorization to issue refunding bonds extends through June 2030.

Proposition E Bond Funds

San Francisco voters approved Proposition E in 2002 and Proposition A in 2018, providing for the Board of Supervisors to authorize issuance of Water, Power, Wastewater Revenue Bonds and other forms of debt with two-thirds approval of the Board members. As shown below in Exhibit 3, the Board has authorized $15.24 billion, of which $10.73 billion has been issued and $4.51 billion is authorized but not issued.

Exhibit 3: Proposition E Bond Authorizations

PUC Division	Authorized	Issued	Unissued	Proposed	New Total Authorized
Wastewater	$8,052,606,653	$5,625,155,128	$2,427,451,525		$8,052,606,653
Water	6,157,510,811	4,650,053,482	1,507,457,329	14,131,507	6,171,642,318
Power	1,029,790,456	456,378,000	573,412,456		1,029,790,456
Total	**$15,239,907,920**	**$10,731,586,610**	**$4,508,321,310**	**14,131,507**	**15,254,039,427**

Source: SFPUC

Approval of the proposed bond authorization ordinance would increase the amount of bonds authorized in accordance with Proposition E to $15.25 billion. The SFPUC plans to issue approximately $10.28 billion in revenue bonds between FY 2025-26 to FY 2034-25, as per their 10-year Financial Plan (amounts are preliminary and subject to change due to market conditions and actual project spending).

FISCAL IMPACT

Debt Service

SFPUC's Ten-Year Financial Plan assumes Revenue Bonds will have a 6 percent interest rate and a thirty-year term. The projected average annual debt service using the assumptions in the Ten-Year Financial plan for the proposed $14.1 million in Water bonds after the capitalized interest period is approximately $1.2 million per year, or $34 million in total debt service over the life of the bond, excluding any interim financing costs. Actual debt service costs may be lower due to market conditions, bond refunding, and access to state and federal lending and other capital revenues.

Financial Policies

The SFPUC FY 2025-26 – FY 2034-35 10-Year Financial Plan projects that the Water, Wastewater, and Hetch Hetchy Water and Power Enterprises will have sufficient net revenues and unrestricted fund balance to maintain debt service coverage ratios in compliance with the Department's financial policies.

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

In November 2023, the Public Utilities Commission adopted a new Affordability Policy, which establishes a non-binding affordability target that the average residential combined water and sewer bill should be no more than three percent of typical household income.[2] According to the Ten Year Financial Plan, the combined water and sewer bill will be 1.7 percent of typical household income in FY 2024-25, rising to 2.7 percent in FY 2034-35 and therefore in compliance with the new Affordability Policy.[3] A target for Hetch Hetchy and CleanPowerSF bills has not been established, however the Financial Plan projects that the rates for each will be between 1.1 and 1.8 percent of average income.

Customer Rates

Exhibit 4 below shows the projected rate increases for each utility service for the next five fiscal years, based on the 10-Year Financial Plan. These are subject to change prior to adoption. Rates for service pay for operating and capital expenditures.

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[2] Typical household income is defined as the 40th percentile of household income in San Francisco, as measured in the U.S. Census Bureau's more recent Five-Year American Community Survey, or $92,915 in 2021. The Affordability Policy also sets planning targets such that the combined water and sewer bill be no more than seven percent of the 20th percentile of San Francisco income, which was $38,376 in 2021.

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

Exhibit 4: Utility Rate Increases (Red = higher than last year, Blue = lower than last year)

Utility	FY 2026	FY 2027	FY 2028	FY 2029	FY 2030
Retail Water	5.00%	7.0%	7.0%	8.0%	8.0%
Wholesale Water	2.1%	1.7%	3.2%	3.8%	7.0%
Wastewater	9.00%	15.0%	15.0%	14.0%	12.5%
Hetch Hetchy Power	10.0%	9.5%	9.5%	8.0%	5.0%
CleanPowerSF Generation	0%	0.0%	0.0%	0.0%	1.5%

Source: FY 2025-26 – FY 2034-35 Ten Year Financial Plan and PUC

Notes: Red highlighting indicates higher increases than projected in last year's financial plan, typically an increase of two percentage points. Blue highlighting indicates lower increases than projected in the financial plan, typically a decrease of two percentage points.

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

Wholesale Water rates are based on a contract with wholesale customers. Rate decreases are use of fund balance to reduce rates in upcoming years, changes to wholesale volume forecasts, and changes to capital projects and their funding sources in the 10-year Capital Plan.

As explained above, Water and Wastewater rates are increasing due to lower water and wastewater sales projections and changes to target a higher debt service coverage ratio and reserve levels. This was in response to rating agency concerns about weak financial ratios and the Wastewater enterprise being placed on negative outlook in Summer 2024. Both Water and Wastewater's rate increases are mainly driven by costs of capital investments. In particular, Wastewater rates are projected to increase by more than 10 percent starting in FY 2026-27 due to large capital investments to address aging infrastructure and regulatory obligations, and debt service associated with completed projects.

Hetch Hetchy Power and CleanPowerSF rates will be adopted annually, given recent volatility in energy markets. The driver of these rate increases is the increasing costs of power purchase and distribution. A Power rate study is ongoing and planned to be completed in Spring 2026. While the Ten Year Financial Plan projected a 3.0 percent increase in CleanPowerSF in FY 2025-26, rates were ultimately not changed, resulting in no increase for CleanPowerSF customers.

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

POLICY CONSIDERATION

Debt Service Coverage Policy

One of the PUC's financial policies is the Debt Service Coverage Policy. The Policy includes two formulas: (1) for maintaining sufficient net revenues and fund balance to exceed debt service coverage requirements in bond indentures and (2) for maintaining sufficient net revenues to exceed debt service. The Indenture Coverage formula explicitly includes enterprise fund balance. The Current Coverage ratio does not explicitly include fund balance, which is consistent with how credit rating agencies and some PUC creditors evaluate debt service coverage.[4] However, according to the Ten Year Financial Plan, on advice of bond counsel, the PUC may include appropriated fund balance in the calculation a PUC Enterprise's Current Coverage, even though it is not specified in the policy formula, as it is a funding source for operating costs. According to the FY 2025-26 to FY 2034-35 10-Year Financial Plan, PUC updated the financial plan to target a higher current coverage ratio (1.25x) compared to the PUC's Debt Service Coverage Policy (1.10x) to address concerns of rating agencies. The Plan also states that PUC is considering potential changes to update formal financial policies which would be incorporated in next year's 10-year financial plan. PUC has confirmed this policy review is underway and will be brought to the Commission for adoption in Q1 of FY 2025-26. We recommend that the PUC clarify that fund balance may be used to meet current debt service coverage requirements. PUC Policy updates remain subject to Commission consideration and approval. We will evaluate any changes to the PUC's financial policies in the next budget cycle.

RECOMMENDATIONS

1. Amend File 25-0601 to clarify that the proposed authorization increases the aggregate principal amount of water revenue bonds by $14,131,507.
2. Approve File 25-0600, File 25-0602, and File 25-0601 as amended.

[4] As calculated in SFPUC's Debt Service Coverage Policy: The Indenture Coverage formula is: ((Annual Revenues – Operating Expenses) + Unappropriated Fund Balance))/ Annual Debt Service. The Current Coverage formula is: (Annual Revenues – Operating Expenses)/Annual Debt Service. The Indenture Coverage must be at least 1.35x debt service and the Current Coverage must 1.10x debt service.