

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

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June 19, 2017

TO: Budget and Finance Committee

FROM: Budget and Legislative Analyst



SUBJECT: June 21, 2017 Budget and Finance Committee Meeting

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Items 6 and 7 Files 17-0675 and 17-0696	Department: San Francisco International Airport (Airport)
EXECUTIVE SUMMARY	
Legislative Objectives	
<p>File 17-0675: The proposed ordinance (a) appropriates \$35,000,000 in Airport General Revenue Bonds, \$35,000,000 in Hotel Special Facility Bonds, and \$60,000 in fund balance, totaling \$70,060,000; and places \$70,000,000 on Controller’s Reserve pending receipt of funds; and (b) de-appropriates and re-appropriates \$25,000,000 in previously-issued Hotel Special Facility Bonds.</p>	
<p>File 17-0696: The proposed resolution approves the issuance of up to \$35,000,000 in Airport General Revenue Bonds, and the issuance of up to \$35,000,000 in Airport Special Facility Bonds to finance the Airport Hotel Project.</p>	
Key Points	
<ul style="list-style-type: none"> • The Board of Supervisors previously appropriated \$243,000,000 for the construction of a 351-room hotel on Airport property, owned by the Airport and operated by Hyatt Corporation. The costs of the Airport Hotel Project have increased by \$35,000,000 from \$243,000,000 to \$278,000,000 due to construction cost increases and project redesign. • The Airport is using a layered financing structure for the Airport Hotel Project in which the Airport would sell (a) \$243,000,000 in tax-exempt General Airport Revenue Bonds at a low interest rate, and (b) \$225,000,000 in Hotel Special Facility Revenue Bonds, which the Airport will buy from itself with proceeds from the General Airport Revenue Bonds. The Hotel Special Facility Revenue Bond proceeds fund construction of the hotel. • The Airport will pay debt service on the General Airport Revenue Bonds from Airport operating revenues as part of its overall debt service on total outstanding Airport General Revenue Bonds. Hotel revenues will pay debt service on the Hotel Special Facility Revenue Bonds. 	
Fiscal Impact	
<ul style="list-style-type: none"> • The Airport proposes to sell \$278,000,000 in Airport General Revenue Bonds to fund the Airport Hotel Project for a 40-year term through a competitive sale at a variable interest rate, estimated to range from 2.0 to 3.18 percent. Total debt service on the Airport General Revenue Bonds that would be issued to fund the Hotel project is estimated at \$589,200,000, of which \$278,000,000 is principal and \$311,200,000 is interest. Annual average debt service is estimated at \$14,730,000. • The Airport proposes to issue Special Facility Revenue Bonds over a 40-year term at a fixed interest rate, estimated to be 3.0 percent, and then buy the Special Facility Revenue Bonds using Airport General Revenue Bond proceeds. Hotel revenues will pay debt service to the Airport on the Special Facility Revenue Bonds. 	
Recommendation	
<ul style="list-style-type: none"> • Approve the proposed resolution and ordinance. 	

MANDATE STATEMENT

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

BACKGROUND

The Airport is constructing a 351-room hotel on Airport property that would be owned by the Airport and operated under a Hotel Management Agreement between the Airport and the Hyatt Corporation. The original project budget was \$243,000,000, as shown in Table 1 below.

At the time that the Airport originally requested Board of Supervisors approval of the on-Airport Hotel in 2015, the Airport anticipated using a layered financing structure for the Airport Hotel Project in which the Airport would sell (a) \$243,000,000 in tax-exempt General Airport Revenue Bonds at a low interest rate, and (b) \$225,000,000 Hotel Special Facility Revenue Bonds, which the Airport bought from itself with proceeds from the General Airport Revenue Bonds. The Hotel Special Facility Revenue Bond proceeds fund construction of the hotel.¹

Under this financing structure, the Airport would pay debt service on the General Airport Revenue Bonds from Airport operating revenues as part of its overall debt service on total outstanding Airport General Revenue Bonds. Hotel revenues would pay debt service on the Hotel Special Facility Revenue Bonds, which would be owned by the Airport, thus generating revenues to the Airport.

The Board of Supervisors previously approved the sale and appropriation of \$243,000,000 in General Airport Revenue Bonds and \$225,000,000 in Hotel Special Facility Revenue Bonds to finance construction of the hotel, as well as appropriation of a \$5,000,000 contribution from the Hyatt Corporation to construct the hotel (File 15-1076).

DETAILS OF PROPOSED LEGISLATION

File 17-0675: The proposed ordinance (a) appropriates \$35,000,000 in Airport General Revenue Bonds, \$35,000,000 in Hotel Special Facility Bonds, and \$60,000 in Airport fund balance², totaling \$70,060,000; and places \$70,000,000 on Controller's Reserve pending receipt of bond proceeds; and (b) de-appropriates and re-appropriates \$25,000,000 in previously-issued Hotel Special Facility Bonds.

¹ The proposed hotel is designated a "special facility" under the Airport's 1991 Master Bond Resolution, which allows hotel revenues to be segregated from the Airport's general revenues and used to pay debt service and other expenses associated with the hotel.

² \$60,000 is allocated to the City Services Auditor.

File 17-0696: The proposed resolution approves the issuance of up to \$35,000,000 in Airport General Revenue Bonds, and the issuance of up to \$35,000,000 in Airport Special Facility Bonds to finance the Airport Hotel Project.

As shown in Table 1 below, the Airport would increase its planned bond issuance in connection with the Hotel by \$35,000,000 in Airport General Revenue Bonds, the proceeds of which would be used to purchase \$35,000,000 in Airport Special Facility Bonds that would be used to finance the Airport Hotel Project.

Increase in Airport Hotel Project Budget and General Airport Revenue Bonds

According to the Airport Director's March 7, 2017 memorandum to the Airport Commission, the construction cost estimate for the Airport Hotel Project increased by \$30,000,000, from \$210,000,000 to \$240,000,000, as shown in Table 1 below. This increase is due to: (a) construction cost increases, particularly for electrical and mechanical systems and interior finishes, and (b) project redesign to allocate more space to meeting facilities and food and beverage outlets.

As a result of the increase in the hotel construction costs, the Airport will need to increase its planned issuance of General Airport Revenue Bonds from \$243,000,000 to \$278,000,000, an increase of \$35,000,000, as shown in Table 1 below.

Table 1: Airport Hotel Project Budget

	October 2015 Budget	February 2017 Budget Revision	Increase
Costs Payable from Airport General Revenue Bonds			
Hotel AirTrain station construction costs:	\$15,000,000	\$15,000,000	\$0
Costs of issuance:	3,000,000	3,000,000	0
Purchase of Hotel Special Facility Bonds:	225,000,000	260,000,000	35,000,000
Total Airport General Revenue Bonds:	\$243,000,000	\$278,000,000	\$35,000,000
Project Costs Payable from Hotel Special Facility Bonds			
Hotel construction costs (including repayment of commercial paper principal and reimbursement of operating funds):	\$210,000,000	\$240,000,000	\$30,000,000
Capitalized Interest, Commercial Paper Interest:	20,000,000	25,000,000	5,000,000
Less contribution from Hotel operator:	(5,000,000)	(5,000,000)	0
Total Hotel Special Facility Bonds:	\$225,000,000	\$260,000,000	\$35,000,000

Airport Hotel Project

California Environmental Quality Act (CEQA) determinations and environmental site assessment for the project were completed in 2014. The design-build contractor, Webcor Construction LP, was selected through a competitive Request for Proposals (RFP) process. The Airport issued the Notice to Proceed to Webcor Construction LP in March 2016. Construction is expected to begin in June 2017, with completion of construction and opening of the hotel in July 2019.

FISCAL IMPACT

Airport General Revenue Bonds

The Airport Commission has previously approved \$7.827 billion in Airport General Revenue Bonds, including the proposed \$35 million in additional bond authority for the Airport Hotel Project. The Board of Supervisors has previously authorized \$7.792 billion in Airport General Revenue Bonds. Of the \$7.792 billion of previously authorized Airport General Revenue Bonds, the Airport has sold \$2.289 billion with a balance of \$5.503 billion authorized and unsold bonds.

Table 2: Authorized Airport General Revenue Bonds (\$ in Millions)

Year Authorized	Airport Commission	Board of Supervisors	Variance
2008	\$718	\$718	\$0
2012	502	502	0
2014	3,554	1,970	1,584
2015 ^a	243	243	0
2017 ^b	2,775	4,359	(1,584)
2017 ^c	<u>35</u>	<u>0</u>	<u>35</u>
Total Authorized	\$7,827	\$7,792	\$35
Total Issued to Date	<u>(2,289)</u>	<u>(2,289)</u>	<u>0</u>
Authorized and Not Issued	\$5,538	\$5,503	\$35

^a Allocated to financing the design and construction of the Airport Hotel Project

^b Authorized by Board of Supervisors in April 2017 (File 17-0211)

^c Subject of File 17-0696

Total Debt Service on Airport General Revenue Bonds

As of June 1, 2017, the Airport has a total of \$4.8 billion in Airport General Revenue Bond principal outstanding. This debt includes bonds issued to finance capital projects included in previous Airport Capital Plans, such as Terminal 2, Boarding Area E, and the new Air Traffic Control Tower, as well as bonds that are still outstanding from the Airport's last major construction program in the late 1990's. Total annual debt service on outstanding bonds in FY 2016-17 is \$413.1 million.

As noted above, the Airport has sold \$2.289 billion of the total authorized \$7.792 billion in Airport General Revenue Bonds with \$5.503 billion in remaining authorization. Total debt service for planned future issuance of the remaining authorized bonds is estimated to be an

additional \$11.8 billion over 30 years, of which \$5.3 billion is principal and \$6.5 billion is interest.³

Debt Service on Airport General Revenue Bonds

The Airport proposes to sell \$278,000,000 in Airport General Revenue Bonds to fund the Airport Hotel Project for a 40-year term through a competitive sale at a variable interest rate, estimated to range from 2.0 to 3.18 percent. Total debt service on the Airport General Revenue Bonds that would be issued to fund the Hotel project is estimated at \$589,200,000, of which \$278,000,000 is principal and \$311,200,000 is interest. Annual average debt service is estimated at \$14,730,000.

Special Facility Revenue Bonds

As noted above, the financing plan for the Airport Hotel Project provides for layered financing. According to Mr. Kevin Kone, Airport Finance Director, the proposed layered financing structure allows the Airport to issue tax-exempt General Airport Revenue Bonds to finance development of the Airport-owned hotel. The Airport proposes to issue Special Facility Revenue Bonds over a 40-year term at a fixed interest rate, estimated to be 3.0 percent, and then buy the Special Facility Revenue Bonds using Airport General Revenue Bond proceeds. Hotel revenues will pay debt service to the Airport on the Special Facility Revenue Bonds.

According to revised financial projections prepared in December 2016 by the Airport's consultant, Jones Lang LaSalle, the Airport hotel's operating revenue will be sufficient to meeting operating expenses, reserves and debt service on the Special Facility Revenue Bonds.⁴

Commercial Paper and Timing of Bond Issuance

The Airport has not yet issued the previously-authorized Airport General Revenue Bonds or Special Facility Revenue Bonds. According to Mr. Kone, the Airport plans to issue up to \$100 million in Commercial Paper as interim financing prior to the issuance of the Airport General Revenue Bonds.⁵ The Airport expects to issue the Airport General Revenue Bonds and Special Facility Revenue Bonds in late 2017 or early 2018.

³ Total debt service of \$11.8 billion for planned future issuance of the remaining authorized bonds excludes the \$243 million in previously authorized Airport General Revenue Bonds for the Airport Hotel Project as it is anticipated that revenues from the Hotel would be sufficient to pay the associated debt service cost on bonds issued for the Hotel project.

⁴ Based on projected revenue per available room (RevPAR) in FY 2019-20 (the first fiscal year of hotel operation) of \$226.54, increasing by approximately 4.9 percent per year.

⁵ Commercial paper is short term debt up to 270 days at a lower interest rate than longer term debt.

Airport's Debt Policy

The Airport pays debt service on Airport General Revenue Bonds from operating revenues. The Master Bond Indenture on the Airport's General Revenue Bonds requires the Airport to maintain a debt service coverage ratio of at least 125 percent of aggregate annual debt service.⁶ According to Mr. Kone, the Airport's FY 2015-16 debt service coverage ratio was 144 percent and the Airport's projected FY 2016-17 debt service coverage ratio is 130 percent.

According to Mr. Kone, because hotel revenues to the Airport are expected to be sufficient to cover the debt service on the General Airport Revenue Bonds, the debt service coverage ratio is not expected to be impacted by the issuance of General Airport Revenue Bonds to fund the Airport Hotel Project.

The Airport's Lease and Use Agreement

Under the Lease and Use Agreement between the Airport and the airlines, the Airport has the authority to increase the landing and terminal fees charged to the airlines to meet its operating expenses, including annual debt service on outstanding General Airport Revenue Bonds. According to the Airport, the airlines approved the revised Airport Hotel Project budget on April 10, 2017.

RECOMMENDATION

Approve the proposed resolution and ordinance.

⁶ The debt service coverage ratio is the ratio of annual net operating income to annual debt service.

Items 10 and 11 Files 17-0589 and 17-0590	Department: Human Services Agency (HSA)
EXECUTIVE SUMMARY	
<p>Legislative Objectives</p> <ul style="list-style-type: none"> • File 17-0589: Proposed resolution would approve a contract between the City and Children’s Council of San Francisco for provision of Early Care Education Integrated Services to support the City’s implementation of the San Francisco Citywide Plan for Early Care and Education for the three-year period of July 1, 2017 through June 30, 2020 for total of \$204,233,857. • File 17-0590: Proposed resolution would approve a contract between the City and Wu Yee Children’s Services for provision of Early Care Education Integrated Services to support the City’s implementation of the San Francisco Citywide Plan for Early Care and Education for the three-year period of July 1, 2017 through June 30, 2020 for total of \$31,322,180. <p>Key Points</p> <ul style="list-style-type: none"> • In 2012, a new San Francisco Office of Early Care and Education was created to coordinate programs and funding streams to provide high-quality early education for children ages zero to five. The Office of Early Care and Education developed a strategic plan for San Francisco’s early care and education system, which was submitted to the Board of Supervisors on April 13, 2016. • After a competitive Request for Proposals (RFP) in January 2017, the Children’s Council of San Francisco (Children’s Council) and Wu Yee Children’s Services (Wu Yee) were selected to jointly deliver subsidy administration and resource and referral services for the Early Care and Education Integrated Services. <p>Fiscal Impact</p> <ul style="list-style-type: none"> • \$167,039,094 or 90 percent of the total \$185,667,143 expenditures for the Children’s Council and \$24,247,782 or 85 percent of the total \$28,474,709 expenditures for Wu Yee would be for pass through funding directly to families for childcare subsidies. • Of the total \$235,556,037 over three years, the Office of Early Care and Education estimates that \$62,411,640, or 26.5 percent, will come from state and federal grants. The balance will be funded with General Funds. The first two years of funding are included in the FY 2017-18 and FY 2018-19 proposed budgets for the Office of Early Care and Education. <p>Recommendation</p> <ul style="list-style-type: none"> • 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 2012, a new San Francisco Office of Early Care and Education was created to coordinate programs and funding streams to provide high-quality early education for children ages zero to five. The Office of Early Care and Education is required to develop a strategic plan for San Francisco's early care and education system, which was submitted to the Board of Supervisors on April 13, 2016. The San Francisco Citywide Plan for Early Care and Education plan set out recommendations for the following categories: (1) birth-to-five approach, (2) racial equity and diversity, (3) quality improvement, (4) family engagement, (5) professional development and workforce, and (6) financing models.

On January 12, 2017, the Office of Early Care and Education, in partnership with the Human Services Agency, issued a Request for Proposals (RFP) to support the implementation of the Citywide Plan for Early Care and Education by administering Federal, State and local child care subsidy programs. By February 17, 2017, the Office of Early Care and Education received two responses from (1) Children's Council of San Francisco and (2) Wu Yee Children's Services. The two proposals were evaluated by a panel based on (1) organizational capacity, (2) program design, and (3) fiscal capacity. After reviewing the two proposals, the panel recommended that a joint award be made to both nonprofit organizations.

DETAILS OF PROPOSED LEGISLATION

File 17-0589: The proposed resolution would approve the contract between the City and Children's Council of San Francisco for the provision of Early Care Education Integrated Services to support the City's implementation of the San Francisco Citywide Plan for Early Care and Education for the three-year period of July 1, 2017 through June 30, 2020, for a total amount of \$204,233,857.

File 17-0590: The proposed resolution would approve the contract between the City and Wu Yee Children's Services for the provision of Early Care Education Integrated Services to support the City's implementation of the San Francisco Citywide Plan for Early Care and Education for the three-year period of July 1, 2017 through June 30, 2020, for a total amount of \$31,322,180.

Details of Services

The Children's Council of San Francisco (Children's Council) and Wu Yee Children's Services (Wu Yee) will jointly deliver subsidy administration and resource and referral services for the Early Care and Education Integrated Services. The two organizations are intermediate partners with the City that match families' needs to childcare reimbursements by (1) informing parents of federal, state, and local assistance with childcare reimbursements through outreach and engagement and (2) brokering childcare payments assistance on behalf of families.

A detailed description of their services is shown in Table 1 below.

Table 1: Detailed Description of Services from Children's Council and Wu Yee for the Early Care and Education Integrated Services

Services	Provider
Administration of state and federal subsidies, such as CalWORKS Stage 1 &2	Children's Council
Administration of local subsidies for Early Learning Scholarship Funding	Children's Council and Wu Yee
Background clearances of license-exempt child care providers through the State Trustline Registry	Children's Council
Preschool for All provider reimbursements	Children's Council
Tracking and reporting to assist with citywide planning related to utilization of Education and Early Care services	Children's Council and Wu Yee
Outreach and support to families through comprehensive resource and referral services	Children's Council and Wu Yee

FISCAL IMPACT

The proposed two resolutions would authorize \$204,233,857 for Children's Council and \$31,322,180 for Wu Yee for a total of \$235,556,037 for the three-year period from July 1, 2017 through June 30, 2020, as shown in Table 2 below.

Table 2: Proposed Budgets for Children’s Council and Wu Yee

Expenditure	Children’s Council				Wu Yee			
	FY 2017-18	FY 2018-19	FY 2019-20	Total	FY 2017-18	FY 2018-19	FY 2019-20	Total
Salaries and Benefits	\$4,366,005	\$4,496,985	\$4,631,895	\$13,494,886	\$998,702	\$1,028,663	\$1,059,523	\$3,086,888
Operating Expense	1,181,467	1,208,708	1,238,288	3,628,463	226,369	229,788	230,108	686,265
Indirect Cost ¹	751,608	773,044	795,331	2,319,983	147,003	151,014	154,757	452,774
Capital Expenditure	<u>16,500</u>	<u>9,000</u>	<u>9,000</u>	<u>34,500</u>	<u>1,000</u>	-	-	<u>1,000</u>
Subtotal (Overhead Costs)	6,315,580	6,487,738	6,674,514	19,477,832	1,373,074	1,409,465	1,444,388	\$4,226,927
Direct Client Pass Through ²	<u>55,679,698</u>	<u>55,679,698</u>	<u>55,679,698</u>	<u>167,039,094</u>	<u>8,082,594</u>	<u>8,082,594</u>	<u>8,082,594</u>	<u>24,247,782</u>
Total Expenditures	61,995,278	62,167,436	62,354,212	185,667,143	9,455,668	9,492,059	9,526,982	28,474,709
Contingency	6,199,528	6,216,744	6,235,421	18,651,693	945,567	949,206	952,698	2,847,471
Total Contract Amount	\$68,194,806	\$68,384,180	\$68,589,633	\$205,168,619	\$10,401,234	\$10,441,265	\$10,479,681	\$31,322,180

1. The indirect cost for Children’s Council and Wu Yee is 13.5 percent and 12 percent respectively of the sum of salaries and benefits and operating expense.
2. Direct Client Pass Through represents the amount of subsidies paid by the Office of Early Care and Education.

As shown in Table 2 above, \$167,039,094 or 90 percent of the total \$185,667,143 expenditures for the Children’s Council would be for pass through funding directly to families for childcare subsidies, and \$24,247,782 or 85 percent of the total \$28,474,709 expenditures for Wu Yee would be for pass through funding directly to families for childcare subsidies.

Initially, Children’s Council and Wu Yee submitted budgets in response to the RFP that included only their administration costs. The two entities estimated their costs to be \$19,890,244 for Children’s Council, and \$13,629,920 for Wu Yee. The Office of Early Care and Education negotiated these costs down by \$412,412 to \$19,477,832 for the Children’s Council and down by \$9,402,993 to \$4,226,927 for Wu Yee. According to Ms. September Jarrett, Director of the Office of Early Care and Education, the negotiation was based on state guidelines for overhead (up to 17.5 percent for state grant funds), local subsidies (up to 10 percent for local grant funds), and Preschool for All guidelines (up to four percent for grant funds).

Of the total \$235,556,037 over three years, the Office of Early Care and Education estimates that \$62,411,640, or 26.5 percent, will come from state and federal grants, as shown in Table 3 below. The balance would be funded with City General Fund monies. The General Fund amounts are included in the FY 2017-18 and FY 2018-19 proposed budgets for the Office of Early Care and Education, subject to Board of Supervisors approval. Funding for the third year of the contracts in FY 2019-2020, would be subject to future Board of Supervisors appropriation approval.

According to Ms. Jarrett, the contingency amount shown in Table 3 below totals \$21,414,185. This contingency amount is included in the proposed resolution to allow the City to draw on incremental increases in Federal and State grants if such additional funds become available during the contract term, without undergoing a new contract process. Ms. Jarrett advises that the proposed ten percent contingency is standard for similar City contracts.

Table 3: Funding Sources

Funding Source	Children's Council	Wu Yee	Total
General Fund	\$ 124,419,473	\$ 27,310,739	\$ 151,730,212
State and Federal Grants	61,247,670	1,163,970	62,411,640
Contingency (10 percent)	<u>18,566,714</u>	<u>2,847,471</u>	<u>21,414,185</u>
Total	\$204,233,857	\$31,322,180	\$235,556,037

RECOMMENDATION

Approve the proposed resolutions.