San Francisco
Water Power Sewer
Services of the San Francisco Public Utilities Commission

MEMORANDUM

DATE:	March 26, 2024
TO:	Capital Planning Committee
FROM:	San Francisco Public Utilities Commission (Water, Power, and Sewer Enterprises)
SUBJECT:	**San Francisco Public Utilities Commission's Rate Impacts on City and County of San Francisco Departments**

The San Francisco Public Utilities Commission (SFPUC) understands that City departments are concerned about potential rate increases associated with the SFPUC's proposed capital plan. This memorandum aims to address these concerns and outline efforts to minimize rate impacts.

The SFPUC is committed to providing reliable, sustainable, and high-quality power and sewer services to City departments and all San Francisco residents, as well as water to over 2.7 million residents throughout the Bay Area. To achieve this, the SFPUC has developed a comprehensive capital plan that prioritizes critical infrastructure investments. These investments are essential for ensuring safe and reliable service delivery, meeting regulatory obligations, and repair and replacement of critical aging infrastructure.

Through this capital plan, the SFPUC will contribute to the economic vitality and vibrancy of San Francisco, in alignment with Mayoral budget priorities. This capital plan invests over $3 billion in the next two years and $11.8 billion over the next 10 years, respectively. These investments will support of 50,000 jobs[1] (many of them union jobs) and businesses while improving the City's essential utility infrastructure and resilience to climate change.

The SFPUC recognizes that these proposed capital investments impact rates. In fact, in the Water and Wastewater enterprises, capital is the main cost driver. Roughly, 57% and 50% of Water and Wastewater's operating budgets, respectively, will be dedicated to capital uses beginning in FY2024-25, and this will grow. In Power, capital is not a major factor driving rate increases. Instead, Power's main cost driver is the cost of power purchase and distribution, which makes up over half the operating budget.

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[1] New APPENDICES: Methodology and Assumptions | Office of Resilience and Capital Planning (onesanfrancisco.org)

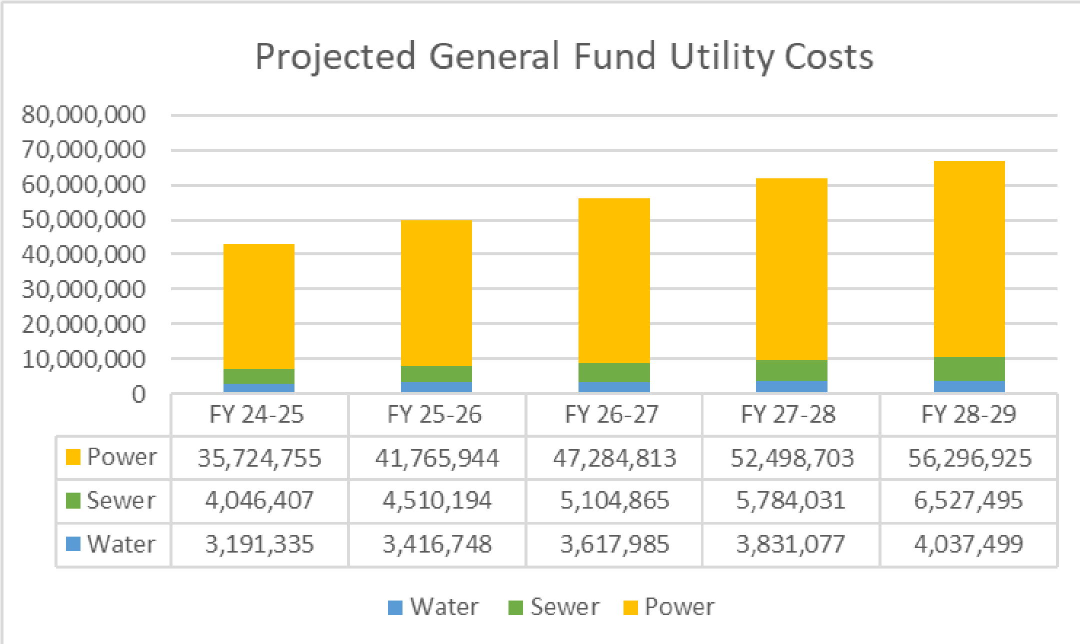
$11.8 Billion x .80 (estimate of projected appropriation to be attributed to construction) = $9.44 Billion.
Convert the billion amount to millions = 9440 Million.
Multiply the million amount by the number of jobs created per million dollars. 9440 million x 5.93 jobs/million dollars = roughly 55,978 jobs over the 10-year horizon.

SEAL OF THE CITY AND COUNTY OF SAN FRANCISCO

Drivers of capital costs and rates:

Water & Wastewater: Regulatory and environmental obligations, and repair and replacement of aging infrastructure are overwhelmingly driving the increase to this iteration of the 10-Year Capital improvement Plan. In addition, because 78% of the capital plan will be debt-funded, increasing interest rates are contributing to the impact on rates. Interest rate assumptions increased from 5% to 6% in the 10-Year Financial Plan, which had a significant impact on rates throughout the forecast period. Growth in this year's capital plan is specifically driven by regulatorily mandated projects like the $1.5 billion Nutrients Reduction project, climate change driven projects like Alternative Water Supply, and projects related to aging infrastructure like the Oceanside Plant Improvements, Moccasin Penstocks replacement, dam improvements, and main repair and replacement projects. Delaying these investments causes significant risk to the reliability of Water and Wastewater systems, could lead to more significant disruptions if commenced later, and higher construction costs and utility rates in the future.

Power: Purchased power and delivery costs, not capital investments, are the primary drivers of Power rate increases. The SFPUC has limited control over these externally driven costs. Historically, General Use Customers (GUSE) customers (mainly General Fund departments) paid rates well below the cost of service. During the SFPUC's last Power rate study, the recommendation was to bring GUSE rates up to cost of service, and SFPUC agreed with the Mayor's Office in 2021 to accelerate rate increases by 3 cents per KwH per year to bring these customers up to cost of service over time. This means all Hetch Hetchy Power customers will eventually be under the same customer class-based rate schedules. Even when GUSE rates reach retail Hetch Hetchy Power retail rates, City Department rates continue to be forecasted to be significantly more affordable than Pacific Gas and Electric (PG&E) rates. For the General Fund, the Power bill is the largest driver of utility costs paid to the SFPUC. Public Power does and will continue to provide tremendous value for municipal customers.



	FY 24-25	FY 25-26	FY 26-27	FY 27-28	FY 28-29
Power	35,724,755	41,765,944	47,284,813	52,498,703	56,296,925
Sewer	4,046,407	4,510,194	5,104,865	5,784,031	6,527,495
Water	3,191,335	3,416,748	3,617,985	3,831,077	4,037,499

Figure 1. Projected Utility Costs for General Fund City Departments

Affordability Policy

The SFPUC is committed to ensuring rate fairness and affordability for its customers. Rate fairness and affordability has been a core focus in developing the 10-Year Capital Improvement Plan. The Commission adopted a new Affordability Policy in November 2023, which made rate affordability targets stricter than ever before to keep rates as low as possible while maintaining necessary investments. The policy focuses on equity and low-income customers. In the new policy, the typical household is defined as the 40th percentile income, rather than the 50th percentile (median) household income, to ensure the typical household being monitored better reflects San Francisco's high cost of living and the lower incomes of San Francisco's Black, Indigenous, and People of Color communities. A low-income household is defined by the 20th percentile household income, in line with affordability standards currently used by the Environmental Protection Agency (EPA). The addition of the low-income customer affordability metric aims to center customers who are most heavily burdened by San Francisco's high cost of living and widening income inequality. For low-income households, bills are calculated both at retail rates and at retail rates after accounting for applicable discount or assistance programs. Water and sewer bills will target less than 3% of the typical customer's income, less than 7% of the low-income customer's income using standard rates, and less than 5% of low-income customer's income after accounting for enrollment in applicable bill discount programs. The budget and capital plans proposed comply with the SFPUC's adopted affordability policy, as shown in *Figure 2*.

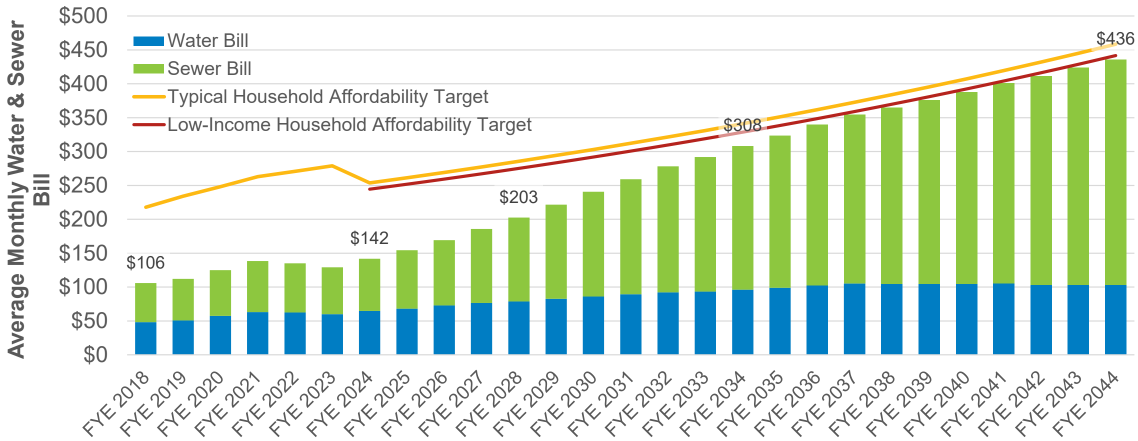


Figure 2. Water and Wastewater Affordability Policy

To meet the Affordability Policy, the SFPUC undertook a significant effort to constrain the budget, including prioritizing and constraining its 10-Year Capital Improvement Plan, leading to $2.7 billion in savings versus the initial internal proposal. This was done as part of an initiative within the SFPUC to improve the way capital planning is done, leading to more efficient budgeting that aligns with the department's capital delivery capacity (this is discussed in the next section). The department will continue the endeavor reduce ratepayer costs of capital investments, including applying for low-cost loans and grants to bring down debt service costs.

Capital Planning Improvement Initiative

The SFPUC's new Capital Planning Improvement Initiative made significant strides in unifying approaches across SFPUC enterprises, making the governance and standardization of enterprise Capital Improvement Plan development sounder, improving budget preparation and guidance, and ensuring project deliverability.

These efforts led to a more efficient budget development process, with enterprises more transparently prioritizing projects based on **deliverability and affordability** – in addition to the risk, criticality, and required investment due to regulatory mandates and aging infrastructure. While challenges remain, the Initiative's continuous improvement efforts are paving the way for a more unified, efficient, and sustainable capital planning process for the SFPUC.

Transparency and Timeline

The SFPUC has demonstrated exceptional commitment to transparently present the proposed budget and has provided the public the opportunity to offer input by exceeding the legal requirements to do so. Between January 22, 2024, and February 13, 2024, SFPUC held five public Commission meetings, totaling over 12 hours. These meetings focused largely on the capital budget, as the biggest cost driver. During this time Commissioners were able to pose questions to SFPUC staff and propose modifications to the budget, if necessary. Given the rigorous development of this year's budget over the proceeding eight months, no changes were recommended.

In addition, the following information has been shared with City department partners:

- Budget projections are not materially different from the "base" budget that rolled over from last year's budget process. In fact, in most cases they are lower, primarily driven by 1) decreased volumes from continued drought-related conservation and greater work-from home patterns, and 2) updated forecasts for the costs payable by City Departments under the new stormwater portion of the sewer bill, which have been reduced form the initial conservative estimates.

- In October 2023, updated rate estimates were shared with the Mayor's Budget Office for inclusion in the 5-year financial plan and General Fund deficit projection. These estimates were updated in February 2024 as the Mayor's Office continued to work toward balancing the budget.
- On February 14, 2024, the SFPUC Financial Planning team shared a memo with City departments outlining proposed rate increases resulting from this year's proposed capital budget to ensure City departments had the opportunity to prepare and/or update workorder projections.

Other Ongoing Efforts to Temper Rate Impacts

In addition to coordinating with other City stakeholders as indicated above, the SFPUC is actively working to minimize rate increases for City departments by:

- **Continuing to seek out lower-cost loans, grants, and outside sources of financing:** The 10-Year Financial Plan assumes the "worst case scenario" of all debt funding (78% of sources) being tax-exempt municipal revenue bonds with a 6% interest rates. The SFPUC has been successful in securing low-cost state and federal loans to support capital work (WIFIA and SRF), which have historically had a 1-2% interest rate. The SFPUC is bolstering the loans and grants team to continue to aggressively pursue these types of funding opportunities which will reduce the rate impacts of the capital plan. In addition, staff continue to seek innovative funding mechanisms. For example, the Southeast Treatment Plant Nutrients Reduction project is driven by an EPA mandate to combat algae blooms in the Bay. The SFPUC is one of several municipalities that discharge treated wastewater into the Bay. A regional solution which may include federal funding, is being explored.
- **Reducing unspent balances:** Historically, the SFPUC faced challenges aligning capital appropriations with expenditures. However, significant progress has been made. A $300 million (12%) decrease in unspent appropriated funds since the last fiscal year exemplifies a renewed focus on responsible resource allocation. Spending down existing appropriations before requesting new funds has been a core focus in SFPUC's deliverability analysis this year. Existing appropriations were taken into account when considering requests for new funds, leading to reductions, in some cases, in appropriation requests in this cycle.
- **Offsetting stormwater costs:** Stormwater charges were introduced as a way of restructuring of the sewer bill in July 2023. These charges are revenue neutral to SFPUC and were instituted to more fairly allocate costs to all customers, by capturing the cost of stormwater runoff from customer properties into the combined sewer system. Customers, including City departments, who capture stormwater on their property using green infrastructure to improve the performance of SFPUC sewer systems can apply for stormwater credits to reduce stormwater charges. Ongoing communication, workshops, and collaboration with City departments ensure programs like the Green Infrastructure Grant Program (GIGP) and stormwater credits program are fully utilized. The San Francisco Recreation and Parks Department has already received $1.5 million in SFPUC grants for green infrastructure installations in Crocker Amazon Park, Buchanan Street

Mall, and Louis Sutter Playground. The San Francisco Unified School District has received $6.7 million. Applications are currently being accepted for this program and departments are encouraged to apply:

- Spring 2024 Application Cycle is open with applications **due June 3, 2024**
- Eligible projects can receive up to **$2M** per project for construction and design costs of green infrastructure
- Completed projects are eligible for a stormwater credit to lower monthly sewer bills
- Contact gigrants@sfwater.org to schedule a site visit and property opportunities assessment with our team
- SFPUC will host an applicant workshop on April 3rd to share more info on the program and answer questions
- Register for the workshop and download the Spring 2024 application and solicitation at www.sfpuc.org/gigrants

- **Conservation Programs:** The SFPUC offers various conservation programs that benefit City departments through rebates, credits (including stormwater credits mentioned above), and technical assistance, ultimately reducing overall water and power usage. Please contact the SFPUC for more information.

Conclusion

The SFPUC's capital plan, represents needed investments in the City's infrastructure and resilience. The proposed capital plan is aligned with City priorities to restore economic vitality and will create over 50,000 jobs.

The SFPUC welcomes ongoing dialogue with City departments on the capital plan and encourages continued participation in SFPUC cost-saving programs. The SFPUC is confident that through continued collaboration with fellow municipal stakeholders, shared goals of fiscal responsibility and a sustainable future for San Francisco can be achieved.