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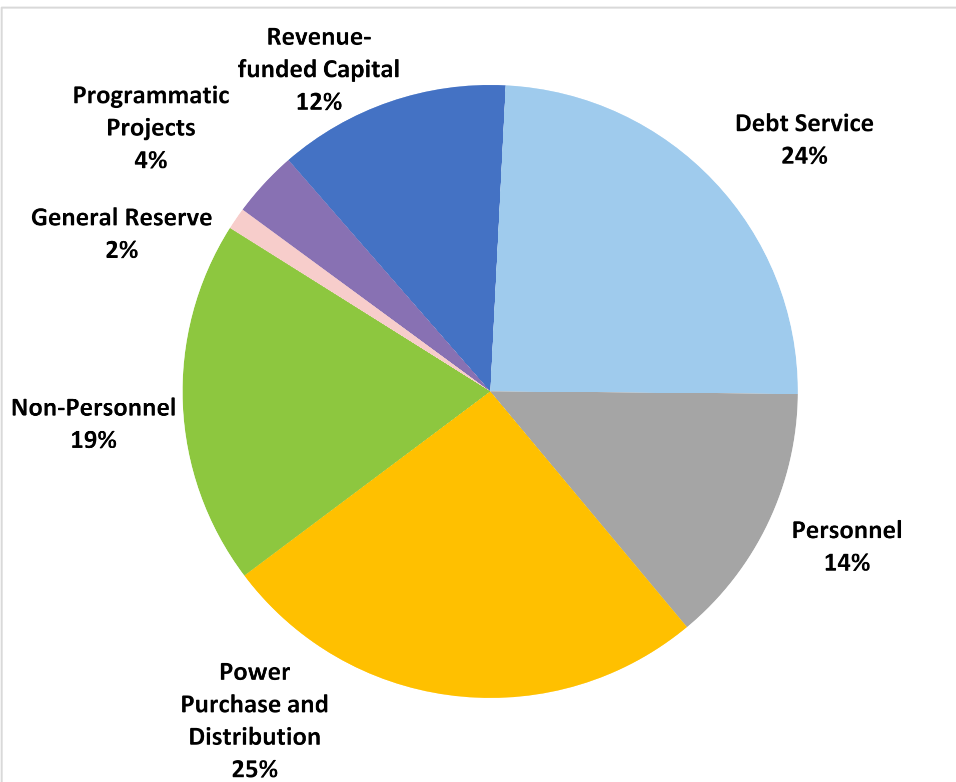
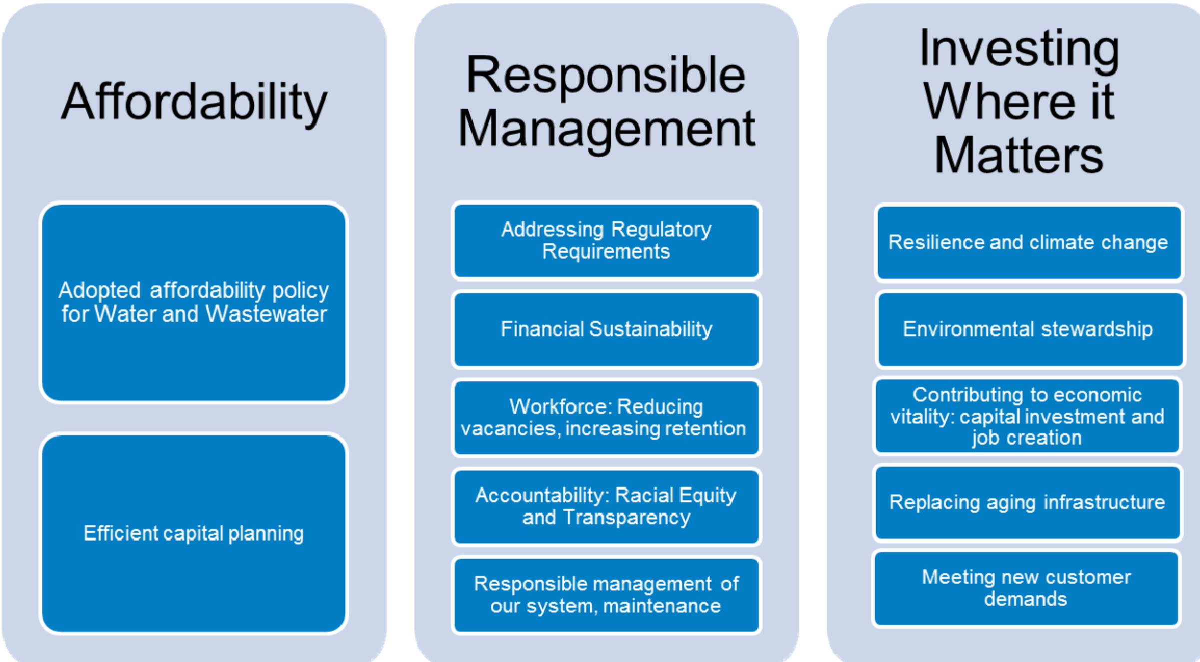
Date:	February 21, 2024
To:	Anna Duning, Mayor's Budget Director Daniel Cawley, Mayor's Budget Analyst Ben Rosenfield, Controller
From:	Laura Busch, SFPUC Deputy CFO
Subject:	**SFPUC's Biennial FY 2024-25 and FY 2025-26 Budget**

The SFPUC is proposing a fixed 2-year operating budget for FY 2024-25 and FY 2025-26. The proposed operating budget for FY 2024-25 is $2,012.7M and FY 2025-26 is $2,146.1M. The FY 2024-25 budget is shown in the pie chart below. Capital is SFPUC's largest cost driver at 36% (debt service 24% + revenue funded capital 12%). Power purchase and distribution is next at 25%. Followed by Personnel and Non-Personnel costs that support daily operations at 14% and 19% respectively

FY 2024-25 $2 Billion Operating Budget by category



Budget priorities
From the outset of our budget process, we have established the following priorities to guide our budget decisions. These priorities are in line with the Mayor's budget priorities.



Here are some examples of ways we are addressing these priorities through our budget proposal:

1. We adopted an Affordability Policy in November 2023. This budget and 10-Year Capital Plan is affordable by these established metrics.
2. We have put several tools in place through the *Capital Planning Improvement Initiative* that have made and will continue to make our capital planning effort more efficient.
3. We are addressing regulatory requirements by transparently planning for projects like Nutrient Reduction in the Bay.
4. We have undertaken rigorous financial planning to ensure our budget proposal and Capital Plan are financially sustainable, this includes making sure we adhere to all our financial policies.
5. On workforce, a huge part of our staffing request is to convert temps to permanent positions to encourage retention and have bolstered our HRS team.
6. Racial Equity continues to be a formal part of our budget process and we are strengthening our Racial Equity team through this budget. The budget also bolsters our Audit team to continue to improve transparency and accountability.
7. We will continue to responsibility manage our system through increased investments such as main repairs, cybersecurity and others.
8. We are facing climate threats head on by specifically planning for projects that will address the impacts of sea level rise and reduce our carbon emissions.
9. We continue to aim to be responsible stewards of the environment around us by prioritizing projects that contribute to a healthier region-

the nutrients project is a prime example of this.

10. We have developed a Capital Plan that will support the economic vitality of San Francisco and the counties that are impacted by our investments, and create 1000s of jobs.
11. The Capital Plan prioritizes the replacement of aging infrastructure to ensure continued reliability.
12. And finally, we are continuing the expansion of our systems, where necessary, to ensure that we can meet new and existing customer demands including expansion of power services at SFO.

Growth drivers

The Operating Budget will grow by 20% or $358 Million over next 2 years. Capital (including debt service) and power purchase remain the large cost drivers, growing by $313.9 Million, or 88% of the growth. Operating budget new proposals (including proposed offsetting savings) are not a significant driver of the overall growth. Net new requests are roughly $36 Million, only 10% of the growth (in other words, growing the budget by just 2%). In addition, there is a reduction in our general reserve contribution vs the current year, in line with our financial plan and reserve policies.

New Operating Proposals

SFPUC is proposing a *net* cost increase of $36M for new operating proposals (offset by attrition savings) which include changes to staffing to increase retention and overcome staffing shortages, accounting for inflationary pressures in equipment and materials and supplies and meeting regulatory requirements. More information about each of our new initiatives can be found in the attachment labeled "new proposals".

Staffing changes

The staffing changes in this year's budget proposal are significant, and amount to an additional 60 on budgeted "A" operating FTE that will show in the AAO. They comprise 5 main areas:

1. **175 Substitutions** are to both repurpose vacant positions for changing operational needs and align job duties with classifications. As part of the budget process we examined every vacant position to see if it could be repurposed. Repurposing vacant positions has allowed us to significantly reduce our requests for new headcount.

2. **87 conversions of temporary "Cat 18" staff to permanent positions** to ensure core operating positions are filled with Permanent Civil Service staff, to support with retention and recruitment. Temporary staff are much more likely to leave employment with the SFPUC. Turnover is a significant challenge for our agency and is a cost to ratepayers as it creates disruption in our business operations, increases labor costs, and has a negative effect on our workforce. Retention of staff is a core priority. In our recent Employee Voice Survey, not having a permanent civil service position is among the top 2 reasons temporary employees consider leaving the SFPUC. Being in a temporary position is more likely to make an employee consider leaving than salary, a lack of meaningful work, or a poor relationship with their supervisor or coworkers. These temp-permanent requests are mostly budget and headcount neutral. These are existing staff we already have on board (or soon will) and are already paying for this fiscal year, but they are on temporary position requisitions. We have

offset the cost (and FTE impact) of these requests with attrition adjustments where possible (explained below).

3. **85 new positions (57 on budget "A", 8 in Infrastructure and supported by Capital and 20 off budget "O")** to address other operational needs, such as staffing shortages in key operational areas like as water quality, natural resources, green infrastructure maintenance; and shoring up our Human Resources team to ensure proper capacity to increase hiring performance. 8 of the on-budget positions are within the Infrastructure bureau and supported by our Capital budgets, therefore have no impact on the AAO FTE count.

4. **Offsetting reduction of -76 FTE due to major changes to attrition.** This year we have undertaken a major effort to get our attrition percentages right. Attrition rates were very inconsistent, in some cases budgeted as "positive" numbers, and seemed to have limited relationship to salary savings or deficits across divisions. We reviewed historic salary savings in each division, as well as our latest salary savings forecast for the current year. Some divisions have seen large salary surpluses, and some have deficits. We went through every division and tried to "rightsize" attrition based on projected salary savings. In some cases this meant increasing attrition, and in some cases reducing it.

   Furthermore, where possible, we also wanted to offset the cost of both the temporary to permanent conversions mentioned above, as well as the substitution of positions that had already been Tx'd. This is because we are already paying for these within our existing budget, so we didn't need to add more money for them.

   The net impact of these attrition changes raises the SFPUC's overall attrition rate from 10.8% to 12.0% which we believe more closely reflects our natural rate of salary savings.

5. **Reduction of -8 FTE in Temp funding to further account for temp to permanent conversions and workorder changes.**

6. **$1.9 M in "extended range" budget, or an equivalent of 14.7 FTE was moved from regular salaries into attrition**. This was at the direction of the Controller's office.

Taking out the impact of the extended range change, which is beyond our control, this means our AAO Operating FTE will increase by around 60 FTE over the 2-year budget. To put this in context, in 6 years since FY 2019-20 SFPUC's AAO FTE has grown by just over 5%, while our operating budget has grown by 50%. This is not just a matter of extra zeros on checks, our work has gotten much more complex and demanding in myriad ways. Our FTE request this year is a result of extremely thorough and thoughtful process and is reasonable and appropriate.

Capital Budget and 10-Year Capital Plan

The proposed capital budget for FY 2024-25 is $1,553,967,407 and FY 2025-26 is $1,566,859,444. These numbers are only minimally different from the projections in the last version of the 10 Year Capital Plan approved by the

CPC.

The new 10-Year Capital Plan totals $11.8 Billion. The plan prioritizes projects that ensure the continued reliable and compliant operation of the SFPUC's Water, Wastewater, and Power (including CleanPowerSF) systems, while acknowledging the need for responsible financial stewardship for our ratepayers.

The plan is $3 Billion larger over the 10-year horizon versus last year's version. The increases were accounted for by balancing affordability amongst the growing caseload of projects related to climate change impacts and projects driven by regulatory mandates inducing previously unaccounted for cost pressures.

The plan was developed with an emphasis on Mayoral priorities like economic vitality, supporting good paying union jobs, addressing the impacts of climate change, and benefits for local communities and the larger region impacted by the Capital Improvement Plan.

The Wastewater Enterprise has the largest share of the plan at 51%, followed by Water at 25%, Hetch Hetchy Water at 13% and Power (including CleanPowerSF) at 10%.

Key projects funded in this capital plan include the completion of the Biosolids Digester Facilities Project, the Southeast Plant Nutrient Reduction project, the Millbrae Yard Campus Improvements, the new City Distribution Division Headquarters, Moccasin Penstock Rehabilitation, stormwater and flood resistance projects, treatment plant improvements, Public Power expansion, repair projects, carbon reduction projects, and replacement of sewer and water mains throughout the system.

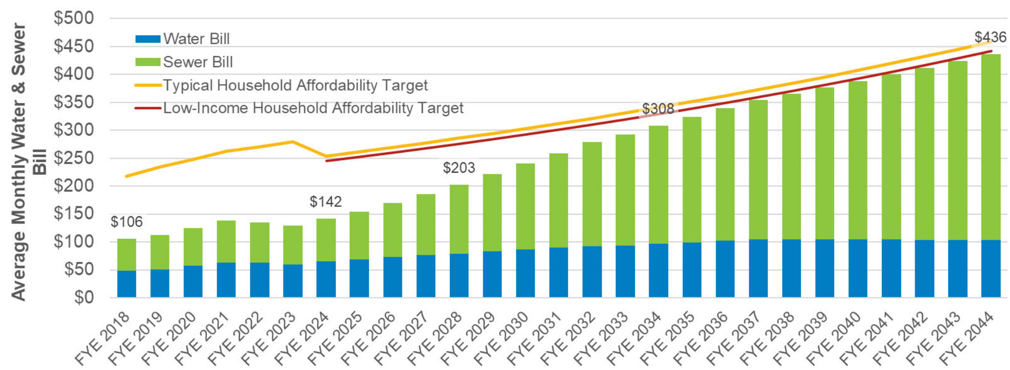
A detailed Capital Plan Report is attached to this memorandum and includes in-depth information with respect to the development of this year's iteration of the 10-Year Capital Improvement Plan.

Rates and Affordability
Our 10-Year Financial Plan (attached) goes into great detail about our rate projections. We are very proud that the Commission Adopted a new Affordability Policy in November 2023, which establishes agency-wide, retail performance metrics to evaluate the impact of the SFPUC's operating and capital budget on future residential rates. 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. The low-income household is defined by the 20th percentile household income, in line with affordability standards currently used by the Environmental Protection Agency. 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 the low-income household, 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 are in compliance with the SFPUC's affordability policy, as shown in the chart:

Affordability policy vs. bill forecast



Projected rates have increased vs. the last version of this plan. The key drivers of this are as follows:

Water and Wastewater rate drivers:

- Higher assumed long term interest rate on revenue bonds (6% vs 5% in the last plan)
- Growth in the 10 year capital plan, largely driven by Wastewater and the inclusion of the new $1.5B Nutrients project.

Water and Wastewater rate increase projection

	FYE 2025*	FYE 2026*	FYE 2027	FYE 2028	FYE 2029	FYE 2030	FYE 2031	FYE 3032	FYE 2033	FYE 2034	10 Year Avg.
Water Rate Increase	5.0%	5.0%	5.0%	5.0%	5.0%	5.0%	4.0%	4.0%	3.0%	3.0%	**4.2%**
Sewer Rate Increase	9.0%	9.0%	12.0%	12.0%	11.0%	10.0%	10.0%	10.0%	7.0%	7.0%	**9.6%**
Combined Bill Impact	**8.8%**	**9.6%**	**9.6%**	**9.1%**	**9.4%**	**8.6%**	**7.7%**	**7.4%**	**4.9%**	**5.6%**	**8.1%**

*adopted rates

Hetchy Power Rate drivers:

- In the short term, significant increases in power purchase, transmission and distribution costs beyond our control (market forces and PG&E), *more than doubling since 2020 to today.* This is the Power enterprise's biggest cost driver and is necessitating large short term rate increases to cover these costs.
- In the longer term, growth in the capital plan, largely driven by projects that will expand the Hetchy Power customer base, including the SFO substation expansion project. These projects will increase our sales volumes and will ultimately have the effect of lowering rate increases as costs are spread over a greater number of customers.
- Higher assumed long term interest rate on revenue bonds (6% vs 5% in the last plan).

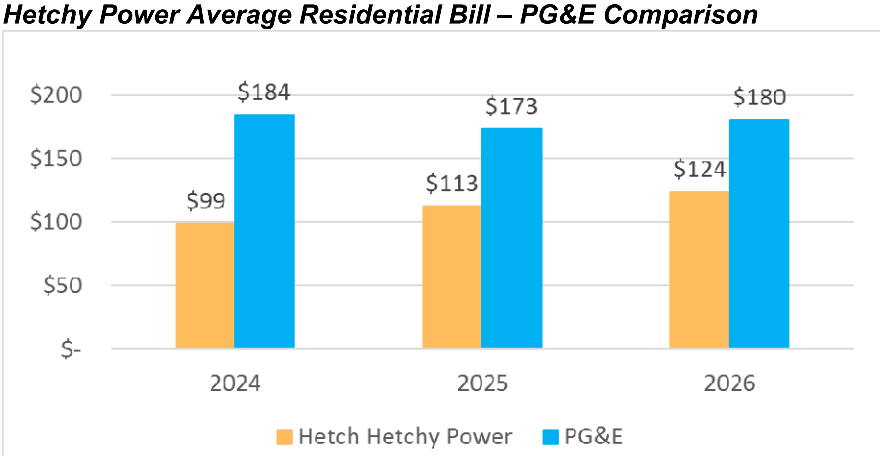
It is important to note that General Fund departments have, for a long time, been paying rates significantly below their cost of service (the “General Use Rate” in the table below), having been *subsidized* by enterprise departments and retail customers including low-income housing customers. In 2021, SFPUC and the Mayor’s Office formally agreed to gradually bring General Fund customers up to their true cost of service, at a rate of 3 cents per KwH per year. Therefore, the “General Use” rate increases look larger than the retail rate increases, as they are playing catch up until they get to cost of service, and will then be on the same trajectory.

Hetchy Power rate increase projection

	FYE 2025	FYE 2026	FYE 2027	FYE 2028	FYE 2029	FYE 2030	FYE 2031	FYE 3032	FYE 2033	FYE 2034	10 Year Avg.
Retail Rate Increase	14.0%	10.0%	9.0%	9.0%	5.0%	4.0%	4.0%	3.0%	3.0%	3.0%	**6.3%**
General Use Rate Increase	18.9%	15.9%	13.7%	12.1%	10.8%	9.7%	8.9%	8.1%	7.5%	7.0%	**11.2%**

It is also important to note that Hetchy Power is not a monopoly provider like Water and Wastewater. Customers have the option of switching to PG&E for their power. PG&E is, however, far more expensive and has seen significant recent rate increases itself. Despite our projected rate increases, Hetchy Power still represents great value. The graph below shows our current and forecasted *average residential bill* compared to what that same customer would pay on PG&E rates. Even with our rate increases over the next two years, we still expect to be more than 30% cheaper than PG&E. This effect is even greater for General Fund Customers, who are still paying well below cost of service.

Hetchy Power Average Residential Bill – PG&E Comparison



Budget Transparency

6 public hearings have been held in the lead up to the budget being proposed, meeting our obligations under Administrative Code Section 3.3b:

- September 9, 2023: update to the Commission on budget priorities and process
- January 22, 2024: detailed overview of operating budget changes, financial plan and capital plan, and Bureaus budgets
- January 26, 2025: Wastewater Enterprise operating and capital budget
- January 29, 2024: Water Enterprise operating and capital budget
- February 2, 2024: Power Enterprise operating and capital budget

- February 13, 2024: adoption of the FY 2024-25 and FY 2025-26 operating and capital budget, 10-Year Capital Plan and 10-Year Financial Plan by the Commission.

Outstanding Items for Mayor Phase

- Utility workorders (where PUC is performing) are not finalized in the department phase of the budget as these are centrally loaded in the system. These numbers will be provided later this month.
- We expect there may be a transfer of function of one FTE from SFPUC to DHR as EEO functions are consolidating in DHR. This needs to be finalized.
- We have discussed with the Controller's Office BAD team that we should try to incorporate a contingency value in our salaries budget to account for potential increase in labor costs once labor negotiations are concluded. At this time, no contingency is included. We would like to work with MBO to determine an appropriate amount for this contingency during Mayor Phase.
- We have an expected $1.2M grant in CleanPowerSF that we need guidance from the Controller's office on how to budget. This will be budget neutral as it will be a source and a use.
- We are not yet in agreement with TIDA on our workorders so those may need to be adjusted.

We look forward to working with you over the coming months as we finalize our biennial budget. If you have questions, please contact me at lbusch@sfwater.org.

Laura Busch
Deputy CFO, SFPUC

Attachments:
Budget Forms
Capital Plan Report
New Proposals forms
10 Year Financial Plan