



THE CITY OF SAN DIEGO

OFFICE OF THE INDEPENDENT BUDGET ANALYST REPORT

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Analysis of the Stormwater Division Funding Strategy Report

OVERVIEW

The June 2018 Performance Audit of the Stormwater Division (SWD) found that stormwater funding is insufficient to meet current and future needs, and included Recommendation #5, which directed the SWD to prepare a long-term funding strategy to meet the SWD's current and future needs. In response, the SWD developed and published a Funding Strategy Report in January 2021. This document was developed in consultation with various City departments, including the Department of Finance and Debt Management Department, as well as the Mayor's Office and the Office of the City Attorney. Our Office would like to thank the Transportation & Stormwater Department for keeping us apprised on the development of the report and the recommendations.

In this analysis, we highlight various findings of the report, including the finding that, even after maximizing various City-controlled resources, that the needs of the SWD will not be met without additional funding. This additional funding will most likely be sought through the design and implementation of a new funding enhancement, which will likely require the passage of a ballot measure. Our Office will also highlight various policy considerations for the Council as the development of a ballot measure takes place over the next year, leading to a potential measure seeking voter approval either during the November 2022 General Election, or through a property owner mailout election sometime in 2022.

BACKGROUND

The lack of sufficient dedicated funding for the SWD has been highlighted by our Office in numerous reports over many years. A large portion of the unmet needs, as described in the History section of the [Watershed Asset Management Plan](#) (WAMP), are driven by increased compliance requirements as a result of new permit requirements from the Regional Water Quality Control Board (RWQCB) in 2013. At that time, the RWQCB shifted the focus of the permit requirements from a minimum level of actions to be implemented by Co-permittees (including the City) to

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identifying outcomes to be achieved by those actions. This required the City to dedicate large amounts of resources over the next several decades to the development of water quality projects in order to comply with the new permit's requirements. It was in response to the new permit requirements that the SWD developed an initial WAMP in FY 2014, which incorporates both the costs of permit compliance as well as the costs of flood risk management, which has historically been the focus of stormwater efforts. However, the initial WAMP has since become outdated, and in anticipation of the development of the new Funding Strategy, the SWD has updated the WAMP to incorporate current compliance deadlines as well as new information on the flood risk and other assets that the Department currently maintains. The expected needs in the new WAMP are projected to be almost \$5.5 billion through FY 2040.

While the funding needs for stormwater have increased dramatically, the amount of dedicated funding for stormwater activities has remained relatively flat during this time. The main source of dedicated funding for stormwater activities is the Storm Drain Fee. Currently, the City imposes a stormwater fee of 95 cents per month per single family home, or \$0.0647 per hundred cubic feet of water use for multi-family and commercial water users. This fee has remained unchanged since the passage of Proposition 218 in 1996. The current fee generates approximately \$5.7 million of revenue per year, which in FY 2021 is entirely utilized to offset operations and maintenance activities which would otherwise be funded from the General Fund. For reference, the FY 2021 Adopted General Fund Budget for the Stormwater Department is \$47.5 million just for operations and maintenance alone.

In June 2018, the Office of the City Auditor (OCA) released its [audit of the SWD](#). Among other findings, Finding #2 from that report indicated that "Stormwater funding is insufficient to fund current and future stormwater needs, and the City has not taken action to develop and pursue a long-term funding strategy." Under this finding, the OCA acknowledged that cost saving efforts and current revenue sources combined would not be sufficient to address the funding gap, and that this funding gap, if left unaddressed, would only continue to grow. In response, the OCA included in the audit report Recommendation #5, which directed the SWD to initiate the development of a long-term funding strategy to meet its present and future capital and operational needs, based off of the updated WAMP, and include in the funding strategy plans to pursue desired funding mechanisms. The Funding Strategy Report directly addresses this audit recommendation.

FISCAL AND POLICY DISCUSSION

Understanding the Various Stormwater Needs

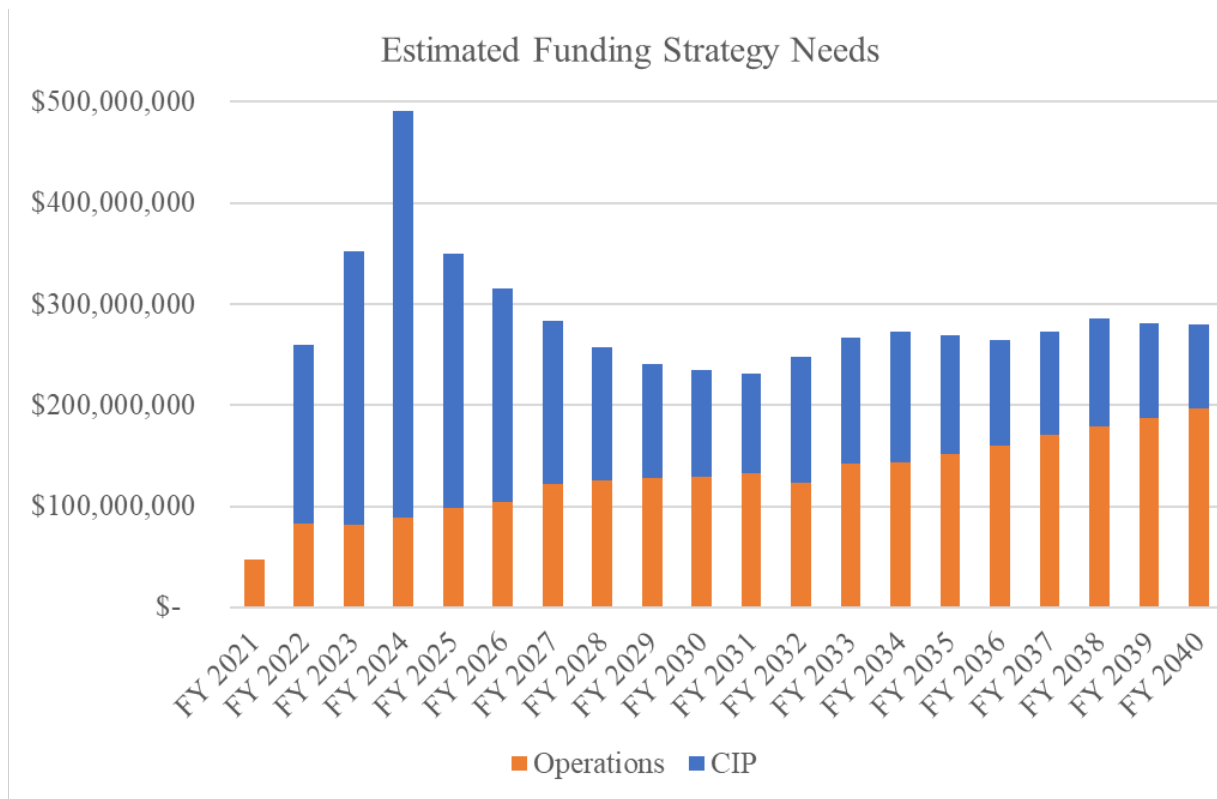
As mentioned previously, the latest WAMP estimates the projected need for the SWD to be almost \$5.5 billion through FY 2040. The estimated needs include both operational needs as well as capital needs that would be funded in the CIP. CIP needs include projects to replace or maintain current infrastructure as well as build out new infrastructure. The estimated needs for operations and maintenance include funding estimates based on the assets that are either currently in place or will be developed based on the WAMP. These needs include both main missions of the SWD, which are flood risk management and water quality compliance. While the WAMP was initially developed in response to the new water quality compliance needs from the permit issued by the RWQCB, it should be noted that there are significant unfunded needs for both water quality and flood risk management. Through FY 2040, flood risk management needs are estimated to total

\$1.1 billion, while water quality compliance needs are estimated to total \$4.3 billion. In comparison, the total estimated funding available during this time frame is just under \$1.0 billion.

Given how large these needs are, it is helpful to note the differences between the two main missions of flood risk management and water quality compliance. Flood risk management is the more traditional stormwater infrastructure that the City has been developing for a number of years, and includes items such as the corrugated metal pipes, pump stations, and storm drains. To determine the capital financing needs, the City, through the WAMP, does a determination of the life cycles and risk profiles of all of the hard assets, and then determines the timeline upon which they all need to be replaced. The WAMP also includes any new flood risk infrastructure that would need to be developed, including additional stream restoration projects as well as storm drain inlets, outlets, and other structures.

Water quality compliance projects focus more on improving the water quality with the stormwater system so that when the water flows to its receiving waters, it is not polluting those waters in a way that is overly detrimental to the surrounding environment. The need for these projects is determined by the water quality standards set by the RWQCB, and those standards are measured in Total Maximum Daily Loads (TMDLs), which include allowable loads for everything from bacteria and nutrients to metals, trash sediment, and other materials. In order to contain these allowable loads, the City must design and implement a number of Best Management Practices (BMPs), which include specific projects such as swales, infiltration and detention basins, and other stormwater capture projects. Most of these projects are also known as multi-benefit green infrastructure, as these types of projects can be integrated into other asset types and create new open spaces and other amenities. Water quality compliance also includes the restoration of lagoons and wetlands within the City, including the ongoing restoration of the Los Penasquitos Lagoon.

The chart below contains the estimated expenditure needs based on the latest WAMP. The figures have been adjusted to smooth expenditures that would have previously been included in FY 2021 over additional years. As displayed in the graph below, over the timeframe shown in the Funding Strategy, CIP costs are the largest sources of need at \$2.9 billion, with operations costs increasing over time and becoming greater in later years, totaling \$2.6 billion through FY 2040. This is due to the fact that as new assets are brought into the City inventory, including new water quality compliance assets, the SWD estimates that operations and maintenance needs will increase correspondingly. Additionally, increases in operations costs in the near term, over what is currently included in the FY 2021 Adopted Budget, are mostly for monitoring costs as well as additional channel clearance costs since channel clearing and maintenance activities are not eligible for CIP expenditures. Further, it should be noted that these cost estimates do not include traditional cost escalators, such as regular or construction inflation. As such, it is to be expected that the needs displayed in the chart are likely to increase as each fiscal year gets closer to the current year.



It should also be mentioned that these needs assessments are based on a regular, scheduled replacement timeline, where projects will be completed using the regular CIP process. As such, the needs do not reflect any need for emergency stormwater projects, which have been increasing in recent years. For example, in FY 2020 there were \$26 million in emergency stormwater projects, which required the redirecting of funds from other projects to these emergencies. It is also expected that there will be another \$26 million required for emergencies in FY 2021. When these emergencies take place, they not only cost more money to fix the failed asset due to the emergency nature of the project, but only work that is required to address the emergency is allowed to be done, leaving additional repairs needed in the future. Emergency projects also cause other projects to increase in cost as those projects are delayed due to a lack of adequate funding for a timely completion.

Understanding the Current Resources

What the City Currently Has or Could Contribute

As previously mentioned, the main dedicated revenue source for stormwater activities is the Storm Drain Fee, which generates approximately \$5.7 million per year, and which is currently utilized to offset General Fund expenditures for stormwater operations. However, there are some other departmental revenues that are attributable to the Stormwater Department in the Adopted FY 2021 Budget. These include revenue from Parking Meter Citations related to street sweeping activities (\$5.3 million), Transient Occupancy Tax (TOT) revenues related to street sweeping activities (\$1.0 million), Parking Meter District Funds, again related to street sweeping activities (\$600,000), and stormwater enforcement and fines (\$125,000). After using all of these resources, the City General Fund in FY 2021 still supported \$34.8 million in expenditures for SWD operations. This level of

support was after the Department absorbed a \$4.9 million budget reduction in FY 2021. For capital needs, the Department only received \$1.0 million in TransNet funds in the FY 2021 Adopted Budget. Subsequent actions have added an additional \$9.4 million in CIP stormwater projects.

While the Funding Strategy includes \$5.5 billion of need through FY 2040, it assumes that the current FY 2021 funding level is the amount of funding that the SWD will receive in each period throughout the forecasted period, resulting in an estimated funding level totaling \$970.4 million through FY 2040. This results in a total funding gap of \$4.5 billion, with an average funding gap of \$225.1 million through FY 2040. It should be noted that these assumptions only include a total of \$1.0 million per year for stormwater CIP projects, which is different than the projections contained in the most recent CIP Capital Outlook.

In the FY 2022-2026 CIP Outlook, there is a total estimated commitment to stormwater activities of \$202.0 million over the next five years. The inclusion of this funding, which is not included in the Funding Strategy, would reduce the average funding gap by approximately \$40.4 million over the next five years. However, the CIP Outlook is just a planning document, and not an actual budget. For example, the [FY 2021-2025 Outlook](#) contained an estimated funding level of \$101.9 million over five years, including \$40.9 million in FY 2021. The actual FY 2021 Adopted Budget, however, only included \$1.0 million. As such, while the Funding Strategy resources do not line up with the City's most recent CIP Outlook, it is not clear that the estimates in the CIP Outlook are solid enough to include for planning purposes for stormwater based on recent experience.

As part of the Funding Strategy, the SWD conducted an analysis on all of the existing resources within the Division's or the City's direct control and determined that even if all existing resources were maximized, it would only yield between \$3.8 million and \$5.7 million in additional departmental revenue. This revenue would come mostly from the imposition of higher fines and fees, including cost recovery levels of fines and fees for street sweeping parking citations and a new inspection fee, as well as cost recovery and additional dis-incentivization fines for other stormwater enforcement activities. The low end of the estimates assumes that fines are only increased to the cost recovery level, while the high end of the estimate includes the imposition of dis-incentivization level fines as well as additional street sweeping routes. In the Funding Strategy, the SWD indicates that it will move forward on implementing a new structure for stormwater enforcement and fines in early FY 2023, while seeking Council approval for a new stormwater inspection and reinspection fee in FY 2022 and street sweeping route and frequency modifications and/or enforcement fine updates in FY 2023. Further, the report assumes that the current level of General Fund support, exclusive of departmental revenues, would remain the same, which is an assumption that should be considered more carefully by the Council (see further discussion below).

How to Implement a New Funding Mechanism

After examining the ability of new fines and other City based resources to cover the estimated needs contained in the WAMP, the Funding Strategy concludes that the capacity for existing resources and other potential new resources will still not meet the needs estimated in the latest WAMP. Based on that conclusion, the Funding Strategy recommends that the City move forward with the design and implementation of a new funding mechanism, which will most likely require approval through a ballot measure, to increase dedicated stormwater resources. As displayed in the Funding Strategy, the City is comparatively low when it comes to the typical amount charged to

single family residences on a monthly basis for stormwater needs.¹ There are many different methodologies for designing and implementing a dedicated stormwater fee, but based on the restrictions of Proposition 218, any increase in a dedicated stormwater revenue would have to go to voters in some form. While the exact nature of the funding mechanism will determine how it can be enacted under Proposition 218, in general there are two methods that could be pursued.

The first method would be to impose a property-related fee. This method requires the opportunity for a protest vote, and then subsequently the approval by fifty percent, plus one, of the property owners who respond to the ballots mailed to them. This election does not need to wait for a general election since the ballots can be mailed out at any time as long as proper noticing requirements are followed. However, a property-related fee would have to meet certain requirements mandated by Proposition 218, including that the fee shall not exceed the funds required to provide the service, and that the amount of the fee imposed shall not exceed the proportional cost of the service attributable to the parcel.

The second method would be to seek an increase through a special tax measure, which would require a two-thirds majority approval at a general or special election. This method, while requiring a high approval rate, also provides more flexibility for funding than a property related fee since it does not have to meet proportionality or benefit nexus requirements.

It should be noted that there is a potential third option to increase stormwater fees. Effective January 1, 2018, the State legislature through SB 231 amended the definition of a “sewer” fee under Proposition 218 to include the work and structures necessary to collect and dispose of stormwater. Under this change, the City could increase the stormwater fee utilizing the same process that the City would use to increase water and sewer fees. However, as this is a relatively new law, and since no municipality in California has attempted to utilize it, there is some question as to whether an increase under this new law would withstand a potential court challenge.

Regardless of the measure ultimately chosen, and assuming that the Council accepts the Funding Strategy and adopts the staff recommendation to move forward with the development of a new funding mechanism, the SWD will need to spend a considerable amount of time over the next year developing a fee methodology, a more detailed expenditure plan based on the chosen funding enhancement mechanism, and collect considerable public feedback on a chosen proposal before final Council approval will be required. Based on the timeline in the Funding Strategy, the SWD will draft an expenditure plan and provide initial stormwater funding mechanism scenarios to the Council in July, with additional refinement based on public feedback and a finalized ballot measure being submitted to the Rules Committee for consideration early in calendar year 2022 for consideration for a 2022 municipal general election.

Further Issues for Consideration

At the Council Meeting, staff from the SWD will present Council with the Funding Strategy and seek approval from Council to move forward with the design and eventual implementation of a

¹ Based on the benchmarking in the Funding Strategy, typical monthly bills for a single-family residence are as high as \$6.92 for the Los Angeles County Flood Control District, \$7.87 in San Jose, \$11.31 in Sacramento, and \$13.11 in Del Mar. Currently, Del Mar and Coronado (approximately \$3.80 per month) are considering an increase to their storm drain fees.

ballot measure to fund stormwater activities. While the City is on the low end of the spectrum of what other cities and municipalities charge for stormwater services, there will be a limit, based on public feedback, as to what the public will be willing to absorb as far as a fee increase. It is quite possible that, even with the additional funding mechanism, the City will still not be able to fully close the stormwater funding gap. Just for illustrative purposes, if the City sought to increase the current Storm Drain Fee to cover the entire average funding gap, it would need to raise the fee by approximately \$37.50 per single family home per month, with an equivalent increase in the fee charged to multifamily and commercial water users. This fee would be significantly higher than any other city included in the benchmarking summary contained in the Funding Strategy. As such, the Council should consider some potential issues (discussed below) regarding the funding mechanism as it reviews the Funding Strategy and considers how to move forward with a potential ballot measure as a more detailed funding mechanism is developed.

How Should Projects Be Prioritized?

The next step in this process towards a new funding mechanism and ballot measure is for the SWD to develop an expenditure plan for such a measure alongside various funding mechanism scenarios. As mentioned though, it is unlikely that a new funding mechanism, in spite of the design, will be able to fully cover the ongoing funding gap. This will cause both the SWD, as well as the Mayor's Office and City Council, to have to prioritize which projects are funded and which are left behind to be either renegotiated with the RWQCB or deferred to after FY 2040. While the SWD in the Funding Strategy has indicated that they will seek to continue to negotiate with the RWQCB on compliance deadlines and targets, as well as seek additional efficiencies, this alone may not bring the funding gap down to a level where a new funding mechanism can cover all of the estimated costs.

As this may be the case, the Council may wish to consider which priorities should be funded before others in the case of scarce resources and seek greater clarification from SWD staff on which projects and spending priorities should come first in line. City staff should also seek input from the public on this topic during their outreach sessions and consider the feedback as they develop the expenditure plan to bring back to Council in July.

Should Additional Funding Cover Existing General Fund Resources?

As previously mentioned in this report, the Funding Strategy assumes that the level of General Fund resources above current departmental revenue levels will remain constant through FY 2040. In doing so, the report also assumes that any additional funding, including through a ballot measure, will be used to close the funding gap instead of providing General Fund relief. While this is certainly a possible policy option, the Council may wish to consider the impacts of having stormwater activities being funded by the General Fund. The General Fund in FY 2022 is facing a significant deficit, and based upon the most recent [Five-Year Financial Outlook](#), these deficits are projected to continue for the next few fiscal years. When the City has faced General Fund deficits in the past, the SWD has absorbed budget reductions, including a reduction of \$4.9 million just in the FY 2021 Adopted Budget alone. As such, by depending on General Fund resources, stormwater activities are at risk of losing additional funding depending on the overall fiscal health of the General Fund.

There is the alternative of utilizing additional resources to make stormwater entirely funded by stormwater resources, in a similar way that the enterprise activities of the City's Water and Sewer utilities operate. Proposition 218 does limit the City's ability to make stormwater an actual enterprise activity since the City cannot raise rates without voter approval as costs increase. This is different from water and sewer service as those activities are exempt from the voter approval process in Proposition 218 and can be raised by the City after an appropriate rate study.

Despite this impediment, other cities within the State have sought to make stormwater activities almost like an enterprise service where almost all expenditures are covered with dedicated stormwater resources. This includes local cities such as Del Mar and Coronado. Further, cities in other states treat stormwater as a city utility alongside water and sewer services, which ensures that stormwater activities are fully funded. Having stormwater be fully funded by stormwater-based revenues would limit the impact that future General Fund deficits would have on the level of support for stormwater activities.

However, while a new funding mechanism can be utilized to provide for General Fund relief, there is a cost to doing so. First, the City must weigh the ability of ratepayers to pay for the necessary stormwater upgrades and set the fee accordingly. As previously mentioned, to cover the entire estimated funding gap would most likely require a fee that would be equivalently higher than any similar jurisdictions. As mentioned in the report, the SWD is most likely going to be looking at a fee that is dramatically different from the flat fee that is currently charged.

Even if no additional funding is utilized to offset General Fund support, it is unclear if a new stormwater fee mechanism will be able to fully close the gap without overburdening ratepayers. Not having to offset current General Fund support would help in that regard but would still leave stormwater activities subject to absorbing General Fund reductions when the City faces a deficit. As the SWD develops the new funding mechanism, the Council may wish to consider what it wants to prioritize as far as how the new funding is allocated.

Should Current Capital Resources be Utilized for Stormwater Needs?

In light of the potential that an enhanced stormwater funding mechanism might not be able to close the entire stormwater funding gap, the Council could discuss whether current CIP resources, such as debt financing, TransNet revenues, and development impact fees should be utilized to cover stormwater expenditures. The Funding Strategy does contemplate that debt financing, whether through bonds issued by the City or through other grants and loans from the State or federal government, could be utilized to fund CIP activities, with debt payments sourced from either current CIP resources or with the new funding mechanism. However, the CIP also continues to be significantly underfunded exclusive of the projected stormwater deficit.

While stormwater is the largest need, both in total need and underfunded need, there is still more than \$2 billion in other unfunded General Fund infrastructure needs throughout the City over the next five years. Again, as with the potential for removing General Fund support, the choice for the City and Council is between how much should a new funding source be utilized to relieve other City activities, versus solely used to close the significant funding gap that currently exists?

Engineering and Capital Projects Department’s Capacity to Deliver These Projects

As described more fully in the most recent CIP Outlook, the Engineering and Capital Projects Department still has staffing issues when it comes to delivering the currently funded level of CIP projects. The current capacity at the end of this fiscal year is projected to be \$600 million at the end of this current fiscal year, with an estimated total capacity of \$730 million at the end of the Outlook period. However, the current priority needs in the Outlook total \$908.8 million, with a projected need (including stormwater) of \$752.7 million in FY 2026. These needs do not include other discretionary needs totaling \$256.3 million in FY 2022, decreasing slightly to \$233.6 million in FY 2026.


Further, these numbers do not include estimates for the Pure Water Program, as those are being handled by staff within the Public Utilities Department. Given the discrepancy between needs and the capacity to complete projects, it is unlikely that, even if funding were identified, that current staffing levels at ECP would be able to accommodate the dramatic increase in stormwater spending in addition to all of the other City projects that they fulfill. With this reality, the Council should inquire as to how ECP’s capacity will inevitably impact any new expenditure plan, and thus the subsequent ballot measure that results.

CONCLUSION

The Funding Strategy presented by the SWD demonstrates that the City will need to pursue an additional funding mechanism for stormwater services, most likely through the approval and passage of a ballot measure, in order to meet the projected stormwater needs in the WAMP through FY 2040. With Council’s approval, staff will next develop an expenditure plan and a proposed funding mechanism during the next six months, with additional public feedback and participation determining a final ballot measure for Council consideration, and ultimately voter approval. During the development of these next steps, our Office recommends that City staff, the Council and public consider various policy goals, including what projects and activities should receive priority funding, to what extent should additional funding offset the use of the General Fund for stormwater operations, the appropriate level of current City CIP resources for stormwater activities, and how much additional ECP capacity will be required to handle the increased stormwater workload if a new funding mechanism is approved.



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