THE CITY OF SAN DIEGO

OFFICE OF THE INDEPENDENT BUDGET ANALYST REPORT

Date Issued: March 4, 2022 **IBA Report Number:** 22-04

City Council Docket Date: March 8, 2022

Item Number: 330

IBA Review of the FY 2023-2027 Five-Year Capital Infrastructure Planning Outlook

OVERVIEW

On February 17, 2022, the Engineering & Capital Projects Department (E&CP) presented the City's FY 2023 – 2027 Five-Year Capital Infrastructure Planning Outlook (CIP Outlook) to the Active Transportation and Infrastructure (ATI) Committee. This report will be presented to the full City Council for discussion on March 8, 2022. As stated in *Council Policy 000-02: Budget Policies*, the CIP Outlook provides a five-year citywide assessment of infrastructure needs and outlines the proposed capital priorities in compliance with the Charter.[1] The CIP Outlook is developed to closely follow the annual release of the Five-Year Financial Outlook to to assist in accurately forecasting future available funding for capital projects, and serves as the basis for development of the annual Capital Improvement Program (CIP) budget.

This is the City's eighth CIP Outlook; the first was issued in January 2015, and covered FY 2016-2020. A long-term capital plan was first recommended the City Auditor in its June 2011 performance review of the CIP, to provide an overall citywide perspective on asset and funding needs to support informed financial decisions on infrastructure investments.

The CIP Outlook is a planning tool to identify all current and future capital needs and available funding within the five-year outlook period. As shown in the CIP Outlook, the City's capital needs far exceed available funding, and the Mayor and Council must therefore make strategic decisions regarding capital infrastructure investments during the annual budget process. Absent new resources, many needs identified in the CIP Outlook will remain unfunded. As the City deals with budgetary and resource constraints, aging and deteriorating infrastructure, and increasing urgency to achieve strategic goals, officials must make wise investments. Ultimately, the City's will need a large-scale and holistic financing and project delivery strategy to address the growing backing of unfunded needs and ensure the City's strategic goals and policies are fully implemented.

[1] Charter, Article VII, Section 71.

This report provides additional information, context, analysis, and issues for Council to consider as it reviews the CIP Outlook and the upcoming proposed FY 2023 Budget. The IBA's role is to analyze the Outlook objectively, through various perspectives, and identify issues and options to assist the Council in decision-making. This information may also assist the public in understanding the CIP budget process and the numerous infrastructure-related challenges facing the City. Note, our Office also annually prepares A Citizen's Guide to Infrastructure which is currently being updated and is expected to be issued in March 2022.

Our Office would like to thank staff from E&CP Department, Department of Finance, Debt Management, asset managing departments, and the Department of information Technology (DoIT) for responding to our questions in preparing this report.

FISCAL/POLICY DISCUSSION

Since the City's first CIP Outlook in January 2015, the Outlook has been enhanced and expanded to include more asset types which we believe is a positive step to reflect key current infrastructure needs. Additionally, the Outlook has evolved as departments have learned more about the state of the City's assets. As highlighted throughout this report, departmental Asset Management practices, such as establishing service level goals, conducting condition assessments, prioritizing projects based on risk, and using Asset Management systems to support planning provide a sound basis for identifying capital needs.[2] While all asset types are not included at this time, now more than ever before, the City has a well-supported understanding of its capital needs.[3] As a result, the City is a good position to develop a financing and project delivery strategy to address significant deferred capital needs that total $4.3 billion in this Outlook.

The City is also in a good position to compete for federal and state funds. The recently passed federal Infrastructure Investment and Jobs Act (IIJA) is not included in this CIP Outlook, but it is expected to provide an unprecedented possibility for significant infrastructure funding to address the City's deferred capital backlog and could fund key water, stormwater, and transportation projects in future CIP Outlooks.[4] The City will receive IIJA formula-based funds allocated through the state of California.[5] In addition, City staff are currently assessing both internal and regional opportunities to develop an effective strategy to apply for competitive funds so that the City is not competing against its regional partners for grants. It will also be important to work with regional partners to achieve strategic goals, including climate change, sustainability, mobility, and a reliable but affordable potable water supply.

Our review of the CIP Outlook includes assets and projects for both General Fund as well as enterprise funded departments, which represent a significant portion of capital needs and funding.

[2] Asset Management is a best business practice for sustainably maintaining, repairing, and replacing infrastructure assets, like water and sewer mains, in the most cost-effective manner. Our Office is conducting a review of Asset Management practices and use of the Enterprise Asset Management (EAM) System to support work management and capital planning; our report is planned to be issued in the spring of 2022.

[3] For example, capital projects needed to achieve Climate Action Plan goals or to address coastal erosion are not included in the CIP Outlook.

[4] IIJA was signed into law on November 15, 2021 and considered to be a once in a generation infrastructure opportunity. It will provide an estimated $1.2 trillion nationwide over the next ten years, with the State of California estimated to receive $46.6 billion.

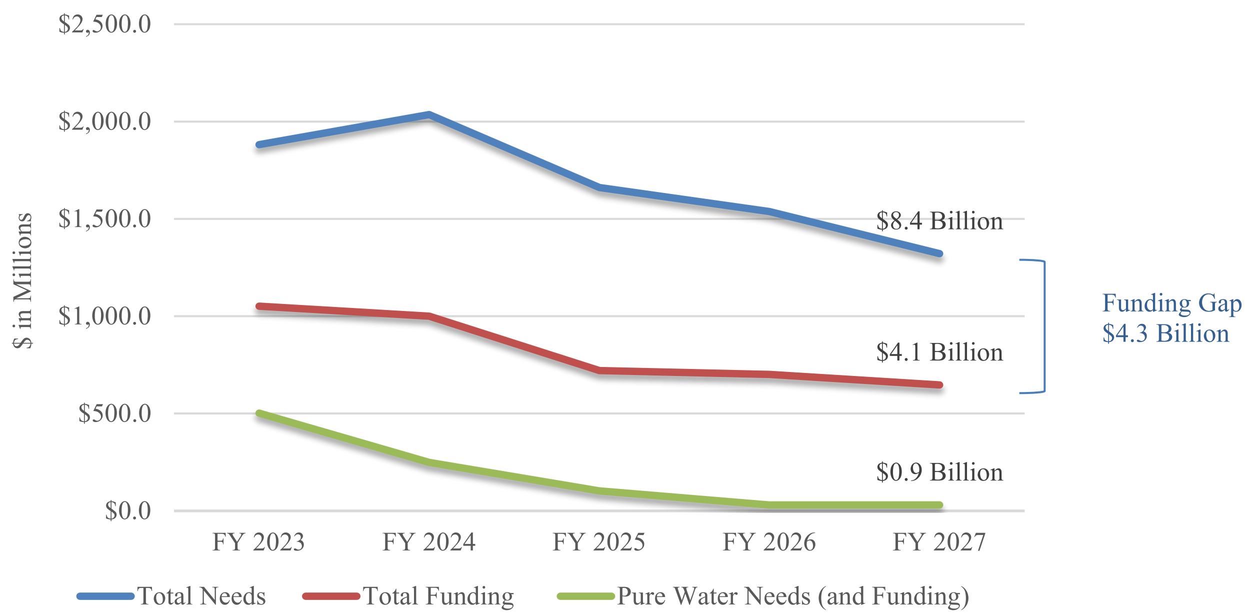
[5] Formula funds are generally based on population, asset types, etc., to allocate federal or state funds to localities.

Our assessment of the funding shortfall or gap will focus on General Fund assets since enterprise assets are assumed to be fully funded in the CIP Outlook.

High-level Overview of the CIP Outlook

The following figure reflects projected capital infrastructure needs, available funding, and the funding gap over the five-year CIP Outlook period. The figure also includes funding and needs for Pure Water Phase 1, the largest and most complex capital project undertaken by the City.[6] The CIP Outlook estimates total capital needs of $8.44 billion from FY 2023 to FY 2027, and projected funding available to support these needs of $4.12 billion, resulting in a $4.32 billion funding gap. Projected capital needs are expected to peak in FY 2024 and then decline through the remaining Outlook period. This is because FY 2024 is the last year of construction for Pure Water Phase 1 which becomes operational in FY 2025. Major costs for Pure Water – Phase 2 are outside of this Outlook period.

FY 2023 – FY 2027 Projected Capital Needs and Available Funding



Comparison with Prior CIP Outlooks

Since the first CIP Outlook was issued in January 2015, the Outlook has been enhanced and expanded to include more assets and information, such as information from ongoing condition assessments, which we believe is a positive step. It will be important to continue to add assets and projects, such as projects needed to achieve Climate Action Plan goals, to ensure the Outlook reflects key current City needs. While not apples to apples, a comparison of prior years is helpful to identify and understand trends.

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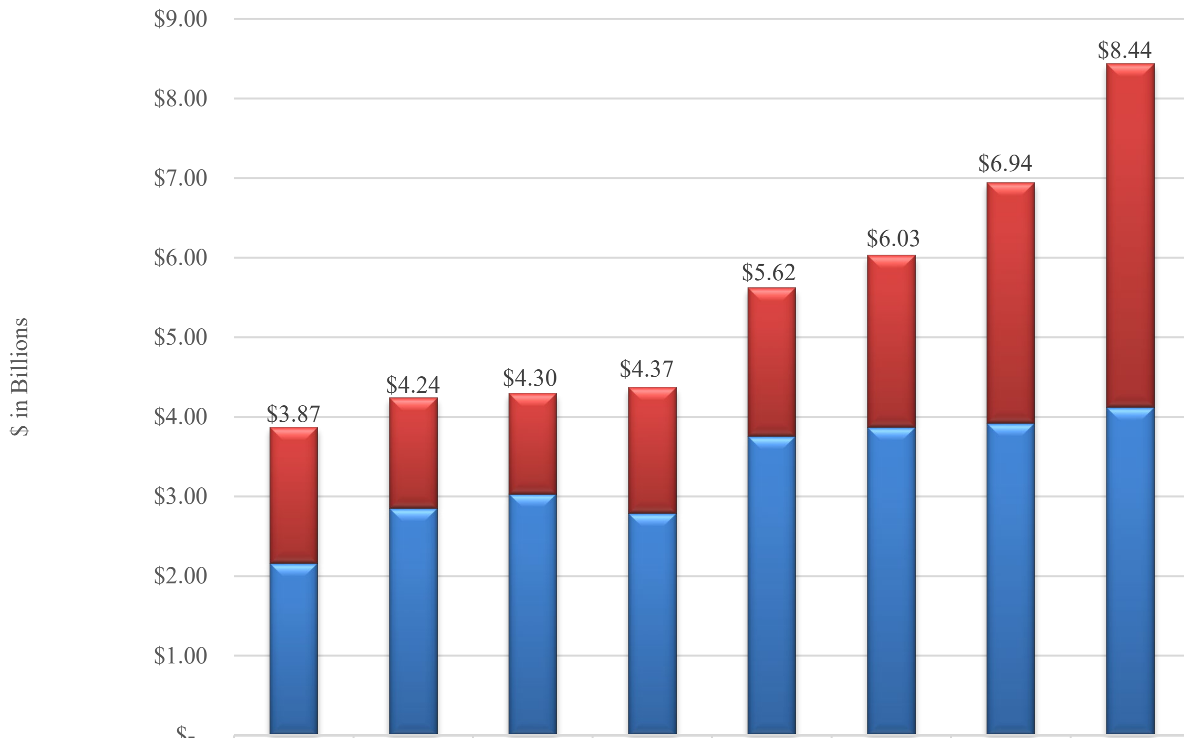
[6] The Pure Water project uses advanced water purification technology to produce potable water from recycled water. Pure Water is intended to provide a safe, secure, and sustainable local drinking water supply for San Diego. Based on the Public Utilities Department's most recent water demand projections, Pure Water will provide nearly half of the City's drinking water supply in 2035.

The following figure shows total needs, funding, and the funding gap for the eight years of CIP Outlooks. If we compare this CIP Outlook to the first Outlook (FY 2016-2020), total capital needs have increased by 118.1% from $3.87 billion to $8.44 billion. Funding has also increased over the same period by 90.7% from $2.16 billion in the first CIP Outlook to $4.12 billion today. The funding gap represents the most dramatic increase of 152.6% from $1.71 billion to $4.32 billion in this Outlook.

Year-over-Year Total Needs, Funding, and Gap for CIP Outlooks



	2016-20	2017-21	2018-22	2019-23	2020-24	2021-25	2022-26	2023-27
Funding Gap	$1.71	$1.39	$1.27	$1.58	$1.86	$2.16	$3.02	$4.32
Available Funding	$2.16	$2.85	$3.03	$2.79	$3.76	$3.87	$3.92	$4.12

Fiscal Years

Note: The methodology to develop the CIP Outlook has evolved over the years, and expenditure and revenue assumptions may vary by Outlook Period.

Compared with the prior CIP Outlook (FY 2022-26), this represents a 21.6% increase in estimated total capital needs, 5.1% increase in funding, and 43.1% increase in the funding gap. This is the largest year-over-year increase in the funding gap since this report was first created. As discussed throughout this report, the significant gap is largely due to competing priorities for limited resources and a lack of new or dedicated funding sources. This led to ongoing deferral of needed projects, resulting in continued aging and deterioration of existing assets, ultimately further increasing costs. This also has resulted in the City spending funds on emergency repairs as assets fail and cause collateral damage.

CIP Outlook Projections by Category

Consistent with last year's Outlook, capital projects are categorized as either priority or discretionary. While these classifications can help to provide a level of ranking or urgency, some needs classified as discretionary may also be very important to Council and/or need to be addressed to prevent reactive or emergency repairs which can be significantly more expensive for the City. Many needed discretionary projects have been identified by condition assessments and/or to meet service level standards and will result in a decrease to operations and maintenance costs once addressed. For example, replacing outdated HVAC systems in existing facilities will increase energy efficiency and result in reduced repairs and energy costs.

Categories of Capital Needs

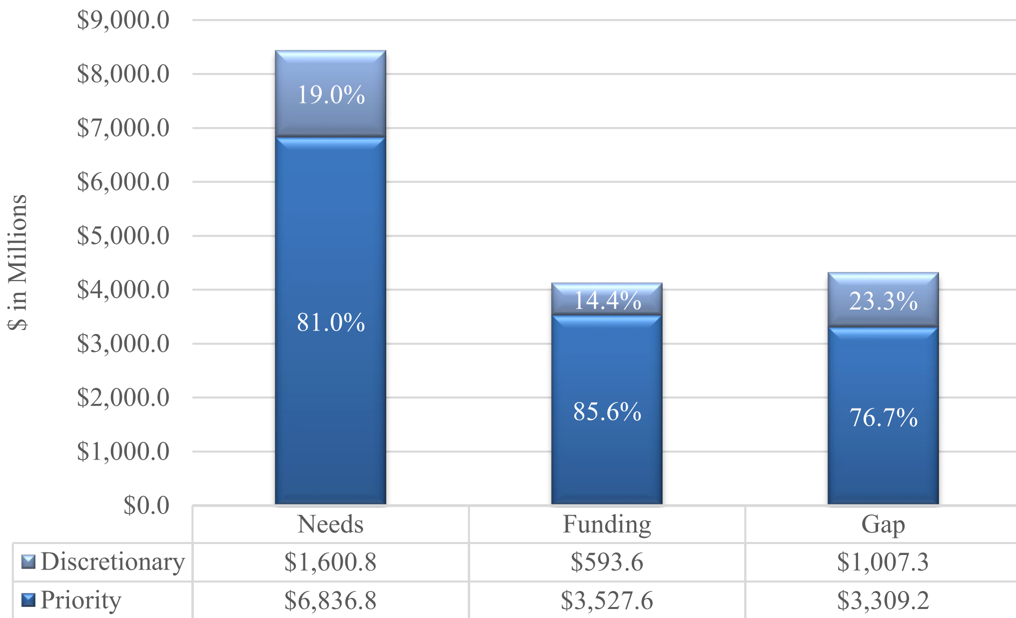
Priority:

- Address life, safety, regulatory requirements, and legal mandates.
- Could impact the core operation of a critical facility or asset.
- Any Mayor and Council priority.

Discretionary:
All remaining infrastructure needs that allow the City to meet and exceed its services to the community to enhance the overall quality of life.

The following figure shows total priority and discretionary needs, funding, and the funding gap projected in the CIP Outlook as well as percentages of each. From the prior Outlook (FY 2022-26), the funding gap for priority needs of $3.31 billion has increased by $1.00 billion. The following asset types were recategorized from discretionary to priority because they were identified as FY 2023 Council Budget Priorities: Sidewalks, Streets and Roads – Modifications, and Bike Facilities.

Total Priority and Discretionary Needs, Funding, and Gap



Of the $6.8 billion of priority needs in this Outlook, Stormwater has 26%. This is roughly twice as much as the next highest asset type, the Pure Water Project which has total priority needs of $914.8 million or 13.4% of total priority needs. A trend throughout the CIP Outlook are the significant needs and funding gap of Stormwater, discussed in more detail in the following sections of the report and Attachment 1.

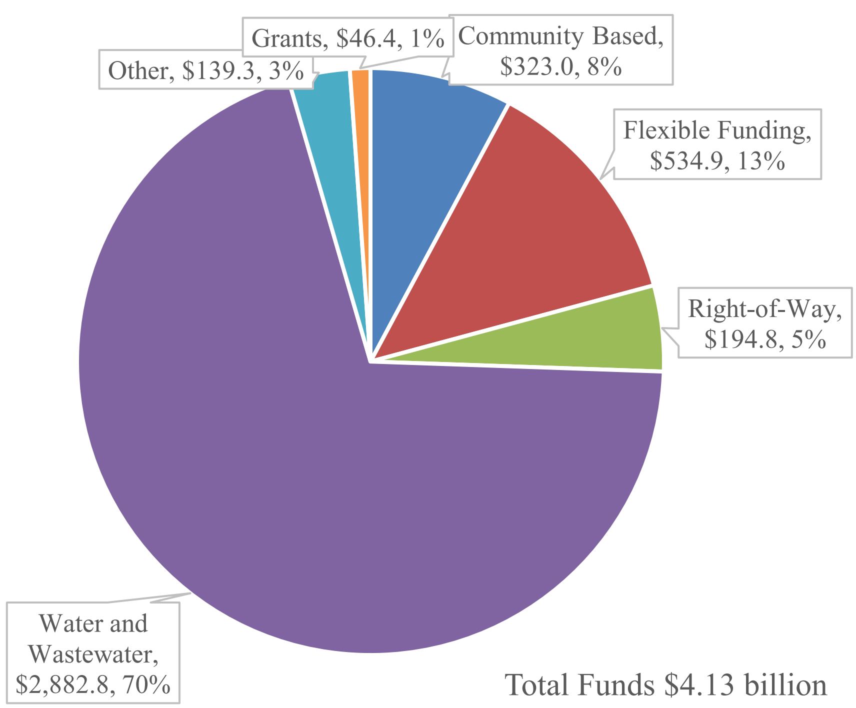
Projected Funding Over the Outlook Period

Overall, the funding projected in the CIP Outlook increased by about 5.1% from the prior year, and totals $4.12 billion. According to the Department of Finance, CIP revenue projections have not been significantly impacted by the pandemic in this Outlook. However, challenges related to the pandemic have significantly increased project execution costs and timelines, as the time needed to secure materials has increased and contractors and consultants are less reliable as they have experienced effects of the pandemic (getting exposed and/or sick, being out for extended periods of time, entire crews are unexpectedly sidelined with a quarantine mandate).

It is also important to note that much of the projected funding carries restrictions on the type of projects it can fund, or the communities in which funds must be spent. When discussing CIP funding sources, there are two important related concepts – whether the asset (1) is enterprise funded or reliant on the General Fund and (2) has use restrictions. An enterprise asset is self-supporting with a dedicated funding source generated from fees or rates charged to customers using the assets, such as water and wastewater. In contrast, non-enterprise assets such as stormwater and parks do not have a dedicated funding source and must compete for the City's limited funding. We discuss enterprise and General Fund assets in more detail in the next section, "CIP Projections by Asset Type."

The following figure shows the percentage of projected funding by five use restricted categories: water and wastewater funds, community-based funds (geographically restricted), flexible funding (generally for use on any General Fund asset), right-of-way, and other funding sources (for example, funds those that must be spent on certain assets, like regional parks).

Percentage of Projected Funding by Use
$ in Millions



Water and Wastewater Funds

A significant majority, or approximately 70% of funding for the CIP comes from water and wastewater fees and can only be used to support improvements to water and wastewater infrastructure. This represents an 8.5% increase from $2.67 billion in the prior year Outlook to $2.88 billion in this Outlook. The Water and Wastewater Funds support the Pure Water Project as well as baseline CIP water and wastewater projects.

The CIP Outlook assumes sufficient rate capacity is obtained to support capital needs throughout the five-year projection. For wastewater, this is based on rate increases approved by the City Council in September 2021 which went into effect January 1, 2022. However, the City's water cost of service study was anticipated to be completed in 2021 but has continued to be delayed due to Patz litigation which could have an impact on future water rate increases and projections.[7] Water and wastewater capital funds are discussed in more detail in our Review of the Public Utilities Department FY 2023-2027 Five-Year Financial Outlook.

Flexible Funding Sources

Non-enterprise assets do not have a dedicated funding source and must compete for the City's limited funding. Allocation of these resources is done within the parameters of each funding source's allowable use, which could require spending in a certain community or on a specific asset type. Many capital needs do not meet these restrictions and therefore must rely on flexible funding sources. Flexible funding sources represent $535.9 million or 13% of projected revenue during the Outlook period, including the Infrastructure Fund and financing, such as commercial paper and Water Infrastructure Financing and Innovation Act (WIFAI) loans for Pure Water and Stormwater.

The Infrastructure Fund in the CIP Outlook includes $159.3 million for capital projects for Bridges, Existing Facilities, Fleet, New Fire Stations, New Lifeguard Stations, Parks, Sidewalks and Stormwater. As adopted by Voters in 2016 as Proposition H, the Infrastructure Fund receives a portion of growth in major General Fund revenues and dedicates those amounts to support City infrastructure. Due to revenue shortfalls in the prior two fiscal years associated with the COVID-19 pandemic, contributions were not made to the Infrastructure Fund in FY 2020 and 2021. The City's economic recovery from the pandemic is expected to result in the City resuming its contributions to the Infrastructure Fund over the Outlook period.[8]

The Outlook includes $375.6 million in financing, including as commercial paper issuances and loans.[9] (In May and August 2018 the City Council approved the authority to issue and expend $88.5 million in commercial paper note proceeds on CIP projects. As of February 2022, there is $3.6 million remaining to be spent. In addition, in August 2021, the City Council approved the

[7] The City's Water System is currently involved in litigation in Patz v. City of San Diego regarding the use of a tiered water rate structure for single-family residential customers.

[8] Proposition H required the City to make contributions to the Infrastructure Fund equal to (1) half of year-over-year growth in Property Tax, Transient Occupancy Tax, and Franchise Fee revenues, (2) all growth in Sales Tax revenue above FY 2016 levels, as adjusted annually by the CPI, and (3) any decreases in annual Actuarily Determined Contributions (ADC) to the Pension Fund below FY 2016 levels. The first requirement for half of year-over-year growth for Property Tax, Transient Occupancy Tax, and Franchise Fee revenues drops off after FY 2022, while the other two requirements remain through FY 2043. The Proposition also allows the Mayor and Council to waive an annual contribution with a two-thirds vote of the Council.

[9] Capital Outlay funds are also a flexible funding source used in the CIP but they are not included in the CIP due to their volatility. They are dependent upon land sales which can vary drastically from year to year.

expenditure of another $160.4 million in commercial paper and lease revenue bond proceeds for various priority CIP projects. The City will begin to spend these funds in FY 2022 and continue to expend them over the next few fiscal years.

Update on Commercial Paper Spending (as of February 2022)			
Total	**Encumbered**	**Spent**	**Remaining**
$ 87,873,470	$ 4,088,690	$ 80,143,946	$ 3,640,834

Note that the difference between the $88.5m and the $87.9 million in the table attributed to the cost of issuance.

Note, the CIP Outlook includes $294 million in federal funding for Water Infrastructure Finance Innovation Act (WIFIA) loans from the federal Environmental Protection Agency (EPA) to finance stormwater CIP activities. The proposed item was discussed at Budget and Government Affairs Committee on March 2, 2022 and anticipated to go to full Council on March 14/15. This proposal is discussed in more detail in Attachment 1 to this report.

Community-Based Funding

Another significant resource for General Fund assets is community-based funding, which includes Facility Benefit Assessment (FBA) and Development Impact Fee (DIF) revenue totaling $323.0 million during the Outlook period. These impact fees are imposed on new development projects to provide a share of the cost for needed public facilities to serve new development. In the longstanding DIF and FBA program, revenue must be spent on specific projects in the community that the development occurred.[10]

However, the Planning Department is currently restructuring its overall DIF program, with the goal of an eventual transition to a Citywide DIF by asset class (such as for parks and public facilities such as libraries). On August 3, 2021, Council approved a new Citywide Park Development Impact Fee (Citywide Park DIF) replacing the existing park components of individual community-based fees. The Citywide Park DIF will allow for future fees to be collected and spent where the greatest need for parks exist Citywide rather than being restricted to the community plan area where the fee was collected. As noted in the CIP Outlook, the Citywide Park DIF will be shown as a different funding source than the traditional community based DIF in future reports. However, this will only apply to newly generated DIF revenue, and existing DIF balances will still carry their earlier restrictions.

On November 9, 2020 Council also approved the Active Transportation In-Lieu Fee. This fee is required for residential and non-residential development projects located in areas of the City designated as "Mobility Zone 4" where there is lower access to transit. Developers may choose to opt-in to the fee if development occurs in other areas of the City in lieu of taking required measures to reduce the increased vehicle miles traveled generated by the development. The fee will be used to construct transit, bicycle, and pedestrian supporting infrastructure where it will be most utilized with the intent of achieving the greatest reduction of vehicle miles traveled and greenhouse gases possible.

[10] Plans that identify needed new public infrastructure for each community include Impact Fee Studies and Public Facilities Financing Plans.

All funds collected through existing community-based fees will remain in dedicated funds to use within the community for the purpose in which they were collected.

Right-of-Way

The CIP Outlook also projects $195.8 million of funds will be available for CIP projects in the right of-way using Regional Transportation Congestion Improvement Program Funds ($25.0 million), TransNet ($114.8 million), Trench Cut/Excavation Fee ($10.0 million), and Undergrounding Utilities Fund ($45.0 million). These funds are primarily planned for street modifications and pavement, sidewalks, streetlights and traffic signals projects.

CIP Outlook Projections by Asset Type

The following table shows total capital needs, funding, and the funding gap by asset type and whether the assets are enterprise or non-enterprise funded. All enterprise assets are projected to fully fund their capital needs with anticipated expenditures and revenues totaling $2.94 billion. The enterprise fund asset types with the highest needs and funding over the Outlook period are Water ($1.19 billion), Pure Water ($916.8 million), and Wastewater ($776.7 million).

For the Public Utilities Department (PUD), all non-Pure Water capital projects are considered the department's baseline CIP for water and wastewater assets. PUD has an Asset Management program to sustainably maintain, repair, and replace infrastructure assets, which helps to ensure critical water and sewer assets are functioning properly and do not fail. For example, when a water pipe breaks the consequences can be significant, resulting in damage to private property, service outages, flooding, road closures, and other negative impacts. It is more cost effective to maintain assets and replace them before they fail and require emergency repairs and cause collateral damage.

The PUD Baseline CIP includes projections of regular, ongoing capital maintenance and replacements to keep the water and sewer systems running smoothly such as improvements to reduce pipeline breaks and emergency repairs; improve Hodges Dam;[11] and enhance treatment and distribution process technology. The baseline CIP also includes expansion and upgrade of the Water System to accommodate growth and maintain compliance with federal and state requirements.

[11] The Baseline includes funding for condition assessments of dam infrastructure, but currently only the assessment of Hodges Dam has been completed. Needs for Dam rehabilitation projects are expected to be significant. As condition assessments are completed, PUD indicated additional needed capital projects will be included in future Outlooks.

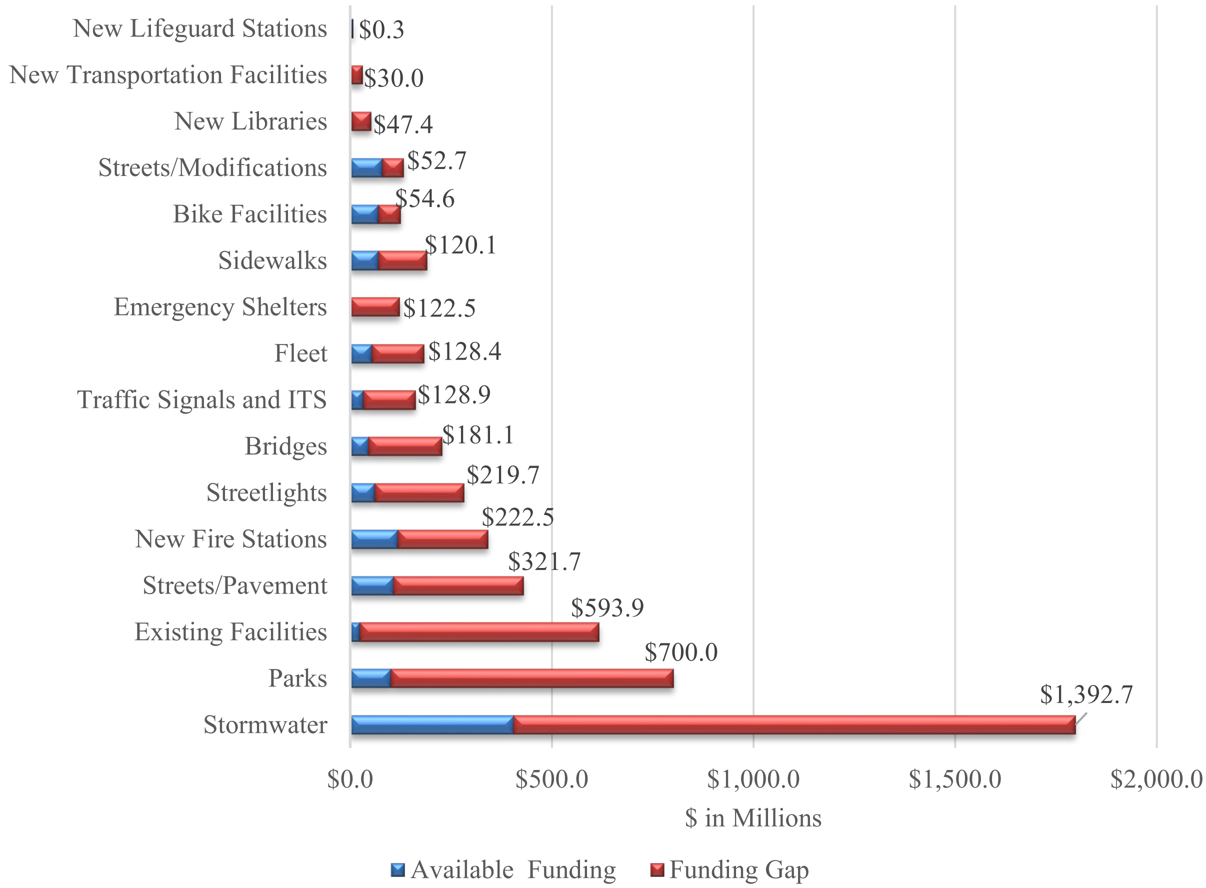
Total Needs, Funding, and Funding Gap by Asset Type

$ in Millions

	Asset Type	Total Needs	Total Funding	Funding Gap	Percentage of Funding Gap
General Fund or Non-Enterprise Fund	Stormwater	$1,798.2	$405.6	($1,392.7)	32.26%
	Parks	$801.2	$101.2	($700.0)	16.22%
	Existing Facilities	$617.7	$23.8	($593.9)	13.76%
	Streets and Roads - Pavement	$429.9	$108.2	($321.7)	7.45%
	New Fire Stations	$341.1	$118.6	($222.5)	5.15%
	Streetlights	$281.5	$61.8	($219.7)	5.09%
	Bridges	$227.4	$46.3	($181.1)	4.20%
	Traffic Signals and ITS	$161.5	$32.6	($128.9)	2.99%
	Fleet	$182.5	$54.1	($128.4)	2.97%
	Emergency Shelters	$122.5	$0.0	($122.5)	2.84%
	Sidewalks	$190.0	$70.0	($120.1)	2.78%
	Bike Facilities	$124.7	$70.1	($54.6)	1.26%
	Streets and Roads - Modifications	$132.7	$80.0	($52.7)	1.22%
	New Libraries	$51.9	$4.5	($47.4)	1.10%
	New Transportation Facilities	$30.0	$0.0	($30.0)	0.70%
	New Lifeguard Stations	$6.9	$6.6	($0.3)	0.01%
Enterprise Fund	Airports	$31.0	$31.0	$0.0	0.00%
	New Fleet Facilities	$0.0	$0.0	$0.0	0.00%
	Golf	$0.5	$0.5	$0.0	0.00%
	Landfills	$23.8	$23.8	$0.0	0.00%
	New Police Stations	$0.0	$0.0	$0.0	0.00%
	Pure Water - Potable Reuse	$916.8	$916.8	$0.0	0.00%
	New Recreation Centers	$0.0	$0.0	$0.0	0.00%
	Wastewater	$776.7	$776.7	$0.0	0.00%
	Water	$1,189.3	$1,189.3	$0.0	0.00%
	Total	**$8,437.7**	**$4,121.2**	**($4,316.4)**	**100.00%**

As shown in the table above, the $4.32 billion total funding gap is entirely attributed to General Fund assets. The following figure shows the projected funding gap by asset type. Stormwater represents $1.39 billion or 32.3% of the total funding gap which is twice the next highest of Parks with $700.0 million or 16%. Key asset types with significant funding backlogs are discussed in more detail in the following section.

Total Needs, Available Funding, and Funding Gap for General Fund Assets



Stormwater

The Stormwater Department has a robust Asset Management program and Stormwater needs are driven by the Watershed Asset Management Plan (WAMP), which was recently updated in 2021. This long-range plan takes into account all of the City's stormwater needs (operating and capital), including the flood risk management system as well as infrastructure needed to comply with water quality improvement targets set by the Regional Water Quality Control Board's (RWQCB).

As shown in the CIP Outlook, stormwater needs make up both the highest level of total needs as well as the largest funding gap over the five-year period. Capital needs, at a level of $1.8 billion, have grown by $320.3 million since the prior CIP Outlook, mostly due to carrying forward the backlog from prior years to the new Outlook period. This extremely high level of need is driven by most of the City's stormwater infrastructure being beyond its useful life and the chronic underfunding of maintenance and capital projects for the storm drain system. This has resulted in high rates of failure within the existing infrastructure resulting in about $63 million in emergency repairs for FY 2019 through FY 2021. Additionally, the City is facing increasing needs to comply with the RWQCB requirements for water quality, as nearly all of the City's rivers and streams are considered impaired under the federal Clean Water Act.

Attachment 1 to this report provides more detail on the magnitude of needs driven by the City's current and required flood resiliency infrastructure; need for additional green infrastructure; and the Stormwater Department's efforts to secure additional funding to address these needs, including the proposed Water Infrastructure Finance and Innovation Act (WIFIA) loan discussed at Budget and Government Efficiency Committee on March 2, 2022. Also, our previous analysis of the Storm Water Funding Strategy is provided in IBA Report 21-04.

Parks

> **Rating Scale for**
> **Park Condition Assessment (PCI)**
> **and**
> **Facilities Condition Index (FCI)**
>
> Good – 0-20%
> Fair – 21-29%
> Poor – 30% or higher

The Park and Recreation Department recently completed a Park Amenity Condition Assessment of all existing developed park amenities/assets (for example, playgrounds, athletic fields and courts, parking lots, roads, etc.) which identified $43.6 million in capital needs to improve each park to the proposed service level of the Park Condition Index (PCI) 15, which is in the "Good" range. Note, the primary difference between calculating a building Facility Condition Index (FCI) and a Park Condition Index (PCI) is that a building FCI is based on the value of the replacement of that entire building while a park PCI is based on replacing those amenities within the park that were assessed, not the full replacement value of the park.

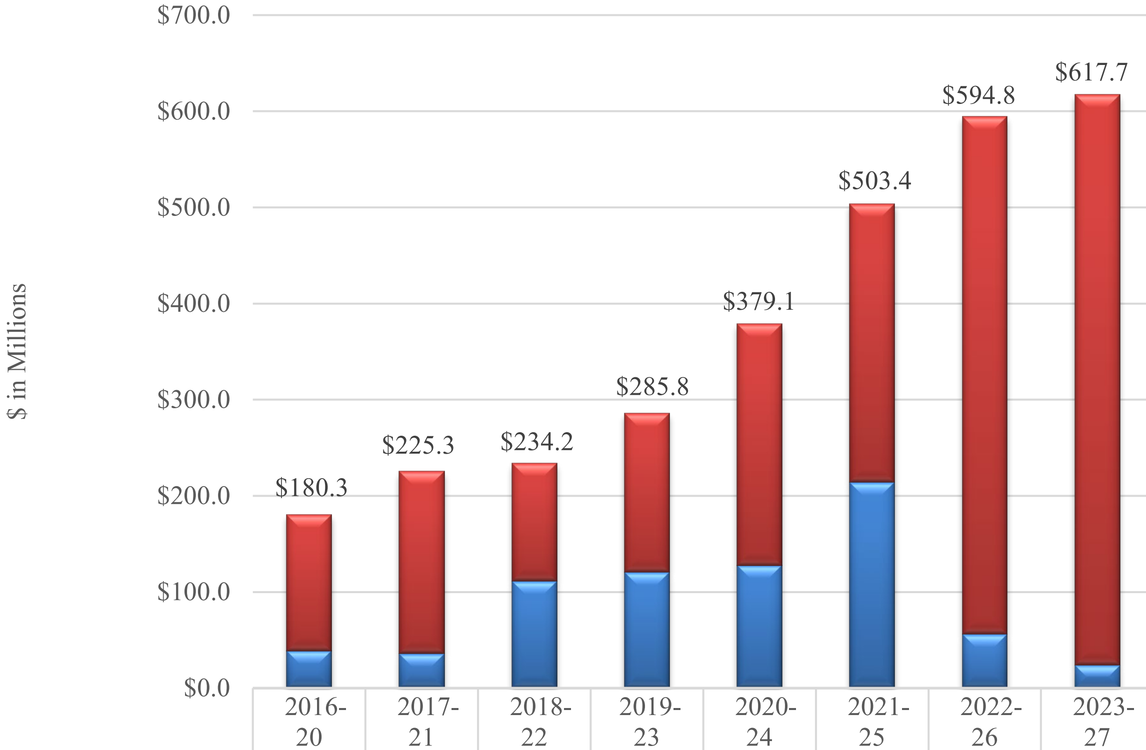
When including $620.2 million in capital needs for park buildings that were incorporated in the Facilities Condition Assessment (FCA) program in April 2016 and March 2017, the total necessary reinvestment in 2021 dollars is estimated to be $663.8 million (FCI/PCI 15). The CIP Outlook includes $78.8 million intended to address needs identified by these condition assessments, of which $13.8 million has available funding.

Total needs for Park assets over the CIP Outlook are $801.2 million, with available funding of $101.2 million resulting in a funding gap of $700.0 million or 16% of the total gap.

Existing Facilities

Capital needs for Existing Facilities were identified in condition assessments conducted between 2014 and 2016. At that time, the assessment identified a need to invest an estimated $828.7 million in City facilities to bring them up to a "good" condition. The CIP Outlook includes five years of funding needs from a draft Facilities Asset Management Plan that was developed to address the facilities backlog. The following figure shows the dramatic increase of needs for Existing Facilities since the first CIP Outlook (FY 2016-2020), more than tripling. At the same, chronic underfunding especially in recent years, has increased the funding gap to $593.4 million over the five years of this CIP Outlook. While Existing Facilities do not have a dedicated funding source, the four years of funding over $100 million/year shown in the figure were funded by deferred capital bond issuances. The drop off in FY 2022-2026 shows what happens without a flexible or dedicated funding source.

Existing Facilities Capital Needs, Funding and Funding Gap Over Eight CIP Outlooks



	2016-20	2017-21	2018-22	2019-23	2020-24	2021-25	2022-26	2023-27
Funding Gap	$141.3	$189.3	$122.8	$165.1	$251.5	$289.3	$538.8	$593.9
Available Funding	$39.0	$36.0	$111.4	$120.6	$127.6	$214.1	$56.0	$23.8

As noted by General Services/Facilities Services Division, unfunded projects contribute to the backlog and allow the City's facilities conditions to continue to deteriorate, leading to potential building system shutdowns which may render a facility unusable or uninhabitable for an extended period of time.

Chronic underfunding of Facilities maintenance and repair has been a significant contributing factor to the current deferred maintenance and capital backlog and funding gap. As stated in our Review of the FY 2023-27 Five Year Financial Outlook, given that the services and programs included in the Outlook were the most requested service level improvements identified through the City's "Get It Done" application, no service level improvements were included for Facilities Services Division. We are concerned that neither the Financial Outlook nor the CIP Outlook place a high priority on critical facilities maintenance, repair, and capital projects.

Facilities Services Division staff currently spends about 80% of their work doing reactive maintenance to fix breakdowns and make emergency repairs, compared with only 20% of their work being dedicated to preventative maintenance. According to the November 2012 City Auditor Facilities Maintenance Report, best practices suggest that preventative maintenance should account for at least 70% of repairs. The Auditor's report noted that achieving the correct balance between these activities is a key factor in an effective and efficient maintenance program and helps manage costs by minimizing expensive emergency repairs and unplanned shutdowns.

Facilities Division staff indicated that the current facilities condition assessment conducted in 2014-16 still has valuable information, but they noted industry standards recommend conducting a facilities condition assessment every five years. We believe Facilities Services Division Asset Management practices provide valuable information to support informed decision making and the City should plan to conduct a new facilities condition assessment in the next couple of years. Additionally, Existing Facilities should be prioritized within a Citywide infrastructure funding strategy for both preventive maintenance and capital needs.

Transportation-related Assets

Streets and Roads – Pavement – Street repaving capital needs in the CIP Outlook are driven by costs to maintain an Overall Condition Index (OCI) rating of 70, signifying "good" condition, and is based on the most recent pavement condition assessment conducted in 2015-16. Total capital needs for street paving over the CIP Outlook period are $429.9 million, which is the same as the prior CIP Outlook. With $108.2 million in available funding, the resulting funding gap is $321.7 million or 8% of the total gap. As noted in our review of the CIP Outlook last year, the average cost per mile for streets has increased significantly at least in part due to challenges related to the COVID-19 Pandemic, such as supply chain issues and inflation. The following table shows paving costs increasing over three years. Note that street overlay costs have almost doubled since FY 2020.

Cost per Mile

Update on Pavement and Reconstruction Costs			
	FY 2020	FY 2021	FY 2022
Slurry Seal	$ 100,000	$ 100,000	$ 130,000
Street Overlay	$ 400,000	$ 600,000	$ 780,000
Concrete	$ 1,000,000	$ 1,200,000	$ 1,500,000
Reconstruction	$ 1,500,000	$ 6,000,000	$ 6,000,000

Note: Prior to FY 2021, the Department had not done a road construction project so did not have a frame of reference for the related costs.

Given that the City's last pavement condition assessment was conducted in 2015 and 2016 and should be updated to reflect current asset condition, the Transportation Department received $700,000 in one-time funding in the FY 2022 budget for a new condition assessment. Department staff told us the Request for Proposal (RFP) to hire a consultant has been delayed because staff are assessing adjusting the scope to potentially include LiDAR[12] and other assets types, such as signage. The RFP will potentially be issued in mid-March and likely only about one-month worth of assessment will be conducted in FY 2022. Since one-time funds do not carryover to following fiscal years, the Department likely will be requesting additional funds for FY 2023.

Streetlights – Streetlight needs are driven to achieve the following service levels standards:

- Installing100 new streetlights per year over 10 year to (by FY 2032) to address all 4,966 new streetlights on the needs list;

[12] LiDAR (Light Detection and Ranging) is a remote sensing method that uses light in the form of a pulsed laser to measure ranges (variable distances) to the Earth. This technology is increasingly being used for conducting condition assessments for a variety of infrastructure assets.

- replacing 2,500 streetlight poles and fixtures per year over 20 years (by FY 2042) to replace approximately 5% of the City's total streetlight poles annually; and
- replacing the remaining 49 obsolete streetlight series circuits to meet modern electrical standards over the next 25 years. Additionally, approximately 150 streetlights are installed annually through the Utilities Undergrounding Program.

The CIP Outlook includes a total of $281.5 million in capital needs for Streetlights, which represents an increase of $17.9 million or 6.8% over the prior year, primarily due to an increase in the number of new streetlights added to the needs list. Total available funding is $61.8 million over the Outlook period resulting in a funding gap of $219.7 million or 5% of the total.

Department staff told us the average cost to install new streetlights has increased at least in part due to challenges related to the COVID-19 Pandemic, such as supply chain issues and inflation. The following table shows increasing costs to install new streetlights over three years.

Update on Costs for Streetlight Installation		
FY 2020	**FY 2021**	**FY 2022**
$ 25,000	$ 44,000	$ 50,000

Sidewalks – Capital needs for Sidewalks are driven by the Transportation Department's goal to replacing all defective sidewalks within ten years, based on the Sidewalk condition assessment conducted in FY 2014-15, as well as addressing sidewalk-related ADA complaints. Note that FY 2023 is considered to be year one of the 10-year period because funding for sidewalks has either been non-existent or extremely small since the condition assessment concluded. The Outlook assumes addressing all known defects by FY2032 if all funding is allocated each year.

Sidewalks were identified as FY 2023 City Council Budget Priorities and therefore were moved from the Discretionary to priority category in the CIP Outlook. Over the five-year Outlook period, needs total $190.0 million, 24.4% above the prior year Outlook. Available funding for Sidewalks is $70.0 million, resulting in a funding gap of $120.1 or 2.8% of the total gap. According to the Department if Council wants to increase sidewalk projects, additional staff will also be needed to plan and manage the sidewalk contracts.

Underfunding of sidewalk projects contributes to unaddressed sidewalk defects that have resulted in sidewalk-related injuries and created significant public liability for the City, as outlined in the 2020 City Auditor Public Liability Management Audit.

Fire Stations

The CIP Outlook includes both new Fire Stations and improvements to existing facilities. New Fire Stations planned in this CIP Outlook have been identified to improve emergency response times. Some fire stations identified in the updated Citygate Standards of Coverage report previously adopted by City Council are included in this CIP Outlook. Over the Outlook period, total projected needs are $341.1 million with $118.6 million is available funding, resulting in a funding gap of $222.5 million or 5.2% of the total.

New Fire Station needs significantly increased from the prior year Outlook because they include $171.8 million for a new Fire Training Facility (Copley Drive), since the existing training facility needs to be vacated by 2027 for the new Public Utilities Water Reclamation Plant for Pure Water Phase 2. Given that the cost for a new, improved facility is not fully funded, the project is planned over multiple years. The Outlook states that E&CP is recommending to minimally grade the site, install utilities, and only construct the buildings necessary to relocate Fire from Liberty Station by 2027 to meet the Pure Water Phase 2 schedule. City officials told us that, because this move is required for the Pure Water project, the City is in early stages of discussing potential cost sharing of the new Fire Training Facility with PUD.

Note, projections for improvements and repairs for existing fire stations and lifeguard stations are included under the Facilities – General Fund needs and were identified in the draft Fire-Rescue Asset Management Plan. Existing Fire-Rescue facilities projections were developed based on the inventory square footage, estimated expansion of the inventory square footage and estimated costs per square foot.

Emergency Shelters

For the first time, this CIP Outlook includes projected funding needs for the creation of 700 additional homeless shelter beds over the next five years, totaling $122.5 million. This is up from the 350 to 500 additional crisis response options (or shelter beds) recommended in the 2019 Community Action Plan on Homelessness. According to the Outlook, the higher need assumes that additional individuals have fallen into homelessness due to the COVID-19 Pandemic and its adverse impact on housing stability. The City will receive updated information on the need for additional shelter beds once the results of the recent Point in Time Count are known.[13]

The $122.5 million included in the Outlook is an estimate and actual costs will depend on a number of factors such as whether the facility supports congregate or non-congregate shelter, whether the facility is built or acquired and rehabilitated, or otherwise improved, and other specific details about the site. The Outlook does not assume additional tent structures, which are not considered by staff to be a good long-term option. As indicated in the report, staff intends to pursue state and federal resources to support these capital costs.

It is important to note that any additional shelters that come online will require significant resources to be operated and maintained. For illustrative purposes, the existing three bridge shelters are expected to cost $21.8 million to operate in FY 2022 and provide 938 shelter beds.

Council Priorities

As discussed in our Office's report on the FY 2023 City Council Budget Priorities, Councilmembers expressed strong support for a wide range of infrastructure needs. All nine Council members were unanimous in prioritizing transportation and mobility safety, street maintenance and repair, and sidewalk repair. The following table includes the infrastructure priorities supported by a majority of Councilmembers, with capital needs, available funding, and the funding gap for FY 2023. The Mayor will set his priorities for General Fund assets through the allocation of funding sources with the most discretion, such as Infrastructure Funds and financing. If the proposed budget does not adequately address Council priorities, Council could consider reallocating funds in the proposed budget to better align with its infrastructure priorities.

[13] The Point in Time Count is an annual event where community partners and volunteers attempt to count the region's homeless population. This year the event took place on February 24, 2022.

City Council FY 2023 Budget Priorities – Needs, Funding, and the Funding Gap
$ in Millions

Asset Type	Needs	Funding	Funding Gap
Transportation and Mobility Safety			
Bike Facilities	$124.7	$70.1	($54.6)
Streetlights	$50.9	$1.2	($49.7)
Traffic Signals	$31.1	$2.8	($28.3)
Streets - Modifications	$45.0	$24.0	($21.0)
Streets - Pavement	$86.0	$7.2	($78.7)
Sidewalks	$27.4	$3.4	($24.0)
Stormwater	$313.0	$24.7	($288.3)
New and Existing Facilities			
Fire-Rescue	$16.5	$8.7	($7.8)
Library	$4.5	$0.0	($4.5)
Park & Recreation	$155.4	$17.0	($138.5)
Total	**$854.4**	**$159.0**	**($695.4)**

Infrastructure Investment and Jobs Act (IIJA)

The federal Infrastructure Investment and Jobs Act (IIJA) is an important funding mechanism to address the City's deferred capital backlog and fund key water, storm water, and transportation projects. IIJA, considered to be a once in a generation infrastructure opportunity, was signed into law on November 15, 2021 and will provide an estimated $1.2 trillion nationwide over the next ten years, with the State of California estimated to receive $46.6 billion over the next ten years. Various funds available under IIJA include:

- formula-based funding, for example, based on population, users, etc.;
- competitive funds, such as grant programs; and
- changes and funding of financing mechanisms, such as State Revolving Fund (SRF) loans.

The City's Government Affairs Department told us they have not heard yet how formula funds from the IIJA will be disseminated and that they are in contact with our state counterparts regarding that issue. The CIP Outlook provides the following general formula funding breakdown by Asset Category for the State of California:

- Highway: $25.3 billion
- Public Transit: $9.45 billion
- Bridge Replacement: $4.2 billion
- Water – State Revolving Loan Funds: $3.5 billion
- Airports: $1.5 billion
- Electric Vehicle (EV) Charging: $384 million
- Wildfires: $84 million
- Broadband Coverage & Cyberattacks: $140 million

Additional funds will be available through a competitive process managed directly by various Federal Government Agencies. Local governments will have an opportunity to compete for these funds through grant and loan applications. The City has established asset-specific working groups that are currently assessing both internal and regional competitive opportunities to develop an effective strategy to apply for competitive funds. According to the Government Affairs Department, IIJA working groups continue to meet and will soon provide an initial list of project priorities for the various competitive grants opening over the next few months.

Key Takeaways and Items to Consider

<u>Asset Management Practices Have Provided a Good Understanding of Capital Needs</u>
Asset Management is a best business practice for sustainably maintaining, repairing, and replacing infrastructure assets, like water and sewer mains, over the asset lifecycle in the most cost-effective manner. Similar to maintenance on a car, like changing oil every 3,000-5,000 miles, infrastructure assets have predictive preventive maintenance strategies that support effective lifecycle management. Asset Management practices, such as establishing service level goals, conducting condition assessments, prioritizing projects based on risk, and using Asset Management systems to support work management and capital planning – provide a sound basis for identifying maintenance and capital needs. As departments are increasingly utilizing these practices and have learned more about the state of their assets, the City has developed a well-supported understanding of many of its capital needs.

To enhance and build on Asset Management practices that provide valuable information and cost-effective management of assets, we believe it's important to:

- Support departments who have robust programs and systems, so they can utilize those systems to their fullest extent or enhance their capabilities. For example, Stormwater has a plan to migrate its WAMP database into the citywide EAM system to enhance functionality and increase efficiency.[14]
- Support departments that do not have as robust Asset Management programs to gain needed systems and plans. For example, the EAM System is currently used by six departments/groups, but the City has a plan to expand to additional departments in EAM Phase 2.[15] Phase 2 was included in the Five-Outlook for FY 2021-25, but the expansion was deferred due to the pandemic and other priorities.
- Consider including some level of related maintenance in future CIP Outlooks to provide a full lifecycle view of asset needs. This will also provide a more comprehensive view of needs for Council.
- Prioritize needs identified in condition assessments to meet minimum service level goals, even though they may be categorized as Discretionary. For example, the draft Facilities Asset Management Plan identified many HVAC replacement projects which will increase efficiency and reduce energy costs.

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[14] The WAMP database is a cloud-based intelligent infrastructure renewal system to support the Asset Management decision-making process. The Stormwater Department is working with DoIT and its consultant to migrate the WAMP content into the capital planning component of EAM (known as Asset Management Planning or AMP). The migration is planned to be completed by the end of FY 2023/early 2024, and the effort will be funded from Stormwater's current base budget.

[15] The departments/groups currently using EAM include Department of Information Technology/Wireless Communications, E&CP, General Services/Facilities Services Division, Public Utilities, Stormwater Department, and the Transportation Department.

Our office is also conducting a review of Asset Management practices and the use of the EAM System to support work management and capital planning; our report is planned to be issued in the spring of 2022.

The City Is in a Good Position to Develop a Holistic Financing Strategy and Project Delivery Plan to Address the Funding Gap

Given that the City has a good understanding of needs for many assets, it is in a good position to compete for IIJA funds and to develop a financing strategy and project delivery plan to address any remaining funding gap. The ultimate goal is to have a citywide holistic view of needs and gaps so the City can determine how to address its infrastructure more broadly. After the City determines what needs will be funded with IIJA, it should consider other creative options for remaining asset needs, like Public, Private Partnerships (P3) and General Obligations bond programs which have been highly successful in San Francisco and Los Angeles.[16]

Without a financing strategy, however, the City will continue to defer capital needs, which will result in the inefficient use of limited funds. For example, deferring storm water capital needs has resulted in 31 emergency projects totaling about $63 million over the past three years (FY 2019-21). To fund these projects, flexible funding has been taken away from other planned storm water projects as well as other high priority projects, such as sidewalks, parks, library, and fire-rescue projects. In addition, when failed infrastructure turns into an emergency project, the City pays for these at a premium and is only allowed to do the minimum work necessary to address the emergency, leaving additional repairs needed in the future. If capital needs of other asset types, like existing facilities, continue to be deferred similar consequences could result.

Deferring capital needs also creates risk for the public and public liability for the City, for example, unaddressed sidewalk defects that have resulted in sidewalk-related injuries.

Effectively Delivering the CIP Will Require Sufficient Capacity and Continued Streamlining

To successfully deliver the current CIP and address the backlog, the City needs to continue investing in capacity. These investments include ensuring sufficient staff to support grant writing for IIJA and other federal and state opportunities and continuing to make needed changes to salaries, job classifications, etc., to attract and retain needed skills and fill vacancies in order to deliver funded projects.

The City recently created the new Strategic Capital Projects Department, recognizing the increasing need to manage larger projects, such as Pure Water Phases 1 and 2, in a more efficient way. We note that the Pure Water program has been managed successfully to date and could be used as a model or guide for other large projects and programs.

The CIP Outlook also notes the external capacity challenge, that is, helping to ensure the base of consultants, contractors and vendors are sufficient to support the current and future volume of

[16] GO bonds offer the City a possible alternative to the use of lease revenue bonds. GO bonds are secured by the city's promise to levy additional property tax sufficient to pay annual principal and interest on the bonds. Since GO bonds require an increase in property tax, they must achieve two-thirds voter approval. They are also typically the least expensive type of debt available to municipalities and can reduce financing costs for CIP projects. For more information, see Comparative Information about other Cities' Bond and Revenue Measures.

work due to future IIJA funds in the region and/or a Citywide financing plan. City engineering officials told us that they are doing the following to address this challenge.

- Through organizations such as the American Public Works Association and Regional Construction Procurement Committee, City officials are working with other local organizations exploring ways to work together to not under cut each other and focus on cooperation.
- Officials are working with contracting groups and other organizations (such as the Associated General Contractors of America, American Society of Civil Engineers, and American Council of Engineering Companies) as well as private firms regarding the anticipated growth of the City infrastructure and potential improvements to the City's process that will make it more appealing for these entities to partner with the City.
- Officials are talking with both groups noted above about strategies to recruit people who have never worked in this business before.

While the City is rebounding from the immediate economic impacts of the COVID-19 pandemic, we note that we may still experience long term impacts from supply chain, inflation, and potential interest rate increases, which are resulting in overall higher costs for projects. In addition, state and federal funding, such as IIJA have contracting requirements and provisions such as the "Build America, Buy America Act", which imposes a domestic preference for construction materials on infrastructure projects that utilize federal financial assistance (grants), starting May 14, 2022. City engineering officials have noted that these new provisions may raise costs and extend project schedules. This underscores the need for E&CP to continue to identify ways to streamline the process of delivering CIP projects. Additional streamlining proposals are expected to come before Council for approval this year.

<u>Future Outlooks Should Evolve to Reflect Current City Needs</u>

Since the City's first CIP Outlook in January 2015, the plan has been enhanced and expanded to include more asset types which we believe is a positive step to reflect key current infrastructure needs. We understand why certain assets/projects have not been included, given the information currently known. For example, the Outlook does not include capital projects needed to achieve Climate Action Plan (CAP) goals because CAP 2.0 is currently in draft and the City is working on an implementation plan to identify needed projects to achieve CAP goals as well as related costs. It is important that the implementation plan is completed in the near term so Council can consider all City needs when developing a financing strategy.

Another asset type not included in the CIP Outlook is Information Technology (IT). In our current high technology environment, it will be important for future Outlooks to include relevant IT capital projects as well as IT needs as part of new facilities. Also, CAP smart building solutions include tracking energy savings which has a tech component, and DoIT will need to be involved to make sure these are secure.

CONCLUSION

The CIP Outlook is a planning tool to identify all current and future capital needs and available funding within the five-year outlook period. As shown in the CIP Outlook, the City's capital needs far exceed available funding, and the Mayor and Council must therefore make strategic decisions regarding capital infrastructure investments during the annual budget process. Absent new resources, many needs identified in the CIP Outlook will remain unfunded. As the City deals with budgetary and resource constraints, aging and deteriorating infrastructure, and increasing urgency to achieve strategic goals, officials must make wise investments. Ultimately, the City's will need a large-scale and holistic financing and project delivery strategy to address the growing backing of unfunded needs and ensure the City's strategic goals and policies are fully implemented.

Since the City's first CIP Outlook in January 2015, the Outlook has been enhanced and expanded to include more asset types which we believe is a positive step to reflect key current infrastructure needs. Additionally, the Outlook has evolved as departments have learned more about the state of the City's assets. As highlighted throughout this report, departmental Asset Management practices, such as establishing service level goals, conducting condition assessments, prioritizing projects based on risk, and using Asset Management systems to support planning provide a sound basis for identifying capital needs. While all asset types are not included at this time, now more than ever before, the City has a well-supported understanding of its capital needs, totaling $8.4 billion over the Outlook period. As a result, the City is a good position to develop a financing strategy and project delivery plan to address significant deferred capital needs and a funding gap that totals $4.3 billion in this Outlook.

The City is also in a good position to compete for federal and state funds. The recently passed federal IIJA is not included in this CIP Outlook, but it is expected to provide an unprecedented possibility for significant infrastructure funding to address the City's deferred capital backlog and could fund key water, stormwater, and transportation projects in future CIP Outlooks. The City will receive IIJA formula-based funds allocated through the state of California. In addition, City staff are currently assessing both internal and regional opportunities to develop an effective strategy to apply for competitive funds so that the City is not competing against its regional partners for grants.

As Council prepares for the upcoming budget season, we emphasize that it can choose to reflect different priorities than those reflected in the CIP Outlook. Council will have the most discretion over allocation of flexible funding sources to fund priority CIP projects. However, because flexible funding is so limited, prioritizing infrastructure needs will likely come with difficult tradeoffs.

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ATTACHMENT 1

Stormwater Needs, Funding, and Funding Gap

The Stormwater Department has a robust Asset Management program and Stormwater needs are driven by the Watershed Asset Management Plan (WAMP), which was recently updated in 2021. This long-range plan takes into account all of the City's stormwater needs (operating and capital), including the flood risk management system as well as infrastructure needed to comply with water quality improvement targets set by the Regional Water Quality Control Board's (RWQCB).

As shown in the CIP Outlook, stormwater needs make up both the highest level of total needs as well as the largest funding gap over the five-year period. Capital needs, at a level of $1.8 billion, have grown by $320.3 million since the prior CIP Outlook, mostly due the carrying forward the backlog from prior years to the new Outlook period. This extremely high level of need is driven by most of the City's stormwater infrastructure being beyond its useful life due to the chronic underfunding of maintenance and capital projects for the storm drain system. This has resulted in high rates of failure with existing infrastructure and resulted in about $63 million in emergency repairs for FY 2019 through FY 2021. Additionally, the City is facing increasing needs to comply with the RWQCB requirements for water quality, as nearly all of the City's rivers and streams are considered impaired under the federal Clean Water Act.

How the Stormwater Need is Determined

The City's stormwater needs are driven by the WAMP, which was initially published in 2013 and updated in 2017 and 2021 in preparation for the Department's Funding Strategy. The WAMP includes all of the City's stormwater needs (operations, maintenance, and capital), and develops a plan to provide for both the maintenance and improvement of the flood risk management system as well as the development of additional infrastructure to comply with water quality improvement targets, which are set by the RWQCB. Taken together, the WAMP provides the City's commitment to meeting all of its storm water needs over the long term, with the current WAMP projecting almost $5.5 billion in needs through FY 2040 (in constant 2020 dollars without escalation).

Stormwater infrastructure needs in the CIP Outlook are primarily categorized as flood resiliency infrastructure and green infrastructure. Flood resiliency infrastructure needs total $463.6 million, or 25.8% of the total need over the five-year period, while green infrastructure needs are $1,334.7 million, or 74.2%. The Outlook also assumes that funding for stormwater needs would be $405.6 million, with $176.8 million or 43.6% for flood resiliency infrastructure and $228.7 million or 56.4% for green infrastructure.

Flood Resiliency Infrastructure – This is the more traditional stormwater infrastructure that the City has been developing for a number of years and includes assets such as corrugated metal pipes (CMP), pump stations, and storm drains. To determine the capital financing needs, the City, through the WAMP, does a determination on the life cycles and risk profiles of all the hard assets, and then determines the timeline upon which they all need to be replaced. The WAMP also includes any new flood resiliency infrastructure that would need to be developed, including additional stream restoration projects as well as storm drain inlets, outlets, and other structures.

Green Infrastructure – These projects focus more on improving the water quality within the storm drain system so that when the stormwater 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 meet these allowable loads, the City must design and implement a number of Best Management Practices (BMPs), which include specific project types 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. Green infrastructure also includes the restoration of lagoons and wetlands within the City, including the ongoing restoration of the Los Penasquitos Lagoon.

Future Need Beyond the Outlook Period

Based on the current WAMP, the need for stormwater projects will continue to grow, especially if the City does not address its current backlog of projects. Of the previously mentioned $5.5 billion in projected needs through FY 2040, $2.9 billion is for CIP projects, with operational needs totaling $2.6 billion over that same time frame. While the current Outlook includes $1.8 billion in needs, this amount includes cost escalation and other adjustments that were not included in the updated WAMP. In the WAMP, the $2.9 billion of CIP costs were evenly split between the time periods of FY 2021-2027 and FY 2028-2040. Additionally, operational needs are currently underfunded in the FY 2022 Adopted Budget, as evidenced by the $395.3 million included in additional compliance costs over the FY 2023-2027 time period in the Five-Year Financial Outlook (issued November 2021). These needs will continue to grow in the outyears due to assumptions that many of the CIP projects will be developing new stormwater assets that will require greater operational needs than currently required.

In addition, through FY 2040, the WAMP estimates flood resiliency infrastructure needs to be $1.1 billion, while green infrastructure needs total $4.3 billion. This is because, as currently negotiated, there are numerous TMDL target deadlines over the next few years that the City must comply with in order to avoid penalties for noncompliance. Penalties can reach up to $10,000 per day per violation. However, the Department continues to negotiate with the RWQCB on a number of TMDL targets. If these negotiations are successful, as they have been in the past, then the amount of infrastructure need to comply with the water quality standards could decline.

Financing Stormwater CIP Costs through Water Infrastructure and Finance Innovation Act (WIFIA) Loans

The Debt Management and Stormwater Departments are currently seeking Council approval to execute WIFIA loan agreements from the federal Environmental Protection Agency (EPA) to finance stormwater CIP activities. If approved by Council, staff would pursue a financing plan for $733 million worth of stormwater projects, with $359 million (49%) coming from the WIFIA program and $374 million (51%) coming from other sources, including additional grants, state loans, or City Lease Revenue Bonds (LRBs).

Of note, the CIP Outlook only includes $294 million out of the $359 million in federal funding for this program, as funding could continue into FY 2028. However, the Outlook only assumes $111.6 million in other funding for stormwater, even though the $294 million would require $306 million in matching funds from the City. Additionally, not all of the $111.6 million may be eligible to be matching funds for the WIFIA program. Thus, if the overall WIFIA program is approved by Council, additional funds will be required to match the WIFIA financed projects within the Outlook, potentially reducing the financing gap from what is currently proposed in the CIP Outlook.

However, our Office also notes that WIFIA financing is debt that will need to be repaid by the City following the conclusion of the drawdown of funds, which staff estimates would total $35 million (including for WIFIA repayment as well as LRB repayment at maximum) starting in FY 2029. If an additional funding mechanism for stormwater is not secured, these repayments will come from the City General Fund.

Closing the Gap – Stormwater Funding Strategy

In January 2021, the Transportation and Stormwater Department released a Funding Strategy Report in response to the June 2018 Performance Audit of the Stormwater Division. Within that report, the Department identified an unmet need of $4.5 billion out of the total of $5.5 billion of need through FY 2040. This is an average funding gap of $225.1 million per year, but at that time only included very minimal levels of CIP support for stormwater projects ($1.0 million per year). The report also concluded that, if the Department were to maximize all of the existing resources that are either under the direct control of the Department or City as a whole, it would yield between $3.8 million and $5.7 million per year in additional departmental revenue. The conclusion of the report was that the City needed to investigate the development and implementation of a new funding mechanism for stormwater activities.

This past February, the Stormwater Department presented its final analysis of a potential stormwater funding mechanism to the Environment Committee. That analysis focused on a measure that would tax the impermeable surface area of properties within the City at a rate between 4 to 5 cents per square foot of impermeable surface. Such a measure, which would cost the typical single-family residence between $128 to $160 per year, would generate between $74 million to $93 million per year for stormwater activities. For reference, the current storm drain fee within the City costs single family residences less than $12 per year, and generates approximately $5.7 million, all of which supports stormwater activities that would otherwise be supported by the General Fund.

Polling conducted by a consultant noted that a majority of voters would support such a measure, but that support was within the margin of error of the two thirds threshold that would be required for the passage of the measure. The Department indicated that they will continue their educational efforts, including through the Think Blue program, to improve the public's perception on the importance of stormwater funding, as well as continue to pursue outside financing mechanisms.

The decision on whether and when to place a stormwater funding measure on the ballot is a policy decision for the Council to consider as they go through the ballot measure development process as well as when discussing the larger picture of the $4.3 billion funding gap in the CIP Outlook. While City staff have recommended one type of funding measure, there are other ways for the City to increase funding for stormwater needs and raise revenue. The three methods that the City would need to follow to increase a fee include:

- *Special Tax:* This would require a two-thirds majority approval of registered voters within the City that voted 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. This is the method currently recommended by the Stormwater Department.

- *Property-related Fee:* This method requires both 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. 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.

- *Additional Sewer Fee (SB 231):* Effective January 1, 2018, the 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 storm water. Under this change, the City could increase the storm water fee utilizing the same process that the City would use to increase water and sewer fees. However, as this is a relatively new law, there is some question as to whether an increase under this new law would withstand a potential court challenge.

If the Council desires to consider a measure further, our Office would recommend that the Council also consider some of the issues we raised on the Stormwater Funding Strategy in Report 21-04 Analysis of the Stormwater Division Funding Strategy Report, which included discussions on project prioritization, using new funds to cover existing expenditures, and the capacity of E&CP to deliver the amount of projects required for stormwater needs.