
OFFICE OF THE INDEPENDENT BUDGET ANALYST REPORT

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Update on Proposed Municipal Water and Sewer Bonds

On September 19, 2008 Council member Frye issued a memorandum to the Chief Operating Officer and the Independent Budget Analyst requesting information regarding upcoming Water and Sewer bond issuances. Specifically, Council member Frye requested the following information:

- The source of funds to be used to make principal payments on the 2007A (\$57 million) and 2008A (\$150 million) Water Department short-term notes;
- An update on the review and approval process for upcoming Water and Sewer bond issuances; and
- A list of projects being considered for upcoming bond issuances.

In response to Council member Frye's requests, memoranda from both Debt Management and the Public Utilities Departments were issued on October 9 and 10, respectively. The IBA feels that these memos adequately address the issues raised by Council member Frye in her September 19 memo. However, we wish to augment the information provided in these memos by commenting on the capital project planning process in general.

We believe that a successful capital program begins with the formulation of a comprehensive capital plan. A capital plan should act as a roadmap for what a department aims to achieve over a determined time period, typically five to ten years, and should address department priorities, legal or regulatory requirements, and operational needs. The capital plan should be presented to the City Council to allow for a broad policy-level discussion and Council input on the direction of a department's capital program.

Currently, the capital plans for both the Water and Wastewater Departments have largely been based on regulatory agency requirements, stemming from the California Department of Public Health Compliance Order for the Water Department, and the Consent Decree

with the U.S. Environmental Protection Agency for the Wastewater Department. The water and sewer rate increases approved in February 2007 were to support capital programs that were largely driven by these requirements. However, these rate cases, and the capital projects included therein, were essentially the Council's only opportunity to provide strategic policy-level direction on the Water and Wastewater Department's capital programs.

We feel that it would be beneficial for a broader policy discussion of the capital plans to be held independently. Once a comprehensive capital plan is established, everything that follows including rate cases, bond issuances, and even the annual budget, are simply vehicles for achieving the goals of that plan. In our view, the capital plan should provide the underlying policy direction, while rate cases provide funding for that plan, bond issuances allow for project financing, and the annual budget appropriates the required funding.

We encourage the Water and Wastewater Departments to consider developing comprehensive capital plans to allow for Council input and policy-level direction, and to provide a basis for the Departments' ongoing capital programs.

[SIGNED]

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