



# Memorandum

**TO:** HONORABLE MAYOR AND  
CITY COUNCIL

**FROM:** Kerrie Romanow  
Jim Ortbal  
Barry Ng

**SUBJECT: STORM SEWER FUNDING  
ALTERNATIVES**

**DATE:** December 5, 2017

Approved

*D. D. S. y. L.*

Date

*12/7/17*

## RECOMMENDATION

1. Accept the report on storm sewer funding alternatives to address obligations under the San Francisco Baykeeper Consent Decree.
2. Direct staff to complete further analysis of the recommended funding mechanisms that will meet obligations under the Consent Decree, as well as other stormwater funding needs, and return to Council in spring 2018, with recommendations for implementation of funding alternatives.

## OUTCOME

Acceptance of the staff report will satisfy the City's obligation to bring forth to the City Council, funding alternatives intended to implement the green infrastructure obligations under the San Francisco Baykeeper Consent Decree.

## EXECUTIVE SUMMARY

In addition to regulatory compliance under a National Pollutant Discharge Elimination System (NPDES) Municipal Regional Stormwater Permit (Stormwater Permit), the City's Stormwater Program must comply with the San Francisco Baykeeper (Baykeeper) Consent Decree (CD) that, among other requirements, obligates the City to prepare a Comprehensive Load Reduction Plan (CLRP, which is the equivalent of a Green Infrastructure Plan, or GIP) by July 2020, and to appropriate at least \$100 million to implement green infrastructure projects identified in the CLRP over a ten-year period.

Recognizing that current revenue sources would not be sufficient to fund the \$100 million CLRP implementation obligation due to already projected regulatory, operational and capital cost

increases, the CD also obligates the City to identify potential new revenue sources for City Council consideration by December 31, 2017. Furthermore, if the City is unable to obtain funding sufficient to implement the CLRP by December 31, 2020, Baykeeper has the option to terminate the CD.

In order to refine the list of feasible funding options, City staff reviewed potential funding mechanisms in the following ways:

- Benchmarked funding mechanisms being used by a sampling of other California agencies
- Reviewed legal requirements and limitations on the City's ability to implement various mechanisms
- Completed preliminary rate payer focus groups and phone surveys to assess attitudes about stormwater, including the potential for a finance measure to fund improvements to storm sewer infrastructure

Based on analysis of the funding gap and consideration of preliminary public opinion research, the funding mechanisms deemed to be most feasible thus far are general obligation bond funding and a parcel tax.

To better determine the feasibility and fiscal impacts of these alternatives, additional tasks are recommended:

1. Develop a more thorough funding analysis/strategy of the two most feasible funding mechanisms: General Obligation Bonds (to fund capital projects) and Parcel Tax (for O&M), or other mechanisms as outlined in Table 1 on Page 6.
2. Develop and implement a more comprehensive outreach/polling plan to more clearly appraise the support for the recommended funding strategies that require voter approval.
3. Refine the analysis of additional stormwater infrastructure and program needs, including increased regulatory requirements, infrastructure improvements, and operations and maintenance costs.

## **BACKGROUND**

Rainfall, irrigation runoff, and other outdoor water enters the City's 1100 miles of storm sewer pipes through approximately 32,000 storm-drain inlets, and flows largely untreated into local waterways to the San Francisco Bay. Due to the possible collection of pollutants as water flows to the Bay, stormwater is regulated under an NPDES Stormwater Permit, which specifies actions necessary to reduce the discharge of pollutants into stormwater, and prohibits discharge of non-stormwater into the municipal storm sewer system to protect local creeks and the Bay.

On February 11, 2015, Baykeeper filed a complaint against the City of San José based on alleged Clean Water Act violations. Baykeeper alleged that the City discharged pollutants from the storm sewer system in violation of its stormwater discharge permit, including discharges of sanitary sewer overflows that entered the storm sewer system. Without admitting liability, the parties settled the lawsuit by entering into a CD that settles the allegations for a period of ten

years. The court approved the CD on August 11, 2016. Among other things, the CD obligates the City to prepare the CLRP by July 2020. The CD further obligates the City to appropriate at least \$100 million to implement green infrastructure projects identified in the CLRP over a ten-year period. The \$100 million can include costs for consultant design, environmental review, staff project management, and operation and maintenance of the resulting green infrastructure projects.

### **Existing Revenue and Expenses**

The current Storm Sewer Operating Fund revenue is approximately \$33.1 million annually, with associated operating expenses of \$24.2 million. The fund also includes Operations and Maintenance (O&M) and Capital Program Reserves totaling \$8.2 million. Each year the program makes transfers to the Storm Sewer Capital Fund to support storm system infrastructure improvements. For 2017-2018, the adopted transfer to the Storm Sewer Capital Fund totaled \$10 million, with annual transfers of \$4 million estimated for the next several fiscal years.

### **Funding Shortfalls for Required Maintenance**

There is a shortfall in the current amount of available funding allocated to perform required maintenance on existing structural controls (trash capture devices) mandated by the Storm Water Permit. Ongoing maintenance of existing hydrodynamic separator (HDS) units and connector pipe screen (CPS) devices requires \$100,000 annually, which is currently unfunded and expected to escalate to approximately \$200,000 per year within the next 10 years. Additionally, the Stormwater Permit requires that the City maintain green infrastructure that will effectively treat stormwater to reduce pollution run-off. In some cases, this results in not only new maintenance activities, but also more frequent maintenance, and is projected to reach an annual outgoing shortfall of \$300,000 within the next 10 years.

### **Identified Capital Investment Needs for the Storm Infrastructure System**

In addition to ongoing and increasing Stormwater Permit requirements, the City's Storm Sewer Master Plan (Master Plan), which generally describes how storm drain infrastructure will be upgraded to reduce flooding throughout the City, has identified \$295 million of critical infrastructure needs. The Master Plan identifies potential project alternatives and different combinations of those alternatives that could include increasing storm drain pipe size, or installing green infrastructure for stormwater retention and treatment. Master Plan projects will be coordinated with Green Infrastructure (GI) planning efforts, as well as efforts in other City Departments, to ensure that cost effective approaches are selected to meet the requirements of all related Master Planning efforts, the CD, and the Stormwater Permit. The key elements of the Storm Sewer Master Plan are described in the February 2017 Deferred Maintenance and Infrastructure Back Report [http://sanjose.granicus.com/Viewer.php?meta\\_id=614772](http://sanjose.granicus.com/Viewer.php?meta_id=614772) , and the November 2017 Storm Sewer Annual Report [http://sanjose.granicus.com/Viewer.php?meta\\_id=681709](http://sanjose.granicus.com/Viewer.php?meta_id=681709)

### **Future O&M Funding Needs**

As the City upgrades its storm sewer infrastructure with both green infrastructure and traditional piping, the costs for maintaining that infrastructure grow with the rising number of assets to be maintained, and the current funding is not sufficient to support that projected growth. As detailed in the reports above, as well as the 2016 Street Sweeping Audit Report [http://sanjose.granicus.com/Viewer.php?meta\\_id=559733](http://sanjose.granicus.com/Viewer.php?meta_id=559733) , there are many other O&M funding needs associated with optimizing the operation and performance of the storm sewer infrastructure, which includes the sewer pipes, pump stations, stormwater treatment devices, outfalls and storm drain inlets. Although not mandated by the Storm Water Permit, maintenance such as increased street sweeping frequency and other enhancements to the street sweeping program, storm pipe line cleaning, street tree maintenance, and increased cleaning frequency for the storm drain inlets should be considered when evaluating future funding sources and their allocations. It is estimated that these additional O&M activities would require approximately \$5.0 to \$7.0 million annually.

### **Baykeeper Consent Decree Compliance**

Recognizing that current revenue sources would not be sufficient to fund the \$100 million CLRP implementation obligation, the CD obligates the City to identify potential new revenue sources. In addition to specifically identifying various Federal and State grant programs, the CD obligates City staff to bring additional possible revenue measures to the City Council for consideration by December 31, 2017. The CD highlights possible revenue measures such as a stormwater sewer fee, a stormwater sewer tax, and bonds. In the event that the City is unable to obtain funding sufficient to implement the CLRP by December 31, 2020, Baykeeper will have the right to terminate the CD.

On October 2, 2017, staff brought this item to the Transportation and Environment Committee for discussion of the Consultant activities that would analyze the CD funding needs over a ten-year planning period, assess potential funding alternatives to meet these needs, and conduct preliminary community surveys to evaluate public knowledge and willingness for increased investment in storm sewer infrastructure. The memo is available at: [http://sanjose.granicus.com/Viewer.php?meta\\_id=665090](http://sanjose.granicus.com/Viewer.php?meta_id=665090). In order to optimize opportunities to leverage funding required for the storm sewer system including CD activities, a stakeholder group of departments, including Public Works, Transportation, and Environmental Services was convened to meet regularly and has consulted with the City Attorney's Office.

## **ANALYSIS**

### **Needs Evaluation**

The Baykeeper Consent Decree compliance costs include the costs of implementing the CLRP (i.e., Green Infrastructure Plan) according to the schedule outlined in the CD. The CD requires the City to appropriate at least \$100 million for implementation costs, which includes acquiring land for infrastructure, environmental review, design, construction, and O&M of projects. The first substantial milestone for this CD requirement is for the City to acquire consultant services on or before September 2021 for purposes of implementing the projects identified in the CLRP.

With an estimated need of approximately 15% of total project costs for the operations and maintenance of the newly constructed green infrastructure, compliance with the \$100 million CD requirement is projected to be generally distributed as follows: \$85 million for project implementation (hard and soft costs) and \$15 million for operations and maintenance.

The City has evaluated the funding gap that results from these projects. The evaluation covers the ten-year period starting in 2021-2022, coinciding with the CD requirement to acquire consultant services. If the amount of the funding gap were fully addressed through new revenue sources, then the City would not need to draw on reserves, and would maintain its cash position during the planning period.

The CD contemplates that new revenue sources will fund the CLRP. Aside from typical cost of living increases, the stormwater program operating costs are expected to remain relatively flat. If no new revenue sources are developed, the current stormwater program is projected to run out of funding by the end of 2026-2027. When the CD funding is added to the current program, the stormwater fund is projected to run out of funding by the end of 2023-2024, with a progressively growing deficit commensurate with the phasing in of the \$100 million expenditures required by the CD over the successive years.

### **Funding Options – Legal Requirements**

The California Constitution imposes a number of requirements and limitations on the City's ability to increase revenues that apply to funding options for stormwater management. These are briefly summarized in the table below:

Table 1: Storm Sewer Funding Options

Revenue Mechanism	Description	Requirements	Restrictions on Revenue Use
General Tax	Revenue for any purpose, e.g. City's general business tax	Majority voter approval at a General Election Measure may not be placed on special election ballot unless a fiscal emergency declared by unanimous Council vote	Any governmental purpose
Special Tax	Revenue for specific purpose, e.g. City's special transient occupancy tax for cultural activities and facilities	Two-thirds voter approval	Limited to purpose specified in ballot measure
Property-Related Fee	A charge imposed on a parcel or upon a person as an incident of property ownership including a user fee or charge for a property-related service.	Notice and Majority Protest Procedures for sewer, water and refuse collection fees  For other types of property-related fees, majority approval by property owners <i>or</i> two-thirds approval by registered voters	Fee Amount Must Correlate to Service Provided to the parcel charged and fee revenue cannot fund general government services

Table 1 (Continued):

Revenue Mechanism	Description	Requirements	Restrictions on Revenue Use
Assessment District Fee	A charge upon real property by an agency for a special benefit conferred upon the real property located within the boundaries of the assessment district	Notice and Majority Protest Procedures <sup>1</sup>  Vote is weighted according to proportional financial obligation of affected property	Charge is limited to “Special benefit” to property and not for general benefits or general government services.  Charge must be for the reasonable cost of the “proportional special benefit” to the parcel.
Parcel Tax or Tax imposed through a Community Facilities District	Flat tax imposed on real property	Cannot be based on property value (ad valorem)  Two-thirds voter approval required	Limited to purpose specified in ballot measure
General Obligation Bonds	Bonds issued by the City. Repayment secured by a promise to levy an additional ad valorem property tax in an amount as necessary to pay debt service on the bonds	Two-thirds voter approval required	Bond proceeds may be spent on the acquisition or improvement of real property only.  Proceeds may not be used for operation and maintenance expenses or for equipment.

<sup>1</sup> The State Constitution does not specify the authority to establish an assessment district. As a charter city, San José may utilize the authority to establish an assessment district under State law or may follow provisions in the City’s Municipal Code authorizing the establishment of an assessment district. However, the requirements under the State Constitution described above must also be followed.

### **Stormwater Funding Benchmarking for Other California Agencies**

In order to refine the list of feasible funding options, stormwater funding mechanisms for 10 California agencies were benchmarked. While all agencies interviewed are facing increased compliance costs with limited funding sources, 8 of the 10 agencies have stormwater fees or taxes that were implemented before the State Constitution's amendments went into effect in 1996, through the passage of Proposition 218. The funding mechanisms utilized by the benchmarked agencies are summarized as follows:

- Voter-approved stormwater and flood control property-related fee increase - Palo Alto successfully raised fees twice in 2005 and 2017 for stormwater management and flood control, that were approved by a majority vote of property owners.
- Voter-approved general obligation bonds – City of Los Angeles voters authorized \$500 million in general obligation bonds for capital improvements for cleaning up polluted stormwater through Proposition O in 2004. Berkeley has passed two general obligation bond measures for stormwater capital projects: Measure T1 in 2016, of which \$1.2 million has been allocated for stormwater project funding, and Measure M in 2012, of which \$1.5 million has been spent on stormwater projects and green infrastructure, and an additional \$3.7 million is allocated for improvements in the next two years.
- Refuse fee funding for trash capture and street sweeping - Fremont has been funding trash capture compliance from the City's solid waste fees since 2003.
- General Fund contributions - San Diego's primary program funding source is its General Fund

### **Funding Mechanism Alternatives Not Recommended**

The City has begun to examine funding mechanisms, including those used by the benchmarked agencies, with an emphasis on those that would generate sufficient revenue to fund, at a minimum, the obligations under the Baykeeper CD.

Other funding alternatives that were considered but have not been pursued include:

1. Obtaining voter approval of a transaction and use tax (sales tax) for stormwater management purposes. This alternative is not available because the City has reached the 2% cap imposed under State law for imposing a local transaction and use tax. The City would need to pursue legislation to amend this State law limitation before placing a measure to impose a sales tax for stormwater purposes on the ballot.
2. Establishing an Assessment District or Community Facilities District (Mello-Roos District) for stormwater management purposes. Assessment and community facilities districts are generally established to provide funding for services or improvements limited to a particular geographic area. For an assessment district, the funding mechanism is an assessment that is subject to the requirements and limitations described above. For a community facilities district, the funding mechanism is a special tax on real property, requiring a two-thirds voter approval by the voters within the district.



The City's storm sewer system is City-wide and as a result the assessment district or community facilities district would need to be City-wide or multiple districts would need to be formed. As the procedure for establishing either type of district is cumbersome and time consuming, neither of these districts is recommended.

### **Funding Mechanisms Recommended for Further Study**

Of the major funding mechanisms examined, a combination of General Obligation Bond funding and a parcel tax is recommended for further analysis, pending the results of polling that is now in process. In addition to these key options, there are other non-voter approval items such as grants, solid waste fees referenced above, and developer fees for storm sewer connections, that could be further reviewed as increasing regulatory, capital, and operations and maintenance needs are identified.

#### General Obligation Bonds

General Obligation Bonds are secured by a promise to levy an additional ad valorem property tax in an amount as necessary to pay debt service on the bonds. Under the State Constitution, a city's authority to issue General Obligation Bonds must be approved by a two-thirds vote of the electorate and the bond proceeds are limited to the acquisition and improvement of real property. Maintenance and operation expenses and equipment that is not affixed to real property (e.g. vehicles and computers) are not eligible to be funded from General Obligation Bonds.

Section 1216 of the San José City Charter limits outstanding general obligation debt of the City to 15% of the total assessed value of all real and personal property within the City limits ("debt limit"). As of June 30, 2017, the total assessed value of taxable property was \$170.5 billion, which results in a total debt limit of approximately \$25.6 billion (total assessed value x 15% = debt limit). As of June 30, 2017, the City had \$362.4 million in general obligation debt outstanding, representing 1.4% of the debt limit and a debt margin of \$25.2 billion (debt limit less outstanding general obligation debt).

Issuing bonds to fund capital improvements required under the CD has the dual advantage of lowering the immediate upward pressure on the City's existing Storm Sewer Service Charge and promoting intergenerational equity for investments in the stormwater system. Since investments are paid off over a longer period, customers in the future who enjoy the added capacity, water quality or other benefits of today's investments, also contribute a share towards those investments through their increased property tax for payment of debt service.

Real property in the City is currently being taxed at a rate of 0.0186% of assessed value for 2017-2018 for current general obligation debt outstanding. For a single-family home with a net assessed value of \$500,000, the tax levy for 2017-2018 is \$93.00. The tax will fund annual debt service (principal and interest) of \$36.2 million on the \$342.8 million in general obligation debt outstanding as of September 1, 2017. The current general obligation debt service declines gradually on an annual basis until the last of the bonds matures in September 2039.

The issuance of General Obligation Bonds should be further evaluated based on current debt levels for the outstanding General Obligation Bonds issued for parks, libraries and public safety purposes, the two-thirds requirement for voter approval, and the level of acceptance of bond funding for green infrastructure projects.

### Parcel Tax

A parcel tax is a tax on real property that can be imposed uniformly on all types of real property, e.g., \$100 per parcel. Alternatively, the amount of a parcel tax can vary depending on the property's use such as the varying rates imposed under the City's Library Parcel Tax linked here: [http://sanjose.granicus.com/MetaViewer.php?view\\_id=&event\\_id=2688&meta\\_id=639229](http://sanjose.granicus.com/MetaViewer.php?view_id=&event_id=2688&meta_id=639229).

As described above, the approval of a parcel tax requires two-thirds approval of voters, which is a high threshold for approval. However, revenues from a parcel tax may be used for both the capital and operation and maintenance costs associated with the Baykeeper CD. As General Obligation Bonds may not be used for operation and maintenance purposes, revenues from a parcel tax can be used to fund the expenses that General Obligation Bonds cannot fund.

### **Community Outreach and Surveying**

On October 12, 2017, preliminary focus groups were initiated with San José residents to assess their attitudes around stormwater, including the potential for a finance measure to fund improvements to storm sewer infrastructure. Issues such as housing costs and homelessness were top of mind for focus group participants, with infrastructure and pollution as relatively much lower-tier concerns. The focus groups demonstrated a basic understanding of storm sewer infrastructure: most know that stormwater is generally not treated before it reaches the San Francisco Bay and the ocean, and recognize that there is a separate storm sewer system that conveys stormwater, although most participants had little idea of its current state. The focus groups' highest priorities for new funding are preventative, including repairing existing infrastructure and preventing pollution from entering creeks, rivers, and the Bay.

Among focus group participants, there was considerable willingness to pay to improve storm sewer infrastructure once they learned about the challenges facing the current system. To begin to better quantify support for the various funding approaches and to test a range of messaging approaches, a preliminary phone survey of 600 resident property owners Citywide is underway.

## **Next Steps**

Based on analysis of the funding gap and public opinion research so far, the funding mechanisms that warrant further analysis for implementation include General Obligation Bonds and a Parcel Tax.

To better determine the feasibility and fiscal impacts of these alternatives, additional tasks are recommended:

1. Develop a more thorough funding analysis/strategy of the two most feasible funding mechanisms: General Obligation Bonds (to fund capital projects) and Parcel Tax (for O&M), or other mechanisms as outlined in Table 1.
2. Develop and implement a more comprehensive outreach/polling plan to more clearly appraise the support for the recommended funding strategies that require voter approval.
3. Refine the analysis of additional stormwater infrastructure and program needs, including increased regulatory requirements, infrastructure improvements, and operations and maintenance costs.

The implementation plan that will be presented to the City Council will also detail critical timeline drivers for funding acquisition, such as required election deadlines for submitting ballot measures, public meetings and resident polling.

## **EVALUATION AND FOLLOW-UP**

A proposed implementation plan for City Council approval will be brought forward to the City Council in spring of 2018.

## **POLICY ALTERNATIVES**

***Alternative #1: Do not move forward with stormwater funding study or subsequent pursuit of additional revenue.***

**Pros:** No additional immediate impact to residents and businesses.

**Cons:** Exposes City to legal action by Baykeeper or other third parties; limited funding to address increasing storm sewer infrastructure needs: capital upgrades, deferred maintenance, and permit compliance activities.

**Reason for not recommending:** If the City is unable to obtain funds sufficient to implement the CLRP/GIP by December 2020, Baykeeper has the option to terminate the CD and pursue further litigation against the City. In addition, the City will not be able to meet long-term funding needs for capital, maintenance, and permit activities.

***Alternative #2: Limit funding needs analysis and potential revenue measures analysis to only what is required to meet Baykeeper Consent Decree.***

**Pros:** Limited consultant scope and associated costs, maintains focus on only what is required to meet City obligations related to the Consent Decree.

**Cons:** This approach misses opportunities to leverage analysis for revenue measures to address all of the City's storm sewer infrastructure needs.

**Reason for not recommending:** With this approach, the opportunity to leverage synergies between the various components of the City's storm sewer infrastructure will be lost and the City Council will not be able to consider potential options for revenue measures that could comprehensively address the City's broader needs related to storm sewer infrastructure and ongoing operations and maintenance of that infrastructure.

## **PUBLIC OUTREACH**

Obtaining resident input and considering stakeholder concerns early in the financing process will be critical for determining the feasibility of potential funding options.

Based on two focus groups that have been held to assess resident attitudes about stormwater, including the potential for a finance measure to fund improvements to storm sewer infrastructure, initial findings show that the public has a basic understanding of storm sewer infrastructure and recognizes that there is a separate sewer system that conveys stormwater. Participants also voiced considerable willingness to pay to improve storm sewer infrastructure and prevent pollution once they learned about the challenges facing the current sewer system.

A preliminary phone survey to better quantify support for the various funding approaches and to test a range of messaging approaches is underway.

This memorandum will be posted on the City's website for December 19, 2017, City Council agenda.

## **COORDINATION**

This memorandum was coordinated with the City Attorney's Office, Finance Department, Parks, Recreation and Neighborhood Services Department, and the City Manager's Budget Office.

## **COMMISSION RECOMMENDATION/INPUT**

This item was heard at the Transportation and Environment Committee on October 2, 2017, where the Committee voted unanimously to accept the staff update and directed staff to continue analysis of obligations under the Baykeeper Consent Decree, as well as other increasing storm sewer infrastructure and compliance needs.

**FISCAL/POLICY ALIGNMENT**

In addition to complying with the Baykeeper CD, this effort supports the City's overall storm sewer system management program.

**COST SUMMARY/IMPLICATIONS**

City Council feedback about this proposed course of action will help staff develop funding alternatives to meet the City's funding requirements under the CD.

Direction to continue analysis of potentially feasible funding mechanisms may have impacts for both the General Fund and Storm Sewer Operating Fund to pay for further consultant analysis in the future, and any such additional costs will be addressed as part of the annual budget process.

**CEQA**

Not a Project, File No. PP17-001, Guidelines Section 15262, Feasibility and Planning Studies and Not a Project, File No. PP17-002, Consultant Services.

/s/  
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