City of Loveland Municipal Broadband Initiative
Information Summary

November 6, 2018

City of Loveland staff were requested to restate and reevaluate several key issues relating to the municipal broadband initiative, specifically:

I. Issues related to competition between a government utility and the private sector
II. Eventual use of surplus revenues
III. Interaction of the Loveland broadband utility with neighboring municipal broadband utilities
IV. Risk mitigation actions
V. Delegation of authority best practices

The City of Loveland is currently considering constructing a municipal broadband fiber service with the following objectives established by the City Council in May 2015:

City-wide Accessibility – service must be available to all homes, businesses, schools, non-profit groups, health service providers, and other users within Loveland.

Fast – The broadband system must deliver symmetrical service at the rate of One Gbps (1000 Mbps) and consider future proofing for higher speeds when new technologies become available.

Reliable – The service must accommodate diverse uses, from home entertainment, to business, education and health care, with high reliability.

Affordable – The initiative has the goal of delivering broadband service to all customers at a reasonable cost, regardless of how broadband service is used.

Customer Service Excellence – Provide consistent and reliable customer service.

I. Issues related to competition between a government utility and the private sector

Establishing a municipal broadband utility does not preclude private internet companies providing ongoing internet, telephone, and other content (*i.e.*, TV) services through their networks. Although fiber would pass by each residence and business, the Loveland broadband utility *would not require residents or businesses to take this service*. Thus, more than anything, *municipal broadband provides consumers another choice in the internet market*. Based on past experiences in other communities with municipal broadband, competition becomes more dynamic with consumers offered more choices and lower prices.

The municipal broadband system gives the opportunity for other services and service providers opportunities to utilize the City's fiber infrastructure through commercial wholesale access or other "over the top" access to Loveland's municipal fiber system. This in turn *provides additional revenues to the municipal owner.* This allows the city installed and maintained fiber system to serve as a highway for the private sector to access and lease space. The proposed retail with regional collaboration business model allows the city's broadband utility to provide and expand service opportunities for customers.

Essentially, constructing and operating a municipal broadband system enhances overall competition within the private sector by compelling incumbent providers to become more nimble and offer more services at lower costs. This in turn results in *benefits to all customer classes including residential, institutional, and commercial with more choices and better pricing*, regardless of their internet provider.

II. Eventual use of surplus revenues

The 10-year financial plan (based on a 42% residential and 27% business "take rate") presented to the Loveland City Council on October 23, 2018 indicated that cash flows for the broadband utility would turn positive in 2023 (year 5 of the enterprise) with additional monies collected in subsequent years. How would these monies be used?

As with other enterprise funds within the City (*i.e.*, water, wastewater, stormwater, and electric), the broadband utility would maintain a reserve fund. Reserve balances for utility systems are funds set aside for a specific cash flow requirement, financial need, project, task, or legal covenant. Certain types of reserves, such as debt-related reserves, are often considered restricted reserves as they are required by a legal covenant and/or are restricted for a specific purpose. Unrestricted reserves, such as working capital or operating reserves, are generally maintained at levels established by formal or informal policies of the utility system and can be either designated for specific purposes (such as funds earmarked for system renewal and replacement) or available for a variety of purposes.[1] Most of these reserve funds are financed at 15% of the utility's annual operating expenses. As *additional revenues are received by the broadband utility they would be applied to the reserve fund to manage potential risks, meet fluctuations in revenue, and meet working capital needs.* Note that initial contributions to this reserve fund will begin in the first year of operation at the 15% goal, and City Council always has the ability to increase the amount of the reserve fund.

Additional revenues could also be applied to early retirement of debt. The same 10-year financial model referenced above assumed a total of 23 years of bond repayment (interest only payments would be made for the first three years). *Any additional revenues exceeding the 10-year financial model projection could be applied, after year 8 or 10 (owing to bond covenants), to reduce debt service payments.* Similarly, *additional revenues could be used to repay the internal loan made by the power division,* which is scheduled for full repayment by 2028.

Additional revenues could always be used to reduce rates to broadband customers; rates that reflect the city's revised costs to provide municipal broadband service.

III. Interaction of Loveland broadband utility with neighboring broadband utilities

Even though the term used to describe this utility is "municipal broadband", staff has always considered regional collaboration one of the strongest pillars supporting this effort. *The proposed business plan encourages establishing a variety of business functions with neighboring governments* including the Platte River Power Authority owners, the Cities of Estes Park, Longmont, and Fort Collins as well as Larimer County and possibly the Cities of Greeley and Windsor among others. The City of Loveland continues ongoing conversations with all of these entities to discuss future collaboration efforts including shared long haul and internet transport, possible sharing of resources and staffing during emergency events, and exchanging information on standards and design practices for mutual support.

[1] Cash Reserve Policy Guidelines, American Water Works Association, Denver, CO, 2018

Eventually, these communities may move towards employing shared resources such as afterhours call centers and service support.

IV. Risk mitigation actions

City staff and its consultants have reduced risk and planned to mitigate risk throughout this process. Practices or procedures can be introduced to protect the City's power customers from adverse impacts (*i.e.*, rate increases) should the broadband utility fail to meet debt service obligations on the bonds underwritten by the power utility.

The 10-year financial model projects a residential take rate of 42% and a business take rate of 27%. Additional financial scenarios with residential take rates of 32% were also evaluated. Although a positive cash flow was not achieved as early as the optimal scenario, long term viability of the enterprise – including debt repayment – was evident.

There are a number of components, some of which were already included in the 10-year financial plan that provide a significant degree of layered risk mitigation:

Capitalized interest on the revenue bonds – the first three years of the bond repayment schedule are for capitalized interest only. This minimizes outgoing cash flow during the initial start-up of the enterprise.

Operational Risk Mitigation Fund – although not presented in the base case 10-year financial model, including a $4M operational risk mitigation fund in the bond sales would provide an additional source of funds should initial revenue expectations not be met. This provides additional time (6-12 months) to the broadband utility to make fiscal and operational adjustments.

15% Operating Reserve Fund – The bond issuance will include an immediate funding of a 15% Operating Reserve Fund similar to other city reserve funds.

Governance ability to adjust broadband utility rates – should insufficient revenues be realized, municipal fiber customer rates could be raised to customers and lease holders, or rates could be lowered for use in promotional and marketing strategies.

Refinance bonds – using the operational broadband system itself as collateral, the revenue bonds could be refinanced at years 8 to 10 (depending on initial bond issuance conditions) to a longer term and lower debt service and also exclude the electric rate payers from future commitments.

Internal borrowing – additional reserves would remain available for internal borrowing from other enterprise funds including power, water, wastewater, and stormwater.

External borrowing – this could be a line of credit or other financing techniques from a financial lending institution.

Lease the utility –the utility itself – now completely built out and in operation – could be leased to a third party for a period of time.

Electric Utility Reserves – depending upon circumstances, the electric utility could use its own reserves to shield electric customers from increased fees or rates as a result of the municipal fiber utility's performance.

Sell the utility – the utility itself – now completely built-out and in operation could chose to advertise and then sell the utility.

Temporarily Impact Electric Rate Payers – Only as a last resort would the electric utility temporarily raise fees or rates to all of its customers as a result of the municipal fiber utility's performance.

The broadband enterprise does not operate in a static environment; thus management and operations of the enterprise would be dynamic and respond to market forces and the business environment. The above-referenced suite of risk mitigation measures would be used as circumstances dictated over the initial years of operating the broadband enterprise. All of these measures would be employed prior to power customers being impacted by a failure of the enterprise.

Exhibit A is a graphic presentation of the cascading nature of risk mitigation actions.

V. Delegation of authority best practices

The City Manager's role in a market driven municipal fiber utility has been discussed with the LCAB and City Council. According to successful municipal broadband owners and credit rating agencies the ability and timing to make adjustments in rates, fees and charges is vital to the successful operation of the municipal fiber utility. LCAB recognized this critical area and recommended that the City Manager be given the authority to set rates, fees, and charges within the parameters and reporting requirements to be set by City Council.

Summary

This document regarding the City of Loveland's proposed broadband utility has addressed issues critical to its initial and long term success: I.) competition between a government utility and the private sector, II.) eventual use of surplus revenues, III.) interaction of the Loveland broadband utility with neighboring municipal broadband utilities, IV.) risk mitigation actions, and V.) governance.

Exhibit A

Risk Mitigation Activities for the Broadband Utility

- **Capitalized Interest of Revenue Bonds** (3 Years)
- **Operational Risk Mitigation Fund ~ $4M** (6 Months to 1 Year)
- **15% Operating Reserve Fund** (4 to 6 Months)
- **Governance Ability to Adjust Broadband Utility Rates**
- **Refinance Bonds**
- **Internal Borrowing**
- **External Borrowing**
- **Lease the Utility**
- **Electric Utility Reserves**
- **Sell the Utility**
- **Temporarily Impact Electric Rate Payers**