TO: HONORABLE CITY COUNCIL

FROM: CITY MANAGER DEPARTMENT: ADMINISTRATIVE SERVICES & UTILITIES

DATE: JULY 25, 2005 CMR:319:05

SUBJECT: RECOMMENDATION TO TERMINATE FIBER TO THE HOME TRIAL AND TO DISCONTINUE MONITORING OF FINANCING METHODS IN OTHER CALIFORNIA JURISDICTIONS

RECOMMENDATION

Staff recommends that City Council:

1. Discontinue the Fiber to the Home (FTTH) trial beginning the earlier of December 2005 or when equipment delivering current services fails.

2. Discontinue staff’s monitoring of FTTH financing methods used by other California jurisdictions.

BACKGROUND

On July 19, 2004, Council approved the following recommendations concerning Fiber to the Home project:

1. Halt consideration of the financing options discussed to date and, instead, monitor the financing methods and results of other California jurisdictions until such time as a viable financing option emerges.

2. Continue the FTTH trial for one year with an evaluation on whether to continue the trial at that time.

During the past year, staff has evaluated the FTTH trial, monitored progress on FTTH financing in other cities, and held general discussions with a private firm with experience in implementing an FTTH program in Utah.
DISCUSSION

FTTH Trial
Staff recommends that the FTTH trial be ended by the earlier of December 2005 when existing contracts with the switch equipment supplier expires or when the existing FTTH equipment fails. The reasons for closing the trial are as follows:

1. The trial has served its purpose as a pilot project that has demonstrated its functionality.

2. The trial was never meant to be a commercial operation and has:
   a. no dedicated support staff
   b. no service contract with the equipment supplier
   c. no equipment replacement fund (current subscriber revenues just cover operating costs)

Given this reasoning, staff believes it best to plan an orderly “winding down” of the demonstration project that has minimal impact on trial participants. Staff will work with trial members to transition to alternative providers.

FTTH Financing in Other California Jurisdictions
In accordance with Council direction, staff continues to follow FTTH financing activity in other jurisdictions. While there has not been significant progress on financing methods, the experience in other localities is informative.

Truckee-Donner Public Utility District
Truckee-Donner still has not implemented its FTTH system. The agency responsible for allowing Truckee-Donner to build FTTH, the Local Agency Formation Commission (LAFCO), did not grant permission to move ahead with the project on a technicality. Once this is resolved, it appears that the District will proceed with its original financing plan that first uses bridge financing and then Revenue Certificates of Participation. The District is legally forbidden to use electric funds to finance non-electric projects or services.

Alameda Power and Telecom
To finance its fiber/coaxial broadband system, Alameda has gone through three financings (2000, 2002 and 2004) with a fourth planned in 2009. These financings included a $10.0 million loan from the Electric Utility and a $2.2 million loan from the City’s Redevelopment Agency. Financing vehicles included Certificates of Participation issued in 2000 and 2002 and Bond Anticipation Notes issued in 2004. During early financings, private funding was utilized by Alameda. As a consequence of past financings, the use of a BAN in 2004 (which utilizes capitalized interest) and an anticipated refinancing in 2009, the FTTH operation will have incurred significant obligations to repay from its revenue streams.
Lompoc Electric Utility

The City of Lompoc’s telecommunications program involves two phases, the first to build broadcasting antennas for a wireless system and the second to build an FTTH system. Completion is expected in four months. The City’s FTTH effort has not begun in earnest. Lompoc has used loans from their Electric Fund to finance the wireless operation.

It is noteworthy that a local write-in campaign against the wireless and FTTH enterprises has been initiated. The Howard Jarvis, California, and Santa Barbara Taxpayers Associations have written letters to Lompoc’s Council opposing the use of City resources for telecommunications and opposing City competition with the private sector. The ostensible rationale for the opposition was that City resources should be used for basic services such as public safety. City officials recently discovered that major local service providers provided financial backing for the taxpayer campaign against the City. While there is strong opposition from incumbent providers and taxpayer associations, Lompoc’s Council and residents intend to move forward with FTTH.

Private Sector

Since last July, staff met several times with a consulting firm, Dynamic Cities (DC), which worked with the Utopia Network in Utah to build and operate an FTTH system. DC is a firm interested in long-term partnerships with cities. While its chief goal is to manage FTTH programs, the firm has expertise in business modeling, financing, and designing FTTH systems.

These discussions were informative and touched on financing vehicles used by other cities as well as evolving financing concepts. DC has been active in interacting with Palo Alto residents who are interested in developing an FTTH program. While DC has an interesting and flexible approach to financing, its ideas have yet to take root in California. More importantly, and as emphasized in last year’s FTTH report, there continues to be sufficient legal, financial, and other concerns that militate against proceeding with FTTH efforts at this time.

These concerns include:

- The inability of the City to use Utility Revenue Bonds backed by the Electric Fund based on analyses of evolving California law (statutes and cases). Based on voter-approved statewide propositions, it is clear that ratepayers, fee payers, and assessment payers should not be required to pay more than the cost of services received.

- Potential protracted and costly legal opposition from incumbent providers.

- Investor and rating agency unfamiliarity with public FTTH projects injects considerable uncertainty and risk/reward considerations into the financing process. Whereas Palo Alto traditionally seeks capital funds by competitively selling bonds based on anticipated revenue streams and reserves, in this case it would have to consider alternative funding such as a private placement or a mixture of private placement and equity investment. Staff analysis indicated (see Attachment A) that, based on potential private placement financing costs, there would not be sufficient financial resources to move forward with the FTTH project.

- Potential for failure of current FTTH trial equipment that would be costly to repair.
• Limited staff resources due to budget reductions and demands of other projects.

Based on these issues, staff recommends halting the monitoring of financing methods used by other jurisdictions.

*Dark Fiber Operation*

The City will continue its dark fiber operations. Staff will return to Council before fiscal year 2006-07 with a report on dark fiber finances and a business plan.

**RESOURCE IMPACT**

Ending the FTTH trial will result in a reduction to expenses and revenues. Contract expenditures to support trial participants will be reduced by $39,600 annually, while revenues from monthly charges to users will decline by $63,240 annually. The FTTH trial has been in operation for approximately three years. It is important to note that the costs cited above do not include:

- Repayment of loans to the Electric Fund for initial capital and start-up costs
- The cost of equipment and equipment maintenance costs necessary to deliver services (equipment was on loan from Motorola at no cost to City)
- City staff support which includes direct and indirect costs

The one-time cost of removing equipment from participant homes is estimated at $12,400 and this cost will be borne within the existing budget. Adjustments to the 2005-06 budget are expected at midyear with amounts depending upon the timing of the trial’s end and removal of participant equipment.

**POLICY IMPLICATIONS**

Recommendations in this report are consistent with prior Council direction.

**TIMELINE**

If Council adopts staff’s recommendations, the FTTH trial will terminate by December 2005.

**ENVIRONMENTAL ASSESSMENT**

The action recommended is not a project for the purposes of the California Environmental Quality Act.

**PREPARED BY:**  Joe Saccio, Deputy Director, Administrative Services
Blake Heitzman, Manager of Telecommunications, Utilities
DEPARTMENT HEAD APPROVAL:  CARL YEATS  
Director, Administrative Services

DEPARTMENT HEAD APPROVAL:  JOHN ULRICH  
Director, Utilities

CITY MANAGER APPROVAL:  EMILY HARRISON  
Assistant City Manager

ATTACHMENTS  
Attachment A: CMR: 360:04