TO: HONORABLE CITY COUNCIL
ATTN: FINANCE COMMITTEE
FROM: CITY MANAGER DEPARTMENT: UTILITIES
DATE: MAY 13, 2008 CMR: 233:08

SUBJECT: ADOPTION OF A RESOLUTION APPROVING A POLICY ESTABLISHING A FIBER OPTICS EMERGENCY PLANT REPLACEMENT RESERVE AND APPROVAL OF FUNDING GUIDELINES FOR BOTH THE FIBER OPTICS RATE STABILIZATION RESERVE AND THE FIBER OPTICS EMERGENCY PLANT REPLACEMENT RESERVE

RECOMMENDATION
Staff recommends that the Council take the following action:

1. Adopt a resolution approving a policy establishing a Fiber Optics Emergency Plant Replacement Reserve;

2. Approve a minimum funding level guideline for the Fiber Optics Emergency Plant Replacement Reserve which will be equal to the lesser of: A) an amount equal to the amount of the City’s liability insurance coverage deductible; or B) an amount equal to the replacement cost of the most essential fiber optics infrastructure which, if damaged or destroyed, would cause a significant interruption in the normal operation of the City’s fiber optics infrastructure; and

3. Approve the minimum and maximum funding level guideline for the Fiber Optics Rate Stabilization Reserve which will be equal to 20% and 50% of the annual sales revenue of the Fiber Optics Fund operations, respectively.

BACKGROUND
In 1996, the City began operating its fiber optics business. Currently, the Fiber Optics operation is a sub-fund of the Electric Fund and the Fiber Optics Rate Stabilization Reserve was created. For the FY 2008-09 proposed budget, the Fiber Optics Fund will be a stand-alone fund and be separated from the Electric Fund. At separation, a Fiber Optics Emergency Plant Replacement Reserve will be funded.
Article VII, Section 2(e) (Public Utilities Revenue) of the City Charter requires a reserve to be established for each utility “for use by the utility, only for replacements or emergency repairs.” Emergency Plant Replacement (EPR) Reserves have been funded for the following Utilities funds: Electric, Water, Gas, and Wastewater Collection Funds. Staff recommends that an EPR Reserve be created for the Fiber Optics Fund as well.

The Council established by policy the Rate Stabilization Reserves (RSRs) in May 1993 for the Water, Electric, Gas and Wastewater Collection Funds, to ensure funds are available to cover short-term situations when expenditures exceed revenues; to provide a depository of excess funds when expenditures are less than revenues; to plan for certain known future occurrences of a non-recurring nature; or to “ramp up” if the expenditure is of an ongoing nature. The key points of the Council policy are:

- Reserves should be used to finance extraordinary one-time contingencies and to cover increased operating costs in the short-run, while allowing rates to gradually increase over a reasonable period.
- Reserves should not be used to solve long-term financial problems or to cover potential major catastrophic disasters.
- RSR level guidelines should be set to allow reserves to float up or down. The decision to hold more money or less money than the guidelines should be based on an assessment of the uncertainties and financial risk facing the utilities.
- The adequacy and prudence of the guidelines will be reviewed internally each year, and if appropriate, revised guidelines will be recommended.

On February 20, 2007, Council approved changes to Electric, Water, Gas and Wastewater Collection EPR Reserve and RSR guidelines (CMR: 143:07). The guideline for the EPR reserves for each fund requires the lower of the City’s liability insurance coverage deductible amount or an amount that would cover the replacement cost of the most expensive critical item.

**DISCUSSION**

Staff proposes the approval of a guideline for the Fiber Optics Fund EPR Reserve that would be the same as the EPR Reserve established for the Electric, Water, Gas and Wastewater Collection Funds. The current deductible for the City’s liability insurance is $1 million. The most expensive critical failure in the Fiber Optics infrastructure is the severance of a main trunk line, which would cause a service interruption. Repairing a severed main trunk line would cost approximately $250,000 to repair. Therefore, the Fiber Optics Fund EPR Reserve should be funded to $250,000.

The RSR guidelines for the Water, Electric, Gas and Wastewater Collection Funds were developed after an evaluation of risks, or cost contingencies, to which the relevant funds are exposed, were made. For the Fiber Optics Fund, the cost contingencies include:
• A decline in sales revenue of 15 percent for two years. The top three Fiber Optics customers provide about 15 percent of the total revenue for the fund;
• A rise in ongoing operating expenses for two years; and
• Unusual one-time cost contingencies (e.g. expansion of the CIP). Fiber optics system expansion and improvements to the system are being evaluated at this time.

The Fiber Optics Fund minimum RSR guideline is proposed to be 20% of the sales revenue. The proposed maximum guideline is 50% of the sales revenue. This guideline is the same as the existing guidelines for the Electric Distribution, Gas Distribution, Water, and Wastewater Collection Funds. Based on current sales revenues, the proposed RSR minimum and maximum guideline levels are $540,000 and $1.35 million, respectively.

RESOURCES IMPACT
Current reserves in the Fiber Optics Fund RSR are about $4 million. Therefore, even after funding the $250,000 for the proposed Fiber Optics Fund EPR Reserve, the Fiber Optics Fund RSR will be above the proposed maximum guideline level. Staff will re-examine rate levels depending on the development of CIP plans.

POLICY IMPLICATIONS
The recommended establishment of a Fiber Optics EPR Reserve and the establishment of the reserve guidelines for the Fiber Optics EPR Reserve and RSR require Council approval.

ENVIRONMENTAL REVIEW
Adoption of the resolution and approval of the recommended changes to the Utilities reserves do not constitute a project that would require environmental review.

ATTACHMENT
A. Resolution

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