CITY COUNCIL COMMUNICATION

MEETING DATE: July 23, 2013 **ITEM NUMBER: 11.D.**

SECOND READING: N/A

TYPE OF ITEM: General Business

PRESENTED BY: Jim Golden, Director of Finance ext. 8629
Jim.golden@ci.longmont.co.us

SUBJECT/AGENDA TITLE: Broadband Financing Options

EXECUTIVE SUMMARY: On May 14th the staff presented to the City Council the Broadband feasibility study. City Council directed to continue pursuing the deployment of a city-wide fiber optic network and direct the Director of Finance to pursue favorable financing options. Staff has met with the City's public finance consultants as well as talked with some nonprofit and private sources of alternative funding. There are essentially still three financing options that are available as originally identified in the May 14th council communication: Certificates of Participation; Sales Tax Revenue Bonds; Utility Revenue Bonds.

COUNCIL OPTIONS: Direct the Director of Finance to pursue one of the following options:

1. Certificates of Participation
2. Sales Tax Revenue Bonds
3. Utility Revenue Bonds

RECOMMENDED OPTIONS: N/A

FISCAL IMPACT & FUND SOURCE FOR RECOMMENDED ACTION: Debt service repayment would come from the broadband utility service revenues.

BACKGROUND AND ISSUE ANALYSIS:

The capital costs to construct the network including all capital equipment of the Broadband enterprise are estimated at $35.4 million and will be needed to complete full system deployment within the first three years of the venture. Revenue generation is projected to start in year two with market share targets projected to be met in year five. As a result, debt repayment for the broadband utility is projected to begin in year three. That means there will need to be capitalized interest for two years of approximately $3.47 million. Add to that issuance costs and the need to establish debt reserves and the total amount to be financed for the capital program will be around $44 million. Separately, operational costs in the first two years will be financed at approximately $2.34 million; this will likely be accomplished through internal financing.

Three financing options were originally included in the communication that was presented to the City Council in May. They were the following:

- Certificates of Participation
- Sales Tax Revenue Bonds
- Utility Revenue Bonds

Regardless of the financing instrument utilized, the intention is for it to be repaid from revenues of the broadband utility and that is how the pro forma of the utility is being modeled. However, if we were to only rely on the revenues from the startup broadband utility for collateral we would be unlikely to secure public financing and more likely to require financing from private equity markets at a higher interest rate. Leveraging the financial strength of our organization to secure public financing enables us to obtain lower interest rates, ultimately reducing the overall cost of the project. The alternative financing mechanisms identified for consideration would use either electric rate revenues or General Fund and Public Improvement Fund revenues as legal backing for the debt.

Regardless of the scenario selected, the City needs to have a plan for the source of debt repayment if the revenue from the broadband utility is not sufficient. Under any of these scenarios there may be the possible need for a funded debt service reserve. While the need for a funded reserve is not absolute, we have structured our projections to include one at this time. It is possible that we would apply for ratings on the deal without a reserve and see if we could still achieve a higher rating. We would not be certain of the need until the completion of the rating process. Using a cash reserve might help a COP rating stay at AA- if it were a close call between AA- and A+.

Below is explanation of the forms of financing and a matrix with a comparison of key aspects of the three financing options. Direction is needed on two questions related to the potential broadband financing. First is the source for debt repayment if the broadband utility does not generate sufficient revenue to repay the debt. Second is the financing vehicle from among the three options presented.

<u>Certificates of Participation</u>
Certificates of Participation (COP's) have never officially been utilized by the City before but it is currently planned to use a COP for the public funding required for the Twin Peaks Mall redevelopment. That financing should take place in a matter of months. That COP is to be repaid from tax increment revenues from the Twin Peaks Urban Renewal Authority and revenue generated by the property tax of the Twin Peaks Metropolitan District. With the COP related to Twin Peaks, the City would do a sale and leaseback of two major properties, the Recreation Center and the Safety & Justice Center.

A COP is a long-term lease agreement secured by a City asset. The lease is repaid by the City in the form of rental payments, which are subject to annual appropriation by City Council. In this case, the City would sell multiple City assets to an investor or a trustee acting on behalf of investors and then lease the City assets back. Certificates of Participation would be sold to investors secured by the City's rental payments. The proceeds from the sales of the COPs would be used for the Broadband project.

The COP would not be a long-term debt or multiple fiscal year obligation of the City. The Lease is renewable from fiscal year to fiscal year by the act of appropriation of the rentals due under the Lease. The City's obligation to make payments under the Lease will not extend beyond any fiscal year for which an appropriation has been made. Annually appropriated lease payments may be paid from any available revenues of the City. The intention would be that broadband utility revenue would be used to make the rental payments.

In 2008, the City used a similar approach to fund the construction of Fire Station #1. The City raised the lease proceeds through a lease/leaseback financing for two existing City Fire Stations. The City leased existing property including Fire Station #3, located at 1000 Pace Street and Fire Station #6, located at 501 South Pratt Parkway. The leased property was then leased back from the purchaser under a lease/purchase agreement for a period of 12 years. The lease will terminate upon the earlier of the full payment of the sub-lease, or upon its expiration.

A sale lease-back transaction would require the use of other city facilities with a current replacement value of over $40 million such as the Civic Center Complex and the Library. Those assets would be pledged over the period of the lease which is currently projected at up to 15 years. Reasons to consider a COP include the following:

- A COP is more marketable as creditors and investors will be less interested in the broadband revenue and more interested in the property being leased or pledged and the City's overall debt and credit quality.

- A COP is an instrument traded nationwide as well as throughout Colorado.

There are aspects of a COP to be aware of including that it is an obligation of the City and that we need to pledge City assets over 15 years which would mean those assets could not be pledged in another deal during that period of time. As an obligation of the City, it is similar to a moral obligation in that if the broadband utility revenue does not perform the City is obligated for payment of the debt service.

While we may be able to identify City assets of up to $40 million it is uncertain if those assets will be as attractive to investors as the two to be used for the Twin Peaks Mall financing. Those two were selected for their value and their age as well as because they will be seen as essential assets of the City. As essential assets, the investor believes the City will be highly motivated to make sure it retains possession of them. Other assets may add up to $40 million of value but they are likely older and some are potentially less essential.

Another factor to consider with a COP is that the City would be seeking over $70 million of financing through COP's in a short period of time. While these two issuances may not occur at the same time, they will occur close enough that the market will consider them together. Thus the rating agencies will likely evaluate the two as one. Essentially the City would be attempting to attain over $70 million of financing by selling and leasing back virtually all of its essential real property assets. While any and all City revenues can be used to repay the debt it will still be seen as a significant commitment of the City. Individually either COP issue might be seen as high as an Aa3/AA- security. It is possible that the rating for the COP's when we are issuing over $70 million could drop down to A1/A+ instead. That would mean that the broadband utility venture would be influencing or raising the interest rates on the mall redevelopment financing.

<u>Sales Tax Revenue Bonds</u>

A Sales Tax Revenue Bond would require voter approval at a November election. With a Sales Tax Revenue Bond the City would be pledging the 2% non-earmarked sales and use tax of the City to provide for the payment of the debt service on the bond. The 2% sales and use tax is currently used to fund ongoing expenses of the General Fund and one-time expenses of the Public Improvement Fund (PIF). Part of those one-time expenses in the PIF is the debt service on the Sales Tax Revenue Bonds issued to fund the Recreation Center, the Museum & Cultural Center & improvements at Roosevelt Park. The debt service on those bonds continues through 2019.

Under this scenario, if the broadband utility were unable to pay the debt service on the Sales Tax Revenue bonds issued for the broadband utility, the legal pledge for the debt would be from the 2% non-earmarked sales and use tax revenue.

A Sales Tax Revenue Bond would likely be in the AA category of ratings (which can include the slightly lower Aa3/AA- ratings) based on the strength of the 2% sales and use tax which generates approximately $30 million currently. The annual debt service from the PIF is currently over $2.7 million while the estimated annual debt service on the bonds for the Broadband utility is about $3 million.

Utility Revenue Bonds

A Utility Revenue Bond would require voter approval but the election can be at any time of the year. In a Utility Revenue Bond the City would be pledging revenues of the electric & telecommunication utility to provide for the payment of the debt service on the bond. The broadband utility would be combined with the electric utility as one Power & Communications utility. Under this scenario, if the broadband utility were unable to pay the debt service on the Revenue bonds, the legal backing for the debt would be from the combined revenues of the two enterprises. A Utility Revenue Bond would likely also be in the AA category of ratings based on the strength of the electric revenues which annually generate over $62 million currently. Electric rates would have to show the ability to provide coverage on the debt service.

	COP	Utility Revenue Bond	Sales Tax Revenue Bond
Voter Approval Required	No – subject to annual appropriation	Yes – can be voted on at any time of year	Yes – must be voted on in a November election
Require combining the Electric & Broadband utilities	No	Yes	No
Collateral	Physical assets of the City	Electric revenues	2% non-earmarked sales & use tax
Revenues used as legal backing for the debt	Any available revenues of the City	Combined revenues of the electric & broadband utilities	2% non-earmarked sales & use tax
Likely rating	A+	AA	AA

ATTACHMENTS:

May 14, 2013 Council Communication

Feasibility Study Powerpoint Presentation