OPTIONS FOR CLICK! NETWORK

Presented to the Public Utility Board

August 26, 2015

CLICK! CABLE TV
TACOMA PUBLIC UTILITIES

TODAY'S AGENDA

Review of last meetings

Options for Click

1. All-in retail best case scenario
    a. Gigabit for everyone
2. Wholesale-only best case scenario
3. Lease

Policy issues

LAST TIME WE WERE HERE…

Council requested options for how to make Click! Network viable

- What is required to go all-in?
- Input from policymakers, including Chair Flint's proposal
- Comparison of options

Council received a legal opinion about the electric utility offering cable and Internet services

- Must have nexus to utility function
- Must be financially self-sustaining, cannot use electric revenues
- Requirement to allocate costs according to use

Policy Objectives*

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5: Fully meets objectives *1: Does not meet/minimally meets*	**All-In Retail**	**Wholesale**	**Lease**
Benefit from public infrastructure			
Vision 2025 goals			
Competition, hold down rates			
Economic development			
Educational opportunity			
Access equity			
Living-wage jobs			
Leverage for cyber security			
Financially self-sustaining			

* Handout from PUB Chair Bryan Flint on July 7, 2015

Framework for All-In Retail Option*

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- Be financially self sufficient within three years
- Achieve 30% or better market penetration within 5 years by:
  - Bundling services such as cable, internet and telephone
  - Increase customer Internet speeds all the way up to gigabit
  - Implementing a marketing plan sufficient to achieve goal
  - Provide attractive rates
  - Take advantage of our excellent Click! customer service

* Handout from PUB Chair Bryan Flint on July 7, 2015

Framework for All-In Retail Option* (cont'd)

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- Decrease expenses by exploring options such as:
  - Allocating cost to Tacoma Power commensurate with its needs for the Broadband network
  - Assessing staffing needs at the management and front line staff levels to seek efficiencies. This involves collaboration with union representation to come up with equitable solutions.
  - Be adaptive to changing market conditions and increased competition that will follow.
  - Looking at alternatives escalating contracts with local broadcasters

* Handout from PUB Chair Bryan Flint on July 7, 2015

Framework for All-In Retail Option* (cont'd)

- Identify potential public private partnership opportunities that preserve public control over public resources
- Identify risk to Click, Tacoma Power and the City
- Financing initial start up cost

* Handout from PUB Chair Bryan Flint on July 7, 2015

Financing Initial Start Up Cost

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- Click! assets are short-lived, so financing would only add interest costs because of the short-term nature of the financing
- Click! would likely not be able to finance – cash flow negative
- Based on legal and financial advice, do not believe it is responsible or prudent for Tacoma Power to consider
- Could be financed by General Government

General Assumptions – All In Retail

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These assumptions are optimistic

- Continued decline of cable TV and escalation of Internet customer counts

	Cable TV	Internet
Current	-7%	5%
High	-1%	7%
Low	-3%	5%

- Cable TV rate increases of 17.5% in 2015, 10% in 2016 and 7% each year thereafter
- No retail Internet rate increases assumed
- Current competitors' services remain static – no major new products or services
- No additional competition in market
- Bundle product sales slow down cable customer loss.

Why Assumptions are Optimistic

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CenturyLink Fiber Build

- Approached Tacoma Power to discuss attaching fiber to jointly owned utility poles – 30K out of 50K poles
- Approached City to discuss Cable TV/IP video franchise
- Can build fiber under their existing rights to be in the public rights-of-way
- Will offer gigabit service
- As a new triple play provider, and one with a gigabit network, they will significantly impact Click!'s future success

All-In Retail Scenario from July 7

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- Maintain current staff
- Gets into retail business and in the high version doubles customers
- Includes the addition of gigabit service
- Requires significant subsidy until it reaches breakeven
- Relies on significant capital investment

All-in Retail Scenario from July 7

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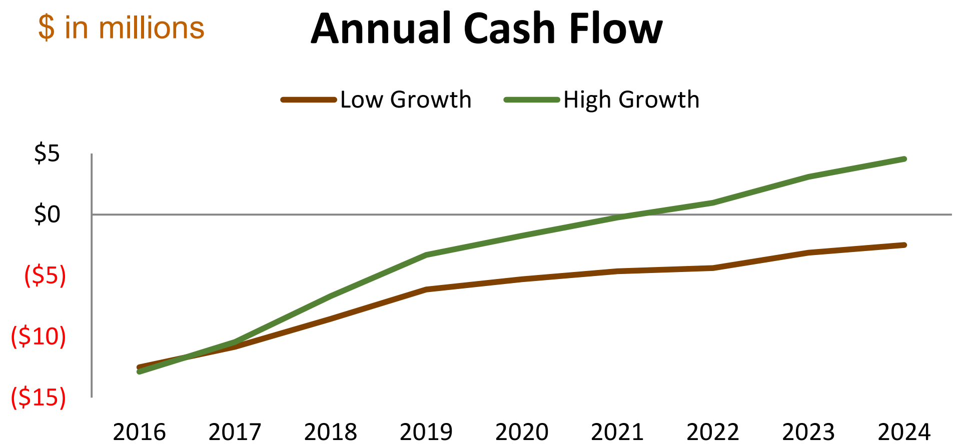
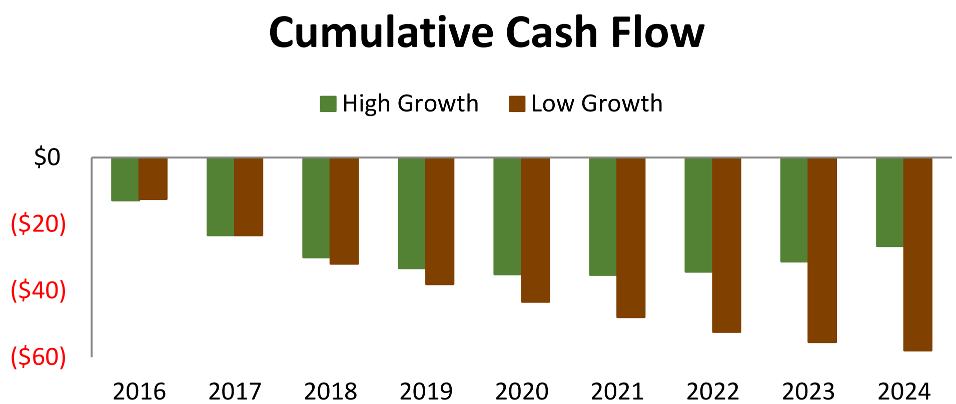
Assumptions		Year 2 2016	Year 5 2019	Year 10 2024
# of Data Customers	L H	6,501 8,326	21,821 27,241	30,574 40,436
Data Market share	L H	4.6% 5.9%	15.4% 19.3%	21.7% 28.7%
# of Cable Customers	L H	17,387 17,787	15,452 16,882	13,078 15,772
Cable Market share	L H	12.3% 12.6%	10.9% 12.0%	9.3% 11.1%
# of employees	L H	104 103	102 101	100 100
Cumulative capital investment	L H	$5.6M $5.9M	$19.3M $19.9M	$40.8M $41.5M
Annual Cash Flow/Subsidy	L H	($12.5M) ($12.9M)	($6.1M) ($3.3M)	($2.5M) $4.6M
Cumulative Cash Flow	L H	($12.5M) ($12.9M)	($38.0M) ($33.3M)	($57.9M) ($26.6M)
NPV	L H	($12.5M) ($12.9M)	($34.1M) ($30.2M)	($48.6M) ($26.0M)

$ in millions





What's Required to Achieve Best-Case All-In Retail Scenario

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- Need a mechanism to streamline rate increases (Lafayette has the ability to do this.)
- Need the go ahead to either buy or compete with the ISPs.
- Need the ability to pay sales commissions to employees.
- Need budget approval for increased capital spending (gigabit network upgrade).
- Need the ability to reduce staff to industry metrics.
- Need the ability to outsource functions when that makes economic sense.
- Need the ability to cover cash shortfalls until successful.
- Need to take politics out of the business.
- Need to operate more like a private-sector business.

Option 1: All-In Retail Best Case Scenario

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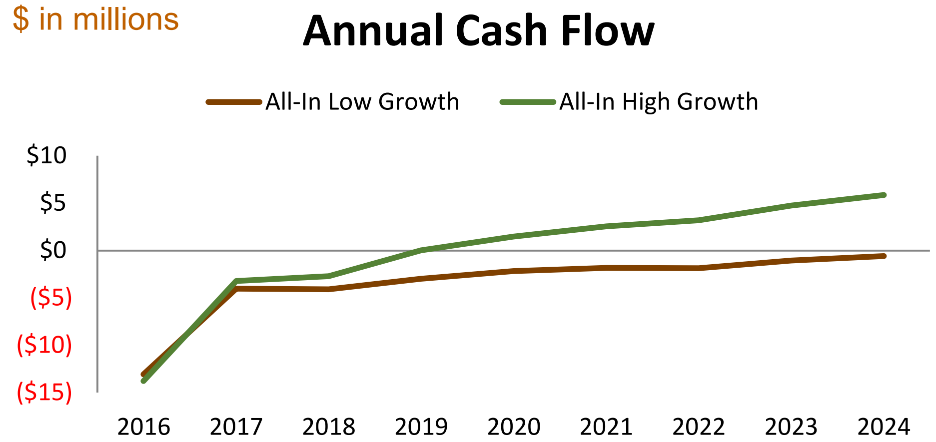
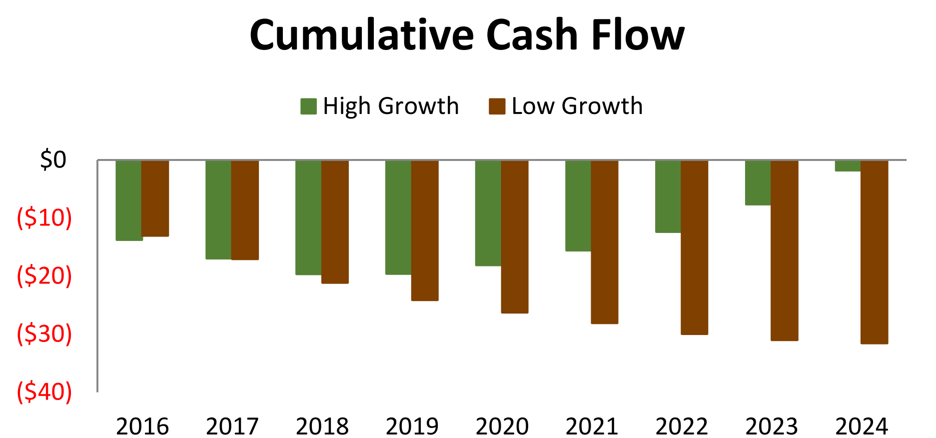
- Begins with the All-In Retail scenario from July 7
- Includes purchasing the ISPs
- Uses a ‘sales burst’ to get more customers
- Makes significant staff reductions and uses outsourcing
- Needs significant subsidies to reach breakeven
- Relies on significant capital investment
- Adjusted every lever possible to make scenario work

Option 1: All-in Retail Best Case Scenario

Assumptions		Year 2 2016	Year 5 2019	Year 10 2024
# of Data Customers	L H	24,756 27,564	31,652 38,506	39,312 50,576
Data Market share	L H	17.5% 19.5%	22.4% 27.3%	27.9% 35.8%
# of Cable Customers	L H	19,187 20,787	17,990 20,926	14,801 18,518
Cable Market share	L H	13.6% 14.7%	12.7% 14.8%	10.4% 13.1%
# of employees	L H	78 85	81 90	86 101
Cumulative Capital investment	L H	$11.8M $12.2M	$24.4M $25.1M	$45.0M $46.1M
Annual Cash Flow/Subsidy	L H	($13.1M) ($13.8M)	($3.0M) $0.0M	($0.6M) $5.8M
Cumulative Cash Flow	L H	($13.1M) ($13.8M)	($24.2M) ($19.6M)	($31.6M) ($1.8M)
NPV	L H	($13.1M) ($13.8M)	($22.1M) ($18.3M)	($27.5M) ($6.0M)

$ in millions





How we got to Option 1

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9-Year Cumulative Cash Flow

Scenarios		Low		High
All-In Retail from July 7		($57.9M)		($26.6M)
Buy ISPs	+	$10.0M	+	$5.6M
Sales Burst	-	$2.4M	-	$0.3M
Operate at Industry Metrics	+	$18.7M	+	$19.5M
All-In Retail Best Case	=	**($31.6M)**	=	**($1.8M)**

Buy ISPs

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- Assumes you pay $4.5M for the ISPs.
- Assumes a $2.0M transition cost to incorporate those customers into Click!
- All scenarios are better by buying the ISPs rather than competing with them.
- But if you pay much more than the above price it would be better to compete.

	Low	High
All-In Retail from July 7	($57.9M)	($26.6M)
Buy ISPs	$10.0M	$5.6M
	($47.9M)	**($21.0M)**

Sales Burst

- A sales burst would entail hiring an external vendor who would send in a door-to-door sales team that would knock on every door in the City that is not a Click! customer.
- Assumes the commissions would be $150,000 plus $200 per new customer acquired. For the two sales bursts in our forecast, that is almost $2 million.
- Customers would be required to sign at least a 2-year contract to get the special prices offered by the sales burst.
- It's assumed that about 2/3 of the customers obtained in this manner become permanent customers (people who shop only on price will not stay).

	Low	High
Subtotal: Buy ISPs	($47.9M)	($21.0M)
Sales Burst	($2.4M)	($0.3M)
	($50.3M)	**($21.3M)**

Operate at Industry Metrics – Labor Efficiency

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- These efficiencies were not included in earlier scenarios because of the policy and union challenges related to these. These have been included now in response to the request to show ways to make the business more financially self-sufficient.
- Labor efficiency
  - Reduces a net of 12 – 16 FTEs
  - Also adds 6 new sales positions and 4 other new positions
  - Net reduction is 5 to 9 represented positions and 7 non-represented positions.
- Long Term
  - As the business grows the business adds back 10 – 15 FTEs by 2024, all represented.

	Low	High
Subtotal: Buy ISPs, Sales Burst	($50.3M)	($21.3M)
Labor Efficiency	$9.1M	$7.3M
	($41.2M)	**($14.0M)**

Operate at Industry Metrics

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- Outsourcing
  - Outsources functions that are routinely outsourced throughout the industry (and only where outsourcing produces a cost savings)
  - Reduces 22 – 23 FTEs.
  - Reduction is 19 to 20 represented positions and 3 non-represented positions.

	Low	High
Subtotal: Buy ISPs, Sales Burst, Labor Efficiency	($41.2M)	($14.0M)
Outsourcing	$9.6M	$12.2M
	($31.6M)	**($1.8M)**

All-In Retail Risks and Uncertainties

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- IBEW Local 483 and Local 120 represent Click! employees (75% of employees are represented)
- Current union contract language prevents alignment of staffing levels and functions with other cable/Internet providers our size
- Wages, hours and working conditions are mandatory subjects of bargaining. Mutual obligation to negotiate in good faith.

ARTICLE 20 – CONTRACTING

The Click! Network Division shall not acquire the services of outside service contractors before it has considered whether or not current employees can complete the work or projects to be performed. If the workload is such that this cannot be achieved, Click! Network will consider the possibility of its own crews working overtime to perform the work within the projected time frame before contracting out said work. No covered employees shall be laid off while contractors are performing work that is covered by classifications within this collective bargaining agreement.

All-In Retail Risks and Uncertainties (cont'd)

- Buying out ISPs: would need to acquire at cost-effective price
- Competitors likely to expand services and products
  - Century Link starting build-out of fiber to the home this year in Click! service area, others may follow
  - Comcast Quad Play
- Rate increases will need consistent approval
- Increasing Cable TV churn – potentially higher loss of customers than projected

All-In Retail Risks and Uncertainties (cont'd)

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- Legal risk
  - Changing the business model could bring a lawsuit from ratepayers, other cable providers, others
- Legislative risk
  - Business model change could result in state legislative limitations on municipal utilities
  - RCW 54.16.330 allows PUDs to build and operate telecommunications network, but says: "Nothing in this subsection shall be construed to authorize public utility districts to provide telecommunications services to end users."
- Political risk – pushback from ISPs
  - ISPs have opposed changes to the business model in the past, anticipate the same going forward

Option 1a: All-in Retail With Gigabit for Everyone

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- Retail Product is $45 gigabit (includes modem fee).
- Requires significant capital spending (more than $26M in 2016).
- Can break even with a 30% penetration after 9 years with a $6.1M annual subsidy.
- Would need more study of the capital needs since this has never been done. But theoretically possible.

Option 1a:
All-in With Gigabit for Everyone

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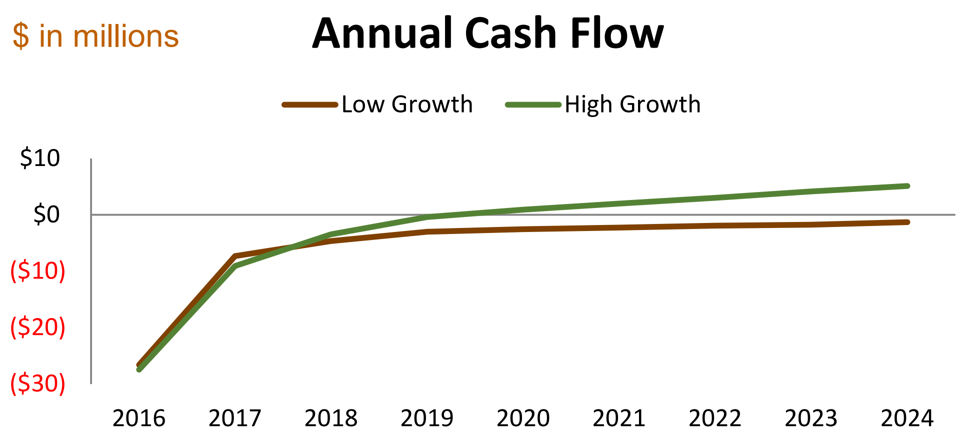
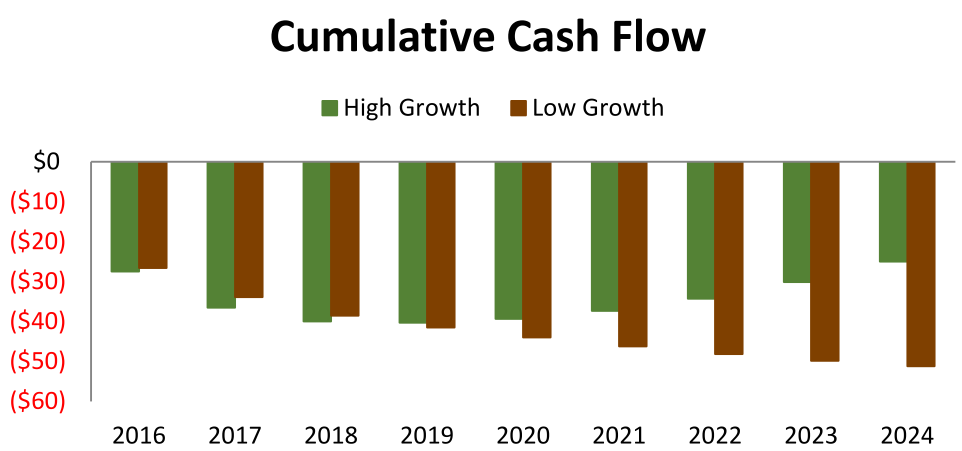
Assumptions		2016 Year 2	2019 Year 5	2024 Year 10
# of Data Customers	L H	26,186 29,404	34,572 42,666	42,382 56,436
Data Market share	L H	18.5% 20.8%	24.5% 30.2%	30.0% 40.0%
# of Cable Customers	L H	19,685 21,311	18,656 21,686	14,814 18,706
Cable Market share	L H	14.0% 15.1%	13.2% 15.4%	10.4% 13.2%
# of employees	L H	81 89	83 95	88 107
Cumulative Capital investment	L H	$25.1M $25.6M	$41.7M $45.5M	$63.1M $67.9M
Annual Cash Flow/Subsidy	L H	($26.6M) ($27.4M)	($2.9M) ($0.3M)	($1.3M) $5.2M
Cumulative Cash Flow	L H	($26.6M) ($27.4M)	($41.5M) ($40.3M)	($51.2M) ($25.0M)
NPV	L H	($26.6M) ($27.4M)	($38.4M) ($37.6M)	($45.4M) ($27.1M)

$ in millions





General Assumptions - Wholesale

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- Exits the cable TV business.
- Reduces staff directly associated with retail operations.
- Continues to operate the network for Power purposes.
- Continues to sell connections to ISPs.

Wholesale Scenario from July 7

- Assumes at least one ISP gets into the cable business.
- Even if they grow twice as fast as today it does not achieve break even.

Wholesale Scenario from July 7

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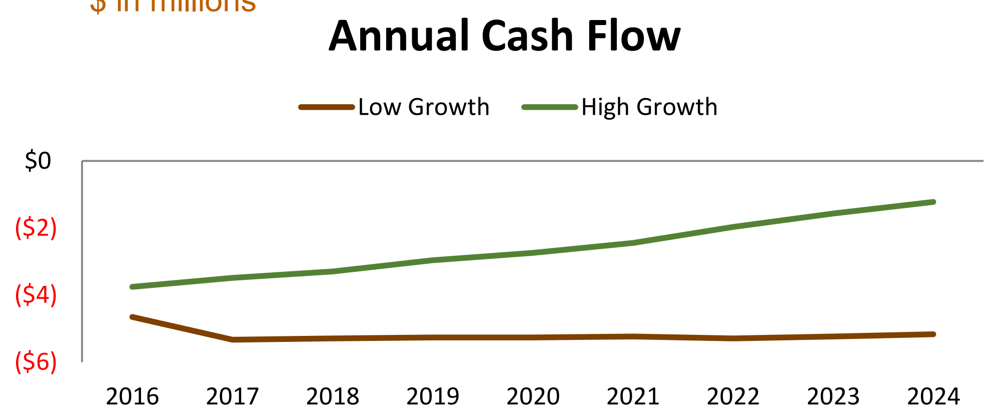
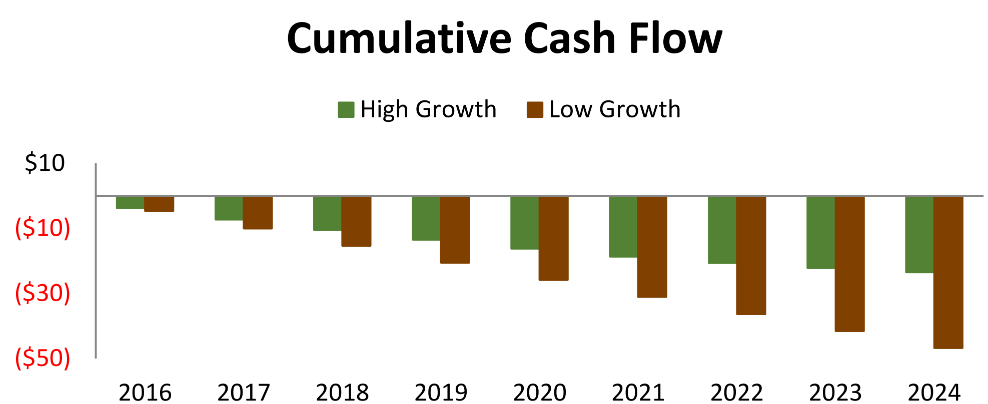
Assumptions		2016 Year 2	2019 Year 5	2024 Year 10
# of customers	L H	19,810 23,956	18,220 28,532	21,220 38,182
Market share	L H	14.0% 17.0%	12.9% 20.2%	15.0% 27.1%
# of employees	L H	60 61	59 62	60 67
Cumulative Capital investment	L H	$2.3M $2.3M	$9.1M $9.2M	$20.5M $21.9M
Annual Cash Flow/Subsidy	L H	($4.6M) ($3.8M)	($5.3M) ($3.0M)	($5.1M) ($1.2M)
Cumulative Cash Flow	L H	($4.6M) ($3.8M)	($20.6M) ($13.5M)	($46.8M) ($23.4M)
NPV	L H	($4.6M) ($3.8M)	($18.2M) ($12.0M)	($36.9M) ($19.2M)

$ in millions





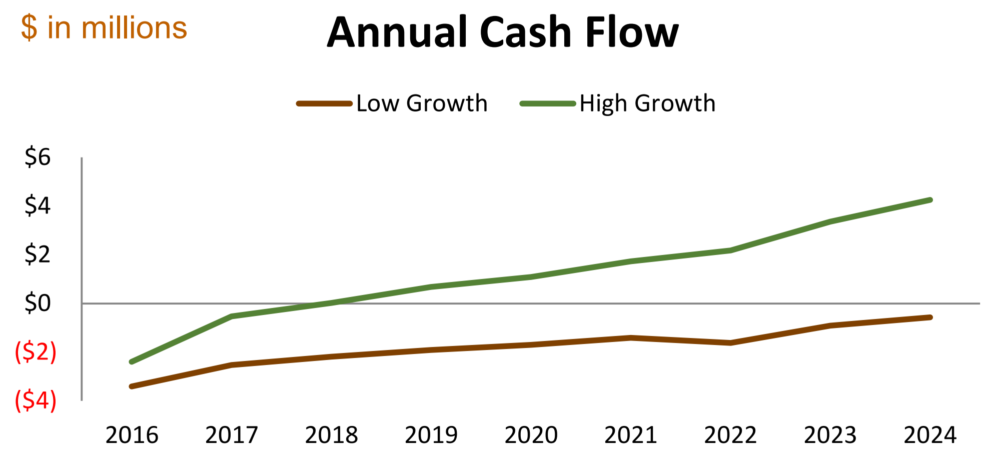
Option 2:
Best-Case Wholesale Scenario

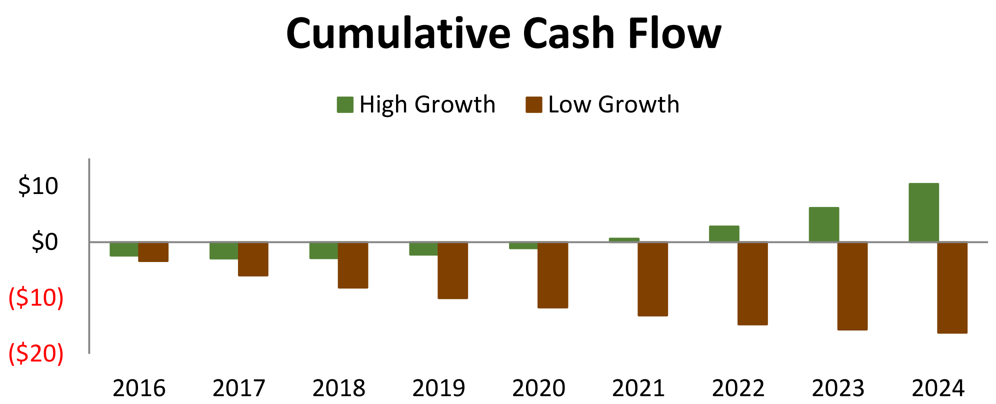
- Success requires ISPs to sell more than today.
- Assumes at least one of them gets into the cable business.
- If they grow at today's speed the subsidies continue (low growth option).
- Assumes significant staff reduction and outsourcing.
- Adds a wholesale gigabit product.

Option 2:
Best-Case Wholesale Scenario

Assumptions		2016 Year 2	2019 Year 5	2024 Year 10
# of customers	L H	19,810 23,956	18,720 29,232	22,720 40,382
Market share	L H	14.0% 17.0%	13.3% 20.7%	16.1% 28.6%
# of employees	L H	26 27	25 28	26 33
Cumulative Capital investment	L H	$3.3M $3.3M	$9.9M $10.0M	$21.0M $21.3M
Annual Cash Flow/Subsidy	L H	($3.4M) ($2.3M)	($1.9M) $0.7M	($0.6M) $4.3M
Cumulative Cash Flow	L H	($3.4M) ($2.3M)	($10.0M) ($2.2M)	($16.2M) $10.4M
NPV	L H	($3.4M) ($2.3M)	($9.0M) ($2.2M)	($13.5M) $6.5M

$ in millions





How we got to Option 2

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10-Year Cumulative Cash Flow

		Low		High
Wholesale from July 7		($46.8M)		($23.4M)
Gigabit upgrade	-	$0.4M	+	$4.6M
Operate at Industry Metrics	+	$30.9M	+	$29.2M
Wholesale Best Case	**=**	**($16.3M)**	**=**	**$10.4M**

Gigabit upgrade

- 1,500 to 2,200 expected customers by 2024
- Cost under $2 million
- Wholesale rate to ISPs at $40

	Low	High
Wholesale from July 7	($46.8M)	($23.4M)
Gigabit upgrade	($0.4M)	$4.6M
	($47.2M)	**($18.8M)**

Operate at Industry Metrics – Labor Efficiency

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- Labor efficiency
  - Eliminates all groups having retail responsibilities (cable TV)
  - Reduces 39 – 40 FTEs: 27 to 28 represented positions and 12 non-represented positions.
- Long Term
  - As the business grows the business adds back 7 FTEs by 2024.

	Low	High
Subtotal: Gigabit upgrade	($47.2M)	($18.8M)
Labor Efficiency	$16.7M	$16.7M
	($30.5M)	**($2.1M)**

Operate at Industry Metrics – Outsourcing

- Outsourcing
  - Outsources functions that are routinely outsourced throughout the industry (and only where outsourcing produces a cost savings)
  - Reduces 17 FTEs: 14 represented positions and 3 non-represented positions.

	Low	High
Subtotal: Gigabit upgrade, Labor efficiency	($30.5M)	($2.1M)
Outsourcing	$14.2M	$12.5M
	($16.3M)	**$10.4M**

Wholesale Risks and Uncertainties

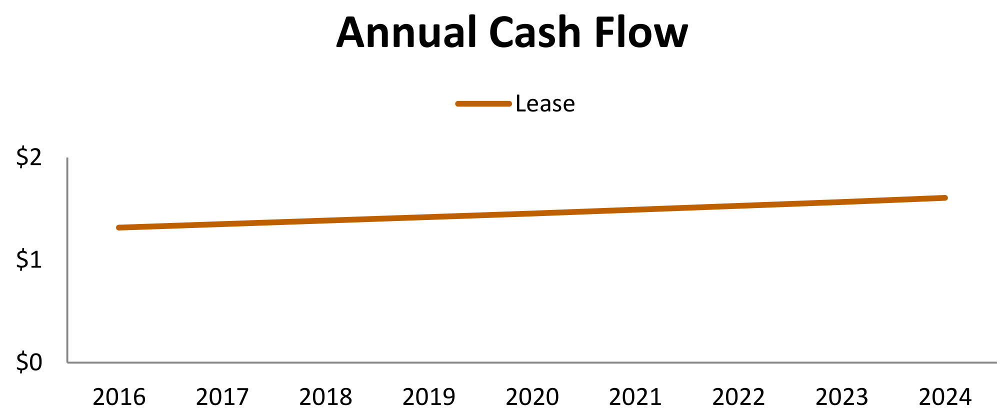
- Success for almost all municipal operators is due to being retail providers and competing with a triple play bundle. The few who have tried a wholesale model have struggled financially (Provo, Utopia).
- Dependent on ISPs to grow market share.
- At least one ISP will need to offer cable if there is to be growth in wholesale customers.
- Not likely to be able to attract another ISP with current market.
- Competitors likely to expand services and products
  - Century Link starting build-out of fiber to the home this year in Click! service area
  - OTT Video (Netflix, etc.) is speeding up the erosion of cable customers everywhere. Whole industry lost 600,000 cable customers in 2^{nd} quarter 2015.
  - Comcast is increasing speeds. They now have a 2 Gig product and continue to increase speeds on their network.
  - It's always possible that some other provider like Google could enter the market.

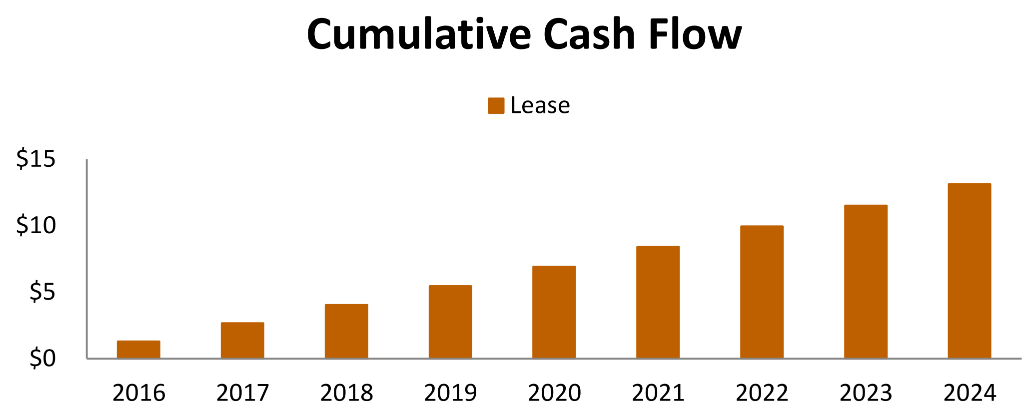
Option 3:
Wave Lease from July 7

- Wave (or other lessee selected through RFP) operates network on behalf of Tacoma Power.
- Assumes Tacoma Power retains 6 employees to support network for electric system
- Assumes operator would provide cable, Internet (including gigabit) and phone services.
- I-Net obligation would be assumed

Option 3:
Wave Lease from July 7

Assumptions	Year 2 2016	Year 5 2019	Year 10 2024
# of Customers	N/A	N/A	N/A
Market share	N/A	N/A	N/A
# of employees	6	6	6
Cumulative capital investment	$0.0M	$0.0M	$0.0M
Annual Cash Flow/Subsidy	$1.3M	$1.4M	$1.6M
Cumulative Cash Flow	$1.3M	$5.4M	$13.1M
NPV	$1.3M	$4.9M	$10.3M





Lease Risks and Uncertainties

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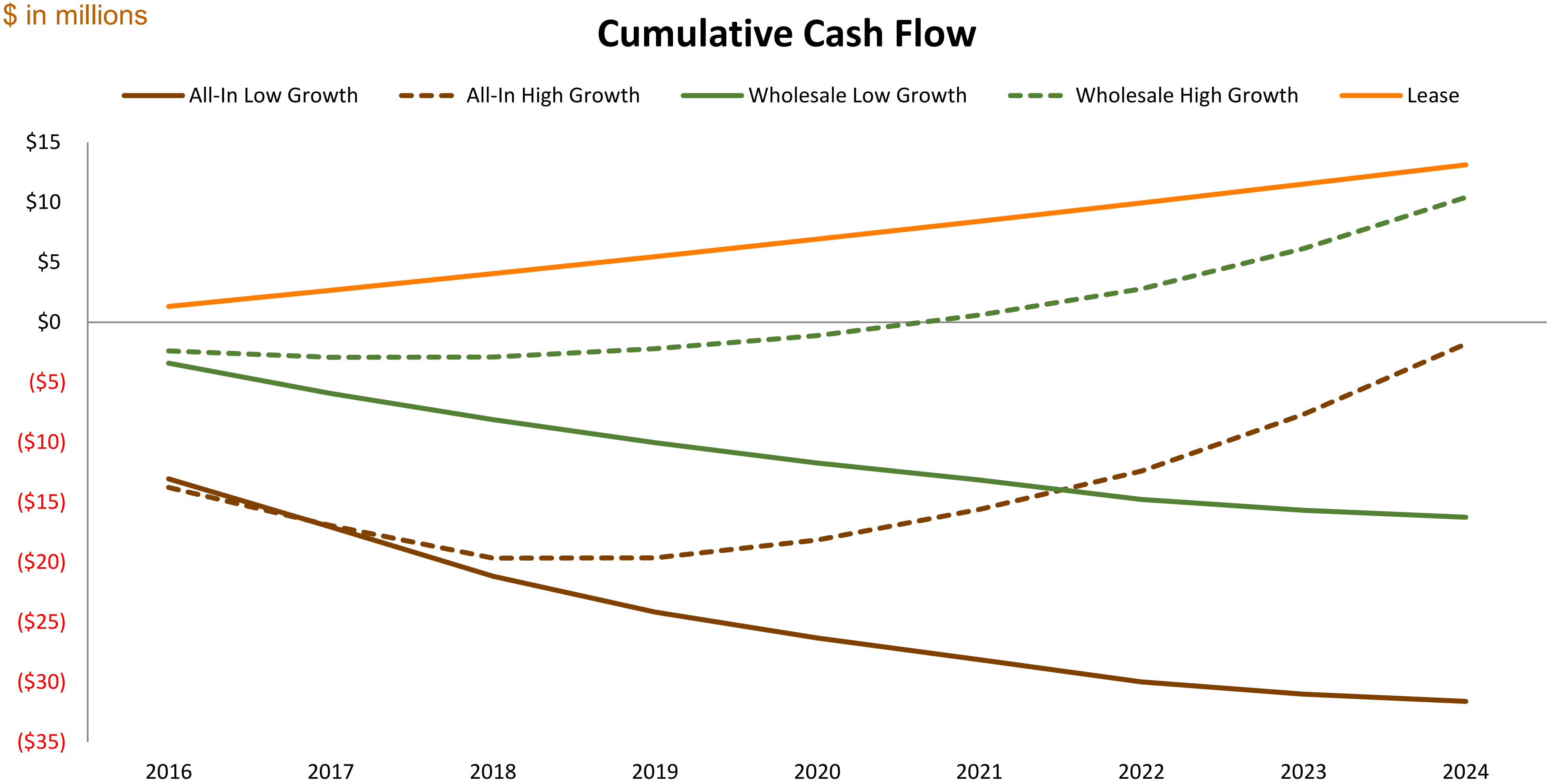
- Non-performance – Lessee does not fulfill its contractual obligations
- Business failure – Lessee exits the business
- These risks, to the extent possible, will be mitigated through a lease and/or franchise agreement
  - Will contain provisions that prescribe how non-performance will be remedied
  - In the event of business failure, how the network would be reclaimed or assigned to another qualified party
  - Contract would prohibit assignment of contract to another competitor without TPU approval

Financial Comparisons

$ in millions



Policy Issues: Funding

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- In all scenarios except the lease, Click! is not able to be fully financially self-sufficient for many years
- Legal opinion suggests Tacoma Power cannot support Click!
- Potential funding sources for shortfall
  - General fund
  - City establishes enterprise funding through bond sales

Policy Issues: ISP contracts

- ISPs are seeking a 30-month non-compete provision in their contracts
- If non-compete is offered it will delay Click! from implementing a retail scenario. There is a financial impact to offering non-compete:
  - The business will continue to lose cable customers.
  - Significant annual losses (subsidies) will continue
  - Delaying competition means pushing out the date when the business will no longer need subsidies.
- Any non-compete may make it impossible for Click! to ever compete in the retail business.

Policy Issues: Rates

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- All models assume the July 1 rate increase (17.5%) was approved, and that another (10%) goes into effect on July 1, 2016
- Currently losing $206,000 per month; $2.5 million per year because of delay
- All future scenarios assume annual rate increases

Summary

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- Century Link building fiber will negatively impact all of the retail projections.
- Several big hurdles to overcome to make retail options work – ability to be flexible with labor, capital to upgrade to gigabit, how to fund the shortfalls, need for timely rate increases, and selling against stiff competition.
- Wholesale scenarios require the ISPs to do better than today without having a Click! cable product in the market.
- Lease is still the best financial option.

Policy Objectives*

5: Fully meets objectives *1: Does not meet/minimally meets*	All-In Retail	Wholesale	Lease
Benefit from public infrastructure	5	3	4
Vision 2025 goals	2	1	3
Competition, hold down rates	5	4	5
Economic development	3	1	2
Educational opportunity	5	2	5
Access equity	5	2	5
Living-wage jobs	5	3	5
Leverage for cyber security	5	5	5
Financially self-sustaining	2	2	5

* Handout from PUB Chair Bryan Flint on July 7, 2015

NEXT STEPS – PENDING DECISIONS

- Council adoption of cable TV rate increase ordinance*
- Decision about non-compete for ISPs*
- Decision about which Click! Network business model option to pursue

*Near term