



MEMORANDUM

Office of the City Attorney

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TO: Mayor and City Commissioners **DATE:** June 16, 2020

COPIES: City Charter Officers

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SUBJECT: Broadband Study – Next Steps: Staff Analysis

Background

On June 20, 2019, Doug Dawson with CCG Consulting presented the City Commission with its requested feasibility study (Legistar File No. 180315) addressing the City Commission's interest in providing new broadband service, in particular one gigabit service. The primary goals identified by the Commission for having the City provide broadband service were to: #1 lower prices and increase speeds for residents; #2 lower prices and increase speeds for businesses; and #3 allow everyone to have access to a municipal network in the designated areas. The secondary goals identified by the Commission were to: #4 provide lowest priced gigabit of internet for residential service in the United States; #5 provide lowest priced internet for businesses in the United States; and #6 provide universal free service. The feasibility study suggested there were scenarios in which this would all be possible, but identified multiple risks and hurdles for the City to provide new broadband service. If the City decided to move forward, the consultant recommended that further analysis be done, including retaining external experts (e.g., legal, financial and engineering) to firm up the capital and operation and maintenance costs of providing broadband service and the legal requirements to do so.

Before spending money on external experts (at an estimated cost of between \$330,000 - \$600,000), staff presented "next steps" to the City Commission on August 15, 2019, including staff returning with this analysis. The Commission supported that approach. Also, on August 15, 2019, the Commission began discussing some form of tax(es) to be used to pay for broadband infrastructure (Legistar File No. 190259).

This memorandum presents the staff analysis from GRUCom, GRU Budget Finance and Accounting and the City Attorney's Office.

Recommendation based on staff analysis

Staff recommends against the City moving forward with a new broadband project at this time because of the convergence of three issues that will make it difficult/impossible to achieve any of the Commission's stated goals, except possibly goal #3 (allowing everyone to have access to a municipal network in the designated areas):

The first issue is the considerable hurdles identified by the consultant. There are multiple risks/factors outside of the City's control in establishing a self-supporting broadband system, including competitive strategies expected from the private providers in this area and the City's ability (or inability) to attract and retain a sufficient customer base to generate the revenue requirements for the system.

The second issue is Section 350.81, Florida Statutes, titled "Communications Services offered by Governmental Entities" that was enacted in June 2005 with the purpose to ensure that governments who provide new (post April 2005) communications services, including broadband, compete on a level playing field with the private providers. In particular, the law prohibits the City from subsidizing broadband by using revenues from sources other than the communications services system, such as revenue from other City utility systems, ad valorem taxes or sales tax.

The third issue is that GRUCom is financially a non-self-supporting system. Current financial information reflects a system that has negative equity of \$7 million and does not hold enough cash to fund a project of this size. Without subsidization (prohibited under the statute), a new \$112 million dollar broadband system would require a significant borrowing, likely through bonds which would require referendum approval before the project could proceed.

Alternative Next Steps

If, notwithstanding the staff recommendation, the Commission decides to move forward with a new broadband project at this time, the Commission may wish to proceed with one or more of the following as next steps:

- a) Re-think/refine the public purpose and goals for a gigabit broadband project (e.g., is it to address the digital divide, is it to spur business/economic development?) including analyzing the proposed project through the Equity Toolkit questions.
- b) Explore partnering with one or more of the private providers to subsidize the provision of affordable broadband services in the City to address whatever specific digital divide, business/economic development or other goals that the Commission identifies as serving a public purpose.
- c) Engage the City's state and federal lobbyists to work to clarify the application of the "grandfathering" provisions in the State Statute and/or remove the prohibition on subsidization in order that a new broadband project could be supported by sales tax, ad valorem tax or other revenue source available to the City.

- d) Retain external experts necessary to develop a business model for the new broadband project that generates enough revenue to be self-sustaining, including an engineering firm to finalize the cost estimates, a financial consultant to assist in the evaluation of the costs and rate setting, consulting with bond counsel to address the financing required and a comprehensive market study to identify product and pricing options that would achieve the necessary market penetration to sustain the business model.

Analysis

While the Commission has expressed the goal to offer the lowest priced gigabit broadband service in the United States and/or universal free broadband service, those are not promises/guarantees that can be made. In simple terms, the rates for broadband service are a function of the system's revenue requirements (e.g., what does it cost to borrow money, build the infrastructure, operate and maintain the service) divided by the number of customers that can be attracted/retained to sustain revenue at or above the cost of providing the service as required by statute.

The CCG Report states "[t]he city presented us with an interesting challenge when we were asked if there is an opportunity to build a retail fiber network that can have the lowest broadband prices in the country . . . what we found was interesting. There are scenarios where the city could provide low-price broadband while operating a fiber business that would be self-sustaining and profitable and that wouldn't need any subsidies from GRU or the city. However, creating such a business is no slam dunk."

The consultant identified "considerable hurdles" to the proposition to provide one gigabit at fifty dollars as follows:

- Finding bond financing
- Reaction of the incumbent providers (AT&T, Cox and others)
- Florida Statutes create a series of hoops for GRU to jump through
- The possibility that the City would hold a referendum to approve the revenue bonds for broadband
- Operational challenge that City would need to sell and install customers quickly and in large numbers in order to make the needed bond repayments
- If the City were to offer 1 gigabit of broadband speed at \$50, it would need to obtain 42% of the market
- To obtain 42% of the market, GRU would need to add between 540 and 850 new customers every month
- If the City were to offer 1 gigabit of broadband at more than \$50 the market rate penetration would be less.

These hurdles are, in reality, the same considerations a private entity must review when entering the market. If the City is to offer one gigabit of broadband service in today's market,

the City should analyze the market as a private entity would. The City will be competing for customers with other communications service providers. Customers will have their choice between Cox, AT&T, Verizon, GRUCom and others. The City will not be able to require a customer to sign up for service, or remain a customer. As CCG stated in the feasibility study:

The City must Consider Risk. Only the city can judge the risk you face in trying to implement one of the scenarios suggested by this study. Our financial analysis quantifies the relative risk if the market stays somewhat unchanged after you launched a fiber network. We have no way to put a number value on big changes in the market. For example, how well might the city do if AT&T was to build fiber everywhere as a reaction to the city building a broadband network? That is an example of an external risk that is never easy to quantify – but it is the kind of risk that a commercial ISP considers when thinking of building in a new market. This is a perfect example of how complex of a decision it is to move forward.

In addition to the risk that a commercial internet service provider (ISP) considers when entering a new market, the City must also consider the long term risk to its citizens and customers if the venture fails – will the City be able to sell the going venture or liquidate the assets? If the proceeds are not sufficient to cover the liabilities, how will the City cover such losses – cut other programs/expenditures, increase ad valorem or other taxes/assessments, reduce the GFT or increase other utility rates?

As summarized above, Section 350.81, Florida Statutes was enacted to require that local governments entering the communications services market conduct a public analysis of the risks before doing so and to ensure that municipalities enter the market without competitive advantage over the private entities who are providing the same service in the community.

The CCG study stated that GRUCom was exempt or waived from compliance with certain requirements set forth in the Statute because GRUCom has been providing communications services prior to April 2005. City staff reads the statutory provisions not as a waiver or exemption, but rather as a “grandfathering” clause – meaning whatever communications services were being provided or financed by an outstanding bond issuance by GRUCom in April 2005 can continue without need to comply with the statute; however, offering new/different services with separate accounting and rate structure would seem to require compliance. City staff is concerned that if the City were to assert the “grandfathering” clause with respect to this broadband project, it would result in costly, lengthy legal challenge(s) with a very uncertain outcome – which is not ideal/acceptable for a project of this magnitude.

If the Commission decides to move forward with a new broadband project, staff recommends compliance with the statutory requirements in order to avoid legal challenges, carefully and publicly assess the risks and develop a solid business plan prior to moving forward. The steps laid out in Section 350.81, Florida Statutes, are summarized as follows:

- (2)(a) **Notice of Public Hearings:** Hold at least two public hearings, at least 30 days apart, with 30 days’ notice in the predominant newspaper of general circulation in the area

considered for service. At least 40 days before the first public hearing, provide electronic notice to the Department of Revenue and the Public Service Commission (each must post notice on their own websites). Within 10 days after receiving notice from the City, the Department of Revenue must send notice by mail or email to the known addresses for all dealers of communications services registered with the department under chapter 202. The notices must include: the time and place of the hearings, a statement that the purpose of the hearings is to consider whether the governmental entity will provide communications services, the geographic areas proposed to be served by the governmental entity and the services which the governmental entity believes are not currently being adequately provided. The notice must also state that any dealer who wishes to do so may appear and be heard at the public hearings.

- **(2)(b) Content of Public Hearings:** At the public hearings, the city must, at a minimum, consider:
 - Whether the service that is proposed to be provided is currently being offered in the community and if so whether the service is generally available throughout the community,
 - Whether a similar service is currently being offered in the community and, if so, whether the service is generally available throughout the community,
 - If the same or similar service is not currently offered, whether any other service provider proposes to offer the same or a similar service and, if so, what assurances that service provider is willing or able to offer regarding the same or similar service,
 - The capital investment required by the government entity to provide the communications service, the estimated realistic cost of operation and maintenance and, using a full cost-accounting method, the estimated realistic revenues and expenses of providing the service and the proposed method of financing, and
 - The private and public costs and benefits of providing the service by a private entity or a governmental entity, including the effect on existing and future jobs, actual economic development prospects, tax-base growth, education, and public health.

- **(2)(c): Written Business Plan:** At one or more of the public hearings, the City must make available to the public a written business plan for the proposed communications service containing, at a minimum:
 - The projected number of subscribers to be served
 - The geographic area to be served
 - The types of communications services to be provided
 - A plan to ensure that revenues exceed operating expenses and payment of principal and interest on debt within 4 years
 - Estimated capital and operational costs and revenues for the first 4 years

- Projected network modernization and technological upgrade plans, including estimated costs.
- (2)(d) **Findings and vote:** After the City Commission makes specific findings on the above factors, the commission may authorize providing a communications service by a majority recorded vote AND by resolution, ordinance or other formal means.
- (2)(e) **Bonds:** If the City issues revenue bonds to finance a communications service and the revenue bonds mature 15 years or later, the City must conduct a bond referendum.
- (2)(f) **No Subsidization:** The city may not price any communications service below the cost of providing the service by subsidizing the communications service with moneys from rates paid by subscribers of a non-communications services utility or from any other revenues. The cost standard for determining cross-subsidization is whether the total revenue from the service is less than the total long-run incremental cost of the service. Total long-run incremental cost means service-specific volume and non-volume-sensitive costs.
- (2)(g-i) **Enterprise Fund:** the city must establish an enterprise fund to separately and accurately account for its operation of communications services.
- (2)(j) **No Eminent Domain:** the city may not use the powers of eminent domain in providing communications services.
- (2)(k) **Annual Review:** The city must conduct an annual review of its enterprise at a formal public meeting to consider the progress it is making to achieve its business plan goals and objectives. At the meeting it must review the revenues, operating expenses and payment of debt.
- (2)(l) **4-year Review:** If after 4 years, revenues do not exceed operating expenses and payment of principal and interest, the city must hold a public hearing and do at least one of the following:
 - Approve a plan to cease providing communication service
 - Approve a plan to dispose of the system and cease providing communication service
 - Approve a plan to create a partnership with a private entity to achieve operations in which revenues exceed operating expenses and payment of principal and interest on debt; or
 - Approve the continuing provision of communications services by a majority vote of the City Commission.

Without subsidization and given GRUCom's current status as a non-self-supporting system, without sufficient cash to fund a project of this size, a new \$112 million dollar broadband system would require a significant borrowing, either revenue bonds (CCG Consulting pointed out they were unaware of a market for same) with a term exceeding 15 years or general obligation bonds (payable from ad valorem taxes), both of which require referendum approval before the project could proceed.

The CCG Study also pointed out the City may be required to pay ad valorem taxes on its communications services facilities (Section 166.047(3), Florida Statutes), but did not include those in the financial projections of the study. Staff shares that concern and that it may extend taxation to all of GRUCom's property.

Article VII, Sec. 3(a) of the Florida Constitution states that "all property owned by a municipality and used exclusively by it for municipal or public purposes shall be exempt from taxation." The question that must be answered though, is "what is a sufficient municipal or public purpose?" When it comes to telecommunications services specifically, the Florida Supreme Court (Florida Department of Revenue v. City of Gainesville, 918 So2d 250 (2005)) determined that "a municipality, using infrastructure advantages gained from its pre-existing utility operations, may enter a market in which a high level of service and competition already exists without introducing new levels of service, fostering innovation or encouraging infrastructure investment. If that is the case, the municipal telecommunications company does not provide a service that is essential to the health, morals, safety, and general welfare of the people within the municipality" and therefore, the tax exemption does not apply. In contrast, if the municipality can prove that its telecommunications service provides customers with freedom of choice, encourages new services, encourages innovation or encourages investment in telecommunications infrastructure, then the tax exemption does apply.

The City (after 6 years of litigation) successfully used this test to obtain a court order in 2008 (City of Gainesville v. Ed Crapo as Property Appraiser, et.al, 2008, 8th Circuit) that stated "the City's fiber optic network and related internet equipment are being used exclusively for a municipal or public purpose under Article VII, Section 3(a), Florida Constitution, and are therefore exempt from ad valorem taxation for tax years 2003 through 2007."

This court order does not extend to the provision of new services, so the City would need to make factual findings to document how its new broadband service meets this test and be prepared for protracted litigation and ultimately the potential for ad valorem taxes to be imposed on some or all GRUCom's property. If ad valorem taxes were levied, utilizing GRUCom's net capital assets from GRU's audited financial statements as of September 30, 2019 as a proxy for their taxable value and applying that figure against the City's current ad valorem tax rate generates a property tax liability of \$203,335. Of course, the City would receive the tax revenue, but it would raise the rates for communications services.