**City of Seattle**
City Budget Office

**M E M O R A N D U M**

**Date:** **June 8, 2015**

**To:** **Michael Mattmiller, Director**
**Seattle Department of Information Technology**

**From:** **Ben Noble, Director**
**City Budget Office**

**Subject:** **City of Seattle Fiber-to-the-Premises Feasibility Study**

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I have had the opportunity to review the recently completed *City of Seattle Fiber-to-the-Premises Feasibility Study* and would like to offer the following observations regarding the potential impact to City finances and the implications for possible paths forward. The Mayor's interest in the development of an affordable and accessible broadband network is clear and unequivocal. As we search for the best strategies for pursuing this goal, we will need to consider the financial constraints facing the City and the competing priorities for municipal resources.

**Financial Constraints – Debt Capacity Limits and Risk to General Fund Resources**
The two most significant financial limitations apply specifically to the contemplated business model that would rely on subscriber revenues as the funding source to support the necessary capital investments and ongoing operational expenses of a broadband network. These constraints relate both to the debt needed to support capital investments and the risks to the City's limited operational resources.

***Debt Capacity.*** Statutory limits on the City's debt capacity and competing demands for the capacity that remains place very real limits on the City's ability to finance a broadband system with General Obligation debt, as anticipated in the financial model presented in the report. Given the relative uncertainty of the revenue stream to be generated by subscriber revenues, it is apparent that a pledge of the City's full faith and credit would be required to sell the debt needed to finance the necessary capital investment. By state law, debt issued with such a broad pledge of City resources is limited to 1.5% of the City's total assessed value. After accounting for existing outstanding debt and the reserves maintained to address potential emergencies, the City currently has just over $1 billion of available capacity.

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With estimated capital costs of between $500 and $665 million, a broadband network could consume roughly 50 to 65% of the available debt capacity. While technically feasible, a bond issuance of this scale would significantly constrain the debt capacity available for such competing priorities as affordable housing, critical public safety facilities maintenance and upgrades (e.g., the Police Department's North Precinct) and other infrastructure needs such as bridges and roadways. Furthermore, issuing this much debt would likely have a negative impact on the City's debt rating, and thus increase the borrowing costs for all City capital projects.

***Risk to General Fund Resources.*** Of potentially greater concern is the financial impact that a less-than-successful municipal broadband business could have on the City's General Fund. The report highlights that the City's entry into the broadband market will face stiff competition from well-funded incumbents, whose aggressive pricing strategies could thwart efforts to build a robust subscriber base for a municipal system. The financial analysis included in the report demonstrates that if the municipal network does not attract a sufficient subscriber base--an outcome which is more likely than is apparent, as success would require take-rates rivaling or surpassing those enjoyed by incumbents after years of large investments--losses could mount quickly. With fixed annual debt service costs of between $40 and $55 million, the capital investment needed to build a municipal network presents a substantial operational risk to the General Fund.

If the municipal effort were in fact to falter, the result would be immediate financial pressure on the City's General Fund. The General Fund represents the roughly $1.1 billion in annual resource that support basic City functions such as police, fire, parks and human services. Any attempt to rescue a faltering municipal effort would necessarily entail correspondingly large cuts to these and other existing City programs and priorities. The City's existing utilities do not create such risks because they are financially separated from the General Fund, operating as protected monopolies with secure revenue sources. A municipal broadband system would not enjoy this protection and would not have the secure revenue streams necessary to be financially independent. Instead, it would be entering a long-established, competitive marketplace served by multiple incumbents.

While a municipal broadband system is an exciting prospect, it would not be prudent to pursue a business model that relies solely on subscriber revenues and a pledge of the City's full faith and credit to support the necessary debt financing. Such an approach would put the City's General Fund at significant financial risk should the endeavor falter or fail.

## Opportunities

The constraints identified above certainly do not imply that the City cannot play a role in achieving the Mayor's goal of expanding broadband services city-wide. The report highlights several other approaches that could help support such an expansion. For example, the potential to pursue state or federal funding, and to work in conjunction with the a partner outside of city government could provide necessary resources while reducing financial risks to the City's finances and to city residents more generally. It appears that joint private-public efforts are being pursued elsewhere in the Country, providing cities the opportunity to achieve broadband policy objectives in a financially sustainable manner.

Voter-approved funding for the project could provide another tool to advance the overall goal of broadband accessibility. Such funding would come in the form of a 60%-majority vote for long-term municipal debt to be repaid from property taxes. Debt issued in this form does not count against the limits described above. This approach would indeed limit risks to the General Fund since some or all of the capital costs would be paid from the levy and not from operating revenue. However, this would not eliminate the issue of risk altogether. The public's obligation to repay such debt via property taxes would remain whether the broadband business model proved successful or not, and operational costs could still put financial pressure on the General Fund should subscriber revenue did not achieve self-sustaining levels. Nonetheless, it is possible that this approach could help provide the resources needed to leverage other public funding or private capital, in pursuit of a more robust broadband network.