

TO: HONORABLE CITY COUNCIL

FROM: CITY MANAGER DEPARTMENT: ADMINISTRATIVE SERVICES

DATE: JUNE 18, 2007 CMR: 261:07

SUBJECT: REQUEST FOR COUNCIL DIRECTION CONCERNING CITYWIDE ULTRA-HIGH-SPEED BROADBAND SYSTEM NEGOTIATIONS

RECOMMENDATION

Staff is requesting direction from the City Council concerning the Citywide Ultra-High-Speed Broadband system project, based upon one of the two options below:

- 1) Confirm the City's commitment to proceed with the project given that the City's financial commitment to the project would be greater than originally anticipated. If Council wants to proceed Council should decide whether to:
 - a. Pay 180 Connect Network Services, Inc. (180 Connect) \$30,000 for the preparation of a business plan. If so, authorize the use of \$30,000 in Council Contingency funds for this purpose; or
 - b. Direct 180 Connect Network Services, Inc. to develop a business plan at its own expense; and
 - c. Authorize the use of \$65,000 in Council Contingency funds to hire legal, financial and telecommunications consultants to support the City's role in the development of the business plan.
- 2) Terminate negotiations with 180 Connect because the City's anticipated financial contribution (or financial risk) of 30 to 40 percent of project cost, or an estimated \$15 million, is too high.

BACKGROUND

The City issued an Ultra-High-Speed Broadband system Request for Proposals (RFP) on September 27, 2006. On January 9, 2007, two firms submitted proposals. On January 29, 2007, Mayor Kishimoto requested that Vice Mayor Larry Klein and Council Member Bern Beecham review the proposals and provide feedback to Council. On March 5, 2007, staff provided Council with an analysis of the two proposals and Council directed staff to enter into negotiations with one of the respondents, 180 Connect. The Mayor designated a two-member

citizens' committee to participate in this process in an advisory capacity. Staff committed to return to Council after preliminary discussions were held with 180 Connect with a recommendation on project staffing needs, a list of City assets that could be leveraged as part of the project, and information on business plan preparation costs.

The proposal from 180 Connect includes a consortium of firms that would partner with the City to develop a broadband system. The consortium (180 consortium) is comprised of the following firms: 180 Connect, who would be responsible for overall project management, construction, installation and system operations; Packetfront, who would be responsible for designing the system and supporting its operation; and RBC Capital Markets ("RBC"), who would be responsible for identifying funding for the system.

DISCUSSION

In accordance with Council direction, in March 2007, staff initiated discussions with the 180 consortium. On March 29, 2007, staff submitted a series of questions to 180 Connect in an effort to ascertain the proposed business relationship, agreements that would need to be established and the contribution required from the City (Attachment 1). On April 19, 2007, staff and the citizens' committee met with the 180 consortium to review its response to these questions (Attachment 2) and to define a plan of action. At this meeting, the 180 consortium indicated that a business plan must be developed and approved by the parties before proceeding with this project.

A business plan would give the 180 consortium and the City the information needed to determine whether or not the project is economically viable and should be pursued. In addition, a business plan would define: 1) the City's financial contribution to the project; 2) the list of City assets and/or other City services that could be leveraged for the project; 3) the relationship and agreements needed between the parties; 4) the financing plan for the project; and 5) the plan for City ownership of the broadband network. The 180 consortium provided a proposed table of contents for the business plan (Attachment 3). The 180 consortium also requested \$30,000 from the City to cover its direct costs in preparing the plan.

At the April meeting, 180 Connect introduced a new consortium member, NorthStar Capital Partners. NorthStar works with RBC to provide financial advisory services, and represented RBC's interests at the meeting. The 180 consortium suggested that NorthStar act as the financial coordinator for the project. Its role would be to work with RBC to arrange for funding to construct and operate the system. Staff has requested background information on NorthStar in order to evaluate its knowledge and experience levels.

NorthStar presented a high-level financing plan to the City at the April meeting (Attachment 4). As part of its presentation, NorthStar indicated that the City's financial commitment to the project would need to be greater than originally anticipated. 180 Connect's RFP response had stated that the 180 consortium could support the project on its own, with a pledge of "limited City assets," and without any capital contribution from the City. This response was consistent with the RFP requirements and with Council's direction to minimize City risk. NorthStar has since indicated that the City would need to provide a pledge representing 30 to 40 percent of the cost to complete the project or a cash equivalent of around \$15 million. This pledge could be in the form of cash, loan guarantees, and/or assets and equipment.

Staff also learned that RBC will not be investing directly in the project. It is anticipated that NorthStar and RBC will work together to seek private investors for the project's financial capital requirements. Since it is probable that funding for the project will come from private investors, the rate of return required could impact the economic viability of the project. With this new information about the City's financial participation in the project, staff would like to confirm Council's commitment to this effort.

If the Council directs staff to proceed with the development of a business plan, staff recommends obtaining legal, financial and telecommunications experts to assist staff in the following areas:

- 1) Outside legal experts in the telecommunications industry (\$10,000) to advise staff on the relationship and agreements between the parties and any legal or regulatory issues.
- 2) Financial advisory services (\$10,000) to review the various financing instruments that could be used to fund the project and analyze the financial condition of the 180 consortium partners. In particular, staff would like to perform a more in-depth review of the financial condition of 180 Connect. During the RFP evaluation process, staff voiced concerns about 180 Connect's financial stability. Since 2003, 180 had a series of net operating losses ranging from \$4.7 million to \$13.3 million. For the 9 months ending September 30, 2006, the company had a loss of \$10 million. During this same time period, the company's balance sheet carried a deficit of \$74 million on assets of \$169 million. As a result of these issues, staff believes it is prudent to obtain an independent assessment of 180 Connect's financial ability to carry out the broadband project.
- 3) Telecommunications industry and other consultants (\$45,000) to provide an independent valuation of the City's General and/or Utility Fund assets, to review the draft business plan, and to provide back-up support to ASD staff enabling it to manage this effort.

In addition to these consulting costs, a significant amount of internal staff time (from Administrative Services and Utilities departments as well as the City Attorney's Office) would need to be devoted to the business plan effort at a cost of approximately \$75,000.

The City's role in the development of the business plan would be limited to: 1) identifying and analyzing the various types of contributions that could be provided by the City (e.g., cash, pledge of revenue, letters of credit, debt instruments, permit fees, etc.); 2) identifying and valuing City assets; 3) providing information about existing City infrastructure and facilities; 4) examining legal and regulatory issues; and 5) providing general information about Palo Alto. Beyond these responsibilities, the 180 consortium would be responsible, with its engineering, technical, marketing, and broadband delivery expertise, for development of the business plan.

RESOURCE IMPACT

If Council directs staff to proceed with development of a business plan, staff requests funds of up to \$95,000 from the Council's Contingency to pay for the plan. The preparation of a business plan will also require the devotion of significant staff time, estimated at \$75,000. If the business plan recommends that the broadband system should be launched, resources valued at about \$15

million would need to be dedicated to the project. Once the broadband network has been constructed, 180 Connect would assume responsibility for all ongoing operating costs.

POLICY IMPLICATIONS

This report is consistent with Council’s policy and program direction provided at its March 5, 2007 meeting.

TIME LINE

If Council directs staff to have the 180 consortium undertake the development of a business plan, staff anticipates that it would take a minimum of six months to complete the plan. During this process, staff would return to Council for direction on the level and type of contribution the City is willing to commit to the project. Upon completion of the business plan, staff would return to Council with a recommendation to proceed or to terminate negotiations with 180 Connect for a broadband system.

ENVIRONMENTAL REVIEW

The actions requested in this report do not constitute a project for the purposes of the California Environmental Quality Act.

PREPARED BY:

JOSEPH SACCIO
Deputy Director, Administrative Services

DEPARTMENT HEAD APPROVAL:

CARL YEATS
Director, Administrative Services

CITY MANAGER APPROVAL:

EMILY HARRISON
Assistant City Manager

ATTACHMENTS:

- Attachment 1: March 29, 2007 Letter to 180 Connect
- Attachment 2: April 10, 2007 Response from 180 Connect
- Attachment 3: Business Plan Table of Contents
- Attachment 4: NorthStar Presentation