



Jason E. Mumpower
Comptroller

November 18, 2022

Honorable Kevin Brooks, Mayor
and Honorable Councilmembers
City of Cleveland
190 Church Street NE
Cleveland, TN 37364-1519

Dear Mayor Brooks and Councilmembers:

Thank you for your recent correspondence. We acknowledge receipt on October 6, 2021, of a request from Cleveland Utilities (the “System”), a component unit of the City of Cleveland (the “City”), to provide broadband services pursuant to Tenn. Code Ann. § 7-52-601 et seq. (the “Plan”). The Comptroller’s Office is required, pursuant to Tenn. Code Ann. § 7-52-602, to review and provide a written analysis as to the feasibility of proposed plans.

The Plan was prepared by the System. The uptake rate or percent of potential customers who will purchase the System’s broadband services is the key assumption for the projection of future revenues to make the proposed broadband division fully self-supporting. Sufficient revenue to meet all expenses of operation and maintenance, and all debt service obligations is the primary factor in determining if the Plan appears to be financially feasible.

Based on the information in the Plan, revenues during the 10-year proforma period appear sufficient to cover all operating expenses and to pay debt service; therefore, we have determined that the proposed Plan appears feasible.

Our analysis is based upon the following assertions as presented in the Plan:

1. The rate of available customers in the System's operational area that will purchase the proposed broadband services (the "uptake rate") is projected to be 30%. The uptake rate is the key assumption for the projections that support the financial feasibility of the proposed broadband division.
2. To fund capital and operational costs for the broadband division during the start-up phase the broadband division will borrow \$8,000,000 from the electric division. The loan will have an 20-year repayment schedule and an estimated 6.0% interest rate.
3. The City intends to provide internet service and Voice over Internet Protocol (VoIP) telephone services through a third party. The City should consult with its legal counsel to ensure they comply with all aspects of state statutes.
4. The System projected in its pro forma schedules that the broadband division would incur a loss of cash from operating activities in years 1 and 2. It is projected that by year 3 the broadband division will generate cash from operating activities of \$1,720,245. Cash flow from operating activities remains positive for the remainder of the 10-year pro forma schedule. Available cash is projected to be positive for the entirety of the 10-year forecast period. The System does not anticipate the need for additional loans to meet working capital needs.

If the City decides to proceed with the Plan, it must publish a notice as required by law in a newspaper of general circulation in the area to be served which specifies the date on which a public hearing concerning this project will be held. In addition, after the public hearing is held, approval must be obtained by a two-thirds (2/3) majority vote of the Governing Body of the City or by referendum.

If the City proceeds with the Plan it agrees to the conditions precedent in Title 7, Chapter 52, Part 6 of the Tennessee Code Annotated. The City should work with its legal counsel in interpreting and understanding these requirements.

If you should have questions or need assistance, please feel free to contact your financial analyst, William Wood, at 615.401.7893 or William.Wood@cot.tn.gov.

Very truly yours,



Sheila Reed, Director
Division of Local Government Finance

cc:

Mr. Tim Henderson, Cleveland Utilities
Mr. Walt Vineyard, Cleveland Utilities
Mr. Marshall Stinnett, Cleveland Utilities

Enclosure: Regulations Applying to Broadband Plans

SR:ww



Regulations

The Tennessee General Assembly has enacted legislation that authorizes local governments to provide these broadband services through their municipal electric systems. This legislation also places numerous responsibilities on local governments who determine to provide such services, including the following:

- A. A separate accounting and record-keeping system must be maintained for the operation of the municipal electric system's internet services program. All costs, both direct and indirect, incurred in the operation of the program must be allocated to the rates charged for the services provided.
- B. A municipal electric system cannot subsidize the activities of the internet services program by using revenues of its power or other utility operations. The only authority to use electric system's funds is through the lending of funds, on a temporary basis, by an electric system. An electric system must charge interest to the internet services program for any loans at a rate equal to the highest rate then earned by the electric system on its invested plant funds.
- C. An internet services program must adhere to the same terms/conditions provided in existing power pole attachment agreements, including cost allocations for rates, insurance and other expenses normally associated with similar programs operated by private providers. The rate charged to the internet services program for pole attachments must be equal to the rate charged other franchise holders providing similar services.
- D. An electric system must provide the same response times and service quality to requests made by a private provider of similar services as it provides to the electric system's internet services program.

E. An electric system, with respect to any internet services provided, must make tax equivalent payments as required by T.C.A § 7-52-606; however, the tax equivalent payment to be made by the electric system may not exceed the amount that would otherwise be due if it were a private provider of internet services paying ad valorem taxes.

F. An electric system, with respect to any internet services provided, is subject to make payments to the appropriate units of government for amounts in lieu of the following taxes: excise and franchise taxes authorized by Tennessee Code Annotated, Title 67, Chapter 4, Parts 20 and 21; sales taxes authorized by Tennessee Code Annotated, Title 67, Part 6; and local privilege taxes authorized by Tennessee Code Annotated, Title 67, Chapter 4, Part 7.

The Legislature has authorized local governments to provide these services that have historically been provided by the private sector. The Legislature has also made it clear that any costs attributable to these programs must be allocated to the rates charged for services rendered, and that none of these costs are to be subsidized by electric system revenues. This requires a significant degree of recordkeeping to ensure that all expenses are properly allocated and reported. The accounting staff of the system should be familiar with these requirements and will be responsible for maintaining these records.

The legislation stipulates that the fiscal operations of the internet services program must be included in the annual financial report of an electric system as a segment of the electric enterprise fund, and must be subject to a financial and compliance audit prepared in accordance with generally accepted governmental auditing standards. The officials of a municipal electric system should be familiar with the requirements that have been previously applied to their other utility system operations. The Comptroller of the Treasury, through the Division of Local Government Audit, shall be responsible for determining adherence to such audit and reporting requirements. Representatives of the Division of Local Government Audit may be contacting you and your independent auditor concerning these audits.