June 2014 Volume 39 Issue 6

THE UTAH TAXPAYER

A PUBLICATION OF THE UTAH TAXPAYERS ASSOCIATION

3rd Party Economic Report: UTOPIA Deal BAD for Taxpayers

The following is an Executive Summary of a May 2014 study by Doug Macdonald, Ph.D. of Econowest Associates, Inc. entitled: **Why the UTOPIA/Macquarie Proposal is Bad for UTOPIA Cities and Residents: An Analysis of the UTOPIA/Macquarie Milestone 1 Proposal.** ***Econowest Associates, Inc. is a Utah-based economic policy group.***

The troubled UTOPIA Fiber Optic Network, a consortium of 11 Utah cities and an associated entity known as the Utah Infrastructure Agency, have been seeking ways to address the substantial debt they have incurred over the past decade (over $355 million to date), reduce the operating costs they incur every year, currently $13 million per year, and find a way to build out the proposed system which has only 11,000 users out of 149,000 households.

The UTOPIA Fiber Optic network is working with an Australian private investment firm Macquarie to propose a PPP (public private partnership) to complete the fiber optic system. An independent analysis by the Utah economics firm Econowest of the proposed PPP between UTOPIA and Macquarie points out a number of issues that the proponents of the plan have not highlighted or acknowledged. A summary of the Econowest findings includes the following.

The New Debt Obligations for UTOPIA Cities and Residents will be as high as $1.83 Billion over 30 years.

The Macquarie proposal to build out the UTOPIA fiber optic system will **require** every household in the 11 cities that participate in the UTOPIA system to pay an annual fee which starts at $240 per year and increases every year for 30 years (a $240 monthly payment increases to $325 per year after 30 years), whether the household wants the service or has an existing internet service. This represents a cost to the average household in UTOPIA cities of over $9,700 for the life of the project. This enormous new cost of $1.83 billion, for a service that has heretofore been unproven, unwanted and duplicative of private internet service, can preclude and crowd out other needed municipal investments and services that residents may want now or in the future.

The method of payment is a required utility fee or tax on every household in the UTOPIA network, without a vote or substantial public input such as is required in a general obligation bond election. Because it is a mandatory fee, and bundled with other municipal public utility fees, the method of forcing payment would be withholding other municipal services, such as cutting off water to the household.

Households Will Subsidize Business Connections in the Mandatory Utility Fee Plan

There are serious equity considerations in the Macquarie mandatory fee schedule. Even though businesses will pay a higher utility of fee of $480 per year vs $240 per year for a single family household, the business receives a substantially higher benefit based on their need and usage. The Macquarie proposal acknowledges that few residents want or need the highest speeds provided by fiber optics, yet a household who only uses the internet for email and other basic services would only receive a 50% reduction of the utility fee

JUNE 2014
VOLUME 39

compared to large retail stores, high tech companies or other high volume users. In addition, apartment dwellers would receive only a 50% discount compared to a single family household, even though the fiber optic trunk connection to an apartment complex can charge a monthly fee to each resident would amount to a revenue windfall.

The Probability of Success in Reaching the Usage Goal is Unlikely

Even with the new public revenue to Macquarie (and a generous return on their investment of 13% on the public funds), and new costs to residents in the form of a mandatory fee for 30 years, the probability of success is very uncertain. Currently the UTOPIA system has 1 out of 6 households or businesses signed up to the plan. To reach their projected financial goals, they will need to convince 2 out of every 5 households and businesses to sign on, a substantial increase in users with no evidence to date that households or business will do that. And in some of the larger and lower income UTOPIA cities, the utilization rate is very low, such as 6.7% of households in West Valley City and 7.4% of households in Midvale signing on to UTOPIA.

The current $355 Million of UTOPIA Debt has a small chance of being repaid

From a business perspective, the $355 million of current debt by the UTOPIA cities is a sunk cost. The current Maquarie proposal requires that all of the new utility fee pay for costs going forward, and does not address existing debt. Existing debt would only be repaid if there is a substantial upsell in "premium" services to households and business above the mandatory fee. That upsell charge is then split three ways, yet to be determined. Given the income levels of many UTOPIA cities, the Econowest analysis indicates that lower usage rate and lower upsell amounts would not generate the kind of revenue surplus to put a dent in the UTOPIA existing debt.

The amount of the current UTOPIA debt is staggering and is 69% of the per capita debt level of the State of Utah's outstanding per capita debt. The State of Utah debt is for working capital like highways, higher education, and buildings while the UTOPIA debt is "stranded" and should be considered a sunk cost. As a sunk cost, the sale or disposition of the assets should be a priority, which would address the debt overhang.

For example, the existing debt for individual UTOPIA cities is $99,000,000 for West Valley City, $77,000,000 million for Orem, $59,000,000 for Layton, $21,000,000 for Midvale, and over $11,000,000 for Centerville and Brigham City, and a significant amount averaging almost $800 per capita for all cities.

The Complexity of the Macquarie Plan and Poor Track Record by UTOPIA Is a Toxic Combination

UTOPIA cities and residents should be wary and hesitant that the bad economic and management decisions in the past will not be repeated in a highly complex financial and business enterprise arrangement with Macquarie. What can go wrong? Many things can, but the risk is not on Macquarie but again entirely on the UTOPIA cities and the residents of those communities. Macquarie would receive a guaranteed revenue stream, and the cities and residents would be on the hook for paying the on-going utility fees, the substantial management fees, construction fees, legal fees, and other costs in the hope that enough people might use the service and then pay a premium for upgraded services to receive anything in return. The Office of the Utah Legislative Auditor General, in the 2012 Audit Summary of UTOPIA said, poor planning, mismanagement, and unreliable business partners have contributed to the Agency's financial difficulties.

For the complete Econowest analysis go to: www.utahtaxpayers.org or uNOpia.org.

Association President
Howard Stephenson

My Corner: It's Time to Say uNOpia to UTOPIA

The wisdom of Will Rogers seems appropriate as the 11 UTOPIA city councils this month decide whether to magnify the ten years of mistakes of their predecessors and force a $1.8 billion tax increase on their citizens: "When you find yourself in a hole, stop digging."

UTOPIA has never finished a single year in the black and is currently saddled with negative net assets. In other words, UTOPIA's hole is already very deep.

For years Utah has lived with a stigma as the scam capital because so many schemers have convinced gullible citizens to turn over their hard earned money in exchange for the economic equivalent of snake oil. The fact that city councils of 11 cities committed their taxpayers to such a scheme was discouraging, but even more appalling is the fact that many of those city councils (which now have new members who didn't make the original decision) are now poised to double down on their original bad bet by forcing their taxpayers to guarantee $1.8 billion in payments to an Australian company to complete the project.

Principles matter

The principles your Taxpayers Association uses to evaluate government proposals include: 1) government should stay out of the business of business (e.g. party caterers), 2) government

proposals to initiate a new service should use the "yellow-pages" test (i.e. if the service is available in the phone book, government ought to stay out of it) and let the private markets provide consumers with what they are willing to buy, and 3) fees for service should relate to the usage of that service where possible (e.g. water bills).

The UTOPIA scheme violated the first two principles from the outset and they are about to violate the third. Clearly UTOPIA cities sought to provide broadband services which a multiplicity of competing companies were already providing without taxpayer subsidies. Today those privately-provided options have expanded even further as broadband speeds climb and many persons get all of the internet connectivity they want by turning their 4G mobile phones into hot spots when they need their computer to go online. (Read the article on page 6 entitled "Utah's Broadband Non-Adopters" to learn why 20% of citizens are simply not interested in signing up for broadband.)

These UTOPIA city councils had the audacity to impose their judgment about what people needed and were willing to pay, instead of relying on the marketplace. The hubris of such elected officials was stunning, but now they know the error of their ways. (UTOPIA failed to meet any of its benchmarks and is mired in debt.) Even more stunning is that there is even a question as to whether they should stop digging.

Sunk costs

One of the first concepts learned in economics and finance classes is the concept of sunk costs. BusinessDictionary.com defines sunk costs this way:

> "Money already spent and permanently lost. Sunk costs are past opportunity costs that are partially (as salvage, if any) or totally irretrievable and, therefore, should be considered irrelevant to future decision making. This term is from the oil industry where the decision to abandon or operate an oil well is made on the basis of its expected cash flows and not on how much money was spent in drilling it."

Failure to understand the concept of sunk costs is what keeps people digging when they should stop. It's what keeps people who have lost their shirts in Las Vegas thinking the jackpot is next, because they've lost so much, they must be on the verge of winning. Failure to understand sunk costs is why some of the 11 UTOPIA city councils may vote this month in favor of another $1.8 billion bet.

Political insiders say the people should be able to decide

UtahPolicy.Com recently asked Utah political insiders whether city councils would approve a $1.8 billion tax hike proposed to bail out UTOPIA. The survey results showed that most Republicans thought 5 or more of the 11 city councils would vote to impose the new tax, while Democrats were less optimistic that cities would sign on.

When asked whether the question of a $1.8 billion tax hike should be put to a public vote, an overwhelming 81% of Republican insiders and 70% of Democrat insiders said yes.

UTOPIA has never finished a single year in the black and is currently saddled with negative net assets.

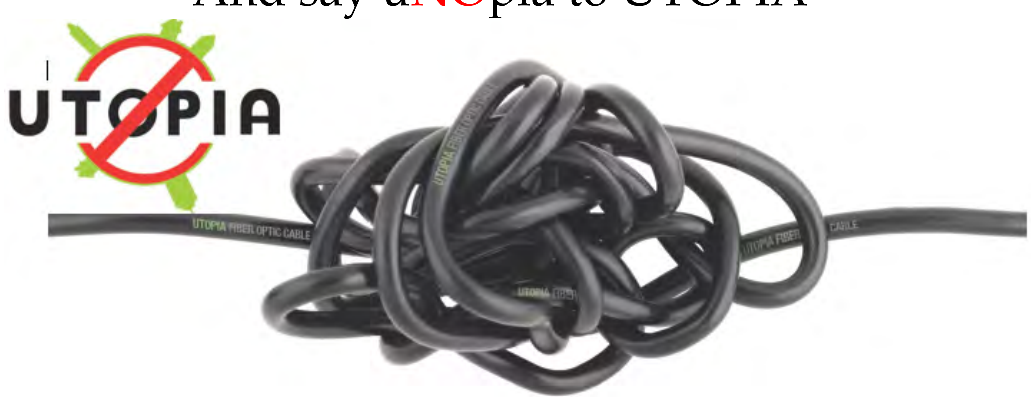
Your Taxpayers Association agrees that this tax proposal should not be adopted without approval of the citizens who will have to pay it. When the original UTOPIA proposal was considered 10 years ago, we also called for a vote. The common response was stated by then Murray Mayor Dan Snarr, "The normal everyday Joe isn't going to take the time to understand . . . so the decision should be left to those people [at the city councils of the cities involved] who take the time to understand all the benefits this system can provide" (Salt Lake Tribune January 18, 2004).

To put the $1.8 billion tax hike into perspective, if this were a statewide tax increase, it would amount to approximately $12 billion, or more than all state taxes in the entire state budget. I don't believe 104 state legislators would come close to approving such a scheme. And neither should city councils in the 11 cities.

Citizen action needed

Your Taxpayers Association is conducting a campaign to inform citizens to get involved and "Say uNOpia to UTOPIA." We are also researching what federal and state laws may be violated through the adoption of the current proposal. To get involved, go to uNOpia.org, sign the online petition and contact your city council members.

Sign the petition at uNOpia.org
And say uNOpia to UTOPIA



36th Annual Utah Taxes Now Conference a Success

4th District congressional candidates Mia Love and Doug Owens debate for the first time in the 2014 election cycle

The Utah Taxpayers Association hosted the first debate, moderated by Frank Pignanelli, between the 4th District Congressional candidates Mia Love and Doug Owens during lunch at the annual "Utah Taxes Now" conference. Love and Owens each laid out their vision for Utah and the 4th district. They discussed Obamacare, Medicaid expansion, tax reform, and entitlement spending.

Over two hundred people attended the debate and joined presenters to discuss bringing technology into the classroom, making Utah a tourist destination, ensuring State Tax Commissioners are well qualified, understanding Utah's Medicaid donut hole, paying for transportation, and many other topics. Governor Gary Herbert, House Speaker Becky Lockhart and Senate President Wayne Niederhauser also addressed the audience. You can find a copy of the presenters' written materials and slides at www.utahtaxpayer.org.

Bringing technology into the classroom

Speaker Becky Lockhart explained her plan to bring one-to-one devices to every student in Utah and the infrastructure needed to implement a large-scale one-to-one device program. Senator Howard Stephenson discussed the benefits of student-centered learning software, which allows students to receive immediate feedback on their assignments.

Media lined the walls during the "Utah Taxes Now" conference

Making sure State Tax Commissioners are well qualified

Senator John Valentine and former State Tax Commissioner Dr. Gary Cornia discussed the importance of having well qualified tax commissioners and how the 2014 legislature helped ensure well qualified commissioners by removing the partisan requirement for serving as a commissioner. Dr. Cornia also explained the complexities that commissioners are responsible for in their role as tax judges.

Improvements to Truth-in-Taxation (TnT)

Senator Deidre Henderson discussed the changes to TnT that were passed in the 2014 legislative session (SB 65), making calendar year budgeting entities hold December TnT hearings thereby streamlining the TnT process for taxpayers and taxing entities.

Fixing Utah's Medicaid Donut Hole

Senator Brian Shiozawa, Dr. David Patton, and Representative Jim Dunnigan discussed various proposals for Medicaid expansion under Obamacare, including full expansion, Governor Herbert's "Healthy Utah Plan"and no or very limited expansion. All plans would have a significant affect on the state budget going forward.

Paying for Transportation

Executive Director of UDOT Carlos Braceras, Repsentative Johnny Anderson and President of the League of Cities and Town Ken Bullock discussed various plans to pay for transportation maintenance and expansion. The discussion focused on changing and creating new funding sources for local and statewide transportation.

Taxpayer Advocate Award and Taxpayer Angel Investor Award

Senator Deidre Henderson received the "Taxpayer Advocate Award." Senator Henderson has been an advocate for taxpayers throughout her service in the legislature and in her role as chair of the Revenue and Taxation Committee. During the 2014 legislative session she sponsored SB 65, which changed the schedule for Truth-in-Taxation hearings for calendar year budget entities. This is a significant accomplishment. The Taxpayers Association has worked on changing the TnT schedule for calendar year budget entities since the original TnT law passed in 1986.

SHED, a charter school developer, received the "Taxpayer Angel Investor Award", accepted by Jed Stevenson. SHED and other charter school developers assume the risk of building charter schools instead of taxpayers assuming the risk. Charter school developers have saved taxpayers $2 billion that would have been needed in new bonds. This allows more Utah families to receive a quality education of their choice.

Guest Commentary:

Preventing Assessment Areas From Being an End Run Around TnT

Representative Curt Webb

Earlier this year Governor Herbert vetoed HB102. A one-year moratorium on the creation of Assessment Areas as defined in 11-42-201.5 was the key component of the bill and the reason for the veto. The bill seemed innocuous and the veto generated no controversy and little discussion. So what was behind the bill and the veto? It is about transparency and compliance with the intent of the Assessment Area statute.

The Assessment Area statute allows a political subdivision to create smaller geographic areas within its boundaries. The areas are created to provide improvements or benefits to that particular area, and to charge fees to the properties in that area in proportion to the benefit received. The assessments are deemed to be fees and are exempt from Truth in Taxation processes. The areas are relatively simple to create and surprisingly difficult for objecting property owners to prevent.

The language of the current code has permitted an evolution of the application of the law that has redefined and even ignored the proportional fee to benefit intent.

At the risk of oversimplifying: here are several of the problems we need to fix:

A) If a city wanted to widen and beautify the sidewalks of a particular block, it would make sense to create an assessment area and charge each property owner their proportional share based on the amount of sidewalk needed for that property. If however, the city chose to assess the fee based on assessed tax valuation (which the code permits) rather than the amount of sidewalk required, a high rise office complex valued at $20 million, would pay 40 times more for the same amount of sidewalk as would a $500,000 cafe next door. The statute did not intend for the fee to be assessed based on ability to pay, but proportionally based on benefit received.

B) The code allows both direct and indirect benefits to be considered. Indirect benefits are extremely difficult to define and quantify, and their inclusion has facilitated justifications that lead away from the original intent. By permitting indirect as well as direct benefits to be considered, the boundaries of an area can be expanded to include properties which do not benefit directly. The result has been the expansion of area boundaries beyond directly benefitted properties in order to spread the cost. If the expansion is calculated carefully the expansion area will contain as many properties as possible for that purpose, but too few to generate protest sufficient to derail the proposal.

C) Assessment areas for economic development are permitted under the current statute. The benefits derived vary widely based on the focus of the development efforts, many of which are indirect. When the focus is on increasing foot traffic and activity to a specific area for the sake of commerce, certain types of properties and businesses are benefited far more than others. The areas are usually expanded as far as is reasonably acceptable, and the likely assessment method (assessed valuation) will have virtually no correlation to the benefit received.

If Assessment Areas do not comply with the proportional assessment to benefit structure then they are clearly a tax and should be treated as such.

There are other elements as well that deserve consideration.

If some of the indirect benefits accrue to the general public, should that portion be calculated and funded by general tax dollars?

If the cost of a sewer or water system was assessed to a specific area for use in that area, should hookups to that system by properties outside of the Assessment Area be required to pay a pro rata share of that benefit back to those who were assessed for it?

Overall, the Governor vetoed HB102 because of 6 rural propane-to-gas conversion projects which were already in process, and which used assessment areas as the vehicle of choice. Most assessment areas comply with the proportional fee to benefit intent. There are many areas which are technically in compliance with current code as written, but which hardly resemble the proportional fee to benefit model. Before the 2015 Legislative Session, the Political Subdivisions Interim Committee will explore draft legislation intended to preserve the original concept, but to limit the parameters to comply with the original intent.

If assessment areas do not comply with the proportional assessment to benefit structure then they are clearly a tax and should be treated as such.

Representative Curt Webb, District 5, serves on the House political Subdivisions Committee, House Public Utilities and Technology Committee, Infrastructure and General Government Appropriations Subcommittee, Natural Resources Agriculture and Environment Interim Committee, and Political Subdivision Interim Committee.

Can't get enough Tax Policy? Follow us on Twitter and like us on Facebook

@utahtaxpayers www.facebook.com/utahtaxpayers

Guest Commentary:

Utah's Broadband Non-Adopters

Megan E. Hansen

Ryan M. Yonk

Last year the average American spent over five hours online daily doing everything from shopping to taking online classes to watching TV. Despite the apparent benefits the majority of Americans get from having in-home high-speed Internet, some still choose not to subscribe to these services.

In a forthcoming report we explore why some twenty percent of Utah residents still choose not to adopt in-home high-speed Internet. We surveyed 500 non-adopters throughout the state of Utah to discover what drove their decision not to adopt. These respondents were asked demographic questions to establish who they were, why they had not adopted high-speed internet, their use and expertise with the internet, as well as their preferences regarding price and service.

In general four main reasons for broadband non-adoption have been identified: price, availability, expertise, and demand. Although each of these reasons are likely playing a role in non-adoption decisions, our study seeks to discover the dominant reason for non-adoption at the state level and in each of the seven association of government regions we surveyed.

The results of this survey were clear; at both the state and the regional level, a lack of demand was the single biggest reason for non-adoption of high-speed Internet. At the state level, 44 percent of respondents said the main reason they do not have high-speed internet access in home is that they don't need it or are not interested in getting it. The next most common reason for non-adoption was price, with 22 percent of respondents identifying that broadband services are too expensive.

To better understand these decisions we sought to create a typical non-adopter profile. Across the state, the average age of non-adopters was 56, and 61 percent were 51 years of age or older. Further the average household income of respondents was $51,347, placing average non-adopters well outside of poverty. Among our respondents 41.2 percent had completed at least a four-year degree and just over 80 percent of respondents were white.

Of the seven regions surveyed, the Wasatch Front region is the largest in terms of population and comprises Weber, Morgan, Davis, Tooele, and Salt Lake Counties. In the region, 48.1 percent of non-adopters said the main reason they do not have high-speed Internet access in their home is that they don't need it or are not interested in getting it. That number is similar although higher than the state average (44 percent).

The key reason for non-adoption of high-speed internet from our data is clearly a lack of interest, and because increasing demand is difficult, these state and regional numbers do not bode well for policymakers who seek to increase adoption rates. Likewise, the second most common reason, that high-speed internet is too expensive, is not easy to address without expensive subsidies on either the supply or the demand side of the broadband market.

We also asked participants what would make them likely to adopt high-speed Internet at home, and 53 percent of respondents at the state level and 49.2 percent of respondents in the Wasatch Front region said training on the computer or internet would increase their likelihood of adoption. Our results provide some indication as to why this might be. When asked to rank their computer skills on a scale from zero to ten (with zero being no skills), 65 percent of respondents at the state level and almost half of respondents in the Wasatch Front region ranked their skills at a five or below.

The results of this survey were clear; at both the state and the regional level, a lack of demand was the single biggest reason for non-adoption of high-speed internet.

Non-adopters were also asked if they know how many high-speed internet providers are available in their area, and a large majority, about 85 percent at the state level, said they did not. Only 57.8 percent of those statewide respondents answered that high-speed internet is in fact available in their area. This means there is likely a knowledge problem, best solved by the provider companies themselves, where some non-adopters aren't adopting simply because they don't know what broadband services may be available in their area.

It may be possible to address the lack of knowledge among non-adopters when it comes to both computer skills and broadband availability in their area through a coordinated, expensive government program. But since the primary motivation for not adopting high-speed internet is largely a simple lack of demand, those programs are likely to cost far more than they are worth since it is clear that some non-adopters simply don't want to get online.

Strata is a non-profit Logan, Utah based think tank. Megan E. Hansen is a policy Analyst at Strata. Ryan M. Yonk is an Assistant Professor at Southern Utah University.