

Agenda Report

DATE: April 22, 2002

TO: CITY COUNCIL
THROUGH: ECONOMIC DEVELOPMENT AND TECHNOLOGY COMMITTEE
FROM: CITY MANAGER
SUBJECT: TELECOM HOTEL DEVELOPMENT FEASIBILITY

RECOMMENDATION

It is recommended that the City Council concur with the staff's findings that the feasibility of developing a telecom hotel in Pasadena is low at this time and should be revisited in 2 years.

BACKGROUND

On November 5, 2001, staff presented to City Council the findings and recommendations from the Telecommunications Market Assessment Study by Uptown Services, LLC. One of the recommendations to emerge from the study was for the City to research the issues surrounding placement of a telecom hotel in Pasadena and determine if the City should provide remedies for current roadblocks or incentives for telecom hotel development to proceed. Telecom hotels are facilities that provide infrastructure and house equipment for telecommunications, Internet, and data management companies, as well as offering a high-speed pipeline to regional networks and the Internet. Having completed this research, staff does not recommend pursuing telecom hotels at this time.

Uptown identified several competitive fiber network service providers in Pasadena. They seem to be making very little use of their fiber to serve local businesses. A telecom hotel in Pasadena would serve as a network hub in facilitating use of the fiber while stimulating competitive service offerings to local businesses.

City Council approved of the recommendation to research development of a telecom hotel. The research was to identify:

- current and future benefits of a telecom hotel in Pasadena;
- current level of interest by developers and businesses in a telecom hotel project;
- what impediments and roadblocks exist in bringing a telecom hotel to Pasadena; and
- potential sites in Pasadena to accommodate a telecom hotel.

Telecom Hotel Development Feasibility

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Since November, Information Technology Services Division and Planning & Development Department staff has been working together with real estate and telecom industry resources to assess the feasibility, availability of potential sites, economic impact and the level of interest in bringing a telecom hotel to Pasadena.

Staff identified a number of likely benefits from the placement of a telecom hotel in Pasadena. These benefits include: a "point of presence" – a network hub providing a link to regional and national telecommunications networks; the facilitation of competition among telecommunications companies; potential cost savings for local government and businesses; and attraction of telecom-dependent enterprises to Pasadena. However, the feasibility of developing a telecom hotel in Pasadena is low at this time.

Lack of Current Investment by Telecom Companies in "Last Mile"

Revival of the interest in telecom hotels is estimated to be 2 to 4 years out, when telecommunications companies reprise their "last mile" infrastructure investments. The last mile is the linking of the space between offices and homes to high-speed fiber networks. The build-out of the last mile is necessary to serve a broader range of services to businesses and ultimately residential customers. Typically, telecom companies need telecom hotel facilities once they have the last mile infrastructure in place. However, under current economic conditions telecom companies have stopped investment in the last mile infrastructure in order to preserve working capital.

Lack of Investment Tied to Economic Downturn

The slowdown in the economy has limited the flow of investment capital for technology infrastructure development. The telecom industry has been especially hard hit while undergoing a major downturn in business growth, and the timetable of its return to profitability is still in question. This has generated little or stagnate investment interest from the capital markets. The access to capital is crucial for telecom hotel development due to highly capitalized front-end needs for property acquisition and building modifications to meet telecom hotel infrastructure requirements.

Telecom hotels need help from banks and builders, many who say telecom hotel users are risky because many tenants are start-ups without substantial capital and are willing to commit only to short-term leases. Consequently, banks and traditional lenders have taken a cautious approach with regard to financing these facilities, given the fact that they are single-purpose facilities, which may be inappropriate for adaptive reuse in a slumping economy.

Significant Expenses to Build/Renovate for Telecom Hotel Uses

Underlining the risk are the major expenses involved in building a telecom hotel. The cost to retrofit or build a telecom hotel can range from \$200 to \$400 per square foot. The major expenses are attributed to a telecom hotel's infrastructure requirements for large capacity to store computer equipment and high structural reinforcement demands. Adding to this is the huge electrical capacity needed to supply the telecom hotel's high consumption for electricity that must be supplemented with a backup energy source to offset the threat of emergency outages.

Limited Telecom Hotel Sites

There were a few sites identified for a telecom hotel development in Pasadena. Only one site was considered as an ideal turnkey location that met the telecom hotel's high requirements of proximity to fiber routes, to Pacific Bell infrastructure, reinforced infrastructure, and sufficient equipment storage space. The disadvantage to this site and a common trait among the most prime locations is the lack of availability. Because Pasadena is well developed, there is significant competition for the few available sites. In Pasadena, there is also the barrier of high acquisition cost for real estate properties, while existing buildings located on potential sites are often involved in multi-year lease agreements.

Excess Supply of Telecom Hotels

Interest in telecom hotels has waned coinciding with the fortunes of the telecom shakeout over the past two years. A recent real estate survey revealed there is little interest among developers and businesses in a local telecom hotel project. Meanwhile, it has been reported that telecom hotel developments in some regions has taken a reverse course with developers undertaking projects to rehabilitate telecom hotels back to usable office space. This trend is supported by a report that in downtown Los Angeles, vacancy rates for telecom hotels is nearing 50% of the 1.5 million square feet of usable telecom hotel space.

Low Feasibility for a Telecom Hotel in Pasadena

The current feasibility of this kind of development project appears low. In a better economic climate, Pasadena would likely be a prime location for development of a telecom hotel with its close proximity to fiber networks and high tech companies. The high level of commitment of capital, planning, and effort cannot be justified at this time for a project in an industry that is suffering through a down turn and where prospects for long-term viability from an investment standpoint are difficult to predict.


Neil Shaw, Principal, Uptown Services has reviewed the staff's findings and concurs with their recommendations. The original Uptown study was completed at a time when it was unclear whether the turmoil in the telecommunications industry had reached its peak. A year later it is clear that the industry is still battered and the shakeout period has no end in sight. Fiber based providers are suffering from the results of building far too much capacity with lower than expected revenues from their targeted markets. Mr. Shaw supports the staff's recommendation of not pursuing the development of a telecom hotel in these times of continuing uncertainty.

Staff will continue to monitor telecom companies' investment in local infrastructure development and will notify City Council of any renewal of interest in telecom hotel projects in Pasadena.

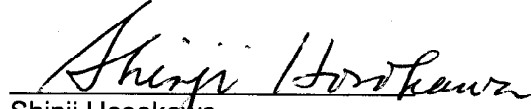
FISCAL IMPACT

There is no fiscal impact associated with this recommendation.

Respectfully submitted,


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