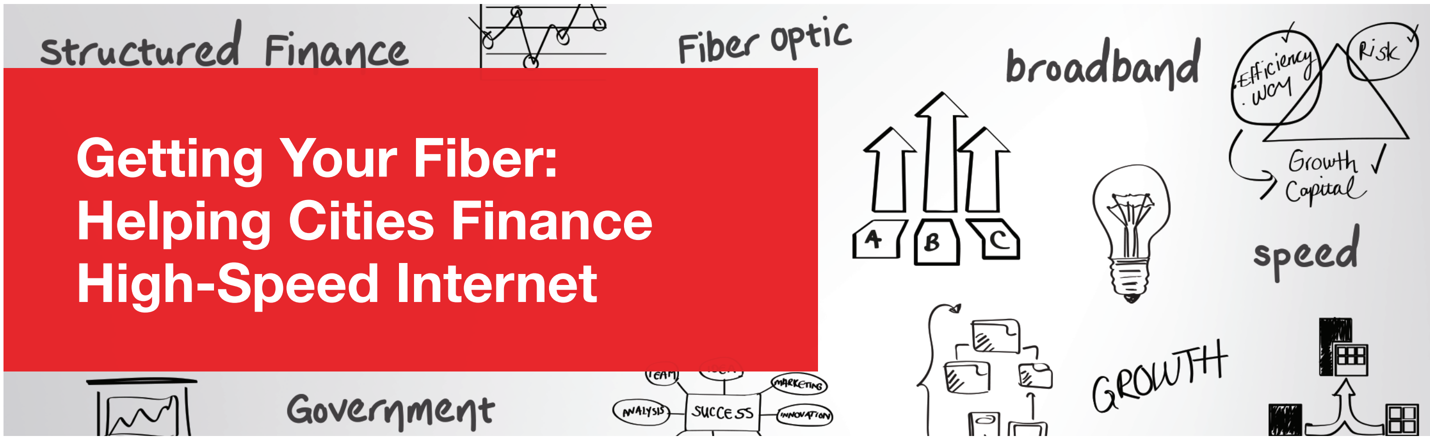
KeyBanc Capital Markets

Getting Your Fiber: Helping Cities Finance High-Speed Internet



Speed is essential when running a city – and it's true for roads and internet alike. A city with nothing but gravel roads and 25-mile-per-hour speed limits would lose its residents and businesses in no time. The same idea holds true for Internet transmission speeds. Cities without high-speed fiber optic cable are being left behind by others that invest in the infrastructure that delivers economic and population growth, and improves public safety by upgrading programs like 911 centers, automatic police notifications, traffic signals and other internet-enabled operations.

In places where private sector companies are not motivated to fund infrastructure upgrades, cities themselves must step in to create a solution. To do so, many are accessing the municipal bond market or a structured finance solution as part of an overall approach to paying for the new infrastructure.

Rarely an issue in major cities, incumbent Internet providers are quick to upgrade big-city networks to fiber-optic speeds, where the high density of users justifies the cost. However, second-tier and third-tier cities are often bypassed by the cable companies due to lower population density – the number of paying customers in the service area is insufficient to cover the cost of upgrades.

The Need for Speed – At Home, Work and School

To be clear, fiber optic lines have carried Internet data across the country for many years. Most cities have fiber optic lines in place – what they lack is the "last mile" connection from these lines to individual homes and businesses, known as fiber to the home,

Key takeaways

Second- and third-tier cities not served by fiber optic providers may access municipal bond markets to fund their own broadband networks.

High transmission speeds offered by fiber optic networks are important not only for economic development but also for public safety programs like 911 centers.

Issues relating to bond financing include ways to structure fiber optic initiatives that mutually benefit cities and private Internet providers.

KeyBanc Capital Markets can help structure optimal deals based on our expertise and relationships in municipal bond and structured finance deals, as well as the technology and government sectors.

or FTTH. Without this connection, users are limited in their ability to transmit digital data, stream movies, play online games, conduct high-quality phone and video conferencing, and other tasks that broadband users take for granted.

Nevertheless, these cities need high-speed transmission, not only to meet the demands of residents and drive economic development, but also to enhance operations. High-speed fiber optic lines are necessary to upgrade to "smart city" infrastructure such as water meters and electrical grids that communicate via the Internet of Things (IoT), as well as to provide a reliable and efficient foundation for public safety programs such as 911 call centers, remote cameras and fire alarms. For example, some cities use an Internet app that alerts police immediately when a gun is discharged in a high school, as well as the caliber of the weapon – but it only works with broadband.

Financing Broadband Initiatives

Faced with a critical need for high-speed transmission, second- and third-tier cities are looking for ways to fund their own Internet infrastructure. Funding these initiatives requires cities to address several complex issues. They must select the right financing structure from a range of possible choices, determine an income stream to repay the debt, and choose a network provider that's equipped to do the work. In many states, cities must contend with laws that bar them from competing with private-sector firms by owning the network they're funding.

The process can be daunting for municipal leaders who have not dealt with these issues. They need a knowledgeable advisor representing their interests, as well as a financial partner that understands both the technological and capital markets implications.

Cities have several options to fund high-speed Internet programs, including a public bond issue, a private placement, a structured finance transaction and a direct loan held on a bank's balance sheet. Factors that can sway cities toward one option or another include the overall cost of financing, the amount of equity that network providers bring to the table, and assets that can be used as security.

No matter what approach is eventually selected, cities must come up with a revenue stream to pay the debt service. Internet user fees from residents and businesses will go to the private-sector provider who typically will contribute equity to the deal and will also oversee the installation and operation of the network. So municipalities must look elsewhere for a source of income, such as property taxes, energy and utility taxes or franchise fees. As most cities are financially stretched already, crafting a solution is a challenging process that requires the involvement of an experienced financial partner. Having completed multiple deals in this arena, KeyBanc Capital Markets experts can attest that each case is unique.

Choosing a Provider

One of the greatest challenges in creating a municipal broadband network is the selection of a private-sector partner equipped to perform the work. An online database maintained by *Broadband Communities* magazine lists 787 providers of these services, including telcos, cable companies, electrical cooperatives and other entities, arranged by acronyms such as ILEC, MSO and WISP. (The same database lists 170 municipalities and 16 public-private partnerships that have undertaken broadband initiatives.) With all the different choices, cities benefit greatly from working with advisors and financial partners that can winnow the field quickly.

Every provider has a unique technology and financial profile that can make or break a successful initiative. At a minimum, a private sector provider should have its own wherewithal and investment in the process, such that its own success is irrevocably tied to the success of the initiative. In addition, the provider selected must offer a good fit with the municipality's needs, in terms of both its technology platform and financial approach. And the deal that's negotiated has to be beneficial to both the municipality and the provider.

Putting the Pieces Together

All the elements of a municipal broadband initiative – selecting a provider, identifying an income stream and developing a capital structure – need to be done concurrently. The provider chosen will affect the financial aspects of the deal, which in turn affects the deal structure. And the reverse is also true. Thus, a successful initiative is not a step-by-step process but a puzzle that must be assembled to create a complete picture.

With deep expertise in the technology and government sectors, professionals at KeyBanc Capital Markets understand the full range of finance issues, and have broad experience connecting municipalities with the right products, partners and structures. Our specialists in public finance keep abreast of developments in the broadband market and are known to many in the provider community. That additional measure of expertise, not found at many financial institutions, helps to ensure that the technological and financial aspects of the deal work for all parties, and meet the needs of the community.

For fresh ideas, contact:

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