A New Way to Finance Fiber

Private activity bonds offer a low-risk way for cities to finance fiber builds. Here's the catch: The project itself must be low-risk.

By Doug Dawson / *CCG Consulting*

I recently was part of a team that arranged the financing to build fiber in Dallas, Oregon, a community of more than 15,000 near the state capital, Salem. The new fiber business, operating as Willamette Valley Fiber, was funded in what I am sure is a new way for the industry.

The funding uses what might best be described as private activity bonds. These are municipal-like bonds that are distributed in the public bond market. In this case, the bonds are issued and the network is owned by a nonprofit corporation. The primary benefit of this financing structure is that the city doesn't have to go on the hook for the new debt – something that many cities are reluctant or unable to do. Building fiber networks is expensive, and many cities are unable to tackle the size of the needed debt. In this case, the city of Dallas, although thrilled to be getting the fiber network, is not associated with or a party to the bond financing.

If there is any hurdle to the financing structure, it's that these are pure revenue bonds – meaning that they are supported only by the revenues of the project. There are no backdrop guarantees by a city or any other entity to support the bonds if the project doesn't perform as expected. That means any business plan funded this way must be solid and conservative enough to make sure that revenues will cover costs. A few key characteristics are necessary for a project to be funded in this way:

- Bond financing generally has higher up-front costs than other kinds of financing, though they are usually offset by lower interest rates. The high up-front costs mean this kind of financing is cost-effective only for projects the size of Dallas or larger.
- It's essential that there are no construction cost overruns because no party, such as a city, can step in to make up for any cash shortfalls. This means that engineering must be completed before funding, and a design-build contractor must be willing to build the network for a guaranteed price, tying down not only fiber costs but also the costs of drops and electronics.
- Understanding the community is mandatory. That requires doing surveys and other market research to make sure the community is receptive to buying services from a new fiber network. It's easy to just assume that fiber sells, but surveys are one of our products at CCG Consulting, and we've seen major differences from market to market, sometimes even within the same region.
- A cost structure that minimizes expenses is also mandatory. The best way to ensure that kind of cost structure is to find an ISP operator that is already successfully operating a fiber business. There are significant expense savings when an ISP opens an additional market. The fiber business is largely an economy of scale business, and there are huge benefits to an operator for spreading joint and common costs across an additional market. As an example, if an ISP opens up a new market that doubles its size, the cost for something like the CFO's salary effectively is halved for the original business as half the CFO's cost is allocated to the new market. The new market benefits by getting a CFO for half of the cost of hiring one.

In Dallas, the operator is MINET, a municipal ISP owned jointly by the nearby cities of Monmouth and Independence, Oregon. MINET has been effective as an ISP, with a penetration rate in its own markets of nearly 85 percent. The Dallas expansion offers the opportunity to double its customer base, so it can allocate a high percentage of existing costs to the Dallas venture – a win-win for both parties.

The CCG team is interested in developing more fiber ventures that meet the above criteria. I'd like to hear from communities that want fiber and already know of a nearby quality ISP that would be interested in operating the business.

I'm also interested in hearing from existing ISPs that can meet our criteria and have a track record of success. An ISP can benefit in two ways from such a venture – it can gain economies of scale and allocate many existing expenses away from its current business. An ISP-operator also can benefit from profit sharing if the new venture is successful. ❖

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