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TO: Vermont State Senate, Committee on Finance
FROM: Timothy & Leslie Nulty, Mansfield Community Fiber
DATE: April 9, 2021
SUBJECT: Finance structure for rural FTTH projects

This memo is in response to your request for suggestions regarding prudent disbursement of federal broadband grant funding to the State.

The Issue: We contend, (and we believe a number of the Committee members agree), that loans are superior to grants because they impose discipline on both the providers and recipients of funds. In normal "market" financing, this is taken as obvious. However, with government-provided or subsidized finance, situations sometimes arise where an investment is of such high social value AND is not financially feasible solely on commercial financial terms that it is wise and defensible to provide financing with grants or subsidized loans. ThisIs certainly true and commonly recognized for public schools, libraries, waste disposal, local roads, fire and police protection, water & sewer projects, etc.

Broadband telecommunications, however, does NOT fall into the above category for the simple reason that, while certainly of very high social value ***it is absolutely feasible to provide universal coverage of first class, state-of-the-art "future proof" broadband profitably using standard commercial loans and investor equit.*** (Grocery stores, pharmacies, and gas stations also provide essential community services — but no one suggests that they should be funded by taxpayer grants.)

This has been demonstrated beyond all reasonable doubt in Vermont by several independent telephone companies and by ECFiber and MCFiber, both of which have been 95% financed by loans and equity, both of which provide service second to none and both of which are financially and commercially successful. Any carrier who alleges that it cannot serve ANY town in Vermont without "free" taxpayer grants should be required to give a rigorous explanation as to why they cannot do what ECFiber, MCFiber, Franklin Tel and Waitsfield Tel (among others) are actually doing. To our knowledge no ISP which has come before this committee (or any other state body) seeking free taxpayer money has met (or even tried to) meet this challenge.

That said, large amounts of federal grant money are coming to Vermont anyway. How should the state respond? The following discussion reviews the facts, poses the policy problem facing the Committee and suggests a solution.

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Q1: *If large Federal Grants are coming should Vermont refuse to utilize them?*

A1: No. Vermont should utilize such resources.

HOWEVER: Vermont should recognize that there are serious downsides to utilizing large amounts of grant funds indiscriminately. Indeed, Vermont broadband carriers have received nearly $200 million of grants over the last decade—most of which has been, effectively, wasted. Had those grant funds been used wisely, including to leverage commercial loans, they could have financed construction of 20,000 miles of state-of-the-art FTTH serving virtually all of Vermont which was not already served by such networks. Needless to say, that is not what happened and most, if not all, of those “free” grant funds were, effectively, “flushed down the drain. In that context, it is simply not true to say that grants are “cost free”: the cost is 10 lost years and a Vermont society and economy which are still severely hamstrung by poor broadband infrastructure. THAT is the true cost of wasted opportunity and resources—and a very high cost it is! It need hardly be said that we really must not make that profligate mistake again.

Q2: *How do we utilize the flood of federal grant dollars that are coming, wisely and effectively?*

A2: Despite the rhetoric about state agencies’ promising careful distribution and oversight, that is often of limited effectiveness. It doesn’t happen because the real incentives are not there and the burden on over-worked state administrators is too large. Ask yourselves: what really happens to the recipient of a grant if their project is botched and the money wasted? Nothing! That is an open invitation to waste, abuse, and even artful misappropriation. The best way to assure genuine accountability is to use grant funds to leverage/support loan financing which must be paid back.

Q3. *How can use Federal money that is designated for grants to, in fact, fund loans?*

A3.i: The most straightforward (and financially soundest) way is to use such money for a revolving loan fund. If federal guidance on the use of ARPA broadband grant funds and/or the expected infrastructure funding due in October prohibits a revolving loan fund other options exist which are discussed below.

A3.ii:: A second sound and straightforward way is to use grant dollars to support “loan loss reserves” which can, in turn, help make commercial loans more feasible.

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However, we believe that VEDA has determined that if federal grant funding prohibits use as a state-sponsored revolving loan fund that also prohibits it being used to create a loan loss "backstop" for commercial loans This should be verified.

A3.iii: A third, equally sound and only slightly more complex, solution is to require grant recipients to obtain "matching" commercial loans as a condition for disbursing their grants, i.e., allow grant funding for less than 50% of project cost. Below the 50% level, the grant % should be varied according to the density of the target area. We know from long practical experience that ***any*** town in Vermont can be wired with FTTH, as a totality, without any grants at all by a competent and experienced operator. Nevertheless there are portions of towns that are so sparse that grant financing would be helpful (as was the case in Fletcher cited above, where the average density is around 8/mile). Keeping the grant share below 50% even for the sparsest areas maintains the potency of loan discipline on both the grantor and the grantee.

We know that this is allowed in some Federal grant programs because MCFiber's joint broadband project with the Town of Fletcher includes a federal grant negotiated on these terms and matched by a normal VEDA loan on commercial terms. (The ratio is approximately 45:55 grant:loan with additional equity contribution from MCFiber). In this case, originally both MCFiber and the Town of Fletcher's lender, VEDA, wanted to have the grant disbursed first and the loan later. However, the federal grantor (wisely and legitimately) declined and required that the loan and grant funds be disbursed in tandem consistent with their relative share of the overall financing. Both VEDA and MCF acquiesced to that requirement and the resulting arrangement is proceeding.

Conclusion: the latter experience suggests that the Federal Government is open to sensible solutions to what any financial professional recognizes as a real and serious problem: namely the opportunity for pure grant funding to encourage "bad actors" and bad behavior. As a state we truly need to avoid any future Jay Peak/EB-5 scandals.

Vermont's senior senator is exceptionally well placed to persuade the Biden administration to permit arrangements like A3iii above in the coming Federal Broadband grant program. We strongly recommend that this be raised with Senator Leahy's staff. The matter may appear "technical" and "down in the weeds", but, in fact, it would make a major difference in the discipline, accountability and effectiveness of the prospective funding.If successful, this will be a transformative program for our state.