How to Build Your Gigabit Network

Resources for Municipalities

Tax-Exempt Financing Discussion

SJ ADVISORS LLC

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Tax-exempt securities are one option that may be used to fund construction of your network

- Funding sources
  - Cash or operating funds
  - Equity investor
  - Debt

- Types of debt
  - Tax-exempt bonds (larger deals, long-lived assets)
  - Taxable bonds (projects or components of projects not eligible for tax-exempt financing)
  - Anticipation notes or Commercial paper (short-term borrowing, but can be an ongoing program)
  - Loans (construction/bridge/term loans, taxable)
  - Lines of credit (working capital or small projects)

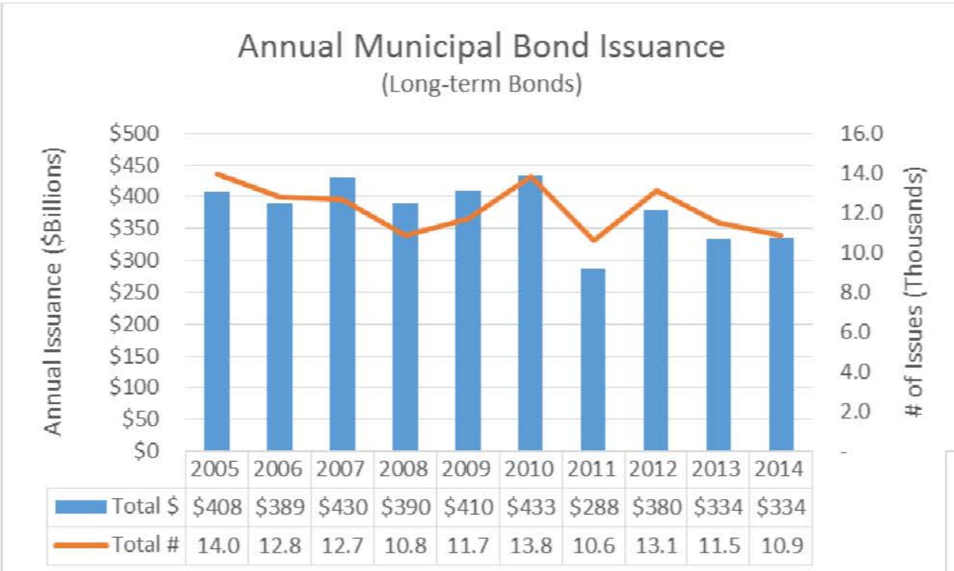
- Debt related products
  - Interest rate derivatives (swaps, caps, floors)
  - Irrevocable standby letter of credit
  - Standby liquidity facility

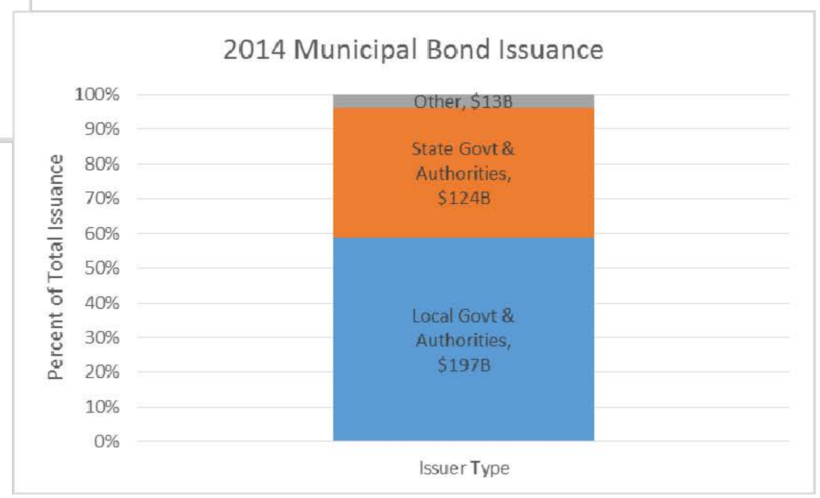
There are various types of tax-exempt bonds categorized by security and source of repayment

- Tax backed
  - Unlimited general obligation (full faith and credit)
  - Limited general obligation (subject to tax rate ceiling, carve outs, or other limitations)
  - Moral obligation (no “legal” obligation, but commitment to make-up any shortfalls)
  - Credit enhanced (state supported for example)
  - Appropriation-backed obligations
  - Certificates of participation
  - Master municipal leases, lease-backed obligations
  - Tax-increment bonds
  - Special assessment bonds
  - Anticipation notes (TANS, RANS, BANS)

- Revenue bonds
  - Payable from project revenue (or borrower revenue) other than taxes.
  - “Double-barreled” include additional pledge or backing (typically taxing power)

Annual municipal bond issuance has averaged $380 billion over the last ten years





Source: SourceMedia

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Many types of entities can use tax-exempt financing…

Governmental Entities

TypesofEntities(Issuers)

- State governments and agencies
- City/town/county governments and agencies
- School districts
- Public colleges and universities
- Authorities and special districts (transportation, utilities, water/sewer, housing, student loans, Industrial development/redevelopment authorities)

TypesofBonds/Notes

- Tax backed bonds (general obligation, moral obligation, appropriation backed, other)
- Revenue bonds (including double-barreled)
- Anticipation notes (TANs, RANs, BANs)

501(c)(3) Organizations

TypesofOrganizations(Obligors)

- Private higher education
- Private schools
- Charter schools
- Hospitals
- Senior and assisted living
- Human services
- Cultural institutions
- Community centers (JCC, YMCA, etc.)

NOTE: These obligors work with a state or local governmental agency to issue tax-exempt securities.

Types of Bonds

- Revenue bonds

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…to finance certain types of projects

Eligible Categories

- Capital Projects
  - Hard costs
  - Soft costs
  - Equipment and furnishings
  - Capitalized interest
- Refinancing existing debt (TE or taxable)
- Reimbursement for prior capital expenditures *(consider need for a reimbursement resolution)*
- Working capital (very limited)
- Financing costs
  - Costs of issuance
  - Capitalized interest
  - Reserve funds

NOTE: Tax-exempt (and taxable) bonds can also be issued for loan programs, such as student loans and housing loans.

Typically Not Eligible

- Projects owned/controlled by a for profit entity
- Portion of projects funded by specific donations
- Refinancing: advance refunding of tax-exempt bonds that have already been advance refunded
- Reimbursement of capital expenditures beyond specific time limitations
- Working capital
- Capitalized interest beyond 3 years (or 1 year after completion of construction)
- Reserve funds beyond prescribed limitations

There are many additional constraints, which can be reviewed with counsel and advisors.

- *Management contracts (structure of compensation is critical)*
- *Religiously affiliated organizations*

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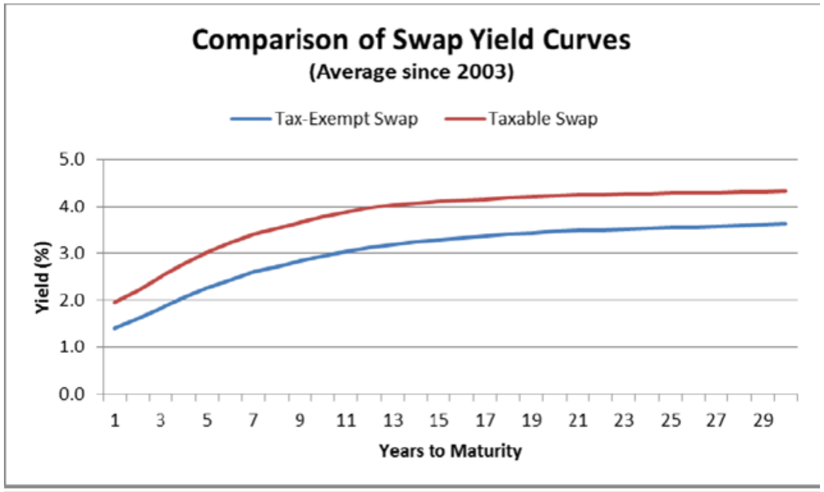
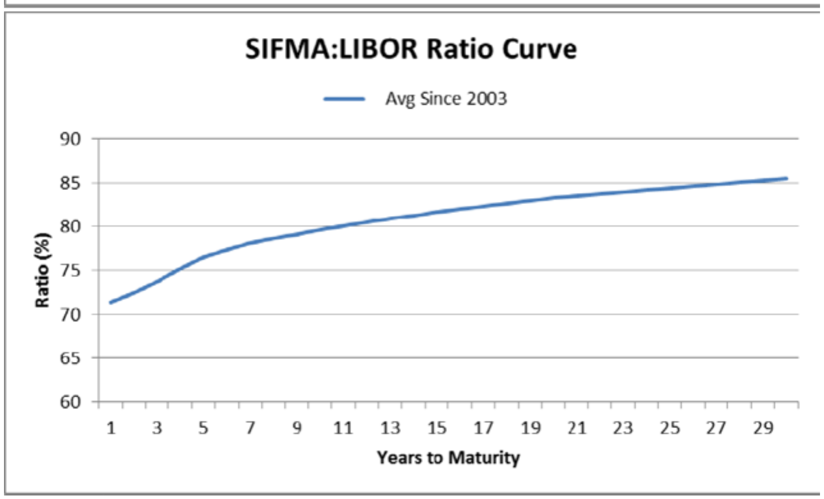
Interest savings typically justify added complexity and costs of issuance for financings greater than a few million dollars





Rate savings

- On average could expect to save about 1% on rate
- Rate differential typically greater when rates are higher and vice versa
- Due to "tax-risk" the ratio of tax-exempt to taxable rates typically increases for longer maturities
- Example: 1% savings on $25 million financing is $250,000 in 1st year; PV savings for 30 year amortizing bonds around $3 million +/- (depends).

Actual rates impacted by many factors

- Credit quality
- Security
- Variable vs. fixed rate
- Final maturity and amortization

Structuring a financing is not a one-size fits all endeavor, especially not for an up and coming segment like broadband networks

Source: Data from Bloomberg

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The timeline for a financing varies considerably, which can take months or years

Planning
(1-24 Months)

- Capital/project plan
- Analyze debt capacity
- Identify sources of financing
- Structure the deal
- Negotiate rate and terms

Execution
(3-6 Months)

- Assemble working group
- Refine the deal structure
- Negotiate rate and terms
- Review documentation
- Due diligence and hearings
- Establish pricing
- Close the deal

Post Issuance Compliance
(Lifetime of Bonds + 6 Years)

- Monitor performance to covenants
- Develop post issuance compliance policy and procedures and periodically review them
- Perform continuing disclosure

Structuring a financing is not a one-size fits all endeavor, especially not for an up and coming segment like broadband networks.

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The make-up of the financing team will vary according to the particular deal structure

- Bond counsel
  - Opines on tax-exempt status of bonds
  - Affirms that deal conforms with state and local legal requirements
  - Drafts certain bond documents and prepares transcript
- Issuers/borrowers counsel
  - Represents issuer/borrower
  - Negotiates documents and terms
  - Provides enforceability opinion
- Financial advisor (registered "municipal advisor")
  - Prepares financial analysis, cash flows, comparisons
  - Reviews credit factors, risks, and risk tolerance
  - Reviews and negotiates rates, terms, and documents
- Purchaser (and counsel)
- Underwriter (and counsel)
- Structured products (and counsel)
- Credit enhancement provider (and counsel)
- Trustee (and counsel)
- Rating agencies
- Various other specialists depending on the deal

Advisory services related to municipal securities are subject to regulations put forth by the SEC and MSRB

- The 2008/2009 financial crisis led to new regulation through the Dodd-Frank Wall Street Reform and Consumer Protection Act.
- “Municipal securities” and “municipal financial products” (tax-exempt bonds and related products such as swaps) now fall under a regulatory regime governed by the SEC and MSRB.
- Providing advice regarding structure, timing, terms, or other similar matters is deemed “municipal advisory activity” and anyone providing this advice is deemed a “municipal advisor”.
- “Municipal Advisors”
  - Must be properly registered with the SEC and MSRB
  - Must be in compliance with the rules governing “municipal advisory activities”
  - Owe a fiduciary duty to their clients
- Various exceptions exist.
  - Professionals providing advice in accordance with their traditional role, such as accountants, attorneys, and engineers, as long as that does not extend to advice regarding structure, timing, terms related to a “municipal security” or “municipal financial product”.
  - If the “municipal entity” or “obligated person” is represented by an independent registered municipal advisor (“IRMA”), then other parties can talk more freely about the transaction without the discussion being considered advice.
- Bottom line: underwriters and other professionals will be more constrained in conversations related to the structuring, timing, and terms of municipal securities.

Questions?

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Additional background on tax-exempt bonds

- Value of tax-exemption
  - Investors do not have to pay federal income tax on the interest income they receive,
  - so are willing to accept a lower rate of interest,
  - which then reduces the cost of borrowing.

- Investors
  - Individuals (retail)
  - Individual proxies (mutual funds)
  - Institutional (commercial banks, insurance companies)
  - Others (endowments, corporate treasuries)

- Issuers
  - Can only be issued by state and local governments,
  - as well as their agencies and instrumentalities.

Comparison of typical bond types

	Traditional Fixed Rate Bonds	Floating Rate Notes	Variable Rate Demand Bonds	Bank Purchase Bonds
Public offering vs. private purchase	Public	Public	Public	Private
Fixed vs. Floating	Fixed	Floating	Floating	Either
Method of achieving fixed rate (optional)	N/A	Swap	Swap	Swap or bank rate
Typical term (varies!)	30 years	5/30 years	5/30 years	5/30 years
Credit enhancement	Insurance (optional)	None	Letter of Credit	None
Covenants	Looser	In between	Tighter	Tighter
Call feature	10 years	At put date	Monthly	Varies
Put feature	No	Yes	Yes	Yes
Cost/Risk (varies)	Highest/lowest	Lower/higher	Lowest/highest	Full spectrum

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Typical deal decisions and factors based on credit strength of borrower

Bond Type/Financing Element	Stronger Credit	Weaker Credit
Public offering vs. private purchase	Public	Private (bank)
Fixed vs. Floating	Mix	Fixed
Method of achieving fixed rate	Traditional fixed rate bonds	Swap or bank rate
Rate	Lower	Higher
Collateral (80% LTV)	Not necessary	Necessary
Covenants	Looser	Tighter

Stronger credits typically have more financing options, pay lower rates, and have fewer covenants. Weaker credits are more likely to require a reserve fund, collateral, or some form of credit enhancement. Very risky deals may require an equity investor.

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