



Rural Broadband Access Loan and Loan Guarantee Program

Connecting Rural America



Committed to the future of rural communities.

The Telecommunications Program



- Telecommunications Infrastructure Loan and Grant Program (“Infrastructure”)
- Distance Learning/Telemedicine Loan and Grant Program (“DLT”)
- “Community Connect” Grant Program
- Broadband Access Loans and Loan Guarantee Program (“Broadband”)

Purpose of the Broadband Program

To provide loans and loan guarantees for the cost of construction, improvement, and acquisition of facilities and equipment for broadband services in eligible rural communities.



FY 2005: Proposed Budget

- Remaining mandatory funds: FY 02, 03
(over \$1,000,000,000 in lending authority)
- \$36M discretionary 4%
- \$255M discretionary C-O-M
- \$40M discretionary Guarantee



Program Statistics

119 Applications Received
Totaling \$1,675,000,000

Applications Processed as of October 8, 2004

35 Approved	\$659,000,000
29 In Review	\$288,000,000
55 Returned	\$728,000,000



Program Statistics – Why they are returned!

- Insufficient credit support
- Insufficient market survey
- Technology does not meet requirements
- Cannot meet minimum financial requirements
- Incomplete application

Program Statistics – Type of Entity

	<u>Received</u>	<u>Approved</u>
Existing Entity	52	22
Start-up Company	67	13

Program Statistics – Technologies

Approved Applications

Fiber to the Home	11
Digital Subscriber Line	10
Wireless (unlicensed)	7
Hybrid Fiber/Coax	6
Wireless (licensed)	1

Eligible Rural Community

Eligible rural community means any incorporated or unincorporated place in the United States, its territories and insular possessions (including any area within the Federated States of Micronesia, the Republic of the Marshall Islands, and the Republic of Palau) that has no more than 20,000 inhabitants based on the most recent available population statistics from the Bureau of the Census – <http://www.census.gov>



Broadband Service

- Must enable a subscriber to transmit and receive at a rate of no less than 200 kilobits per second;
- Must provide data transmission service and may provide voice, graphics, and video.

Applicant Eligibility

A legally organized entity providing or proposing to provide service to an eligible rural community and has sufficient authority to enter into a contract with RUS and carry out the purposes of the loan.



Eligible Organizations

- Corporations
- Limited Liability Companies
- Cooperative or Mutual Organizations
- Indian Tribes
- Public Body

Who is not Eligible?

- Individuals
- Partnerships (including LLPs)
- Any entity serving more than 2% of the telephone subscriber lines installed in the United States

Eligible Purposes

- New construction and improvements to existing facilities
- Broadband facilities leased under the terms of a capital lease (limited to 5 years and option of ownership)
- Acquisitions (less than 50% of the requested loan amount)
- Refinancing existing Telecommunications Program debt (up to 40% of requested loan amount)

Ineligible Purposes

- Acquire stock, facilities, or equipment of an affiliate of the applicant
- Finance customer terminal equipment (including modems) or inside wiring not owned by the applicant
- Vehicles that are not used primarily in construction

Ineligible Purposes

- Broadband facilities leased under an operating lease (i.e., tower leases, building leases, land leases, etc.)
- Mergers or consolidations
- Operating expenses (i.e., salaries, marketing, legal, etc.)

Types of Loans

- Direct Cost-of-Money Loans
- Direct 4% Loans
- Private Guarantees (up to 80% of the total loan amount)

Direct Cost-of-Money Loans

Bear interest at the cost of money to the Treasury for comparable maturities.

The interest rate is set at the time of each advance of funds

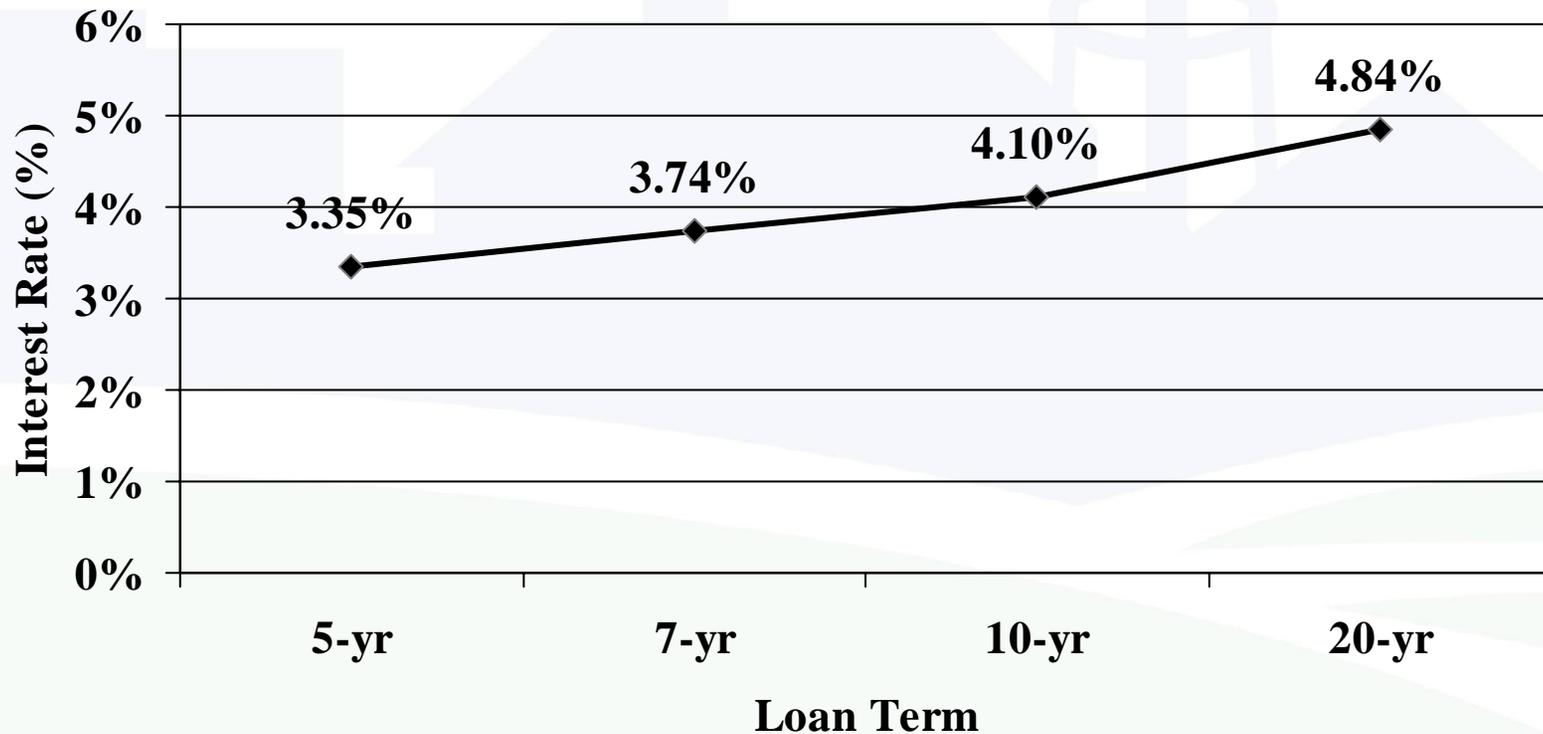
The current rates can be found at:

<http://www.federalreserve.gov/releases/h15/update>



Direct Cost-of-Money Rates

Rates as of October 1, 2004



Direct 4% Loans

- To be eligible for this loan, the applicant must be proposing to serve a community that:
 - Does not have any broadband service;
 - Has a population of 2,500 or less;
 - Located in a county with a per capita personal income that is less than or equal to 65% of the national per capita income; and
 - Has a service area with a maximum population density of 20 persons per square mile



Direct 4% Loans

- Loan Amount is limited to \$7.5 million
- Can be made simultaneously with Direct Cost-of-Money loans

Private Loan Guarantees

- Bear interest at a rate set by the lender
 - The interest rate must be fixed and remain the same for the guaranteed and the unguaranteed portion of the loan
- RUS will guarantee up to 80% of the principal amount of the loan

Private Loan Guarantees

- Private Lender
 - Is subject to credit examination and supervision by a federal or state agency;
 - Must demonstrate the capability of adequately servicing loans;
 - May establish charges and fees that are no greater than for similar loans; and
 - Is required to fully service the loan

Loan Terms

- Loans are made for a term equal to the expected useful service life of the facilities financed
- Funds are advanced as needed
- Interest is payable monthly on funds advanced
- Principal payments are deferred for 1 year from the date of the first advance

Loan Terms

- The minimum amount of a loan that RUS will consider is \$100,000
- Maximum loan amounts apply only to the direct 4% loans (\$7.5 Million)
- RUS requires a first lien on the borrower's assets
- The minimum TIER is 1.25 in the 5th year of the feasibility study

Loan Terms

TIER means **T**imes **I**nterest **E**arned **R**atio.

TIER is the ratio of an applicant's net income (after taxes) plus interest expense, all divided by interest expense. For the purpose of this calculation, all amounts will be annual figures and interest expense will include only interest on debt with a maturity greater than one year.

Application Information

The regulation, application, application guide, and all other relevant information is available on our website at:

www.usda.gov/rus/telecom/broadband.htm



Application Submission

- Prospective applicants should contact their respective General Field Representative (GFR) prior to submitting the application
 - List of the GFRs and the contact information is included in Application Guide
- There is no deadline to submit applications
- Applications will be reviewed and processed on a first-come, first-served basis



Key Components of an Application

- Credit Support
- Market Survey
- System Design
- Business Plan
- Financial Information

Credit Support

THE NUMBER ONE REASON
APPLICATIONS ARE
RETURNED!



7 CFR 1738.20

- Minimum of 20 % of the requested loan amount
- Cash for one full year operating expense
- Un-depreciated assets, cash, letter of credit

How much do I need?

If the loan application is for \$1,000,000:

minimum
credit
support

$$= (\$1,000,000) * (20\%) = \mathbf{(\$200,000)}$$



Cash Requirement

- Defined as sufficient cash to cover one full year of operating expenses.
- For telecommunication companies with positive cash flow for the two previous years, this requirement can be waived.

What is a full year of expenses?

The operating expense as shown for the second year of the five year loan period as detailed in the pro-forma financial statement included as part of the application.

What is acceptable for Credit Support?

- Cash
- Un-depreciated assets less any outstanding liens
- Licenses (purchase price less any amortization/depreciation)
- Irrevocable letter of credit (LOC)

*What is **not** acceptable as Credit Support?*

- **Account receivables**
- **LOC for cash requirement**
- **Parent's assets**
- **Equity infusions over the life of the loan**
- **Loans**
- **Value of company if sold**
- **Value of customers**

Letter of Credit: Bank Terms

- Investor to enter into LOC to benefit Broadband Borrower and the Government
- LOC to be irrevocable permitting unconditional draws by the Broadband Borrower and the Government
- LOC to be in effect for 5 years

Letter of Credit: Borrower Terms

(Included as conditions in the loan agreement)

- LOC must be in effect for the shorter of 5 years or until the Borrower achieves an equity level of 20%
- Borrower agrees to draw on the LOC if the quarterly financials show a negative cash flow.



Borrower Terms: Continued

- Borrower agrees to draw on the LOC when directed by RUS
- Failure to maintain the LOC will be an Event of Default

Credit Support Examples

<i>Type of Entity</i>	Start-up
<i>Loan Amount</i>	\$2,000,000
<i>Full Year Ops. Expense</i>	\$300,000

<i>Minimum Credit Support</i>	\$400,000 (20% of \$2M)
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Of this \$400,000 amount, **\$300,000** must be cash to fulfill the operating expense cash requirement.

The remaining **\$100,000** can be met with cash or other acceptable options previously listed.



Credit Support Examples

<i>Type of Entity</i>	Start-up
<i>Loan Amount</i>	\$2,000,000
<i>Full Year Ops. Expense</i>	\$500,000

<i>Minimum Credit Support</i>	\$500,000
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If Operating Expense amount is greater than 20% of the requested loan, then the Operating Expense figure becomes the credit support amount.

All **\$500,000** must be in the form of cash.



Credit Support Examples

<i>Type of Entity</i>	Existing Telecom* <small>*with two prior years' positive cash flow</small>
<i>Loan Amount</i>	\$2,000,000
<i>Full Year Ops. Expense</i>	\$500,000

<i>Minimum Credit Support</i>	\$400,000
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In this case, the cash requirement is waived for the applicant. However, minimum Credit Support of **\$400,000** (20% of \$2M) still applies, and can be met with cash or other acceptable options previously listed.



Evidence of Credit Support

- **Audited financial statements**
- **Bank statements**
- **Escrow accounts**
- **Investment agreements**
- **Line of credit**
- **Appraisals of assets performed by qualified firms**

Satisfying Credit Support

(NEW ITEM) The credit support requirement must be satisfied before loans funds are released.

(PREVIOUSLY) This requirement had to be satisfied prior to loan approval.

Additional Support Requirements

If the financial analysis of the application indicates that an applicant will experience a negative cash flow at any time during the forecast period, RUS will require that arrangements be put in place to make additional infusions of equity.

Market Survey

Critical to determine the interest and demands of the targeted communities for the proposed service offerings

Market Research

Provides:

- Knowledge of market potential
- Understanding of competition
- Knowledge of demands/needs of potential customer base

Supports:

- Feasibility studies
- Strategic planning goals



Market Survey

- Market Survey Methods
 - Direct Mailings
 - Telephone Surveys
 - Door-to-Door
 - Town Meetings
 - Pre-subscriptions/signed contracts



Market Research

- Do **not** use the Internet as a survey tool
 - Not an indication of the desires of the whole population
 - Only surveying those who have computers and Internet service; **and**
 - Only those who subscribe to your Internet service
 - Cannot extrapolate results to the community as a whole

Market Survey - Design

- Computer ownership
- Current Internet usage – dial-up, Broadband, time online, rate
- Satisfaction with current provider – quality of service, value, likes/dislikes
- Willingness to switch to Broadband or change providers
- Service offerings/rates (including any installation or upfront charges for equipment)

Market Survey - Design

- Acceptance of wireless technology
- Other service offerings with rates
 - Voice
 - Video
 - Triple Play
- Demographic Information

Market Survey – Design

Do not list a range of prices when doing a market survey because people will usually pick the lowest prices

Market Survey

- The Magic Number – How many responses/surveys are sufficient?
 - There is no magic number
 - Statistically significant – depends on the size of the population

Market Survey

The Magic Number - the larger the population surveyed, the lower the response rate required for 95 ($\pm 5\%$) percent confidence interval

Population Size	Percent Response Required
500	43.6
1,000	27.8
2,000	16.2

Market Survey

In the end, the sample must be representative of the population of the community

Market Survey – Results

- Based on households/businesses – not population (generally one connection per household)
- Recognize the differences between communities – income, age, competition

Market Survey - Results

- Do **not** base results on:

- National Statistics

*“No direct mailer or door-to-door surveys were completed since past history for broadband service clearly demonstrates the need. See OPASTCO web page ... for details of rural survey for broadband subscription rates...”
(Applicant projected 25-30 percent subscription rate)*

- Conjecture

“We are currently achieving a penetration rate of 10% of the households without an aggressive marketing campaign. Once we launch our advertising campaign, we expect to achieve a 30% subscription rate”



Market Survey

Exception to conducting Market
Surveys – Greenfield Areas:
Contact Washington Staff



Market Survey

In the end...

The market survey must support the applicant's subscriber forecast, both in total numbers and in distribution among service offerings.

Note: Some financial models are highly dependent on a certain percentage of subscribers taking higher data rates at the higher prices

Market Survey

One last thing – market surveys are only considered valid if conducted within 6 months preceding the date of submission of the application to RUS.

System Design

- Consists of all the information in order to do a comprehensive technical evaluation of the proposed system
- Prepared and certified by a qualified employee of the applicant's staff or an outside consultant who is licensed in the state where the facilities will be constructed

System Design

- The System Design shall include a detailed description of the following:
 - Applicant's existing & proposed service areas
 - Types of services to be provided (voice, video, data) and the number of subscribers
 - Technology to be used to deliver the broadband services
 - Existing system (if applicable) and proposed system
 - Licenses/agreements required to operate the proposed system

System Design

- Other items needed to support the System Design
 - Deployment/construction schedule
 - Project Costs
 - Network Diagrams
 - Environmental Report

System Design

- Deployment/Construction Schedule
 - Annual Basis
 - Projects should be shown on a community/site basis
- Project Costs
 - Includes loan funds & non-loan funds to be spent over the loan forecast period
 - Schedules Q-1 through Q-11 should be completed accordingly
 - Information supporting the costs in each schedule should also be included

System Design

- Network Diagrams
 - Existing & Proposed Network
 - Block diagrams that clearly show the flow of traffic from the subscriber to the backbone network
 - Wireless Networks – approximate coverage area of each radio site
 - Sample Network Diagrams included as Attachment 2 in the Application Guide

Environmental Report

- All construction proposed in the loan application must be covered by an Environmental Report
- The Environmental Report must be prepared in accordance with 7 CFR Part 1794.
- CFR and guide for preparing the Environmental Report is available on the web site
 - <http://www.usda.gov/rus/telecom/publications/html/1794.htm>
 - http://www.usda.gov/rus/telecom/publications/word_files/1794a600.doc



Business Plan

- General Overview
 - How will loan funds be used?
 - Details on working capital
 - Investments required
 - Management

Business Plan

- Business Purposes
 - Goods and Services
 - Existing services, if applicable
 - Proposed goods and services
 - State of development
 - Status of licenses and regulatory approvals

Business Plan

- Main competitors in Target Market
- Market Analysis
 - Description of primary market
 - Influences to industry
 - Target customers
 - Product Pricing
 - Advertising/Promotion
- Financial Information

Financial Information

- Provide sufficient financial information for RUS to determine that the loan will be feasible and adequately secured
- Forecast analysis should be based on knowledge of the external and internal factors that affect the company's operations
- Historical and projected financial statements required

Historical Financial Statements

- Certified financial statements for the last 3 years (or for as long as applicant has been in business if less than 3 years)
 - Audited statements are preferred, if available
 - Balance Sheet
 - Income Statement
 - Statement of Cash Flow

Historical Financial Statements

- If applicant is a subsidiary of another company, parent's financial statements are also required
- If another affiliated company is providing operations and/or management services to the applicant, that company's financial statements are required

Subscriber Projections

- Provide projections on a yearly basis for 5 years
- Include existing and proposed communities
- Breakdown by each community and by the types of services proposed
- **MUST** correspond with market survey results

Subscriber Projections

- If “green field” areas are proposed, include information that justifies the subscriber penetration rates since no market information is available
 - Developers build-out plans
 - Lots proposed to be constructed
 - Lots already sold

5-Year Financial Forecast

- Must be inclusive of **ALL** operations of the applicant
- Must include a balance sheet, income statement, and statement of cash flow
- Must include **detailed** assumptions that support the projected numbers

Revenues

- Broadband Revenues
 - DSL, Wireless, Cable Modem
- Sales Revenues
- Cablevision (TV) Revenues
- Telecom Revenues
 - Local and Long Distance
- Dial-Up Internet Revenues
- Access/Connecting Company Revenues
- Web Hosting/Storage Revenues

Expenses

- Cost of Goods Sold
- Access/Transport Fees (T1's, DS3's, etc.)
- Programming Expenses
- Cable and Spectrum Leases
- Connecting Company Fees
- Depreciation Expense
- Interest Expense

Expenses

- Salaries/Payroll Expense
- Rent/Leases (Buildings, Towers, etc.)
- Miscellaneous
 - Utilities, Supplies, Insurance, Advertising, Maintenance, Taxes
 - Professional Fees (Accountants, Lawyers, etc.)

Assumptions

- Must be in narrative format
- Should clearly address each revenue and expense line item
- Provide a clear picture of how figures were derived
- Sample assumptions provided in guide

Depreciation Schedule

- List categories of equipment and facilities and the expected useful life
- Useful life should be based on the manufacturers' recommended useful life
- Will determine maturity of the loan
- Schedule included in guide

Outstanding Indebtedness

- Include a listing of all outstanding indebtedness, including loan maturities, interest rates, and terms and conditions
- Include a copy of all loan documentation
 - Notes
 - Loan Contracts/Agreements
 - Mortgages

Getting through the System

What does the Washington staff really do every day?



Loan Processing Breakdown

- Initial Review
- Full Review
- Loan Review Meeting
- Loan Committees

*Our goal is to process a complete application
in 60 days!!!!!!!*



Initial Review

Ineligible – Return application

Incomplete – Ask for info/clarification

Complete (APC) – Proceed with full review



Full Review

Comprehensive assessment:

- Run feasibility studies and sensitivity analysis
- Thorough technical/engineering review

Loan Committees

- Assistant Administrator's Loan Committee (AALC)
- Senior Loan Committee (SLC)

Legal Requirements

- Loan and Security Documents
 - Loan Agreement
 - Mortgage
 - Promissory Note
 - Closing Instructions

Legal Requirements

- Satisfaction of Legal Requirements
 - Executed Loan and Security Documents
 - Regulatory/Commission Approval
 - Certificate of Resolutions
 - Evidence of UCC Filing
 - Executed Pledged Deposit Account Agreement
 - Attorney Opinion

Release of Loan Funds

- Clearance of Loan and Security Documents
- Submission of Current Financials
 - Balance Sheet
 - Income Statement
 - Statement of Cash Flow
- Executed Certificate of Authority

Release of Loan Funds

- Executed Automated Clearing House (ACH) Form
- Evidence of Fidelity/Theft Insurance Coverage
- Evidence of Satisfying Additional Conditions

Construction Procedures

All construction financed by RUS loan funds must be done in accordance with RUS Bulletin 1738-2, Rural Broadband Access Loan and Loan Guarantee Program, Advance and Construction Procedures Guide.

The guide is available on our web site at:

<http://www.usda.gov/rus/telecom/broadband.htm>



Advance Procedures

- Advance procedures are covered in 1738-2.
- Borrower submits a request for funds on Financial Requirement Statement – RUS Form 481
- Funds can be requested for:
 - Approved contracts (equipment, construction & engineering)
 - Completed work orders
 - Work Order Fund
 - Acquisitions & Refinancing (if approved in the loan)

Advance Procedures

- Funds are wired into the Pledged Deposit Account
- Pledged deposit account shall only be used to advance and disburse loan funds and no other purpose
- Funds should be only be disbursed for the purposes as approved on the RUS Form 481
- First advance should be used to pay-off any interim debt
- Any equity funds proposed to be used for plant investment, as part of the 20% credit support requirement, must be deposited in the Pledged Deposit Account

Reporting Requirements

- Quarterly Reports
 - Financial Reports – Balance Sheet, Income Statement, and Statement of Cash Flow
 - Construction/Subscriber Reports – showing the number of sites/communities in operation and the respective number of subscribers
- Annual CPA audits
 - Follow guidelines in 7 CFR Part 1773

Questions and Answers

At this time, please feel free to ask all of the questions that you have been thinking about.

