

Issuing Bonds to Finance a Municipal Broadband System

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City of Rock Falls at a Glance

9200 Population – Whiteside County

- ✓ New 2017 estimates 8911 population

Staggering loss of Industry since 2001

Low Median Income

- ✓ Risen to \$40,543 since 2010 census

Utility Driven City Budget (ESW&F)

- ✓ 3300 Water & Sewer Customers
- ✓ 5500 Electric Customers

EAV realizing low increases

- ✓ 2017 EAV \$73,793,527 – 1.39% increase



“When you stop growing you
start dying.”

William S. Burroughs

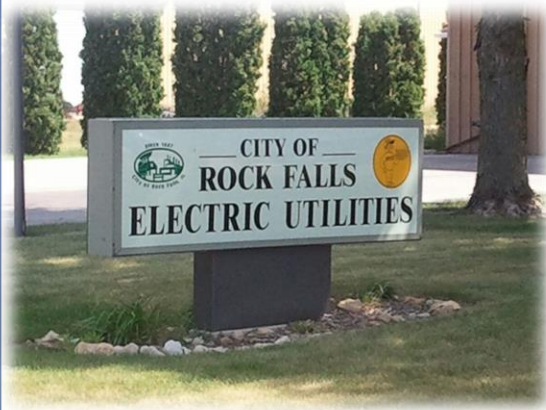
THINGS WE NEEDED TO ADDRESS:

Quality of Life
Retaining our Youth
Economic Development
Embracing our Assets &
Strengths

Our Biggest Asset & Strength is our Utilities!



City of Rock Falls Electric our #1 Strength



5500 Metered Customers



2 Megawatt Hydro Facility



9 Caterpillar Gen Sets



3 Substations

Rock Falls has miles of fiber in the ground which allows our municipal electric system to network our operation centers, power-generating facilities and substations.

A Pressing Need for a Reliable Local Provider is a **MUST**



- High Prices
- No Local Office
- Customer Service
- Unreliable Service
- Lower speed

Due Diligence & Education in Broadband

- ❖ Attending broadband industry conferences
- ❖ Investigating consulting firms
- ❖ Legal Issues - Both local counsel & FCC counsel
- ❖ Spoke to local cable provider
- ❖ Spoke to other communities
- ❖ Spoke to our residents and businesses



Decisions Made

1. Allowable by law
2. Needed a Consultant
3. FTTP – Fiber to the Premise
4. Fiberhood Model
5. Internet Only – No VoIP or Cable
6. Financing with Bonds

Partnered with Consultants

- ❖ Feasibility Studies
- ❖ Educating Public & City Officials
- ❖ Engineering
- ❖ **Business & Finance Plan**
- ❖ Financing & Grants
- ❖ Project Management
- ❖ Marketing



Financial Plan is key to minimizing risk



How much will it cost to build?

1. FTTP structure full City build out
2. Fiberhood model

Financing Structure

1. Cash
2. Grants
3. Bonding (Taxable and/or Tax Exempt)

Pricing - Can you make a profit?

Pro Forma Fiscal Year	2019	2020	2021	2022	2023	2024
Service Revenues						
Residential	\$ 111,180	\$ 458,320	\$ 1,012,656	\$ 1,370,727	\$ 1,570,588	\$ 1,984,098
Business	\$ 63,990	\$ 213,300	\$ 384,770	\$ 470,547	\$ 519,780	\$ 660,370
Subtotal Service Revenue	\$ 175,170	\$ 671,620	\$ 1,397,426	\$ 1,841,274	\$ 2,090,368	\$ 2,644,468
Installation Revenues						
Residential	\$ 17,440	\$ 36,480	\$ 39,520	\$ 33,040	\$ 15,600	\$ 4,560
Business	\$ 4,860	\$ 7,290	\$ 5,040	\$ 3,420	\$ 1,710	\$ -
Subtotal Installation Revenue	\$ 22,300	\$ 43,770	\$ 44,560	\$ 36,460	\$ 17,310	\$ 4,560
Subtotal Other Revenues	\$ 37,299	\$ 23,430	\$ 23,430	\$ 23,430	\$ 23,430	\$ 508,371
Total Revenue	\$ 234,769	\$ 738,820	\$ 1,465,416	\$ 1,901,164	\$ 2,131,108	\$ 3,157,399
Cost of Service - Expenses						
Total Cost of Service	\$940,351.70	\$1,147,934.70	\$1,173,591.05	\$1,201,040.68	\$1,307,815.57	\$1,325,020.69
Operating Profit (EBITDA)	\$ (705,583)	\$ (409,115)	\$ 291,824	\$ 700,123	\$ 823,292	\$ 1,832,379

Marketing is Must



- ✓ **No Data Limits**
- ✓ **Built in Free Wi-Fi**
- ✓ **No equipment rentals**
- ✓ **No contracts**
- ✓ **Local Customer Service**
- ✓ **24/7 Tech Assistance**
- ✓ **Reliable Service**
- ✓ **Net Neutral ISP**

RESIDENTIAL

- **250 Mbps** up/down - \$75.00 per month
- **1 Gigabit** up/down - \$125.00 per month
- *No equipment rental*
- *No contract*

BUSINESS

- **250 Mbps** up/down - \$150.00 per month
- **500 Mbps** up/down - \$275.00 per month
- **1 Gigabit** up/down - \$375.00 per month
- *No equipment rental*
- *No contract*

Risky Business

- **Financial Risks**
 - ✓ Higher construction/equipment costs
 - ✓ Lower than anticipated customers
 - ✓ Delays in Construction
- **Industry Risks**
 - ✓ Internet transport
 - ✓ Competition
 - ✓ State Legislature & Congress



Future Rewards



Forbes magazine reported - 5 of the nation's fastest growing economies were small cities, which despite their smaller size, possess the basic infrastructure: hospitals, schools, airports & broadband, these are essential to economic growth.

- ❖ Growth in Population
- ❖ Growth in EAV
- ❖ Quality of Life
- ❖ Retaining our Youth
- ❖ Economic Development

Structure of the Bonds

- Alternate Revenue Source Bonds with a pledge of Broadband System Revenues and Sales Taxes.
- Covered abatement for rating, bond insurance, and investor marketing purposes.
- 20 year term overall level debt service.
- Taxable and tax-exempt series.

Broadband System Revenue Pledge

- No history of revenues to demonstrate 1.25x coverage and investors were largely unfamiliar with the stream.
- A solo pledge of Broadband System revenues would have required a feasibility study.
 - Prepared by an independent accountant or feasibility analyst with a national reputation for expertise in such matters.
 - Projects revenues through the term of the bonds to demonstrate 1.25x coverage or better.
- The City engaged a consultant to prepare a detailed business plan and pro forma.
 - The consultant did not qualify as an independent accountant or feasibility analyst.
 - City did not want to incur additional feasibility study fee when projections had already been completed.

Sales Tax Revenue Pledge

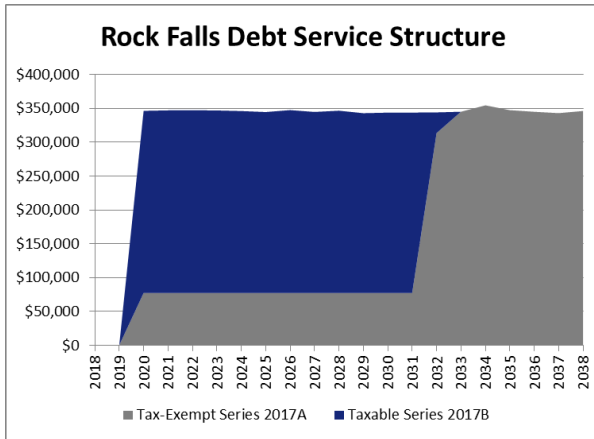
- Demonstrated long history of collections.
- Gave investors comfort in the security of the bonds.
- Met the 1.25x coverage requirement (over 5.5x).
- Did not require a feasibility study.

Taxable/Tax-Exempt Structure

- Issued a taxable and tax-exempt series that amortized over a 20 year term and achieved overall level annual debt service.
 - Proceeds of the taxable series was used to finance the operational and administrative costs of the project.
 - Amortized the taxable series first (2019-2031) and tax-exempt series last (2031-2037) to generate the overall lowest borrowing cost for the City.
 - The Bonds were structured to fit into the projected revenue stream provided by the consultant.

2 Years Capitalized Interest

- Interest cost covered through April 2019 during the construction period.
- Cap-I limited to two years per State of Illinois law.
- Phase I of construction expected to be completed soon.



Fiscal Year Ending April 30	Sales Tax Revenues	Tax-Exempt Series 2017A			Taxable Series 2017B			Aggregate			
		Principal (10/1)	Interest (4/1 & 10/1)	Capitalized Interest	Total Debt Service	Principal (10/1)	Interest (4/1 & 10/1)	Capitalized Interest	Total Debt Service	Debt Service	Coverage
2018	\$2,029,231		\$71,810	(\$71,810)	\$0		\$79,768	(\$79,768)	\$0	\$0	-
2019	\$2,029,231		\$77,400	(\$77,400)	\$0		\$85,978	(\$85,978)	\$0	\$0	-
2020	\$2,029,231		\$77,400		\$77,400	\$185,000	\$83,989		\$268,989	\$346,389	5.86x
2021	\$2,029,231		\$77,400		\$77,400	\$190,000	\$79,720		\$269,720	\$347,120	5.85x
2022	\$2,029,231		\$77,400		\$77,400	\$195,000	\$74,905		\$269,905	\$347,305	5.84x
2023	\$2,029,231		\$77,400		\$77,400	\$200,000	\$69,570		\$269,570	\$346,970	5.85x
2024	\$2,029,231		\$77,400		\$77,400	\$205,000	\$63,695		\$268,695	\$346,095	5.86x
2025	\$2,029,231		\$77,400		\$77,400	\$210,000	\$57,208		\$267,208	\$344,608	5.89x
2026	\$2,029,231		\$77,400		\$77,400	\$220,000	\$50,055		\$270,055	\$347,455	5.84x
2027	\$2,029,231		\$77,400		\$77,400	\$225,000	\$42,378		\$267,378	\$344,778	5.89x
2028	\$2,029,231		\$77,400		\$77,400	\$235,000	\$34,210		\$269,210	\$346,610	5.85x
2029	\$2,029,231		\$77,400		\$77,400	\$240,000	\$25,540		\$265,540	\$342,940	5.92x
2030	\$2,029,231		\$77,400		\$77,400	\$250,000	\$16,350		\$266,350	\$343,750	5.90x
2031	\$2,029,231		\$77,400		\$77,400	\$260,000	\$6,400		\$266,400	\$343,800	5.90x
2032	\$2,029,231	\$240,000	\$73,500		\$313,500	\$30,000	\$600		\$30,600	\$344,100	5.90x
2033	\$2,029,231	\$280,000	\$65,050		\$345,050					\$345,050	5.88x
2034	\$2,029,231	\$300,000	\$54,500		\$354,500					\$354,500	5.72x
2035	\$2,029,231	\$305,000	\$42,400		\$347,400					\$347,400	5.84x
2036	\$2,029,231	\$315,000	\$30,000		\$345,000					\$345,000	5.88x
2037	\$2,029,231	\$325,000	\$18,013		\$343,013					\$343,013	5.92x
2038	\$2,029,231	\$340,000	\$6,163		\$346,163					\$346,163	5.86x
Term Bonds		\$2,105,000	\$1,367,635	(\$149,210)	\$3,323,425	\$2,645,000	\$770,364	(\$165,746)	\$3,249,619	\$6,573,044	

Rating Agency Consideration

- Since this was for a project that is rarely financed, the financing team was cognizant of potential rating agency concerns.
- Prepared full rating presentation that discussed project, projections, and rationale.
- Had a rating call to present and answer any questions.

S&P Perspective

- S&P has not rated many broadband financings.
 - Private sector has provided most of these services.
 - They have not developed a formal view (negative or positive).
- They tend to take the “worst case perspective” until a project proves itself.
 - Assume project underperforms (i.e. customers and revenues).
 - In this case, a levy would be needed.
 - Include financing in debt burden analysis.
 - If underperforming and the City doesn’t want to levy a tax, it could possibly decide to reduce reserve levels.
- Once project produces, S&P will categorize it as “self sufficient”.

Moody's Perspective

- Local governments that operate municipal broadband systems are vulnerable to enterprise risk.
- Considered a nonessential government service.
- Subject to robust competition from large private operators which often can offer lower prices.
- Need to incorporate technological change and increase broadband speed to remain competitive.
- Investments typically come with high capital costs and additional borrowing.
- Could face a choice of funding a struggling enterprise at the expense of core governmental operations.

S&P's Views of Rock Falls

- Statements in 2018 Rock Falls rating report:
 - “Advances in telecom technology and potential competition from the private sector could erode the City’s customer base.”
 - “Should this pressure materialize, revenue from the system could be less than projected, leading to reliance on other revenue to support the Bonds.”
 - “This could potentially pressure finances if it cannot support the debt from enterprise revenue.”

Value of Bond Insurance

- Bond insurance can add significant value to “A” rated bonds in Illinois.
 - Lower yields approximately 20 to 25 basis points (0.20%-0.25%) out 20 years.
 - Broaden the universe of investors which can drive lower yields.
- Rated “A” by S&P, Rock Falls benefited from the purchase of bond insurance.
 - Lowered overall borrowing cost of 2018 Bonds by approximately \$115,000.

Bond Insurer Perspective

- Rock Falls did not qualify for BAM insurance, in part because of its municipal owned broadband system.
 - BAM will not insure bonds with a standalone broadband system pledge, but will consider those with a secondary pledge (e.g. GO backing).
 - Even if proven as a viable system, BAM views them as high risk money users with large capital costs and ongoing technology updates required.
 - BAM considered Rock Falls broadband investment as large for a smaller city and was worried it would put pressure on its General Fund.

The Role of Bond Counsel

Three Fundamental Questions for any Borrowing:

- Is the proposed borrowing **politically feasible?**
- Is the proposed borrowing **financially feasible?**
- Is the proposed borrowing **legal?**



Duties of Bond Counsel

- What we do:
 - Advise as to state law authorization
 - Advise as to tax exempt status
 - Prepare major bond documents (ordinance, resolution, tax agreement) and other proceedings
 - Prepare bond transcript
 - Render unqualified opinion as of closing

Bond Counsel Opinion

- What it covers:
 - Validity
 - Security
 - Tax-exempt status
 - Bank qualification (if applicable)
- What it does not cover:
 - Financial feasibility or fiscal prudence of the debt issue
 - Form, content, adequacy or correctness of any disclosure related to the debt issuance

- State Law
 - authority (constitutional, statutory)
 - authorization (procedures)
 - security
 - debt limits (if applicable)
 - debt service limits (if applicable)
- Federal Tax Law
 - federal tax treatment of interest on the obligation
 - post issuance compliance
- Securities Law
 - primary market disclosure (official statement)
 - continuing disclosure

Fundamentals of Public Finance

Municipal bonds must be issued:

- (a) for lawful public and corporate purposes;
- (b) subject to constitutional, statutory, or other limitations (such as debt limits); and,
- (c) pursuant to proper constitutional, statutory, or other (such as charter) provisions.



Home Rule Cities and Villages

- May exercise any power and perform any function pertaining to its government and affairs including, but not limited to, the power to tax and incur debt
- Subject to constitutional limitations and (possibly) certain statutes
 - Preemption requires three-fifth majority of each house

Non-Home Rule Governmental Units

- Dillon's Rule: may exercise only the powers which are expressly granted by the legislature or powers which are necessarily implied or incident to those powers which are expressly granted
- If the power to borrow is neither expressly granted by statute nor necessarily implied, it does not exist
- Must find powers in the statutes

Statutory Framework

A. Enabling Statutes

- borrowing alternatives
- required authorization procedures
- debt limits

B. Omnibus Bond Acts

- supplemental grants of power; may provide additional borrowing alternatives
 - Example: Local Government Debt Reform Act

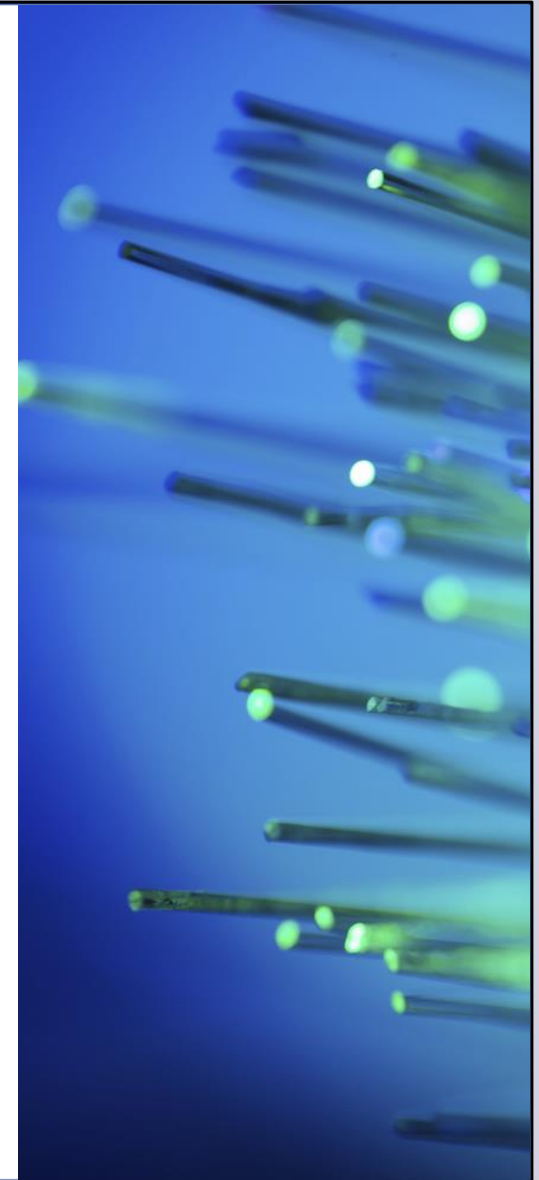
Statutory Framework (continued)

C. Special Considerations

- Tax Cap Law
- Open Meetings Act
 - Type of meeting
 - Notice requirements
 - Agenda
- Bond Issue Notification Act
- Ethics Act

High Speed Internet Services and Information Technology Act

- Local broadband projects
 - Any municipality or county may undertake local broadband projects and the provision of services in connection therewith; may lease infrastructure that it owns or controls; may aggregate customers or demand for broadband services; may apply for and receive funds or technical assistance to undertake such projects to address the level of broadband access available to its businesses and residents. To the extent that it seeks to serve as a retail provider of telecommunications services, the municipality or county shall be required to obtain appropriate certification from the Illinois Commerce Commission as a telecommunications carrier. (Source: P.A. 95-684, eff. 10-19-07.)



Borrowing Limits/Debt Limits

- Overall Debt Limit

- 8.625% of City's EAV
- Includes Referendum Bonds, Non-Referendum (Limited) Bonds, Installment Contracts, and Debt Certificates
- Excludes Alternate Bonds, which do not count against the debt limit unless taxes are extended for payment

- Non-Referendum Bond Debt Limit

- 0.5000% of City's EAV
- Includes Non-Referendum (Limited) Bonds
- Excludes Alternate Bonds
- If Tax-Capped, must have Debt Service Extension Base in order to levy taxes to pay non-referendum bonds

What is a BINA?

Bond Issue Notification Act

BINA – Bond Issue Notification Act

- Requires units of local government proposing to sell non-referendum general obligation bonds (other than refunding bonds) to hold at least one public hearing concerning the issuer's intent to sell the Bonds before the Bonds are authorized
- City Clerk must publish notice of the hearing at least once in a newspaper of general circulation not less than 7 and not more than 30 days before the date of the hearing
- The hearing notice must be posted continuously at the principal office of the governing body at least 48 hours prior to the hearing
- At the hearing the governing body must explain the reasons for the proposed Bond issue and permit persons to present written or oral testimony
- The governing body must then wait at least 7 days following the hearing before adopting the Bond Ordinance for the sale of the Bonds

What is a Backdoor Referendum?

Sometimes called a “Petition Period”

Backdoor Referendum (Petition Period)

- Adopt an ordinance setting forth the City’s intent to issue the alternate bonds
- Publish the notice of intent to issue the alternate bonds in a newspaper of general circulation within the City
 - Publication commences the “Petition Period”
 - 30 day period during which a petition containing the requisite number of voter signatures may be submitted to the City Clerk to request a referendum on issuing the Bonds
- If a petition is signed by the greater of (a) 7.5% of the registered voters in the City, or (b) the lesser of 200 of those registered voters or 15% of those registered voters, the City must either pass a referendum to proceed with the bond issuance or opt not to proceed with the issuance
- If there is no petition, or there are not enough valid signatures, the City can proceed with the issuance of the bonds (after BINA hearing)

General Obligation Alternate Bonds (Double Barreled)

- Payable from enterprise revenues or from a revenue source, or both, with a full faith and credit general obligation property tax levy as back-up security, thus the name “double barreled”
- Must have a pledged revenue source not less than 1.25 times (or, in some cases, 1.10 times) the maximum annual debt service
- Outside the tax cap
- Payment period cannot exceed 40 years
- Subject to backdoor referendum
- BINA Public hearing required
- Must abate debt service annually
- Does not count against the 8.625% debt limit, unless taxes are extended to pay the debt service

Disclosure Obligations

Issuing bonds in the public market?



**The importance of full and
accurate disclosure**

Primary Market Disclosure

- The official statement is a document prepared by, or on behalf of, the Issuer in connection with a primary offering of its bonds
- The official statement discloses all material information on the offering
- The official statement is the main source of anti-fraud liability in a municipal transaction
- The ultimate obligation for the accuracy and completeness of the disclosure lies with the City
 - Experts may assist, but cannot completely discharge, the Issuer's obligation
 - City, Underwriter, Municipal Advisor, Attorneys all have potential anti-fraud liability for material misstatements and omissions in an official statement

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