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# APPENDIX 2

## CASF-Broadband Infrastructure Revolving Loan Account – Application Requirements and Guidelines

# CASF – The Broadband Infrastructure Revolving Loan Account

## Application Requirements and Guidelines

CPUC – Communications Division

*CASF - The Broadband Infrastructure Revolving Loan Account*
*---Application Requirements and Guidelines---*

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# I. Background

Senate Bill No. 1040 (Stats. 2010, c.317, codified at California Public Utilities (P.U.) Code § 281)), approved by Governor Schwarzenegger on September 25, 2010, expanded the California Advanced Services Fund (CASF) to include the Broadband Infrastructure Revolving Loan Account (Loan Account) (P.U. Code § 281(a)(3)). Pursuant to P.U. Code section 281(e), moneys in the Loan Account "shall be available to finance capital costs of broadband facilities not funded by a grant from the Broadband Infrastructure Grant Account. The commission shall periodically set interest rates on the loans based on surveys of existing financial markets."

# II. Loan Account Guidelines and Requirements

## *A. Eligibility Requirements*

Applicant and project eligibility requirements for the CASF Broadband Infrastructure Grant Account (Grant Account) and the Loan Account will essentially be the same since the moneys in both accounts finance capital costs of broadband facilities. Adopting one set of requirements for both accounts will provide an efficient and simplified way for applicants to submit an application and avoid complications in determining what is needed for each type of funding. The Commission will award funds from the Loan Account as supplemental financing for projects also applying for funds from the Grant Account. In other words, the Loan Account will cover a percentage of the project's total costs that are not funded by the Grant Account.

### 1. Applicant Eligibility

In this decision, the Commission adopts revised Broadband Infrastructure Grant Account applicant eligibility criteria. For the Loan Account, the Commission also adopts those revised Broadband Infrastructure Grant Account applicant eligibility criteria.

### 2. Project Eligibility

The Loan Account is intended to finance capital costs of projects deploying broadband facilities in **unserved** and **underserved** areas of California. The CASF Funds are only to be used for capital costs of the project and not for any recurring and/or maintenance costs. The Commission will use the current Broadband Infrastructure Grant Account project eligibility criteria for the Loan Account with some modifications to the definition of unserved and underserved areas. The Commission will set forth those revised definitions as part of the Grant Account modifications in this decision. All projects approved by the Commission must conform to Rule 2.4 (CEQA Compliance) of the Commission's Rules of Practice and Procedure as set

forth in Attachment B.

### 3. Financial Eligibility

In setting up the financial eligibility criteria for applicants to the loan account, it is the Commission's responsibility to lend to entities that are capable of repaying its loans. Applicants must provide specific financial documents as listed below. As explained in further detail below, applicants must also meet specific financial eligibility criteria such as an equity requirement and a minimum Time Interest Earned Ratio of 1.5.

As used herein, **equity** refers to total assets minus total liabilities, as calculated from the applicant's balance sheet. The applicant must have equity in an amount equal to 20% of the requested loan amount at the time of application and at loan closing. For example, if the loan amount is for $500,000, 20% of the requested loan amount is $100,000. The applicant must then have equity in an amount equal to $100,000 to meet the requirement. A 20% equity requirement ensures that the Commission only funds financially sustainable entities and provides a reasonable assessment of the long-term viability of the project. Further, the applicant must sustain the 20% equity requirement throughout the life term of the loan, e.g. 5 years.

**TIER (Time Interest Earned Ratio)** indicates how well a company can cover its interest payment on the borrowed funds. The larger the TIER, the more capable the company is at paying the interest on its debt. An applicant must meet the minimum TIER of 1.5 through the life term of the loan. As a general rule, when a company's time interest earned ratio is lower than 1.5, a lender should question the company's ability to meet interest expenses. If the ratio falls below 1, the company is not producing earnings to cover its interest expenses.

**Formula: TIER = (EBIT[1] / Interest Expense)**

It is the responsibility of the applicant to make sure it provides the Communications Division (CD) with the financial information requested to determine that the loan application sought meets all of the requirements set forth, will be feasible, and is adequately secured. If a newly formed or start-up entity is applying and does not have CPA audited or attested financial statements for the last three years, the applicant must provide CPA audited or attested financial statements for as long as the applicant has been in business.

As part of its application, the applicant must submit the following:

[1] EBIT = Revenue – Operating Expenses

a) Financial Documents Required[2]:
   - CPA audited or attested financial statements for the last three years. The statements are to include:
     - ✓ Balance Sheet
     - ✓ Income Statement
     - ✓ Statement of Cash Flows
   - Pro Forma Financial Forecast over the life term of the loan (i.e. 5 years) that includes a list of assumptions supporting the data. For projects applying for a grant only, the pro forma financial forecast will be over 5 years. Future projections must include the following financial statements:
     - ✓ Balance Sheet
     - ✓ Income Statement
     - ✓ Statement of Cash Flows
   - Annual EBIT (Earnings Before Income and Tax) projection over 5 years
   - Schedule of all outstanding and planned debt over 5 years.
     The Commission may ask for documentation of the applicant's outstanding loans, including all loan agreements and security agreements.
   - Collateral documentation (applicable to applicants for loan/grant combination only): The applicant must list and identify all assets that will secure the loan. The applicant must also include a depreciation schedule that shows the economic life of each asset, equipment, and or facilities that is being used as a collateral for the loan only.

b) Equity Requirement (applicable to applicants for loan/grant combination only): The applicant must demonstrate 20% of the loan amount equity requirement at the time of application and at loan closing. The applicant also must sustain the 20% equity requirement throughout the life term of the loan, e.g., 5 years.

c) Times Interest Earned Ratio Requirement (applicable to applicants for loan/grant combination only): An applicant must meet the minimum TIER of 1.5 through the life term of the loan.

[2] If an applicant is a subsidiary without any audited financial statements, the applicant may submit audited financial statements of the applicant's parent company. If the parent company's financial statements are relied on or otherwise used in the financial viability review of the subsidiary (i.e. the applicant), the loan agreement will name the parent company as a financially responsible party.

**Formula: TIER = (EBIT / Interest Expense)**

d) Additional Financial and/or Other Documents (if needed): If the financial evaluation requires more information from the applicant, the CD and/or the partnering agency servicing and underwriting the loan will request such additional information (e.g. tax returns).

### *B. Application Requirements*

The Commission will adopt the current Grant Account application requirements checklist for the Loan Account, but modify it to include the financial requirements set forth above. The application must contain all the documentation/information required in the checklist to be considered a completed application. The Commission will set forth the application checklist as part of the Grant Account modifications in this decision.

### *C. Application Review and Evaluation*

CD will check all submitted applications for completeness, evaluate the applicant and project eligibility, and review a company's financial position. The Commission will adopt one set of scoring criteria for both the Broadband Grant Account and Loan Account. However, applicants applying for a loan will need to meet the two supplemental financial requirements set forth above: (1) an equity requirement of 20% and (2) a minimum TIER of 1.5. The Commission will use the proposed Grant Account scoring criteria and modify those criteria to include one more criterion: **Financial Position.** The Commission will reset the weight points to accommodate this additional criterion. A company's financial position will be based on the average projected **EBIT (Earnings Before Interest & Taxes)**[3] over five years. The Commission will set forth the scoring criteria as part of the Grant Account modifications in this decision.

If the loan applicant satisfies CD's initial evaluation, CD will forward the application to the partnering agency to conduct the detailed financial evaluation and issue a recommendation of the applicant's financial viability back to CD. Upon receipt of the recommendation, CD will determine if the loan should be approved. If CD determines that the loan should be approved, CD will recommend the approval of the loan to the Commission through the resolution process. If CD determines that the loan should not be approved, CD will send a rejection letter to the applicant explaining the reasons for the rejection. CD will reject the application as a whole, including the request for grant funding. The applicant however, can re-apply as a "Grant Only"

[3] EBIT is an indicator of a company's profitability and is also often referred to as operating income.

EBIT = Revenue – Operating Expenses

applicant within the pre-set application windows set by the Commission; CD will process this "Grant Only" application as a new application for review.

### *D. Transparency and Public Notice*

In efforts to increase transparency and provide public notice in the application process, the Commission will modify the applicant information that is posted on the CASF website for the Broadband Infrastructure Grant Account. The Commission will post the same information for the Loan Account that is adopted for the Grant Account. The Commission will set forth the changes as part of the Grant Account modifications in this decision.

### *E. Loan Terms*

A direct, fixed rate loan will be available under the Broadband Infrastructure Revolving Loan Account. The Loan Account **will not** be considered a "lender of last resort". The term "lender of last resort" typically applies to an agency that finances very risky loans and tends to attract financially unviable entities. In efforts to mitigate the high risk, the lender of last resort generally charges a higher interest rate to the total loan amount. The objective of the CASF Loan Account is to be a source of supplemental financing to eligible CASF projects to extend broadband infrastructure service to areas that do not have broadband service or have inadequate service based on the unserved and underserved definitions set forth in the program. An applicant who has any previous outstanding CASF loans will be able to apply for a new loan as long as all outstanding CASF loans are current and in good standing. The loan terms are as follows:

#### 1. Grant/Loan Combination Funding Percentages

If an entity applies for a grant and a loan combination, the total combination of the loan/grant funds should not exceed 80%-90% of the project's total cost. Applicants need to cover a minimum of 10%-20% of the total project cost on their own (i.e., with funds outside CASF). The current grant amount for CASF is 40% of the project's total cost. The CASF grant amount will cover up to 60%-70% of an eligible project's total cost depending on whether the project is for unserved or underserved areas, allowing for a loan to cover 20% of the total project budget. Requiring applicants to self- cover 10% -20% of the total project cost will help ensure that the Commission is loaning funds to applicants who are serious about their broadband project investment and long-term commitment to manage the infrastructure built. The following breakdown of CASF grant and loan funding will apply for unserved and underserved areas:

**a. Unserved Areas -**

| Grant (% of total project cost) | Loan (% of total project cost) | CASF Total Funding (grant + loan) | Self-funding (% of total project cost) |
|---|---|---|---|
| 70% | 20% | 90% | 10% |
| 0% | 0% | 70% | 30% |

If applicant does not apply for a loan

**b. Underserved Areas -**

| Grant (% of total project cost) | Loan (% of total project cost) | CASF Total Funding (grant + loan) | Self-funding (% of total project cost) |
|---|---|---|---|
| 60% | 20% | 80% | 20% |
| 60% | 0% | 60% | 40% |

If applicant does not apply for a loan

## 2. Interest Rate

In reviewing existing revolving loan programs, interest rates on loans vary by agency and programs. Public Utility Code Section 281 (e) requires the Commission to periodically set interest rates on the loans based on surveys of existing financial markets. CD staff researched the following financial indices to determine what interest rates should be adopted for the loans:

- U.S. Prime Rate[4]
- U.S. Treasury securities for obligations of comparable maturity (i.e. 20-year constant maturity)

CD Staff undertook a side-by-side comparison from the last 30 years of these financial indices to recommend a stable, fair, and competitive interest rate for the Broadband Infrastructure Revolving Loan Account. The Prime Rate, as reported by the Wall Street Journal's bank survey, is the most commonly used financial indicator in setting rates on commercial loans. The Prime Rate has been low in recent years due to the Country's economic environment. In 2007, the Prime Rate peaked at 8.05% and has been dropping annually to

[4] U.S. Prime Rates as specified in the Wall Street Journal

5.09% in 2008, and 3.25% in 2009 – April 2011[5]. The **U.S. Prime Rate** will be the fixed set interest rate used on CASF loans to offer applicant(s) a fair and competitive rate. The current U.S. Prime Rate is set at **3.25%** (and has been for the last two years). It will provide a fair, competitive rate to applicants. Pursuant to P.U. Code section 281(e), the Commission will periodically analyze the interest rate on new loans it approves, but will not change the rate of existing and/or already approved loans.

### 3. Loan Duration

Setting a fixed repayment period on the loan requires an understanding of the average life of broadband technology. The loan repayment period will be **5 years** since 5 years provides a sufficiently long term for repayment while remaining within the range of the economic life of the equipment being funded, as set forth in Attachment A. (Attachment A shows the useful life of broadband technology such as broadband switching equipment and networks). Setting a repayment period of more than 5 years will deplete funds from the account due to a longer duration of administrative costs to service the loan. A longer repayment period also means that those funds are not available to the Commission to lend to other applicants. In other words, if borrowers repay its loans in a reasonable amount of time, those funds will then become available to finance other projects. If a borrower wants a repayment period of less than 5 years, the loan agreement will reflect that agreed-upon repayment period.

### 4. Loan Amount Maximum and Minimum

Based on historical data from the original CASF Broadband Infrastructure Grant Account, the minimum grant approved by the Commission was $2,420 with a maximum grant approved for $19,294,717. The range is wide on how much money a project requests. The Broadband Infrastructure Revolving Loan Account is expected to collect a maximum of **$3,000,000 per year** over 5 years, totaling **$15,000,000**. Based on these assumed set amounts, the maximum amount of a single loan is capped at $500,000. This cap will allow for multiple applicants to access funds from the loan account and avoid the situation of one loan depleting all or most of the account's available funds. If and when the Loan Account grows, CD staff will revisit the currently set maximum loan amount and recommend resetting it as appropriate, subject to Commission approval.

### 5. Loan Security

The Commission will require collateral, such as equipment assets, as security for the

[5] Time Period: 2009 – April 2011 Prime Rate has been constant at 3.25%

loan. The loan must be 100% secured. As part of the application, the Commission will require a collateral document that lists all assets that will secure the loan. The applicant must also submit a depreciation schedule that shows the economic life of each asset, equipment, and facility that is being used as collateral for the loan amount. The Commission may require the borrower to execute a security agreement with the Commission.

As a general rule, the collateral identified as security for the CASF loan must not be used as collateral for any other outstanding or future loan. However, we acknowledge Small LECs' concern that they rely extensively on loans from the United States Department of Agriculture's Rural Utilities Service (RUS), and that RUS requires its borrowers to secure RUS loans with all of the borrower's telephone company assets. Therefore, we set forth this exception to the general rule above: we will allow CASF loan account applicants to use as collateral assets already used to secure a RUS loan or loans, as long as (1) the total amount borrowed/to be borrowed -- that is, the amount of the outstanding RUS loan(s) plus the amount of the potential CASF loan -- does not exceed the total value of the assets encumbered, and (2) the Commission is able to and does enter into an agreement with RUS where both RUS and the Commission have a first lien position on all identified collateral based on the amounts of each loan. The depreciation schedule that shows the economic life of each asset, piece of equipment, and facility that is being used as collateral for the CASF loan amount must show (1) the value of each asset that is used to secure the RUS loan(s) and (2) the value used to secure the potential CASF loan. We remind applicants that, as a general rule, the CASF loan can be secured by the assets purchased with the CASF loan funds as well as all other assets that are not used as collateral for other loans.

### 6. Loan Closing

Once the Commission approves a loan via a resolution, the borrower must sign a loan agreement[6] that contains all the terms and conditions of the loan. If the required parties do not sign a loan agreement, the Commission will not execute the loan and will revoke the loan offer. The borrower cannot withdraw funds without a signed loan agreement in place.

### 7. Loan Funds Disbursement

Once the Commission approves a loan via a resolution and the required parties sign the loan agreement, loan funds will be made available to the borrower based on a set **withdrawal schedule**. The withdrawal schedule will contain up to 4 payment windows based on the project's key milestones and generated in collaboration with the borrower. The withdrawal schedule containing the dates of the payment windows will be part of the loan agreement. The

[6] The Borrower will be required to sign a formal document that evidences the loan (hereinafter the "loan agreement").

borrower must submit a withdrawal request form [7] to CD **two weeks prior to each set payment window** for CD's review and approval. If CD has any concerns regarding the progress of the project, such as a high risk of the borrower being unable to continue or complete the project, CD will not release the remaining loaned funds to the borrower. All projects must be completed and loans fully disbursed within 2 years from application approval.

### 8. Loan Funds Repayment

The borrower will make all payments on the loan on a monthly basis as detailed in the signed loan agreement document. Repayment can begin as soon as funds are withdrawn by the borrower, but no later than the next immediate month following the withdrawal of any funds. A monthly repayment allows for simpler administration of all loans with outstanding balances since CD staff will know exactly when all loans are due and when late fees apply. A monthly repayment also allows for funds to revolve at a faster pace and become available for re-lending to future applicants. Repayment will include interest plus principal amortized over the term of the loan; i.e. 5 years. Interest will begin accruing when the first withdrawal of funds is made. Any subsequent withdrawals will be added to the balance due of the loan and subsequently amortized over the remaining term of the loan. If repayments are not received as specified in the loan agreement, a late payment charge will be added to the amounts due under the terms of the loan. A loan can be repaid in full or at an accelerated rate during the set loan terms; no prepayment penalty will apply.

### 9. Loan Default

The borrower, CD staff, and the partnering agency servicing the loan will work together to discuss any issues that occur throughout the life-term of the loan. In the event of default by the borrower, e.g. non-payment or bankruptcy, the Commission may pursue all available legal remedies. In addition, the Commission may decide to take further action including (1) terminating any future funding of existing grants and/or loans and/or (2) deeming the applicant ineligible for future grant and loan funding.

## *F. Loan Servicing*

CD staff will conduct the technical project eligibility review of applicants but will require a partnering agency (with the staff and tools in place for lending) to perform the financial eligibility review and loan servicing piece. It is expected that a reasonable application fee and/or other fees will be charged to loan applicants. The application fee could be a fixed amount or a

[7] Attachment C – CASF Broadband Infrastructure Revolving Loan Account Funds Withdrawal Form

small percentage of the loan amount the applicant is seeking. The Commission will propose and approve fees associated with a loan application via a resolution. If the Commission does not approve the application, the application fee will not be reimbursed.

# ATTACHMENT A – Estimated Useful Life of Equipment

## *Broadband USA – Technology Useful Life Schedule Fact Sheet*

| Category | Type | Estimated Useful life |
|---|---|---|
| **Buildings** | ■ Construction of new buildings, prefabricated buildings, or concrete pads | ■ 20 years |
| | ■ Modification, rehabilitation, or outfitting of existing buildings | ■ 15 years |
| **Outside Plant** | ■ Aerial coaxial plant, aerial copper plant, aerial fiber plant, buried copper plant, buried coaxial plant, buried fiber plant, underground plant, taps, amplifiers, drops, NIDs, etc. | ■ 20 years |
| **Towers and Poles** | ■ Construction of new towers or poles or modifications of existing towers or poles | ■ 20 years |
| | ■ Emergency power generation equipment at tower site | ■ 10 years |
| **Network and Access Equipment** | ■ Broadband switching equipment, broadband routing equipment, broadband transport equipment, network broadband access equipment (e.g., CMTSs, DSLAMs, Radio Network Controllers, etc.), wireless base stations, antennas, emergency power supply equipment | ■ 10 years |
| **Operating Equipment** | ■ Billing/Operations systems | ■ 10 years |
| | ■ Office furniture and fixtures | ■ 10 years |
| | ■ Work equipment and vehicles | ■ Five years for non-construction related motor vehicles; 10 years for work-related motor vehicles |
| **Customer Premise Equipment** | ■ Customer broadband access equipment (e.g., cable modems, DSL modems, wireless modems, etc.), general purpose computers and peripheral equipment, office machinery | ■ Five years |

# ATTACHMENT B – CPUC Rules of Practice and Procedure Specific Sections

## *2.4. (Rule 2.4) CEQA Compliance*

(a) Applications for authority to undertake any projects that are subject to the California Environmental Quality Act of 1970, Public Resources Code Sections 21000 et seq. (CEQA) and the guidelines for implementation of CEQA, California Administrative Code Sections 15000 et seq., shall be consistent with these codes and this rule.

(b) Any application for authority to undertake a project that is not statutorily or categorically exempt from CEQA requirements shall include a Proponent's Environmental Assessment (PEA). The PEA shall include all information and studies required under the Commission's Information and Criteria List adopted pursuant to Chapter 1200 of the Statutes of 1977 (Government Code Sections 65940 through 65942), which is published on the Commission's Internet website.

(c) Any application for authority to undertake a project that is statutorily or categorically exempt from CEQA requirements shall so state, with citation to the relevant authority.

Note: Authority cited: Section 1701, Public Utilities Code.

# ATTACHMENT C – Funds Withdrawal Form

CASF Broadband Infrastructure Revolving Loan Account

**Funds Withdrawal Form**

| | |
|---|---|
| **Date** | |
| **Borrower's Name / Organization** | |
| **Contact Information (address, phone number, email address)** | |
| **Resolution # Loan Awarded Under** | |
| **Total Loan Amount Awarded ($)** | |
| **Requested Withdrawal Amount ($)** | |
| **Withdrawal Payment Window # (1, 2, 3, or 4)** | |
| **Initial Withdrawal: Describe Specific Planned Project Activities for this Funding Withdrawal Window** | |
| | |
| **Subsequent Withdrawals: (A) Describe Specific Actual Project Activities and Describe Your Reasons for any Variance From the Previous Withdrawal Window Planned Activities (B) Describe Specific Planned Project Activities for this Funding Withdrawal Window** | |
| | |

**(END OF APPENDIX 2)**