

# UTOPIA Network PPP



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**UTOPIA Network PPP: Milestone One Report**  
Macquarie Capital

**FINAL VERSION – EXECUTIVE SUMMARY**

APRIL 29, 2014

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# 1. EXECUTIVE SUMMARY

Macquarie Capital (“Macquarie”) and First Solutions P3 Alliance (“First Solutions”) have significantly advanced our plan for the completion and long term operation of the Utah Telecommunications Open Infrastructure Agency (“UTOPIA”) and Utah Infrastructure Agency (“UIA”, and together with UTOPIA, the “Agencies”) fiber to the premises network since execution of the Pre-Development Agreement (“PDA”) in December 2013 and are pleased to present this Milestone One Draft Proposal to the Agencies’ member cities (the “Cities”).

## 1.1 The Proposal

Macquarie’s proposal has been structured specifically to achieve the Agencies’ key objectives of providing a ubiquitous, open access network that increases competition and choice in the Cities, while eliminating the network’s existing operating deficit and defraying existing debt service obligations.

Furthermore, the Macquarie proposal reduces transaction execution risk for the Cities, and transfers development, financing, operating and maintenance risk to the private sector, all while maintaining ultimate ownership of the network.

MACQUARIE’S MILESTONE ONE PROPOSAL	
<b>PROJECT NETWORK</b>	<ul style="list-style-type: none"> <li>▪ Open access, active ethernet network providing a ubiquitous last mile gigabit fiber connection to all addresses in the Cities</li> <li>▪ Network portal will be installed on outside of standalone addresses (eg, single family homes), and in telecommunications closet of multiple dwelling units (“MDU”) and multi-tenant commercial buildings</li> <li>▪ Internet service providers (“ISPs”) will be responsible for completing connections inside the premises</li> </ul>
<b>PROJECT STRUCTURE</b>	<ul style="list-style-type: none"> <li>▪ Utility fee-based public-private partnership (“PPP”) with 30 year term</li> <li>▪ PPP will build the network on a fixed-price, date certain basis within approximately 30 months of financial close</li> <li>▪ PPP will operate, maintain and refresh the network for 30 years on a fixed price basis subject to strict performance standards</li> <li>▪ Wholesaler will manage ISP relationships and help market the network</li> <li>▪ ISPs will service end users directly with little involvement from PPP or Wholesaler</li> <li>▪ PPP and Wholesaler will assume UTOPIA operating deficit from close</li> </ul>
<b>UTILITY FEE</b>	<ul style="list-style-type: none"> <li>▪ Each address will be charged a utility fee, which is a direct reflection of the expected cost of building, operating, maintaining, and financing the network for 30 years</li> <li>▪ Preliminary range of \$18-20 per address per month               <ul style="list-style-type: none"> <li>○ Escalated annually at a mutually agreeable index</li> <li>○ Addresses in MDUs to receive 50% discount</li> <li>○ Business addresses to be charged 100% premium</li> </ul> </li> <li>▪ Grace period of up to 6 months from construction to allow time for ISPs to</li> </ul>

MACQUARIE'S MILESTONE ONE PROPOSAL	
	connect users
<b>BASIC SERVICE</b>	<ul style="list-style-type: none"> <li>▪ Symmetrical basic service of up to 3 Mbps with a 20GB data cap available for free to all addresses</li> <li>▪ ISPs operating on the network will be required to provide the basic service for free in exchange for ability to market premium services to users</li> </ul>
<b>PREMIUM SERVICES</b>	<ul style="list-style-type: none"> <li>▪ ISPs will compete to provide premium data, voice and video offerings to network users</li> <li>▪ ISPs will be charged transport fees related to the provision of premium services</li> <li>▪ These revenues will then be split between the Agencies, the Wholesaler and the PPP, with the significant majority going to the Agencies</li> </ul>

Macquarie has extensively reviewed alternative implementation options and transaction structures, and believes that delivery of the project as an availability PPP will create the best value for the Cities.

## 1.2 Key Proposal Benefits

Macquarie feels its proposal achieves the following key benefits.

KEY PROPOSAL BENEFITS	
<b>ACHIEVABLE SOLUTION</b>	<ul style="list-style-type: none"> <li>▪ Independent review of the proposed business model supports its feasibility</li> <li>▪ Positive feedback from lenders suggests appetite for funding</li> </ul>
<b>RISK TRANSFER</b>	<ul style="list-style-type: none"> <li>▪ Cities will not be required to contribute funding to the project's development</li> <li>▪ All design-build, integration and ongoing operating and maintenance risks are transferred to the PPP</li> <li>▪ The PPP will be required to operate the network to well-defined specifications</li> <li>▪ Proposed upside sharing mechanism ensures alignment of interests between all parties</li> </ul>
<b>FINANCIAL UPSIDE FOR CITIES</b>	<ul style="list-style-type: none"> <li>▪ Premium service revenues, assuming long-term upgrade rates of 30-50%, expected to total \$1.0-1.5 billion over the term</li> <li>▪ Equivalent to approximately 2-3 times the existing debt service obligations</li> <li>▪ Cities retain ownership of network assets and, upon handback at the end of the term, will receive an asset with expected annual free cash flows in excess of \$100 million</li> </ul>
<b>VALUE FOR MONEY</b>	<ul style="list-style-type: none"> <li>▪ Significant majority of residents currently pay well in excess of the utility fee for their internet connectivity</li> <li>▪ Symmetrical basic service of up to 3Mbps is comparable to competing products in the market area</li> </ul>

KEY PROPOSAL BENEFITS	
<b>GREATER COMPETITION</b>	<ul style="list-style-type: none"> <li>Separation of network infrastructure and services significantly reduces market entry and exit barriers</li> <li>Proposed step change in network scale has generated interest from regional and national ISPs</li> <li>Whether residents use the network or not, they will likely see pricing reductions from their incumbent providers, serving to offset the utility fee</li> </ul>
<b>SCALE AND UBIQUITY</b>	<ul style="list-style-type: none"> <li>Scale of project allows for efficiencies in financing, development and operating costs, and ability to attract world class design-build contractors, systems integrators and hardware providers</li> <li>Standardized demarcation point across network drives operating cost efficiencies</li> <li>Universal access will help shrink the digital divide</li> <li>Provides scale required to attract stronger ISPs, promoting competition and choice for consumers</li> <li>Connectivity amongst the cities lays a foundation for a collaboration platform amongst community services</li> </ul>
<b>ISP INVOLVEMENT</b>	<ul style="list-style-type: none"> <li>Clear distinction of responsibilities and handoff points between network and ISPs will ensure timely remedy of user issues and improved customer engagement</li> <li>Requirement to provide basic service for free will incentivise ISPs to invest in marketing premium services</li> <li>Large number of potential customers incentivizes ISPs to deploy significant resources to develop a robust service and maintenance operation</li> </ul>
<b>ALIGNMENT OF INTERESTS</b>	<ul style="list-style-type: none"> <li>Sharing amongst all parties in upside revenues</li> <li>Private funding model will not require the Agencies or Member Cities to contribute additional funding to realize the network's potential</li> <li>Speed of basic service will be competitive, if not superior, to incumbent offerings that have higher costs than the proposed utility fee</li> <li>All-in costs (utility fee plus ISP charge) of premium services will be competitive to incumbent offerings of inferior speed and quality</li> <li>Users will not be billed the utility fee until they have had the opportunity to connect to the network</li> </ul>
<b>PLATFORM FOR GROWTH</b>	<ul style="list-style-type: none"> <li>Complete network will command a much higher take-rate for premium service, which will provide additional revenues for the Cities</li> <li>Network can be expanded to include other cities and benefits of scale shared amongst a greater number of users</li> </ul>

### 1.3 Comparison of Alternatives

The network currently faces significant capital constraints. Removing those constraints could unlock significant economic and civic benefits. A thorough evaluation of potential development models indicated that the PPP was the structure most likely to deliver these benefits, particularly given the Cities' desire to ensure the network remains open access as well as being ubiquitous across the Cities.

OBJECTIVE	PPP	SELL	SHUTDOWN
Reduction in the Agencies' Operating Deficit			

OBJECTIVE	PPP	SELL	SHUTDOWN
Defray Service Obligations on Existing Debt	●	●	●
Parity of the Network Build Across the Cities	●	●	●
Certainty of Execution	●	●	N/A
Expand the Existing Subscriber Base	●	●	●
Ubiquitous Last Mile Connection	●	●	●
Increase Service Offerings to Users	●	●	●
Provision of Civic Benefits (Public WiFi, etc.)	●	●	●
Increase Price Competition & Choice for Users	●	●	●

● High probability     
● Medium probability     
● Low probability

Macquarie believes the divestment model carries excessive execution risk to be considered a viable option. Firstly, the Cities lose control over the network and future investment will only occur if the acquirer considers it commercially viable. The capital cost of the project is substantial, and the benefits from a ubiquitous buildout are such that divestment would only be a viable alternative if there is a well capitalized buyer able to propose a feasible alternative to the PPP. Macquarie understands that no such bidders have tabled an offer to the Cities.

### 1.4 The Proposed Model

The business model has been developed to maximize efficiency and alleviate current operational issues through the implementation of clear handoff points between the PPP, the Wholesaler and the ISPs. The Agencies will not have an operational role in the network but will be responsible for overseeing the PPP and auditing its performance relative to the standards set out in the Concession Agreement.

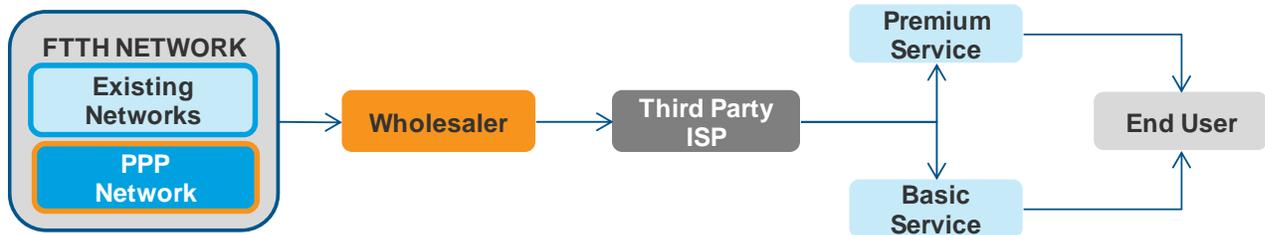
	Design-Build	Operations & Maintenance	Network Refresh	Sales & Marketing	Basic Service	End User Contact
Agencies	x	x	x*	x	x	x
PPP	✓	✓	✓	x	✓	x
Wholesaler	x	x	x	✓	x	x
ISPs	x	x	x	✓	✓	✓

\*Agencies will only participate in the network refresh in the event network specifications are changed from those established in the Concession Agreement.

The PPP will build the network to a designated demarcation point on the outside of a residence or at the communications cabinet of a business or MDU. The ISPs will be responsible for completing the connection into the home or business. The PPP will subsidize the ISPs' installation costs, and ISPs will be prohibited from charging additional costs to the customer for a standard installation.

Users with installed connections will select a preferred ISP, who will be required to provide a symmetrical best efforts service of up to 3Mbps with a 20GB monthly data cap at no incremental charge above the utility fee. The ISPs will market products above this basic service as premium services for which they can charge a fee.

The Wholesaler will generate revenues from the transport fees paid by the ISPs for bandwidth used by premium service customers. UTOPIA will receive the significant majority of these revenues, while the Wholesaler will receive a share that increases with take rates. The PPP will also have modest participation in these revenues as part of a broader alignment of interests to operate the network in such a way that incentivizes users to upgrade, and in recognition of the increased costs of operating a network with more traffic.



**UTOPIA** UTOPIA retains 100% ownership of the network infrastructure

## 1.5 Milestone One Work Program

Macquarie and First Solutions undertook a significant work program during Milestone One. The key components of that process are outlined below:

<b>Design-Build</b>	<ul style="list-style-type: none"> <li>▪ Prepared Request for Qualifications and solicited expressions of interest to complete the outside plant from 14 local, regional and national contractors</li> <li>▪ Shortlisted two proponents, Black &amp; Veatch and Corning               <ul style="list-style-type: none"> <li>○ Each of these two contractors will develop fixed-price date-certain design-build proposals in competition to ensure the best value solution for the network</li> </ul> </li> <li>▪ Shortlisted proponents prepared indicative cost estimates for completion of the network buildout – expedited timeframe generated pricing 7 weeks after RFQ</li> <li>▪ Commissioned an independent technical analysis of the existing network and UTOPIA’s internal cost and scheduling estimates for network completion</li> </ul>
<b>Network Equipment &amp; Systems Integration</b>	<ul style="list-style-type: none"> <li>▪ Solicited proposals for equipment and system integration from 4 world-class providers</li> <li>▪ Coordinated highly competitive process to select equipment vendor (Alcatel-Lucent) and systems integrator (Fujitsu) partners               <ul style="list-style-type: none"> <li>○ Both partners provided detailed cost estimates</li> </ul> </li> </ul>
<b>Operations, Maintenance &amp; Refresh</b>	<ul style="list-style-type: none"> <li>▪ Solicited proposals for ongoing network operations, maintenance and refresh services from a number of world class providers</li> <li>▪ Investigated cost structure of current business operations, maintenance and refresh program, and identified a number of areas that can be improved to lift the network’s overall performance and efficiency</li> </ul>

	<ul style="list-style-type: none"> <li>▪ Developed estimates of operating costs under a variety of scenarios, including self-perform and partially outsourced (with Fujitsu) options</li> </ul>
<b>Market Analysis</b>	<ul style="list-style-type: none"> <li>▪ Commissioned market feasibility report to assess competitive landscape, marketing considerations, take rate forecasts and transport fee levels, among other issues</li> <li>▪ Commissioned a UTOPIA brand study with 700 respondents across the Cities to assess current market behaviors and attitudes to UTOPIA and other telecommunications providers</li> <li>▪ Conducted focus groups to obtain a more detailed assessment of attitudes toward telecommunications providers and the Macquarie PPP proposal with 24 registered voters in Murray, Centerville and Orem</li> <li>▪ Met with most of UTOPIA’s current ISPs to discuss acceptability of the business model</li> <li>▪ Met with ISPs not currently operating on the UTOPIA network, including national players, to discuss participation on the completed network</li> </ul>
<b>Public Relations</b>	<ul style="list-style-type: none"> <li>▪ Met with city councils of West Valley City, Orem, Murray, Lindon and Brigham City to introduce the PPP structure and our proposed business model</li> <li>▪ Regular, detailed updates to the Cities of each working group’s progress through steering committees with appointees from each of the Cities</li> </ul>
<b>Financing</b>	<ul style="list-style-type: none"> <li>▪ Initial discussions with 5 lenders to gauge potential market appetite for debt financing of this nature and validate our indicative financing assumptions</li> <li>▪ Initiated discussions with UTOPIA bondholders to begin exploration of issues related to existing debt</li> </ul>
<b>Legal</b>	<ul style="list-style-type: none"> <li>▪ Preliminary legal structure provided by the Cities</li> <li>▪ Commenced analysis of integrating the project network into the existing network</li> <li>▪ Commenced discussions with City Attorneys to begin exploring legal issues implicated by PPP’s proposed business model and implementation approach</li> </ul>