

Funding options for BDUK funded broadband infrastructure

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Introduction

The 2016 National Broadband Scheme Decision allows for implementing bodies to choose the most appropriate funding model to their broadband project, specifically referencing the following models as examples:

- Public Sector Owned (or municipally owned)
- Concession to Build-Operate-Transfer
- Public Private Partnership
- Gap Funding model

This paper provides an overview of these different funding models to introduce implementing bodies to them, explain how they work, and what key considerations should be made when deciding which model to proceed with.

The purpose of this paper is to introduce these models only. Implementing bodies should seek their own advice for more detailed information to support any decision making regarding what model might be used. As part of BDUK's assurance process, implementing bodies will be required to complete a template explaining their selection of a delivery and funding model. This justification must include feedback from the market as well as well consider the resources of the implementing body.

Public Sector Owned Supplier Model

How does it work?

Under this model a public entity (or a dedicated division within an existing public entity) would be established to own, deploy and manage the network. (This public entity could be owned by one or more implementing bodies.) A tender for the attribution of the contract to the public entity would not be required.

The network would be deployed by using one of the following approaches:

- directly by the public entity by resourcing for and managing the rollout of the infrastructure; or
- through a procurement for civil engineering or network deployment companies (not telecom operators)

Once deployed the network would be owned and managed as a wholesale provider by the public entity who would commercially operate the network, as well as manage the associated commercial revenues and risks.

Key considerations for applying this model

- The public entity is liable for any commercial risks associated with the network. BDUK's 2016 State Aid decision specifies that the public entity will need to have undertaken their own analysis to assure themselves that they are able to bear the commercial risks and have the financial and resource capacity associated with undertaking a public sector owned model (see paragraph 41 of the decision).
- The public entity would be required to fund the operational expenditure of the network up to the point where it generates enough cash to be self-funding. This could take a number of years and in some instances might not happen at all. The public entity would need to make a decision on whether it was willing to make this investment and commitment to the project.
- The 2016 State Aid decision also specifies limitations regarding the services that can be provided by a public sector owned entity that is funded by the National Broadband Scheme (see paragraph 27 of the decision). The Decision refers to the following limitations:
 - o that the publicly owned network operator must its activities to within the pre-defined area(s) targeted under the 2016 NBS, and must not expand to other areas that might be deemed commercially attractive
 - o that activities under the project are limited to maintaining and granting access to passive infrastructure, not engaging in competition at the retail level with commercial operators

- o that funds used for operation of the network are managed and accounted for separately from other funds available to the public entity.

International applications of this model

- Australia's National Broadband Network scheme (see http://www.oecd-ilibrary.org/science-and-technology/broadband-networks-and-open-access_5k49qgz7crmr-en)

Concession to Build-Operate-Transfer

How does it work?

The public entity contracts with a private sector partner to design, build and operate the broadband infrastructure. The private sector partner will derive economic benefit from, and bears the commercial risk associated with, the infrastructure for the duration of the contract. At the end of the concession, the network returns to public hands and the public entity can decide to either retender the contract, operate the network itself, or sell the network.

There are two types of concession that can be applied:

1. Full concession, where the private sector partner provided some financing, designs, builds and operates the network; and
2. Operating concession, where the public entity finances the infrastructure and contracts with a private sector partner to design, build and operate the network.

Key considerations for applying this model

- The public entity can benefit from greater levels of control and governance, however there are significantly higher levels of funding required during the initial build phase if the public entity opts for an operating concession. As the asset reverts back to the public entity at the end of the contract, even under a full concession model the level of subsidy required will be greater than under the investment gap funding model.
- Under an operating concession the public entity bears the majority of the risks associated with network financing, ownership and reinvestment. At the end of the contract a new entity would need to be set up to compete in the wider commercial market (akin to the Public Sector Owned model) or consideration could be given to further a concession or potentially selling the network. These risks are reduced under a full concession, as the private sector finances the delivery of the infrastructure and the operation of the network during the initial contract term.
- Both the public entity's and the private sector partner's returns from the operation of the infrastructure are dependent on securing take up and revenue and controlling operating costs and re-investment costs. These shared objectives can lead to greater levels of cooperation between the public entity and the private sector partner.
- The public entity bears the risk of the technology and design of the network becoming obsolete towards the end of the contract. The public entity will need to manage the private sector partner closely to ensure any deployed infrastructure is future proofed to still be useful after the contract expires.

- At expiry of the contract, ownership reverts to the public entity (at no additional cost). As the expiry of the contract nears, the private sector partner may be less incentivised to maintain high levels of commitment and investment if the asset is to be transferred and they cease to realise any of the associated benefits of the asset.

International applications of this model

- France's Auvergne Haut Debit scheme – concession to design, build, operate, and transfer (see <http://www.auvergnehautdebit.fr/>)

Public Private Partnership

How does it work?

The public entity and a private sector partner form a joint venture which designs, builds and operates the network.

Both parties own equity in the entity (most commonly 50/50) and split the risks and rewards of ownership. Equity is invested by the public entity and the private sector over the deployment period in proportion to their shareholdings.

The public entity also pays a social policy objective grant to the joint venture during the contract term. The grant is sized to address the commercial viability gap associated with the wholesale investment and, as with the Investment Gap Funding model, the grant payments will be subject to the joint venture meeting specified service levels and contractual obligations.

Key considerations for applying this model

- The public entity and the private sector partner share the responsibility of the network deployment.
- The public entity and the private sector partner share the risks and rewards of network operation and commercial exploitation. If costs overrun, or the expected demand does not materialise, this could mean that the public entity is required to subsidise the project more than was originally envisaged.
- As with the Public Sector Owned Supplier model, because the public entity would be a (part) owner of the joint venture they would need to satisfy themselves that they had the financial and resource capability to make this commitment.
- The risks and rewards are shared in proportion of their respective ownership stakes in the joint venture.
- Both parties will need to be prepared for potential discussions during the contract, if one party decides they wish to leave the joint venture /obtain ownership of the share they do not currently own. The timing of these discussions may be affected by changes to either party's overall business strategy which may be subject to change without the influence of the other party in the joint venture.

International applications of this model

- Italy's Progetto Lombardia scheme (see page 40 of http://www.eib.org/epec/resources/epec_broadband_en.pdf)
- New Zealand's Ultra-Fast Broadband Initiative (see <http://www.crownfibre.govt.nz/ufb-initiative>)

Investment Gap Funding Model

How does it work?

The public entity contracts with a private sector partner who will finance, design, build, own and operate the broadband infrastructure. A capital subsidy is paid to the private sector operator through grants which are paid during deployment and through the operational life of the contract. The private sector partner retains ownership of the network after the contract expires. The public subsidy is the minimum amount necessary for the private sector to deliver the project whilst also making an acceptable rate of return.

The actual financial performance of the network build is monitored to ensure that during the life of the contract the private sector partner only receives the minimum amount necessary in public subsidy. This may result in clawback if the private sector partner realises more financial benefit from the network than was originally envisaged (see separate guidance on the clawback mechanism for additional detail). For example, where the private sector partner experiences higher levels of take up and therefore receives a stronger financial return from the network than originally envisaged, the public entity claws back a proportion of these additional profits from the private sector supplier. This proportion is the same as for public investment into the contract, so that the supplier retains an incentive to strive for increases in take-up and revenues.

A key feature of the Investment Gap Funding Model is that placing the long-term ownership of the network with the private sector allows private sector bidders to leverage the use of their existing infrastructure and encourages them to continue to invest in the network to develop and exploit new markets facilitated by the wholesale network.

Private sector bidders may reflect the benefits in the “strategic value” that they place on winning and gaining ownership of the asset to come out of the contract which in a competitive tender process is likely to drive down the amount of public subsidy required.

Key considerations for applying this model

- The private sector partner bears the risk associated with the wholesale network deployment, operation and exploitation over the contract term and beyond.
- The private sector partner retains ownership of the network at the end of the contract. The public entity would receive no stake in ownership of the infrastructure at the end of the contract despite having contributed significant sums of money towards its construction.
- Once the contract has ended the public entity would lack any control over policy objectives across the network.

- The public entity will need to include a number of enduring contract clauses as required by the 2016 National Broadband Scheme decision, in particular that the access new passive infrastructure must be indefinite.

International applications of this model

- Broadband Delivery UK contracts (see <https://www.gov.uk/government/publications/bduk-new-procurement-pipeline>)
- Canada's Connecting Canadians scheme (see <https://www.ic.gc.ca/eic/site/028.nsf/eng/00588.html>)