

Municipally Owned Broadband Networks: A Critical Evaluation

(Revised Edition)

This analysis, revised and updated to reflect national and local changes during the past two years, finds the case for municipal ownership of broadband networks is even weaker than it was then. Broadband services that were scarce two years ago are now plentiful and reasonably priced. New data from communities that attempted to build and operate municipal broadband systems suggest taxpayers would be very much at risk, even under financing schemes involving certificates of participation. A broadband initiative in Illinois' Tri-Cities area (Batavia, St. Charles, Geneva) continues to be a useful case study and precautionary lesson for other communities with similar plans.

1. Advocates of municipally owned broadband networks claim they would produce a long list of benefits.

Critics say telephone and cable companies are moving too slowly to offer affordable high-speed broadband services to many parts of the country, particularly rural areas and small towns. Public construction and operation of broadband systems, they say, can fill the gap. Among the alleged benefits of municipally owned broadband networks are ubiquitous service, greater efficiency, a boost to economic development efforts, lower prices, and access to enhanced broadband services.

2. Broadband services are already available to virtually everyone who wants them.

Unlike two years ago, today virtually everyone who wants broadband services can get Digital Subscriber Line (DSL) service from their telephone company or cable modem service from their cable company. Cable, telephone, and wireless broadband providers have spent billions of dollars rolling out service in areas that were previously underserved. T-1 service is available to businesses over existing telephone lines and Direct Broadcast Satellite (DBS) service is available from DirecTV and EchoStar. MDS (multipoint distribution service), or wireless cable, is widely deployed in smaller towns, and starting next year, WiMax will be deployed in communities across the country.

3. The speed of broadband services is rising and the price is falling.

Critics say platforms other than fiber-to-the-home (FTTH) fail to provide an acceptable level of speed and quality, but this too has changed with time. Most broadband platforms operate at speeds dramatically faster than two years ago. DSL now can reach 3 to 6 Mbps (largely in support of video applications), and an enhancement to the standard that can accommodate up to 15 Mbps will begin deployment in 2005. Cable modems provide high-speed data distribution between 500 Kbps and 4 Mbps, and commercial cable modem services can go even higher. Wireless broadband can reach 54 Mbps, depending on several factors. WiMax will offer speeds of between 17 Mbps and 75 Mbps, depending on distance from the tower and other factors.

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While speeds have increased, prices have fallen. SBC offers DSL “Express” service for \$26.95/month and “Pro” service for \$36.99/month, and T-1 service for around \$250.00 per month. Comcast offers free cable modems and Internet access for \$42.95/ month.

DirecTV offers satellite broadband service for between \$99/month and \$129/month; after 15 months you own the equipment and the price falls to between \$59/month and \$89/month. When WiMax arrives, it is likely to cost \$25 a month for broadband and \$40 to \$50 for a package that includes unlimited telephone service.

4. Municipal broadband is not a boon to economic development efforts.

Consultants often try to sell municipalities on the idea of building broadband networks by claiming they are essential to economic development efforts, but their reports invariably present no evidence of a link between broadband and economic growth. In fact, econometric research consistently finds subsidies to corporations—whether in the form of cheap access to land, sewers, or broadband—are an unreliable and often counterproductive strategy for economic development. Cities and states that make these expenditures do not create jobs or increase personal income at higher rates than cities and states that don’t. The expected private benefits of a few users do not justify the cost of connecting every business and household in the community with expensive fiber-optic lines.

5. It is unlikely a public utility would operate as efficiently as competing private companies offering telecommunications services.

Another claim commonly made by advocates of municipalization is that public utilities operate more efficiently than private companies. However, research on the costs and quality of public services produced via municipal ownership versus private provision is extensive and conclusive. It shows *privatization*, not municipalization, delivers significant cost savings, greater accountability and responsiveness to consumers or elected officials, and a level of quality equivalent or superior to public-sector delivery. The claim that municipalization is more efficient than relying on private companies fails on empirical grounds.

6. Cities that have attempted to build and operate broadband networks often report large losses borne by taxpayers or ratepayers.

Of some 55,000 towns and municipalities in the U.S., only about 200, or 0.5 percent, operate municipal broadband networks. Many communities that have taken the plunge have experienced large losses that must be paid for by taxpayers or ratepayers. For example, *Iowa Communications Network* “consistently requires large subsidies to continue in business”; *California’s CALNET system* was some \$20 million in debt when it was privatized in 1998; *Lebanon, Ohio* originally projected the cost of building its FTTH network at \$5 million and ended up spending \$9 million and later had to authorize \$14.8 million in mortgage revenue bonds to cover operating losses; and *Marietta, Georgia* lost more than \$35 million operating its municipal broadband network before it was sold (at a loss) to American Fiber Systems in September 2004.

“That’s why we should not be in this business—you have to keep reinvesting. It’s negative cash flow once you consider reinvestment of capital.”

— Bill Dunaway, Mayor
Marietta, Georgia

7. Municipal broadband networks are very risky ventures.

Municipal broadband utilities most commonly fail or run deficits because the *cost of construction* exceeds initial projections and burdens the utility with high debt retirement costs; *legal restrictions* prevent cities from subsidizing their municipal broadband networks directly with tax dollars or by raising rates for other utilities; *optimistic projections of the number of customers* delivered by contract-seeking consultants have misled many city officials; and the *failure to find content consumers will pay for* limits the appeal of municipal networks. Consultants and municipal officials tend to focus exclusively on bandwidth and the technological advantages of fiber-to-the-home instead of understanding broadband is part of the larger and very competitive entertainment and business services industries.

8. Certificates of participation do not offer a promising alternative form of financing for municipal FTTH networks.

Advocates of municipalization have sought ways to reassure voters that their tax dollars would not be at risk in the event the broadband utility begins to lose money or is forced into bankruptcy. One way to do this is to suggest the use of certificates of participation rather than general revenue bonds to finance construction. But it appears no broadband network in the U.S. has ever been financed by certificates of participation, probably because investors view such projects as being too risky. In a market where broadband services are already ubiquitous and inexpensive, they are almost certainly correct.

The use of certificates of participation may offer somewhat more protection to taxpayers than using revenue bonds, but there is a price to pay for that protection. Generally in such cases, ownership of the

asset is held by the lender while the client—in this case the local governments—pays down the loan. This means the network will not be “community owned” but only leased by local governments from investors. Those investors, in turn, are free to sell the network to other investors or, as one consultant told a group of municipalization advocates on July 7, “we will sell it to Comcast if it doesn’t work.”

Finally, it would be misleading to imply that arranging for private financing of the *construction* of the FTTH network means taxpayers and ratepayers won’t later find themselves “on the hook” to pay for operating costs and upgrades to the system. One of the lessons from other cities that have tried to make municipal broadband networks work but failed is that operating costs per customer are often higher than expected, resulting in the need for annual subsidies. Using certificates of participation would not protect taxpayers and ratepayers from having to pay more to keep the utility operating in the years ahead.

9. Generally speaking, municipal ownership of broadband networks is probably not in the best interests of residents and most businesses.

Generally speaking, municipal ownership of broadband networks is probably not in the best interests of residents and most businesses, even in communities not well served today by private providers. Access to broadband services is more plentiful than advocates of municipalization claim or admit, suggesting the real issue is not availability but *price* and who should pay it.

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It is unlikely that more than a small number of residents would benefit from a municipally owned broadband network, that their benefits would justify the steep cost, or that it is fair to force other residents and businesses to subsidize them. It is fanciful to imagine that municipal broadband is a cost-effective way to promote economic development.

Very few cities attempt to build and own broadband networks because the costs and financial risks are too great. Cities that have taken the leap simply illustrate the riskiness of the venture, costing their taxpayers and ratepayers millions of dollars in subsidies with no end in sight. Threatening to build a municipal broadband network may have been a good strategy two years ago, to prompt incumbent cable and telephone companies to make good on past promises. Following through with municipalization, however, is not a good idea.

Based on *Heartland Policy Study* #105, “Municipally Owned Broadband Networks: A Critical Evaluation (revised edition),” by Joseph L. Bast. Copies are available from The Heartland Institute for \$10 each.

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