MBDA

MICHIGAN BROADBAND DEVELOPMENT AUTHORITY

ANNUAL LEGISLATIVE REPORT

March 1, 2007

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Vice President's Message

Throughout the year 2006, the Michigan Broadband Development Authority (MBDA) has restructured and reassessed the organizations goals and mission. In April of 2007 the MBDA will cease its lending activities, and will further more cease its operations. To fully understand the context of the changes that have occurred over the past twelve to eighteen months, it is important for readers of this report to understand the complete history of the MBDA.

In 2001 there was a report issued by the Michigan Economic Development Corporation (MEDC) entitled 'LinkMichigan'. This report highlighted the fact that the State of Michigan was falling behind other states and countries in terms of access to high-speed telecommunications infrastructure. It noted that our state had some natural disadvantages that needed to be overcome (i.e., peninsula state surrounded by water) to attract more broadband investment. The idea for the creation of the MBDA grew out of this report, and the report called for changes to right-of-way permitting rules among other things to encourage such investment. Ultimately, as a package of broadband bills, the Legislature created the METRO Authority and the MBDA. The MBDA received a $50 million loan from the Michigan State Housing Development Authority (MSHDA) to provide start-up resources. The MBDA issued its first loan in 2003 and has since approved $31 million in loans to broadband providers across the state including both the Lower and Upper Peninsula.

During the same time the MBDA was launchings its operations, the large telecommunication firms and cable companies were at that very same time experiencing the largest market value losses in their histories. Under initial leadership at the MBDA, the Authority aggressively tried to market its loans to these large telecommunication firms and cable companies. The MBDA staff sought to build a portfolio worth hundreds of millions of dollars. Working towards this initial goal of building an extensive loan portfolio, the MBDA turned away many small broadband providers because it didn't think it could afford to process such small loans. However, unfortunately the large companies were shedding debt and not looking to take on new debt. In short, the MBDA's staff and loan processing capacity was built on a larger scale than what turned out to be necessary, because the latter types of borrowers were the only entities interested in the MBDA's loan programs.

The MBDA originally was headquartered in Ann Arbor, MI, however in late 2003, the MBDA was moved to Lansing, MI and the Governor brought me on board to lead the agency. We worked to reduce administrative costs and refocused the MBDA's efforts toward small entrepreneurial providers. Since that time, the MBDA has approved more than a dozen loans for more than $31 million. Loans to these providers are now helping to deploy cutting edge technologies across the state, impacting more than 375 cities, townships and villages. While the size of the MBDA's loan portfolio seems modest in historical telecommunication investment terms, new broadband technologies are more cost-efficient and the MBDA's loans will leverage an impact on more than 78% of the counties in the State of Michigan.

With regards to the loan portfolio performance, all of the MBDA loans have performed well (we have made no bad loans). The MBDA has worked directly with dozens of companies and consulted with roughly 45 local government organizations in Michigan to support broadband expansion efforts. The MBDA reviews its loan applications similar to an investor, and does not simply 'give' the money away to fledgling start-ups. This is supported directly with the fact that 100% of our loan portfolio is in 'good' standing. The requirements to which the loan applicants have to meet are detailed and explicit. Since inception in 2003, the MBDA has rejected nearly three times as many loan requests as it has approved-working diligently to ensure that borrowers have a business plan and the technological and financial sophistication to succeed.

Building on this success, in the fall of 2005 Governor Granholm asked the Authority to dedicate its remaining MSHDA resources for projects in the most underserved regions of the state. Department of Labor and Economic Growth (DLEG) Director David Hollister also worked with the Authority to further reduce administrative costs to conserve dollars for loans. Several MBDA staff members were placed in positions with MSHDA and other DLEG agencies. Staffing levels have been reduced to 3 employees allowing more resources to be targeted at rural markets. The Governor's Rural Broadband Initiative (RBI) was subsequently launched with a Request for Proposal (RFP) that was released on November 30, 2005. $17 million was made available at a reduced interest rate of 4 percent. With respect to the $17 million RBI loan monies, the MBDA has been able to work with seven different companies, having to-date approved $13.1 million in loans and is in the process of performing due diligence on another $3.8 million in loans. The MBDA will transition the loan portfolio to MSHDA, where the loan portfolio will continue to be monitored and any adjustments to existing loans can be made as needed.

As you look back on the MBDA's start-up experiences, much can be learned. The Authority was a successful experiment in state government, and the Authority was able to impact 78% of the counties in the State of Michigan. These experiences include the following:

1. Early on the MBDA spent too much time and money chasing large statewide deals with major telecommunications carriers, when smaller entrepreneurial companies were banging on MBDA's doors with low-cost alternatives for many markets;
2. Lending entities like the MBDA need to spend more time communicating about successes and challenges to members of the State Legislature;
3. Like MSHDA and other start-up financing organizations, the MBDA really needed an upfront subsidy/grant start-up investment for administrative costs (even though the MBDA had begun to build a loan portfolio that was covering costs);
4. The MBDA statute should have allowed equity positions (the MBDA functions much like a venture capital firm and its deals require large amounts of review from experienced technical and financial staff) so it could better cover its costs;
5. Aggregation strategies and other subsidies are needed to build profitable business plans for broadband investment in rural markets;
6. Generally, financing should not be provided to pure start-up broadband companies yet, regardless of size, target those who have been in the broadband market and/or have run a successful enterprise (as an ISP, data center host or some other I.T. business).

The MBDA has developed a positive national and global reputation having consulted with 19 states and two foreign governments looking to replicate Michigan's programs and to gain insight on the lessons learned from the MBDA experience.

Over the past four years, the MBDA has attracted entrepreneurial investments that have put Michigan on the cutting edge of broadband deployment. As the MBDA winds down its lending activities, it can look back proudly in knowing that it built a positive national reputation for our state as a place where entrepreneurs in the broadband industry can more easily expand and invest in new technologies. Beyond lending, the MBDA has pushed the envelope in Michigan by communicating and advocating the need for expanding the availability of high-speed Internet services. It has championed the need for communities to have wireless/mobile options in addition to traditional broadband services. It has been an important component of the State's overall effort to expand the 21st Century infrastructure needed to be competitive in today's global marketplace.

MBDA Board of Directors

- Bob Swanson, Department of Labor & Economic Growth (Chairman)
- Robert Klein, State Treasurer
- James W. Butler III, Michigan Broadband Development Authority Vice President
- Michael DeVos, Michigan State Housing Development Authority Executive Director
- George Franklin (D), Franklin Public Affairs
- Joel I. Ferguson (D), Ferguson Development LLC
- Larry Leatherwood (D), Executive Consultant
- Frida Waara (R), Videographer
- Matthew E. McLogan (R), Grand Valley State University Vice President
- Cindy Zerkowski (R), Macomb County Chief Information Officer

Mission, Powers, and Funding

The MBDA was created in 2002 by a near unanimous vote of both the House and Senate. Its legislatively-established mission is to help the state attract more private sector investment in high-speed Internet infrastructure and to increase demand for and utilization of broadband services. The Legislature also called for the MBDA to help improve competition and affordability of broadband services across the state. The Authority meets these objectives by offering financing to telecommunications companies and others needing assistance in expanding broadband infrastructure. Eligible projects may include expansion of fiber backbone networks, last-mile connectivity solutions (such as wireless, cable, digital subscriber line (DSL), BPL, satellite or other technologies), or network operations centers, for example.

The Authority is authorized to issue investment grade, taxable and tax-exempt bonds, the proceeds of which can be used to provide financing assistance to companies. In an effort to support the start-up of the MBDA, the Michigan State Housing Development Authority (MSHDA) provided a $50 million line of credit to the MBDA. This note was initially designed to balloon in 20 years, providing the MBDA with sufficient time to build loan volume and generate revenues necessary to make repayment. In 2005, however, MSHDA proposed a restructuring that would allow them to receive payments immediately in exchange for the forgiveness of a portion of the original MBDA debt.

MSHDA/MBDA Financing Agreement Changes

The MBDA had a $50 million financing arrangement with MSHDA that was entered into in April of 2002. This financing was evidenced by an Investment Agreement and an associated bond. The original financing was altered in October of 2003 to recast it to operate like a line-of-credit arrangement. A further alteration of the financing was approved by the MBDA and MSHDA boards on November 16, 2005 and subsequently closed as of that date.

This new revision was made to accommodate a lower interest rate for future MBDA loans in rural markets and to accelerate payment of existing MBDA cash and revenues to MSHDA. Neither of the prior agreements called for the MBDA to make any principal payments to MSHDA for 20 years. Given MSHDA's desire to recoup a portion of these dollars more quickly and given the net present value of money, MSHDA chose to forgive any non-loan related debt in exchange for immediate payment from existing and future MBDA loan revenues. As a result, the Amended and Restated Investment Agreement restructures the financing, in pertinent part, as follows:

- The agreement provides for the repayment and cancellation of the prior bond. This provision includes a pledge of property, which specifically includes borrower payments on existing loans, to MSHDA as security for the new bond. This provision further provides that the payment and irrevocable pledge shall be deemed to be a final accounting of the then-outstanding principal amount on the prior bond and accrued and unpaid interest thereon as of the closing date, with any difference being thereupon forgiven by MSHDA and extinguished. MSHDA forgave $14,657,451 at the end of fiscal year 2006.
- The agreement provides for a new investment and bond. The amount of the new investment is in the principal amount of $35,483,810.20. The investment is comprised of $23,237,613 in funds to be held in an escrow fund, and $12,246,197.20 of existing loans financed by MBDA with prior bond proceeds.
- The agreement provides that MSHDA will accept directions from MBDA regarding the usage of escrow funds subject to the following limitations:
  - An amount not greater than $4,992,613 shall be available to make advances on existing loans;
  - An amount not greater than $17,000,000 shall be available to make RFP rural and underserved loans;
  - An amount not greater than $250,000 shall be available for the settlement of accounts payable and other accrued expenses;
  - An amount not greater than $995,000 shall be available for the operating expenses of MBDA.
- The agreement provides for the transfer of escrow funds back to MSHDA at the seventeen month calendar anniversary of the closing date, with certain exceptions.
- The agreement provides that the rate of interest on the new bond and investment shall be 0% per annum.

The bond is characterized as a limited obligation of MBDA payable solely for the pledged property and also states that the State of Michigan is not liable on this bond.

MSHDA/MBDA Financing Agreement Changes Cont.

2002 Agreement

Amount: $50 million
Interest Rate: 6%
Payments: No Principal payments for 20 years - $300,000 Interest Payment Annually
Administration Position: Building a self-sustaining organization not a near-term priority.

2003 Agreement (Replacing 2002 Agreement)

Amount: $50 million "Line of Credit" ($47 million returned to MSHDA)
Interest Rate: 6%
Payments: No Principal payments for 19 years - $100,000 to $300,000 varying Interest Payment Annually
Administration Position: MBDA will repay loan and work to become self-sustaining.

2005 Agreement (Replacing 2003 Agreement)

Total Amount: $35.5 million
Interest Rate: 0% (4% for Rural Broadband Initiative loans)
Funds for Existing Loans Prior to 2005 Agreement: Approx. $18 million
Funds Available for MBDA Lending: $17 million (dollars not committed within 17 months returned to MSHDA)
Amount Returned to MSHDA in FY06: $2.1 million immediately plus $200,000 per month in loan payments from MBDA borrowers
Funds Available for MBDA Operations: $995,000 (dollars not spent within 17 months returned to MSHDA)
Funds for Expenses Incurred Prior to 2005 Agreement: $250,000
Payments: All monthly loan payments from MBDA borrowers made directly to MSHDA
Administration Position: Provides near-term resources for Housing Programs.

MBDA Historical Accomplishments

1. Since its inception, the MBDA has approved $31 million in loans which are impacting more than 375 cities, townships and villages across the state. The Authority has worked directly with more than two dozen companies and consulted with roughly 40 local government organizations in Michigan to support broadband expansion efforts.

2. While the size of the MBDA's loan portfolio seems modest in historical telecommunication investment terms, new broadband technologies are more cost-efficient and the MBDA's loans will leverage an impact on 78% of the counties in the State of Michigan, and more than 2.4 million people and 900,000 households in the aforementioned 375 cities, townships and villages.

3. The MBDA has not had a lack of interest in its loan programs, having reviewed more than $120 million in loan applications. It has been diligent in lending only to those companies that have solid business plans. It has received criticism for not generating loans more quickly, but has held to an important underpinning of only doing loans that meet strong financial underwriting criteria. The Authority has done this and the companies it has backed are successful and growing. The MBDA currently has a 100% success rate, and has not had one bad loan.

4. MBDA borrowers have generated roughly $55 million in revenues in just a few short years and employ approximately 245 people. They continue to grow and expand.

5. In addition to its lending activities, the MBDA has also consulted and helped several companies receive federal RUS dollars or other monies for expansion. These include companies like LDMI, Agri-Valley Communications, Air Advantage, Casair and Merit Network among others. The combined revenue of these companies exceeds $150 million annually and together they employ more than 500 people.

6. The MBDA has developed a positive national and global reputation having consulted with 19 states and two foreign governments looking to replicate Michigan's programs and to gain insight on the lessons learned from the MBDA experience. These include the States of Indiana, Illinois, Ohio, Wisconsin, Minnesota, Iowa, Nevada, Kentucky, Virginia, Arizona, North Carolina, West Virginia, Florida, Pennsylvania, Washington, Oregon, Texas, California and the District of Columbia. The MBDA has also been recognized by two prominent organizations. The Ash Institute for Democratic Governance at Harvard University's John F. Kennedy School of Government asked the MBDA to apply for its Innovation in American Government Award. The Pioneer Institute for Public Policy Research also recognized the MBDA and asked for a similar submission for their "Better Government" competition.

7. Within the State of Michigan, the MBDA has consulted with Ottawa, Oakland, Washtenaw, Muskegon, Marquette, Kent and Genesee Counties. It has also worked with the cities of Detroit, Grand Rapids, Lansing, East Lansing, Ann Arbor, Flint, Jackson, Saginaw, Warren, Marquette, Coldwater, Quincy, Traverse City, Boyne City, Bay City, Ferndale, Royal Oak, Iron City, Kalamazoo, Battle Creek, Springfield, Port Huron, Marshall, Ypsilanti, Highland Park, St. Joseph, Benton Harbor and Alpena—all of which are looking to expand wireless and other broadband options in their communities.

8. The MBDA has attracted investments that have put Michigan on the cutting edge of broadband deployment. MBDA loans have been used to attract innovative investments to the State. For example:

(a) The MBDA is responsible for attracting the 5th commercial deployment of broadband over power line (BPL) technology in the U.S. with its loan to Lighthouse Broadband, Inc., in Grand Ledge.
(b) Its three loans to SpeedNet have helped leverage what is the largest deployment of a commercial wireless network in the U.S. utilizing a "Wi-Max" type of non-line of sight technology that will eventually provide super high-speed mobile broadband services across the state.
(c) A loan to M-33 Access in Rose City has helped expand what is now the largest line of sight wireless network in the U.S. spanning a 10,000 square mile region in rural northeast Michigan.
(d) The MBDA championed the use of CDBG grant dollars in combination with its loans to help expand broadband into low to moderate income communities. As a result, Michigan is the first and only state in the nation to be allowed to pilot this effort. In Muskegon County, through a loan and grant to Lansing-based Arialink, Inc., this program will help bring broadband service to more than 3,300 low-income households. Muskegon County is presently preparing for its MEDC and MBDA review to determine the broadband system's operational functionality. This system should be fully operational by late summer of 2007. The MBDA has also entered into agreement Marquette County to put an affordable broadband system in place utilizing CDBG funds. That system is to be operational by the end of 2007. With this success, the Michigan model will very likely be replicated across the country in the future.

9. With the help of the MBDA, the State of Michigan was named the 'top state' in boosting broadband high speed internet by the Lansing State Journal in July, 2003. In the article, the Lansing State Journal said that 'Michigan has done a lot to spread broadband access through its Michigan Broadband Development Authority, which offers loans to companies that want to expand high-speed Internet hookups around the state'.

In summary, MBDA loans have expanded service into locations where few if any other broadband services existed and in markets where there was typically only one dominant carrier. In the latter markets, the MBDA has seen prices drop dramatically as a result of the competitive pressure created by its loans and the resulting expansion of broadband services. ACD.net, for example, has used MBDA loans to expand services in several dozen bedroom communities outside major metropolitan areas, from Lansing to Battle Creek, to Kalamazoo, Grand Rapids and Benton Harbor. In each instance, the incumbent carriers have matched or reduced pricing and have expanded their investments in those same areas. Quantifying the overall impact of this "multiplier" investment is difficult, but it is significant.

Beyond lending, the MBDA has pushed the envelope in Michigan by communicating and advocating the need for expanding the availability of high-speed Internet services. It has championed the need for communities to have wireless/mobile options in addition to traditional broadband services. It has been an important component of the State's overall effort to expand the 21st Century infrastructure needed to be competitive in today's global marketplace.

Loan Activity Prior To November, 2005

As noted earlier, the MBDA has worked and consulted directly with dozens of companies in Michigan to support broadband expansion efforts. Prior to Governor Granholm's Rural Broadband Initiative (explained in more detail later in this report), the MBDA had closed on 12 loans totaling $18 million. Each of these loans are current and are performing to plan. Three of these loans have been paid-in-full. The providers and the areas covered are depicted below:

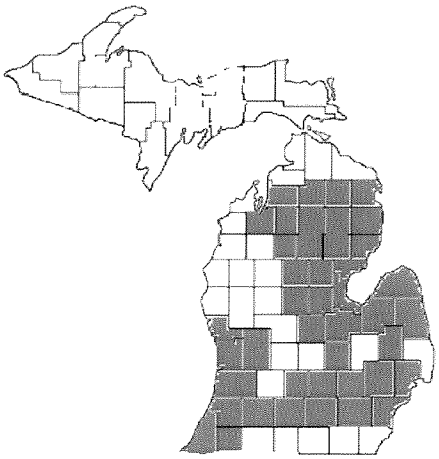
MBDA

Continuing to Achieve Our Vision and Making an Impact : Loan Activity Prior To November, 2005

$18M Approved Projects

(Pre RBI)

Area Served



**The Approved Projects (Pre-RBI) are in the green color*

Borrower

ISP Wireless ($342,000)
PCS Broadband ($510,000)
M-33 Access ($1,300,000)
ACD.net ($1,200,000)
Michigan Lightwave ($826,000)
Appia Communications ($760,000)
MI UPLink ($50,000)

ACD.net WEST ($1,600,000)
Arialink ($5,800,000)
Lighthouse Broadband ($520,000)
SpeedNet ($1,500,000)
SpeedNet-BadAxe ($3,600,000)

Rural Broadband Initiative Update

On November 30th, 2005 the MBDA released an RFP for the Governor's Rural Broadband Initiative (RBI). The MBDA agreed to provide $17 million of loans at a 4 percent fixed interest rate to qualifying broadband providers willing to build in underserved markets of the State of Michigan with interest-only draw periods of up to 24 months. The RBI loan applications were due February 28th, 2006. The Authority had a very strong response, and has currently approved $13 million of loans. The MBDA is also in the process of approving an additional $3.8 million of Near-Term RBI loans. During the application period over 100 individuals registered and downloaded the RFP.

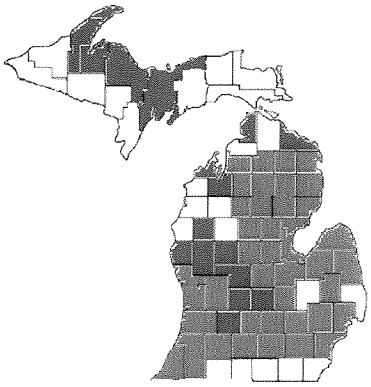
Please see below for a more detailed RBI Update:

MBDA

Continuing to Achieve Our Vision and Making an Impact : Rural Broadband Initiative (RBI)

$13M RBI Approved Projects

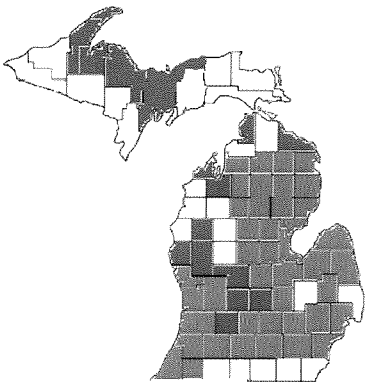
Area Served



Borrower

SpeedNet ($5,600,000)
Pasty.net ($600,000)
Arialink ($6,000,000)
Town & Country Cable ($640,000)
ISP Wireless ($280,902)

$3.8M Near-Term RBI Applications



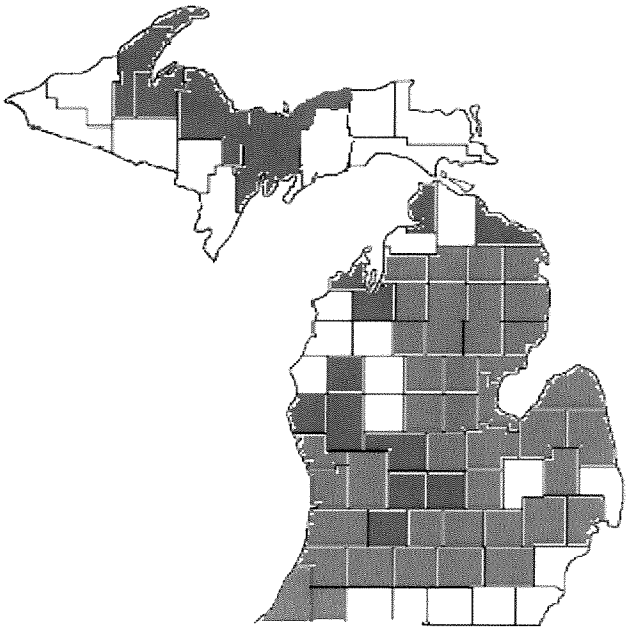
ACD.net ($2,600,000)
Great Lakes Communications ($1,200,000)

**The Approved Projects (Pre-RBI) are in the green color*

**The Approved RBI Projects are in the pink color*

**The Near-Term RBI Projects are in the yellow color*

Loan Portfolio Summary & Anticipated Projects



Total number of counties impacted:
65 of Michigan's 83 = 78%

Total number of cities impacted**: 375+**

Total $ amount of Disbursed projects:
$18M

Total $ amount of Approved RBI projects:
$13M

Another **$3.8M** of RBI loan requests to be processed

Anticipated total of all loans:
$35M

Note:

The Approved Projects (Pre-RBI) are in the green color

The Approved RBI Projects are in the pink color

The Near-Term RBI Projects are in the yellow color

2007 Outlook

The MBDA has reduced its staffing levels to 3 employees and has recast its operations and future mission as noted above. Consistent with the plan to crease operations by the end of April, 2007, the MBDA will focus on the following:

a. *Managing the Rural Broadband Initiative (RBI) underwriting processes*

b. *In conjugation with MEDC, Managing the Digital Divide Investment (grant) Program which has pilot projects underway in Muskegon County and Marquette County.*

c. *Monitoring loans and administering the necessary meetings with the MBDA Board of Directors for approval of loans and modifications of existing lending agreements.*

In short, the MBDA will process all Rural Broadband Initiative (RBI) loan applications and make recommendations to the MBDA Board of Directors for approval of such loans. As necessary, the MBDA will work with MSHDA staff to review applications and develop loan documents for the MBDA Board of Directors consideration.

For an electronic color copy of this report, along with other information about the Authority's activities, please visit our website: www.broadbandauthority.org