

Burlington, VT Receives Credit-Positive Dismissal of Municipal Broadband Lawsuit

On January 2, a federal district court dismissed a three-year-old lawsuit against Burlington, VT (Baa3 stable) concerning the city-owned broadband provider Burlington Telecom (BT). The dismissal is credit positive for the city because it effectively ratified a settlement reached between the city and the complainant Citibank, N.A. (A2 stable, B-/Caa2 stable¹) last February, which is favorable to the city.

Under the deal, Burlington and its co-defendant, law firm McNeil, Leddy & Sheahan, paid Citibank \$10.5 million, well below Citibank's original claim of \$33.5 million, plus a share of BT's future value. The court's dismissal comes after the city took steps to ensure all settlement conditions were met, including approval from the Vermont Public Service Board (PSB) and finalizing all funding sources to pay Citibank.

The PSB unanimously approved the settlement in November. The PSB ruled in 2010 that Burlington violated its charter by subsidizing BT with taxpayer funds. When the subsidies that reached nearly \$17 million stopped, BT terminated its lease-purchase agreement with Citibank. The bank then filed the lawsuit for the unpaid portions of the deal.

Burlington had not finalized primary funding sources for its \$9 million share of the \$10.5 million payment in February. Since then, the city has lined up \$6 million in bridge financing through the sale of BT assets. Other funding came from the sale of city property, BT revenues and insurance.

Burlington's sale of its City Market property provided approximately \$475,000 for the Citibank settlement. The amount, which equals only 1% of fiscal 2013 revenue, is the only portion of the settlement supported by taxpayer funds. By not tapping the general fund, the city avoids a further reduction in reserves. Burlington's financial position has improved recently, but the available general fund balance was a negative \$928,000 at the end of 2013.

Burlington's \$6 million in bridge financing came from Blue Water Holdings, LLC, which is led by local investor Ray Pecor III and financed by a loan from Merchants Bank. The entity purchased BT assets and leased the BT infrastructure back to the city for continued operations. We estimate the financing, which carries a 7% interest rate, will cost the BT system \$558,500 annually, based upon a 20-year amortization. The city's sale-leaseback agreement with Blue Water Holdings specifies the lease payments will be subject to appropriation, but made solely from BT revenues. Based on the city's audited financials,² BT's operating income provides about 1.5x coverage on the annual lease payments. BT provides high-speed Internet, telephone and TV service to city residents, and competes with Comcast (A3 positive) and other providers.

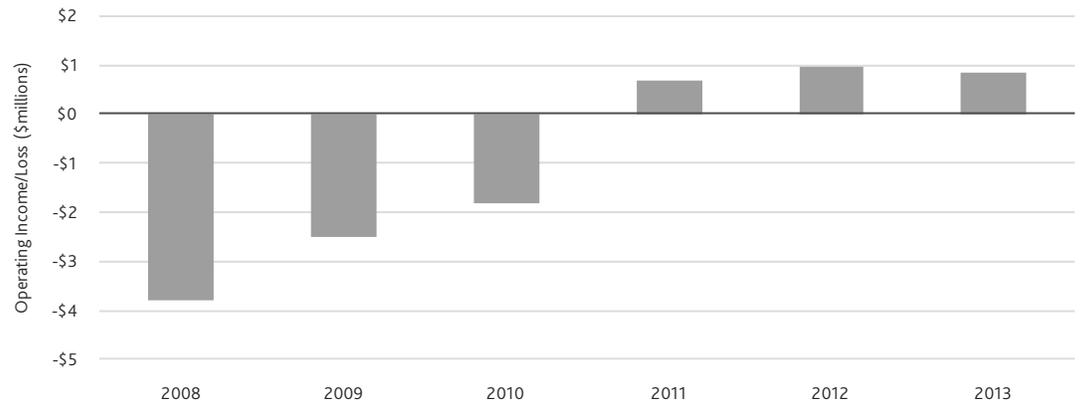
The Blue Water Holdings deal offers the city breathing room as it seeks a buyer for BT over the next four years. If a sale takes place in the first three years, the city reaps 50% of net proceeds above a \$6 million sale price and other deal costs. If the city fails to find a buyer in four years, Blue Water Holdings can oversee the sale and the city could collect only 10% of net proceeds (or less). The city would split any proceeds with Citibank to account for a share of BT's future value.

BT had a customer base of approximately 4,975 at the end of 2014, up more than 25% since January 2012. The enterprise has managed to produce operating income since 2011 (see Exhibit). However, the telecom industry is capital intensive challenging the city to maximize performance during this interim period while it seeks an investor.

¹ The ratings shown are Citibank's deposit rating, its standalone bank financial strength rating/baseline credit assessment and the corresponding rating outlooks.

² The city's 2009 through 2013 audited financials include a disclaimer of opinion on the Burlington Telecom Enterprise Fund.

Burlington Telecom Has Generated Operating Income in Recent Years



Source: City of Burlington audited financial statements
