Guiding Europe through the FTTH funding maze

By Hartwig Tauber, Director General of the FTTH Council Europe

BRUSSELS, 4 June 2013 - The FTTH Council Europe has heard the argument many times: “there isn’t enough money to finance the roll-out of fibre to the home (FTTH) networks”. Citing the seemingly insurmountable obstacles of shareholder demands, increasing competitive pressure and the economic downturn, operators and politicians claim that they simply cannot afford FTTH networks. But like the emperor’s new clothes, their arguments do not stand up to closer scrutiny.

Let’s start with some facts and figures. The European Telecommunications Network Operators' Association (ETNO), which represents incumbent operators across Europe, said its members invested €29 billion annually, on average, over the last six years, of which approximately €17 billion was for fixed networks. In addition, alternative operators invested nearly €16 billion annually, and we assume a similar proportion of their investment was directed towards fixed networks. If the level of operator investment remains stable, then up to €210 billion would be available for investment between now and 2020. If we take into consideration additional spending to increase fibre backhaul capacity for 4G/LTE mobile base stations, the investment potential would be even greater.

We see that money is out there; that is one myth dispelled. However, incumbent operators typically build FTTH networks in the most profitable areas, such as major towns and cities, where the deployment cost is lower and they are under pressure from competitors. As a result, the incumbents account for less than one quarter of FTTH deployments to date, and it is unlikely that they will roll out FTTH everywhere. Investing in smaller towns and villages requires a longer-term vision, and so it is mainly utility companies, small regional operators and municipal government who have taken the lead in those areas. Regrettably, small players are often caught in a financial no-man’s land because of their size, and some potential FTTH projects struggle to get off the ground. While the investment is too big and too special to be handled by local banks, it is too small to be addressed by institutional investors.

It is all the more surprising, therefore, that the European Commission has concentrated its broadband policy on the incumbent and other large operators. The telecom sector, in our view, will not be willing or able to self-finance the copper-to-fibre transition: operators face financial constraints, and there is no guarantee that a more benign regulatory framework will result in higher capital spending. Instead, we believe the Commission should focus on policies to attract external sources of finance.

The European Commission tried to do exactly that through the “Connecting Europe Facility” (CEF), proposing a budget of €7 billion to finance broadband infrastructure. Through a multiplier effect, this was expected to leverage investments of up to €50 billion between 2014 and 2020, which would have made a significant difference. Unfortunately, European member states killed the initiative when they cut the CEF budget drastically. Out of the three sectors seeking finance – energy, transport and broadband – only one said that it neither wanted nor needed the finance on offer.

Given this strange positioning by Europe’s operators, it shouldn’t be any surprise that the energy and transport sectors became the main beneficiaries of the fund.

By rejecting this source of finance, Europe's member states have effectively taken back the responsibility of ensuring that they can deliver their national broadband plans. Yet only a few countries seem to be ready to tackle the challenge head on – many appear to think that interim solutions such as upgraded copper or mobile networks will suffice. France is one of the few countries that have set a positive example by committing to a broadband plan with a clear fibre focus and multibillion-euro financing. This contrasts sharply with the situation in the UK, where the national policy encourages the incumbent to invest in bandwidth-limited copper upgrades.

We have observed that member states that identify FTTH as their goal and plan accordingly are making the most progress towards Digital Agenda targets. At a minimum, national governments need to ensure that FTTH investment is identified as a top priority. Member states also have their own sources of finance available to add some impetus to network build. In the 2006 – 2013 budget cycle member states committed €2.4 billion to the construction of broadband networks, and the 2014 – 2020 budget cycle operates within a similar funding envelope. We firmly believe that there is a strong case for increased use of European Structural and Cohesion Funds, as well as money for rural development, to fund FTTH infrastructure.

It is unfair to blame the major operators for their reluctance to embrace FTTH. As stock-market-listed companies, their objective is to serve their shareholders, not to fulfil any Digital Agenda targets or to save the national economy. Many shareholders don't even think about the longer term – they are looking towards the next profitable quarter, and don't necessarily care how the company will be positioned in 10, 15 or 20 years. If the company doesn't perform, they can simply sell the shares.

This situation highlights the importance of investment incentives for different types of investor. Investors who invest in the primary assets, such as a factory or network, and secondary investors, who buy derivatives of these assets such as shares or options, may share the same perspective on current events, but significant differences can emerge over longer timescales. This is particularly true for big infrastructure projects where the time to market, the level of investment and the payoff period may be measured in decades rather than quarters. Quick and dirty (i.e. cheaper) solutions often yield good dividends in the short term, but may expose primary investors in the longer term.

Politicians also need to recognise that many investors are desperate for sound long-term investment opportunities. The low interest-rate environment has made government bonds unappealing to pension funds or insurance companies. Infrastructure as an asset class could provide an attractive investment opportunity with greater returns. To make this possible, the European Commission needs to develop a coherent approach that takes the requirements of long-term investors into account, backed up by supportive financial regulation.

The good news is that investors have already expressed an interest in investing in FTTH networks; however, this will require changes in the market structure. Long-term investors tend to prefer projects with low risk and strong contractual commitments that ensure a steady income. The vertically integrated network structure that is favoured by incumbents pollutes the low-risk network investment with high-risk technology choices. The separation of the network and technology – as has been done in New Zealand – leads to a de-risking of those primary FTTH investments. If network separation could be combined with operator commitments to purchase a minimum number of connections, it would open up new sources of finance for the sector.

There is one final challenge: the investors need to be matched up with the appropriate investment opportunities. As we noted earlier, many projects are too small to target the institutional investors directly. Smaller projects need to be aggregated into compatible groups, and they need to translate

their business plans into terms that meet the requirements of these investors. The FTTH Council Europe is actively working on these issues.

We started an "investor's project" in 2012 to openly discuss the challenge of financing fibre networks and to find mutually acceptable solutions for investors and FTTH projects. The first FTTH "Investors Day" in London earlier this year brought together more than 80 experts representing institutional investors, investment banks and FTTH projects. The results of this meeting were promising: institutional investors and pension funds are ready to see passive fibre networks as an asset that qualifies for long-term investment, and projects are willing to adapt their project to the needs of such institutional partners. Following the event, more than 10 fibre projects came forward seeking combined investments of over €350 million. At the same time several institutional investors confirmed, in principle, their willingness to make more than one billion euro available. The FTTH Council Europe has already planned additional "Investors Day" meetings over the coming year: Helsinki on 10 September 2013 and Brussels have been confirmed, and others will follow (www.investors.ftthcouncil.eu).

The next steps to ensure FTTH financing in Europe are clear. Having voted against the CEF scheme, governments across Europe need to acknowledge that they have responsibility to develop national financing frameworks for FTTH as the only sensible long-term solution for broadband networks. Institutional investors need to be educated to understand that passive fibre networks are a long-term infrastructure investment. And projects need to learn to speak the language of the investors, and to be prepared to adapt their approach to fit the need of this specialist group.

As the saying goes, "Everyone said it was impossible because nobody tried; then one day someone came along who didn't know that it was supposed to be impossible, and he did it." The FTTH Council Europe calls on forward-looking leaders in Europe who are willing to believe that widespread and inclusive deployment of FTTH networks IS possible – and simply do it.

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About the FTTH Council Europe:
The FTTH Council Europe is an industry organisation with a mission to accelerate the availability of fibre-based, ultra-high-speed access networks to consumers and businesses. The Council promotes this technology because it will deliver a flow of new services that enhance the quality of life, contribute to a better environment and increase economic competitiveness. The FTTH Council Europe consists of more than 150 member companies.
www.ftthcouncil.eu

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