

E-RATE UTILIZATION ANALYSIS

DEFINING THE ISSUE AND ITS CAUSES

October 2008



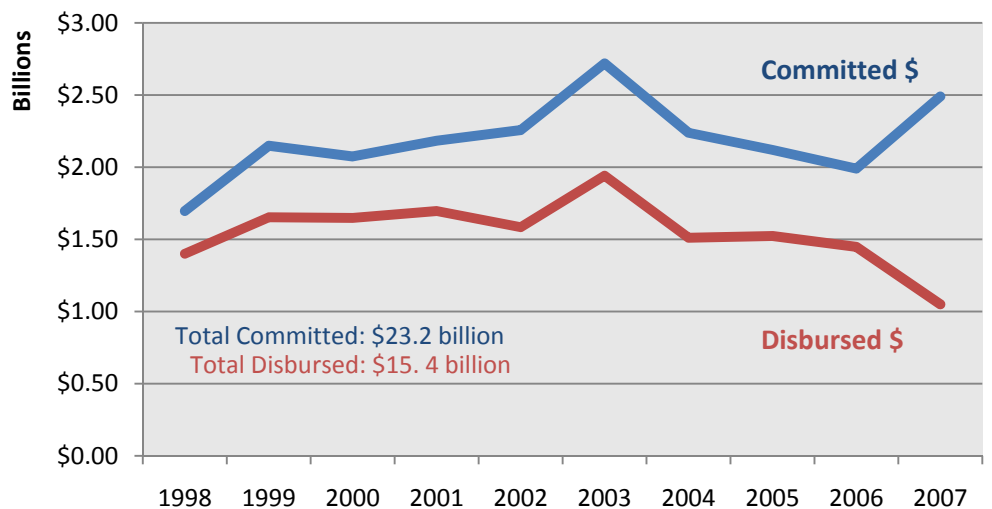
The E-rate program provides \$2.25 billion annually to help schools and libraries connect to the Internet and provide discounts on telecommunications services and essential networking components. The underlying concept of the E-rate program is to provide discounts on goods and services that are used for educational purposes and allow for the flow of voice, video, and data to the classroom. Discounts on E-rate eligible services range from 20 to 90 percent and are based on the E-rate Discount Matrix as established by the Federal Communications Commission. This means that the applicant will always have some payment burden when receiving approved services.

The SLD can disburse up to a maximum of \$2.25 billion each year in E-rate discounts. Throughout the history of the program, utilization of funding has never reached this level. Recognizing this fact, the FCC now allows the SLD to commit funding in excess of \$2.25 billion in an effort to more fully utilize the annual allotment from the Universal Service Fund. Additionally, the Commission permits unused funds to be committed in future funding years.

Based on a Funds For Learning analysis, E-rate stakeholders leave over 25% of committed funds unutilized each year. Annually, this amounts to tens of millions of dollars in funding that goes unused. The following chart shows a comparison of E-rate commitments and disbursements by funding year. Detailed information about E-rate commitments and disbursements can be found in Table 1 at the end of this report.

E-rate Commitments and Disbursements

Funding Years 1998 -2007



Source: Funds For Learning, LLC

Factors of under-utilization of commitments

When looking at this issue, it is helpful to understand some contributing factors to under-utilization. While the publicly available E-rate data does not give us detail about the reason a specific funding commitment has

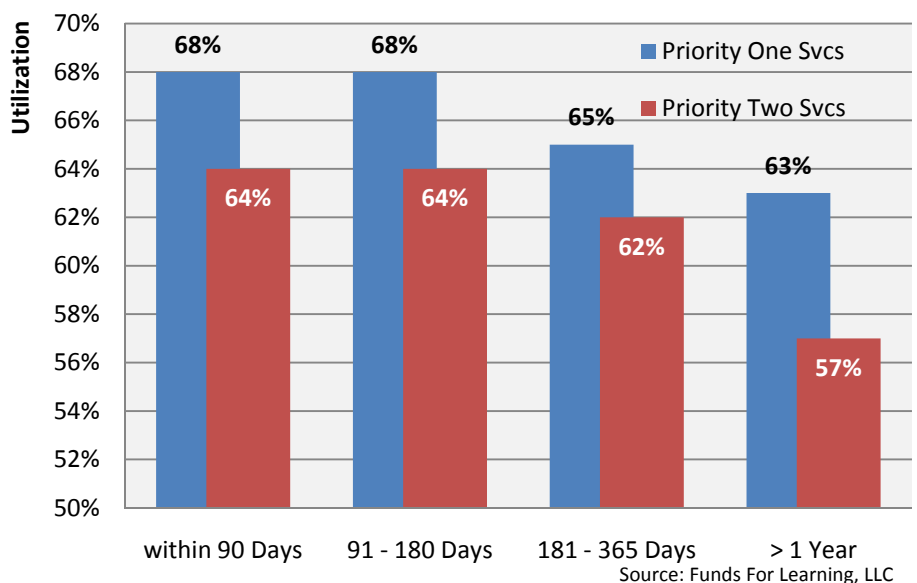
gone under-utilized, our many years of experience in working with E-rate stakeholders and an analysis of available data give us a superior perspective to identify these causes.

Application Review Time

The most remarkable factor affecting funding utilization is the amount of time after the start of the funding year that the applicant receives a funding commitment decision. An analysis of Funding Year 2002 – 2006 commitments and utilization shows that utilization drops as the days beyond the start of the funding year (July 1) pass. The rate of utilization drops from an average of 68% to 63% for Priority One services and from 64% to 57% for Priority Two services. This chart illustrates the drop on utilization in relation to the amount of time an application remains under review:

Utilization and Days after July 1 to Funding Commitment

Funding Years 2002 - 2006



Pricing Reductions Over Time

The nature of the E-rate application and review process requires service providers to give pricing details for eligible products and services at least several months before delivery begins. This lag time between quote and delivery can be expanded to twelve or more months in the case of Priority Two Internal Connections and Basic Maintenance requests. Over the course of these months—and in some cases years—the price for these products can decrease. Once a funding commitment is approved applicants are oftentimes able to receive lower pricing, resulting in less funding utilized.

Overestimation of Applicant Needs for Technology

Another occurrence of under-utilization of committed funds happens when the applicant requests more funding than it eventually uses. Typically when this happens, it is in the Priority One service categories of

Telecommunications Services and Internet Access where variable pricing is involved. As an example, long distance telephone service is generally billed on a per-minute basis. Since an applicant cannot know how many minutes of long distance service they will use in a given month, it will typically estimate at the highest possible level of usage to ensure that the full measure E-rate discounts can be realized each month. A similar overestimation can be made for services such as cellular telephone charges.

Other instances of overestimation include the anticipation of adding additional capacity either in number of lines (in the case of local phone service) or additional bandwidth (in the case of Internet Access) that doesn't come to fruition.

Lack of Understanding of Program Rules and Deadlines

A fourth factor that contributes to under-utilization is stakeholders' lack of understanding of program rules and deadlines. This fourth factor comprises a wide variety of reasons that can affect utilization of commitments. While the SLD should be commended for its efforts in managing the program and educating stakeholders, the fact remains that E-rate rules are complex and deadlines for post-commitment paperwork vary and can change for many reasons.

As an example, the funding year for recurring Priority One services runs from July 1 to June 30. For Priority Two installations, the deadline for delivery is September 30 following the end of the funding year. Payment paperwork—the Form 472 and Form 474—must be postmarked no later than 120 days after the last date of service or 120 days after the date of the Form 486 notification letter, whichever is later. In other words, the payment paperwork deadline could be October 28 (for typical recurring services), January 29 (for typical one-time installations), or some other date depending on the type of project or service and the timing of Form 486 notification letter.

Other factors that affect the delivery and payment paperwork deadlines include the date on which the funding commitment is issued, the need to request additional time to complete a project, the need to request a service or product substitution, or the need to change service providers.

Summary

The issue of commitment underutilization has existed since the inception of E-rate program. It is the opinion of Funds For Learning that this will continue to be an issue because of the factors illustrated in this analysis. While the FCC and SLD can undertake efforts to reduce the amount of under-utilization in the program, there will always be stakeholders that are unable to fully utilize funding committed to them.

Table 1 – E-rate Commitments and Disbursements**All Service Categories****October 2, 2008**

Year	Committed Amount	Utilized Amount	Utilization %
2008	\$1,324,007,189.40	\$30,187,723.00	2%
2007	\$2,490,332,602.26	\$1,049,977,910.43	42%
2006	\$1,989,331,881.25	\$1,447,694,292.27	73%
2005	\$2,119,795,039.92	\$1,523,117,798.06	72%
2004	\$2,237,870,245.20	\$1,511,557,803.32	68%
2003	\$2,719,568,666.53	\$1,941,140,549.45	71%
2002	\$2,257,644,765.14	\$1,584,239,991.63	70%
2001	\$2,183,236,602.05	\$1,696,518,761.24	78%
2000	\$2,073,785,628.58	\$1,648,687,719.86	80%
1999	\$2,148,482,892.25	\$1,653,053,151.57	77%
1998	\$1,695,999,989.84	\$1,399,911,589.19	83%
Total	\$23,240,055,502.42	\$15,486,087,290.02	