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Kentucky Stumbles in Finding Revenue for Broadband Debt.

Six months after Kentucky borrowed millions to build a 3,400-mile broadband network, the state is having to rethink one of the revenue sources it had expected to be available to pay off the bonds.

The Kentucky Economic Development Finance Authority sold \$232 million of municipal debt in August to build the fiber-optic network for state agencies, schools and far-flung residents. Yet a challenge by AT&T Inc. to Kentucky's effort to shift a contract that provides Internet to schools is jeopardizing \$11 million a year it was counting on for the bonds, according to the state.

Republican Governor Matt Bevin's administration, which took office in December, said that even with the challenge, the state will find the revenue to fund payments on the bonds, which were sold subject to legislative appropriation. State agencies will use the system, and other users are expected to generate revenue.

"The Commonwealth recognizes its contractual obligations under the project agreement and is evaluating all options to ensure the necessary revenue streams are in place to support the program," said Jessica Ditto, Bevin's spokeswoman, in an e-mail.

Kentucky sold its bonds as part of a trend among U.S. state and local governments to build their own broadband systems. About \$4.2 billion of debt for broadband and other telecommunication services is outstanding, according to Bloomberg data.

Federal Grants

After the bonds were sold in August, then Democratic Governor Steve Beshear, who championed the project, said the network would bring jobs and more economic opportunity to parts of the state such as the Appalachian coal mining regions in eastern Kentucky that have lost industry jobs and lack broadband capacity.

The state had planned to re-bid a contract to provide Internet service to school districts after selling the bonds. The contract is paid for with \$11 million of federal grants. But AT&T, which has the contract to serve schools, raised a conflict of interest challenge to the state's plans in November. Terms of the federal grants require competitive bidding.

AT&T objected to a request for proposals, or RFP, to provide broadband to the state's public schools, said Daniel Hayes, a spokesman for AT&T. Steve Rucker, who was then the executive director of the Kentucky Communications Network Authority, which was set up to oversee the broadband project, had helped write the request for proposals in an earlier job as deputy director of the state's finance and administration cabinet.

"AT&T believes such involvement in both the development of the RFP and also as a principal in a vendor bidding on the RFP jeopardizes the fair and open requirements of the bid process," said Hayes, in an e-mail.

Debt Service

Pamela Trautner, spokeswoman for the finance and administration cabinet, referred questions to the governor's office.

Annual debt service is scheduled to be \$13 million in 2016, increasing to about \$28 million by the last year of payments due in 2044, according to bond documents. The state will generate revenue by having its own agencies and academic institutions use the network rather than outside vendors, according to bond documents.

The state offers enough protection through its appropriation process that Daniel Close, portfolio manager with Nuveen Investments, which manages more than \$100 billion of munis, including some of Kentucky's broadband bonds, said he isn't worried about the school contract affecting revenue to back the debt.

Celebrated Issue

"You have enough incentives in place that long-term this isn't going to add any risk," said Close, who noted that the deal involves a partnership with private companies. "Long term there is very little risk."

The bonds were sold with low investment grade ratings, Baa2 from Moody's Investors Service and BBB+ from Fitch Ratings. The spread of the one of the bonds maturing in 2035 to top-rated debt rose in a Feb. 11 trade with an average yield of 4.12 percent. The yield in the previous month had been under 4 percent.

The bond sale won the deal-of-the-year award from Bond Buyer, a trade paper, which cited the unique public-private partnership to bring the Internet to all 120 Kentucky counties. The state partnered with Macquarie Group Ltd., an Australian banking and advisory company, to build the system. Rishi Sharma, spokesman for Macquarie, declined to comment.

* An earlier version of the story was corrected to say that a Macquarie spokesman declined to comment.

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by Darrell Preston

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