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Fitch: Kentucky Wired Wins Commonwealth Approvals; Funding Hurdle Remains.

Fitch Ratings-New York-01 May 2018: Although the Kentucky Wired PPP project has won legislative and gubernatorial support for appropriations and bonding authority, securing funding for an $88 million commonwealth commitment to resolve outstanding project issues remains a key financial hurdle, according to Fitch Ratings.

On April 14, Kentucky's legislature passed SB 200, legislation that authorizes the Kentucky Communications Network Authority (KCNA, a state agency) to borrow up to $110 million by "leveraging future revenues." The governor signed the bill into law on April 26. The borrowing authorization in SB 200 provides a mechanism for the commonwealth to pay $88 million owed under a memorandum of understanding (MOU) reached between the commonwealth and various project parties to address outstanding supervening events under the project agreement. However, the specifics of how the commonwealth will use the borrowing authority under SB 200 to raise the necessary funding is not established yet, posing an ongoing risk to the project. The Kentucky Wired project remains on Rating Watch Negative due to the uncertainty regarding the future borrowing. Fitch will continue to monitor the situation and will re-evaluate the transaction upon further details of the plan of finance.

To date, Kentucky has abided by all terms of the project agreement and Fitch anticipates the commonwealth will fulfill its MOU obligations, including the $88 million funding commitment. A failure to do so could put the ratings of related project debt and the commonwealth itself at risk, according to Fitch. A failure by Kentucky to meet its obligations under the PPP contracts will also create some uncertainty among market participants, including contractors, infrastructure investors and lenders regarding the vitality of PPP finance for infrastructure more generally.

SB 200 authorizes KCNA to borrow up to $110 million by leveraging future revenues, and KCNA intends to use $88 million of this to fund the commonwealth's commitment under the MOU. However, the commonwealth has not determined exactly how to raise the necessary funding. Under SB 200, the revenues that could be leveraged are from "provision of government-to-government services and sale or lease of excess capacity." After discussions with the commonwealth and KY Wired, Fitch interprets that to include various options such as higher availability payments from Kentucky reflecting public sector use of KY Wired's infrastructure, or leasing of some of KY Wired's broadband capacity to private vendors. Fitch anticipates the commonwealth, through KCNA, will determine a funding approach within the next several weeks given funding deadlines laid out in the MOU.

Under the MOU, the commonwealth has already paid $2 million of the $88 million settlement using available project liquidity. The next payment of $13 million is due on July 6, with the balance due over the course of a new construction period as outlined in the MOU (ending October 13, 2020 with a longstop date of October 13, 2021).

With SB 200 the legislature also modified the funding for ongoing availability payments for the

project over the next biennium. In the separate budget bill, the legislature had designated the availability payments as Necessary Government Expenses (NGEs) without line item appropriations. SB 200 revises that to instead establish specific line item general fund appropriations for the availability payments, as originally requested by the governor.

Failure of the commonwealth to fund the settlement agreement would imperil the MOU and the project itself as Fitch noted in a recent rating action commentary on the project debt ("Fitch Maintains Rating Watch Negative on Kentucky Wired Infrastructure Company's Senior Revs" dated April 10, 2018). It would also raise concerns for Fitch about Kentucky's willingness to abide by terms of the project agreement and could lead to negative rating action on the project debt, the commonwealth's counterparty obligation rating, Kentucky's IDR, and ratings on approximately $8 billion in appropriation-supported debt. Fitch rated the commonwealth's counterparty obligation for the Kentucky Wired PPP project using our "Public-Sector Counterparty Obligations in PPP Transactions Rating Criteria" and notched it from Kentucky's IDR given the strength of the commonwealth's legal commitments under the project agreement. In Fitch's view, counterparty obligations under PPP project agreements extend beyond simply making availability and milestone payments to also include adherence to all terms of the agreements as well as related commitments such as those in the proposed settlement agreement.

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