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Fitch: Third Kentucky Wired Budget Dispute Reveals Continued Political Tensions Over P3

Fitch Ratings-New York-28 March 2022: Fitch Ratings anticipates that a budget dispute around the Kentucky Wired public private partnership (PPP) project will be resolved before the 2022 Kentucky legislative session's end, but the return of the issue shows that political tensions related to the 2015 PPP (P3) project remain active and ongoing.

Fitch expects the commonwealth's ultimately enacted budget will allow it to meet various contractual obligations for the Kentucky Wired project over the next biennium, including availability payments. An unexpected failure to provide for the necessary funding could place the ratings of both related project debt and the commonwealth itself at risk.

Fitch rates the Kentucky Wired project bonds 'BBB+'/'Outlook Stable' and rates the commonwealth's counterparty obligation to provide periodic payments to cover operating and financing related costs for the project 'A'/'Outlook Stable' using its "Public-Sector Counterparty Obligations in PPP Transactions Rating Criteria". The counterparty rating is notched down from Kentucky's 'AA-'/'Outlook Stable' Issuer Default Rating (IDR) given the strength of the commonwealth's legal commitments under the project agreement. Kentucky undertook the Kentucky Wired PPP in 2015 to build state-wide broadband access, the first such state-wide effort in the country.

There have been two prior budget disagreements in the Kentucky legislature since the project began. The first was in 2018 and the second in 2020. Both occurred in years in which Kentucky's state elected leaders were required to formulate and adopt a biennial budget.

The governor's executive budget for the fiscal 2023-2024 biennium recommends roughly \$40 million in Kentucky Wired funding for each fiscal year. On Jan. 20, 2022 Kentucky's House passed its own budget bill (HB 1) for the upcoming biennium that included funding for Kentucky Wired at roughly the levels requested by the governor. The Senate's version of the budget bill, passed on March 9 by that chamber, did not include an appropriation for the PPP availability payments, however.

The House and Senate are entering conference committee discussions to reconcile various differences in their approved budget bills, including the Kentucky Wired funding. Fitch anticipates the joint Free Conference Committee could emerge with a final budget bill that both chambers approve as soon as the end of this month. Kentucky's legislative session ends on April 15.

The budget dispute is notable in that it comes amidst an improving commonwealth fiscal situation. Kentucky concluded fiscal 2021 with a \$1.1 billion general fund surplus due to unexpectedly strong revenue performance. Solid revenue growth in fiscal 2022 is putting the state on track to conclude the current fiscal year with a \$1.9 billion surplus. The two prior Kentucky Wired-related budget disputes occurred when Kentucky had fewer fiscal resources.

In addition to the potential effect on its credit ratings, a failure by Kentucky to appropriate sufficient funds in its biennial budget to cover Kentucky Wired project payments and meet its obligations under PPP contracts would create uncertainty among market participants, including contractors and

investors, regarding the viability of the PPP model for financing infrastructure in Kentucky.

Renewed and persistent opposition to the project by members of the legislature, coupled with repeated opposition to biennial appropriation requests, could indicate broader philosophical opposition in the Kentucky legislature to PPP projects that require support from general fund appropriations.

For additional information on the project bonds, please see “Fitch Affirms Kentucky Wired Infrastructure Co’s Senior Rev Bonds at ‘BBB+’; Outlook Stable” published on Feb. 18, 2022 and available on ‘www.fitchratings.com’.

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