

THE BOND BUYER

Thursday, August 27, 2015 | as of 2:01 PM

ET

Regional News

Kentucky Issues Bonds for Statewide Internet System

by [Shelly Sigo](#)

AUG 26, 2015 1:53pm ET

Clarification: *Revised to clarify how Kentucky will support the project.*

BRADENTON, Fla. — Kentucky is financing a statewide high-speed Internet system in a first-of-its kind P3 deal that market participants said should offer higher yield to investors.

The Kentucky Economic Development Finance Authority, as conduit issuer, is pricing \$230.05 million of 30-year tax exempt bonds Thursday.

Bond proceeds will be loaned to the concessionaire in the Bluegrass state's first availability payment public-private partnership.

Co-managers on the transaction are Bank of America Merrill Lynch and Barclays Capital Inc.

The funds will be used to construct the more than 3,200-mile-long, fiber-optic "middle mile" system, which is expected to have an overall cost of \$324 million, according to state officials.

Kentucky's transaction "is a first-of-its-kind approach to broadband connectivity statewide," said Fitch analyst Daniel Adelman, making it a unique, first-generation telecommunications project.

Fitch expects to rate the bonds BBB-plus, while Moody's Investors Service assigned a provisional Baa2 rating. The ratings will be confirmed after the deal is finalized, analysts said.

The nature of the deal, driven in part by the BBB-level ratings, will potentially offer better yields to buyers that have participated in similar P3 transactions, said Ryan Barrow, executive director of Kentucky's Office of Financial Management.

"We expect good demand from institutional investors based on the familiarity of the Commonwealth's name in the marketplace and the credit structure that has been negotiated between us and our private partners," he said.

As investors consider the deal, the state's long-term commitment to the P3 also should be considered, according to Municipal Market Analytics partner Matt Fabian.

"Availability payment P3s are, and should be, treated as long-term debt that ultimately isn't much different from the state's other bonds, except with more yield," Fabian said.

The transaction is structured with capitalized interest, maturities between 2018 and 2045, and an optional 10-year call provision.

The overall financing includes \$57 million of privately placed taxable senior revenue bonds and a \$14.9 million subordinate tranche that are not being offered this week.

"The expected amortization profile of the bonds is driven by a forecasted constant debt service coverage ratio," Barrow said.

Kentucky has no general obligation bonds outstanding, and relies entirely on appropriation-backed debt.

The state has never failed to appropriate funds or defaulted on debt service payments, and much of the funding for the Internet P3 project is included in the current biennial budget, Barrow said in an online road show for investors.

The Next Generation Kentucky Information Highway System is designed to offer broadband service to a state that has areas with some of the slowest connection speeds in the country.

Kentucky has entered into a 30-year concession agreement with a consortium called KentuckyWired Operations Co. LLC. The agreement includes a 35-month construction period.

The consortium's investors are Macquarie NG-KIH Holdings Inc. as 75% owner, Leducor US Ventures as 15% owner, and First Solutions LLC, which owns 10% of the company.

The owner's contributions to the project include \$14.9 million in subordinate debt and \$6.4 million in equity, which is secured by an irrevocable, on-demand letter of credit.

The consortium also includes Black & Veatch, Fujitsu Network Communications, and Bowlin Group, a local company.

Kentucky will support the project with \$30 million of bond-financed equipment, a \$23.5 million milestone payment upon completion using federal funds, and a series of availability payments based on performance of the system.

The system will connect more than 1,000 government agencies, public libraries, K-12 schools, and higher education institutions to the system, which will consume about half of the available capacity.

The remaining capacity will allow the state to provide access to Internet service providers, other users and communities, which also services as an economic development strategy, according to state officials.

Fitch said its rating assesses the portion of the system that connects government and public users, not the state's plan to lease the remaining 50% of capacity through wholesale agreements.

The BBB-plus rating on the bonds also incorporates Fitch's first assessment under recently revised criteria for availability-based P3 projects, Adelman said.

The new criteria includes an expected A rating on Kentucky as it relates to the state's obligation as a counterparty.

"The rating is based on the contractual obligation of Kentucky to make the payments," Adelman said.

While KentuckyWired is the state's first availability payment P3, which increases contract implementation risk, Moody's said that officials are "keenly aware of their responsibilities" under the project agreement.

"Construction work is very straightforward yet the vast statewide project footprint complicates project execution given a significant amount of coordination with third parties across the state," said Moody's analyst John Medina.

Most of the Internet system will be installed on utility poles within existing right of way.

Moody's said its provisional Baa2 rating considers the fact that the state selected an experienced consortium in P3 procurement and telecommunication projects.

"This experience supports the sound construction and operating budget build up with good contingency and escalation to absorb higher costs," Medina said.

KentuckyWired is an initiative of Gov. Steve Beshear, who is term-limited out of office later this year.

The project has also enjoyed bipartisan support of the General Assembly, which has also approved some funding in the current biennial budget.

"Broadband, like electricity, water and sewer, is now an essential service but has been too expensive for private carriers to build out a high-speed, high-capacity network across the entire state," Beshear said last week as he announced a governing board to manage the system.

"In nearly every ranking of broadband capacity and adoption, Kentucky ranks at or near the bottom," Beshear said.

Kentucky's external P3 advisors on the project were Herbst Stokes and Lide PC, Polsinelli PC, and Dinsmore & Shohl LLP.

Bond counsel is Orrick, Herrington & Sutcliffe LLP. Issuer's counsel is Stites & Harbison PLLC.

Borrower's counsel is Dressman Benzinger LaVelle psc. Torys LLP, Orrick, and Dressman are counsel to KentuckyWired Operations, the concessionaire.

Underwriters' counsel is Greenberg Traurig LLP.

