

# **KentuckyWired Investigation Status Report**

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## **Program Review and Investigations Committee**

**June 7, 2019**

Contributing staff

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# History Of KentuckyWired

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- 2011/2012 ➤ Concept development by Center for Rural Development
- 2013 ➤ SOAR presentation, RFP for consultant
- 2014 ➤ Procurement and interim contract
- 2015 ➤ Detailed planning, negotiations, restructured contracts, and bond sale

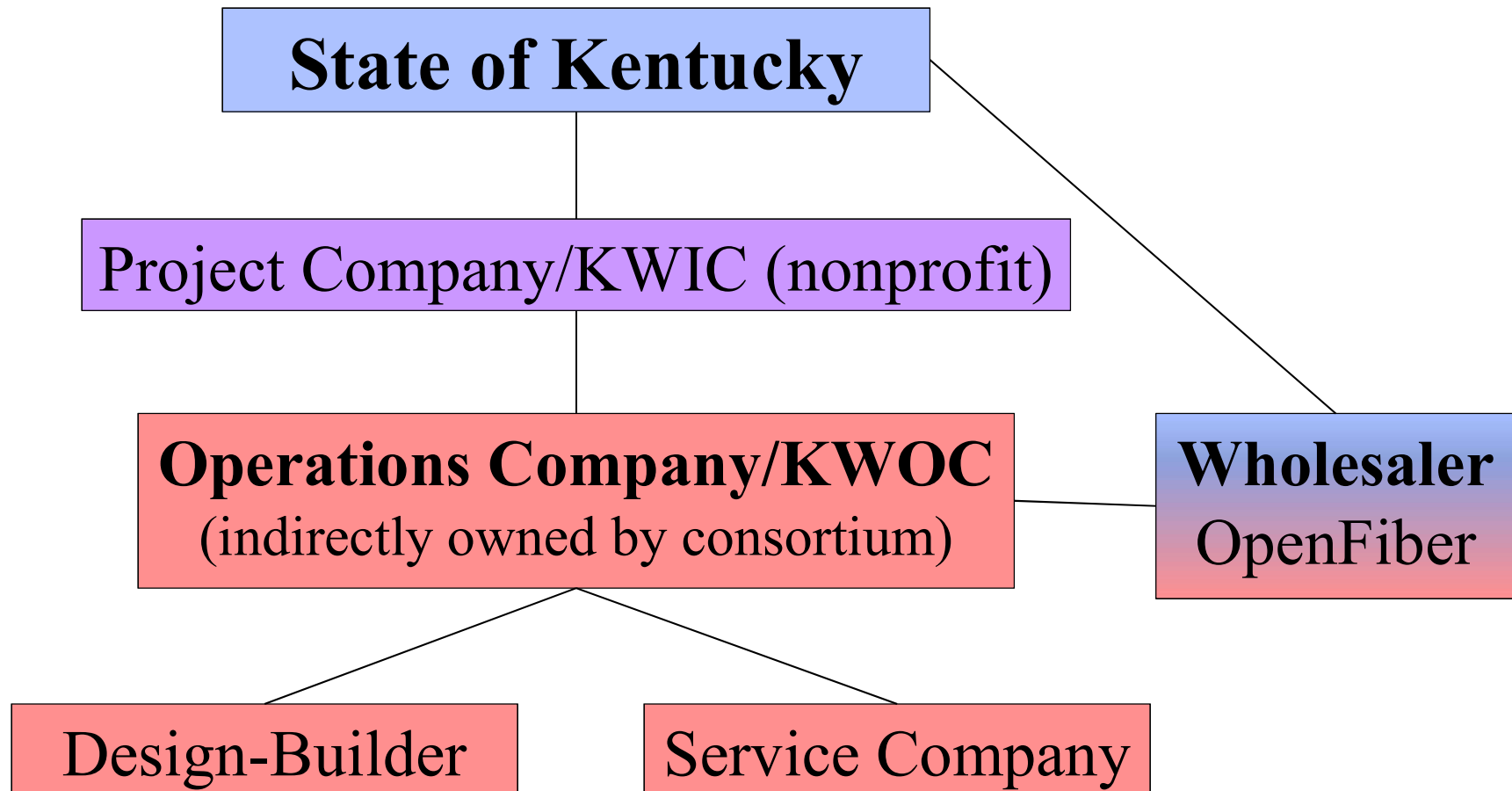
# History Of KentuckyWired

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- 2015-2018 ➤ Construction with costly delays
- 2018 ➤ Planned completion in July
- 2018 ➤ Settlement of claims, ongoing construction
- 2019 ➤ KCNA borrowing to fund settlement
- 2020 ➤ Revised completion in October

# KentuckyWired Project Structure

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# KentuckyWired Financial Structure

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- A common P3 financing method
- “Non-recourse” bonds and equity return supported by availability payments (AP) over 30 years
- APs supported by appropriations

# KentuckyWired Financial Structure

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- Assumed existing agency broadband spending would pay for APs
  - But unable to use K-12 funds
- Wholesale revenues originally considered supplemental income

# Delays And Payments

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- Claims of supervening events caused delays and extra costs
- Settlement agreed December 2018
  - Estimated claims of \$191 million negotiated to \$101 million
  - New completion date October 2020
- New borrowing of \$110 million authorized
- APs locked into original schedule

# Wholesale Revenues

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- Network designed with extra fiber to lease
- Macquarie projected more than \$1 billion wholesale revenue for state
  - Revenue projection is uncertain
  - Revenue could cover shortfalls and extra expenses



# Major Conclusions

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- Financing and funding
- Project structure and risks
- Policies and procedures
- Project Justification

# **Financing And Funding Conclusion**

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KentuckyWired faces significant funding challenges, most of which should have been anticipated. These include possible revenue sharing, loss of expected K-12 participation, substantial costs outside the availability payments, and variations in market prices.

# Financing And Funding

## Detailed Findings

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- Availability payments
  - Cover operations & maintenance costs, debt service, and equity return
  - Structured to match state's internet spending (state agencies, higher education, K-12)
  - Subject to adjustments annually
  - Estimated to total \$1.15 - \$1.2 billion

# Financing And Funding

## Detailed Findings

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- Shortfalls in funding of APs
  - Example: Failure to obtain K-12 contract potentially represents 45 percent of funds needed for APs
- Wholesale revenues could make up for the shortfall
  - Center for Rural Development might receive a significant portion of the state's wholesale revenue share

# Financing And Funding

## Detailed Findings

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- Examples of additional costs not covered by APs
  - System refreshes
    - Two required system refreshes with a total estimated cost of \$87.4 million
  - Settled and future supervening event claims
    - Will be funded with up to \$110 million in additional borrowing

# Financing And Funding

## Detailed Findings

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- Tax-exempt financing saved money, but other tax-exempt financing options might have saved more
- The reliability of the wholesale revenue projections is unknown
- The project is sensitive to changes in broadband market prices

# Project Structure And Risks

## Conclusion

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The chosen risk allocation might have been the only way to obtain financing and lower costs. State officials handled some risks poorly.

# Project Structure And Risks

## Detailed Findings

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- Risk allocation favored private partners, but rating agencies found it reasonable
- Rewritten contract structure similar to original Macquarie proposal but cost more
  - 37% cost increase from Macquarie's proposal, approximately \$74 million more
- Failure to make contractual availability payments would damage state's credit rating
- Establishing Project Company had no effect on state's risks or obligations



# Project Structure And Risks

## Detailed Findings

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- State's consultant predicted many key risks that were poorly managed
  - Pole attachment agreements
  - State highway rights-of-way
  - Private easements
- Settlement terms described as reasonable
- State agencies and other potential customers have doubts about service

# **Policies And Procedures**

## **Conclusion**

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Although the contract negotiations and bond sale technically followed all legislative oversight rules, the bond issue might have been inconsistent with the 2014 branch budget bill. Statutes do not appear to provide formal consequences for this and other apparent violations of policy.

# **Policies And Procedures**

## **Detailed Findings**

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- Post-award negotiations were typical of a P3, but the Model Procurement Code at the time did not address this contractual structure

# **Policies And Procedures**

## **Detailed Findings**

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- Financing might have been inconsistent with 2014 budget
  - Several 2015 meetings of Capital Projects and Bond Oversight Committee were canceled, so the committee did not review financing
- Other violations of law or policy
  - No formal consequences specified

# **Project Justification**

## **Conclusion**

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High-speed broadband was seen as necessary, and state officials chose to focus on the middle mile to stimulate economic development and to increase broadband competition.

# Project Justification

## Detailed Findings

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- Economic alternative to private sector middle-mile broadband
  - Increase competition and internet speed
  - Lower costs
- High-speed broadband is an expected public utility like electricity
- No reliable information on existing middle mile
- Last mile is a major expense
- It is unknown if KentuckyWired will facilitate last mile expansion