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## Amid rate controversy, Kit Carson co-op bullish on fiber-optic 'investment'

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*The Taos News*, 1/7/2016

In 2014, Kit Carson Electric Cooperative spent around \$1.5 million to help get its fledgling broadband network off the ground. Co-op CEO Luis Reyes said electric ratepayers have put a total of around \$2.6 million into the fiber-optic network so far, and it could take millions more to finish.

Those "investments," as Reyes describes them, come as the utility seeks an electric rate hike to fend off what the coop's own analyst calls "current financial distress."

Reyes maintains that a proposed increase, which is still awaiting approval by state regulators, is in no way related to the broadband initiative or any of the co-op's other side ventures.

But records obtained by *The Taos News* suggest federal lenders have taken a closer look at how broadband costs are affecting Kit Carson's bottom line.

In 2010, under the federal stimulus program, the co-op was awarded a \$44 million grant/\$19 million loan to build a fiber-optic network across its entire service territory.

While the grant/loan covered most of the project expenses, Reyes says some costs — things like permit fees and environmental studies — were outside the scope of the award.

Reyes says the co-op is prudent in how it lends money to the broadband project, but he acknowledges neither he nor the board of trustees has put a cap on how much the utility is willing to spend.

"I don't think it's defined, but there is a limit," Reyes said in a recent interview. "We're building a network that needs to be built. And we're spending the money it takes to make the network workable."

At this point, Reyes says it might cost between \$7 million and \$10 million more to complete connections to every home and business that wants one. The co-op probably won't have to shoulder that entire burden itself, according to Reyes, but he did say the co-op would have to borrow whatever money it needs to finish the job.

In recent weeks, Reyes and the co-op's attorneys have gone to great lengths to defend Kit Carson's broadband, telecom and propane ventures — all of which have been attacked by the co-op's fiercest critics as the primary driver behind the rate increase.

Broadband expenses are hardly Kit Carson's only financial burden. Energy sales are slipping, and Reyes says costs that are beyond the co-op's control are increasing. According to the co-op's most recent financial figures, the electric company alone lost \$500,000 between January and November 2015. Broadband or not, it's almost certain Kit Carson will need to raise rates — or significantly cut expenses — to keep the electric utility solvent.

So, how does a utility struggling to turn a profit and desperate for a rate increase still have the means to put \$1.5 million toward its broadband network?

Part of the answer has to do with how the co-op is seen by its lenders.

The Rural Utilities Service — part of the U.S. Department of Agriculture — is Kit Carson Electric Cooperative's biggest creditor. At the end of last year, the co-op owed the agency nearly \$50 million, according to the utility's financial records. About \$12 million of that is tied to loans for the broadband project.

Like any lender, the federal government wants to make sure borrowers can pay back what they borrow, so when it lends money to co-ops like Kit Carson, it requires that the utilities generate enough money every year to cover their debts.

The agency uses several methods to measure the financial health of its borrowers, but the most common is the "Times Interest Earned Ratio," or TIER. It gauges a borrower's ability to repay its long-term debt.

Under the Rural Utilities Service rules, co-ops must have a TIER of 1.25 or better to be in good standing. If they miss that or other financial targets, they must reduce costs or raise revenue (that is, hike rates) so margins match the debt load. Otherwise, they default on their loans.

Based on financial statements turned in to regulators, Kit Carson had margins of \$613,000 and a 1.19 TIER in 2014 — just shy of the mandatory minimum. But if the co-op hadn't diverted \$1.5 million to help get the broadband network on its feet, Kit Carson would have had margins in excess of \$2.1 million and a 1.67 TIER.

In its formal rate increase notice, the co-op said the purpose of the higher rates was to meet mandatory benchmarks, including TIER.

But TIER is only one of four targets that the co-op has to hit. Two other mandatory targets measure only the electric utility's health. The co-op is well below the minimums on both, meaning some kind of rate hike would likely be needed to satisfy the feds.

Reyes says the electric company's troubles should not make it more difficult to borrow more money to finish the fiber-optic network.

Despite Reyes' insistence the rate hike is driven solely by the cost to get electricity to customers, documents obtained through a Freedom of Information Act request also show broadband-related expenses caught the eye of a federal employee tasked with assessing Kit Carson's performance.

In April 2014, Larry McGraw, a longtime employee for the Rural Utilities Service, filed a report after meeting with Reyes at the co-op offices to discuss the utility's financial condition. At the time, McGraw

noted the co-op was underperforming and “is analyzing a need for a rate increase.” The one expense McGraw specifically referenced was the \$1.2 million the co-op put into the broadband project in 2013.

Then, in January 2015, McGraw filed another report, again noting that financial targets weren’t met, and again making specific mention of broadband expenses. Once again, McGraw said the co-op was exploring the possibility of a rate increase.

While side ventures have been eating away at the bottom line for years, Reyes said the money going to these side businesses is both an investment and a public service. They improve infrastructure and create a more competitive market that benefits all consumers, he says.

Reyes is especially bullish on the broadband, which he describes as a major economic driver for the region. The co-op is the only entity making real progress in local economic development, he argues. And with most of the fiber-optic project subsidized by the feds, Reyes says the network is a can’t-miss investment that could revolutionize the local economy. Major telecommunications subscribers have recently signed on to the network, Reyes said, and he expects it to be in the black by the middle of 2017.

Once the network is making money, Reyes says it will pay back what it borrowed, and it could actually subsidize electric rates.

But for the moment, broadband does not turn a profit. And it’s not clear when electric ratepayers might be made whole.

The co-op’s propane company, for example, was started about 15 years ago. After years of losing money, the company is now profitable and makes regular payments to the co-op for hundreds of thousands of dollars a year. However, Reyes says the propane company still owes the electric company \$1 million on the \$5.6 million it had to borrow to get going.