STATE OF NEW HAMPSHIRE
PUBLIC UTILITIES COMMISSION

DW 15-196

PENNICHUCK WATER WORKS, INC.

Petition for Financing Approval

Order *Nisi* Approving Petition

O R D E R N O. 25,808

September 2, 2015

This order *nisi* approves a petition of Pennichuck Water Works, Inc., to issue tax-exempt bonds in an aggregate principal amount of up to $25,500,000 through the New Hampshire Business Finance Authority. PWW will use the proceeds primarily to refinance existing long-term debt and to fund capital investment. We find that the debt is consistent with the public good and approve the financing as proposed.

I. PROCEDURAL BACKGROUND

Pennichuck Water Works, Inc. (PWW), provides retail water service to approximately 27,000 customers in the City of Nashua and in the Towns of Amherst, Bedford, Derry, Epping, Hollis, Merrimack, Milford, Plaistow, Newmarket, and Salem. PWW is a subsidiary of Pennichuck Corporation, which is wholly owned by the City of Nashua.

On May 29, 2015, PWW filed a petition seeking authority, pursuant to RSA Chapter 369, to issue new tax-exempt bonds in the aggregate principal amount of up to $25,500,000. PWW will finance the bonds through the New Hampshire Business Finance Authority (NHBFA). PWW stated that the financing proceeds will be used to: (1) refinance approximately $16,400,000 of currently-outstanding tax-exempt bonds, which includes roughly $200,000 of accrued interest, (2) finance construction of a new operations facility for an estimated amount of

$7,000,000, (3) fund anticipated issuance costs of approximately $1,400,000, including capitalized interest, and (4) fund a debt service reserve fund or other credit enhancement measure of approximately $700,000, if necessary to secure the best-cost debt. In support of its petition, PWW filed the testimony of Larry D. Goodhue, Chief Financial Officer. That testimony, along with PWW's petition and subsequent docket filings, other than any information for which confidential treatment is requested of or granted by the Commission, is posted to the Commission's website at http://www.puc.nh.gov/Regulatory/Docketbk/2015/15-196.html.

On June 23, 2015, the Office of the Consumer Advocate (OCA) filed a notice that it would participate in the proceeding on behalf of residential ratepayers. *See* RSA 363:28. On August 11, 2015, Staff recommended approval of the petition. The OCA took no position on PWW's petition or on the Staff's recommendation.

II. POSITIONS OF THE PARTIES

PWW

PWW contends that its petition is consistent with the public good. PWW also contends that it is entitled to issue the proposed bonds and consummate the transactions described in its petition under RSA Chapter 369.

The $16,400,000 refinancing component is a continuation of PWW's plan to transform its capitalization to a format that is better aligned with its current ownership structure. The new format is meant to mitigate various types of risk associated with the debt that PWW acquired prior to the change from an investor-owned, publicly-traded company to a privately-owned company.[1] One result of this change in ownership is that Pennichuck no longer offers equity in

[1] On January 25, 2012, PWW's parent company, Pennichuck Corporation (Pennichuck), then a publicly-traded company, was acquired by the City of Nashua (the City or Nashua). *City of Nashua*, Order No. 25,292 (November 23, 2011).

the public market as a means of financing the capital needs of its subsidiaries. PWW's post-acquisition capitalization requirements are met primarily in the form of debt.

According to PWW, its pre-acquisition tax-exempt debt poses greater risks to the Company and its customers than will the debt financing proposed in the petition. PWW's pre-acquisition debt structure assumed certain equity levels in the Company's capital structure, ready access to outside equity investment, compliance with certain covenants, and access to sufficient resources for "balloon" loan payments. Due to its new ownership structure, PWW cannot reasonably comply with existing covenants, which could result in loan defaults. Nor can PWW reasonably respond to the balloon payments required at the end of the existing debt's term, which will occur well before the assets purchased with the debt are fully depreciated. PWW claims that the proposed refinancing "stabilizes" the Company's capital structure by matching the term of the debt with the useful lives of assets to the greatest extent possible. PWW also points to interest rate risk faced by the Company if it waits to refinance its tax-exempt debt. PWW observed in testimony that interest rates are now at "historically low levels."

PWW began a process of transitioning its pre-acquisition debt with a financing filing in Docket DW 14-130. That financing included a request to refinance four of seven outstanding tax-exempt bond issues in the approximate amount of $23,375,000.[2] The loan and trust agreement associated with the 2014 financing contained covenants that are better aligned with PWW's new ownership and capitalization structure. Additionally, the 2014 refinancing eliminated balloon payments associated with the replaced debt. The replacement bonds were fully amortizing and were issued in the midst of a favorable interest rate environment. Standard and Poor's (S&P) reviewed the 2014 financing and, as a result, issued an "A" rating with a stable outlook relative to the ultimate bond issuance.

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[2] See, *Pennichuck Water Works, Inc.*, Order No. 25,734 (November 7, 2014).

The refinancing that PWW proposes here continues the debt transition process by refinancing the Company's three remaining pre-acquisition tax-exempt bond series. All originally issued in 2005, those remaining bond series consist of $12,125,000 of 2005 Series A revenue bonds with a fixed interest rate of 4.70%; $1,765,000 of Series 2005A revenue bonds with a fixed interest rate of 4.70%; and, $2,310,000 of Series 2005 B bonds with a fixed interest rate of 4.60%. The Series 2005B bonds mature in 2030, while the other two revenue bond series mature at different times in 2035. All three bond series are subject to balloon payment requirements at their respective maturities. The proposed refinancing also covers approximately $200,000 of accrued interest on the 2005 bonds.

The actual terms and conditions associated with the refinancing bonds at issue in this proceeding cannot be determined until the time of issuance; however, PWW provided assumed terms. Specifically, PWW assumes that the bonds will be issued as fully amortizing tax-exempt debt. PWW anticipates that the bonds will have a term not greater than 30 years, but more likely ranging from 16 to 21 years. This length of term matches the useful lives of the underlying financed assets. Repayment of the refinancing bonds will be unsecured, and the interest rate will be fixed. According to PWW, bond issues containing similar terms and conditions are currently being issued at rates ranging between 3.2% and 4.2%. PWW assumes a conservative 5.5% projected interest rate. PWW intends to issue the proposed refinancing bonds pursuant to the loan and trust agreement which was adopted for the 2014 financing, including the covenants contained therein. PWW will not issue the refinancing bonds until after October 20, 2015, to avoid triggering federal alternative minimum tax requirements. PWW anticipates that the terms and conditions projected for the 2015 refinancing bonds will mitigate risk in the same manner as the 2014 refinancing.

PWW will use $7,000,000 of the debt proceeds to replace its current operations facility. A new operations facility is necessary primarily due to the 50-year age and the condition of the current facility. In addition, there is insufficient storage space for the Company's inventory and vehicles making them susceptible to both damage and theft. The current facility limits the Company's ability to test meters of various sizes and capacities. The current building also lacks appropriate facilities to support PWW's current mixed-gender workforce. Finally, the current facility lacks the proper office and room space to conduct meetings and other appropriate training for employees. These as well as other deficiencies will be resolved with the construction of the new operations facility. PWW is anticipating that construction of the new operations facility will be completed by the close of 2016.

As with the refinancing bonds, the actual terms and conditions associated with the construction bonds will not be determined until the time of issuance. Nonetheless, PWW anticipates that the bonds will be issued as fully amortizing tax-exempt debt with a term of 30 years, which approximates the projected useful life of the new operations facility. Repayment of the construction bonds will be unsecured and the interest rate will be fixed. According to PWW, bond issues containing similar terms and conditions could be issued between interest rates of 4.0% and 5.0%. PWW assumes a more conservative interest rate of 5.5%. PWW intends to issue the proposed construction bonds pursuant to the same loan and trust agreement as the refinancing bonds. PWW also intends to issue the construction bonds concurrently with the refinancing bonds as soon as possible after October 20, 2015.

All payments of principal and interest on both the refinancing and construction bonds will be limited obligations of the NHBFA and will be payable solely from payments made by PWW. The bonds will not be general obligations of the State of New Hampshire, and neither the general credit nor the taxing power of the State of New Hampshire or any subdivision thereof, including the NHBFA, will secure payment of any obligation under the bonds.

PWW included $700,000 in the financing for the possibility that a Debt Service Reserve Fund (DSRF) or other credit enhancement measure might be required to support the best-cost issuance of the refinancing and the construction bonds. Based on the credit rating received on the 2014 bond issuance, as well as the bond market's willingness to purchase those bonds without a DSRF, PWW does not anticipate that such a requirement will be necessary. Nonetheless, a final determination will not be made until the time of issuance. If it is ultimately determined that a DSRF or other credit enhancement is not necessary, the $700,000 will be removed from the financing.

The financing proposal also includes $1,400,000 for estimated bond issuance costs, including legal and underwriting costs. The actual bond issuance costs will not be known until the bonds are issued. Consistent with past practice, PWW intends to amortize those costs on a straight-line basis over the respective terms of the newly-issued bonds.

On March 27, 2015, PWW's Board of Directors approved the issuance of the debt obligations and authorized management to pursue all steps necessary to complete the transactions, and, on May 12, 2015, the City, acting in its capacity as sole shareholder, also approved the proposed financing. PWW's filing contains copies of those approvals. On May 18, 2015, the NHBFA Board of Directors granted preliminary approval for the issuance of the tax-exempt bonds on behalf of PWW. Staff's recommendation letter to the Commission included a copy of that approval. On August 5, 2015, the State of New Hampshire Governor and Executive Council (G&C) voted unanimously to approve the NHBFA issuance of the proposed

2015 bonds. In its filing, the Company stated that it would file a copy of that approval with the Commission "as soon as it becomes available." Goodhue Testimony (May 29, 2015) at Bates 20, lines 11-12.

PWW attests that the proposed financing will have no "discernible impact on rates or deleterious effect on capitalization."

STAFF

Staff opined that the debt and PWW's use of the proceeds is consistent with the public good and recommended that we approve the Company's financing as proposed.

III. COMMISSION ANALYSIS

RSA 369:1 states that a utility "may, with the approval of the commission but not otherwise, issue and sell … notes and other evidences of indebtedness payable more than 12 months after the date thereof for lawful corporate purposes." The Commission must conduct a "hearing or investigation as it may deem proper," then authorize the financing "if in its judgment the issue of such securities upon the terms proposed is consistent with the public good." RSA 369:4.

The Commission reviews the amount to be financed, the reasonableness of the terms and conditions, the proposed use of the proceeds, and the effect on rates. *Appeal of Easton*, 125 N.H. 205, 211 (1984). The rigor of an *Easton* inquiry varies depending upon the circumstances of the request. As we have previously noted, "certain financing related circumstances are routine, calling for more limited Commission review of the purposes and impacts of the financing, while other requests may be at the opposite end of the spectrum, calling for vastly greater exploration of the intended uses and impacts of the proposed financing." *Public Service Co. of N.H.*, Order No. 25,050 (December 8, 2009) at 14, *cited in Lakes Region Water Company, Inc.*, Order

No. 25,391 (July 13, 2012), at 20-21.

We engage in a more limited review for routine financing requests. *Public Service Co. of N.H.*, Order No. 25,050 at 13-14. A routine request is one "that will have no discernable impact on rates or deleterious effect on capitalization, [and] in which the funds are to enable numerous investments appropriate in the ordinary course of utility operations." *Id*. at 13. A routine request calls for a more limited examination of whether the "use of financing proceeds [is] in the public good without further review of possible alternative uses of the funds." *Id*. at 16. We find PWW's request to be routine. The underlying standard to be applied is whether the use of the financing proceeds is in the public good. RSA 369:4. We need not examine other possible uses of the money. *Public Service Co. of N.H.*, Order No. 25,050 at 16.

A large portion of the proceeds ($16,400,000) will be used to refinance outstanding indebtedness of PWW. The terms of the new financing will be more consistent than the existing debt is with the Company's current ownership and capital structure. A further portion ($7,000,000) will be used to finance construction of a new operations facility. This use is reasonable and necessary. Finally, an amount of up to $2,100,000 will be used for the payment of bond issuance costs and to fund the establishment of a debt service reserve fund if necessary to secure best-cost financing, which we also find to be reasonable.

PWW's filing includes sufficient information about the proposed uses and benefits of the financing. The primary benefits include a new operations facility, reasonable interest costs, and the continued availability of adequate financial resources for the maintenance and improvement of the Company's distribution system.

The proposed financing is also consistent with PWW's recent financings and efforts to align the funding of its capital investments with its ownership structure. In particular, approval of the Company's proposed financing mitigates certain risks associated with investor-financed debt incurred by PWW before Nashua acquired it in 2012. This reduction in risk will benefit the Company and its customers. Also, PWW has secured required approvals from its owner, Pennichuck; Pennichuck's owner, the City of Nashua; the NHBFA Board of Directors; and the Governor and Executive Council.

In conclusion, we find the proposed financing consistent with the public good. It represents an appropriate balancing of Company and customer interests, and we approve it as filed. We note the proposed financing is consistent with the principles of our orders approving the City's acquisition of PWW's parent and Pennichuck's Integrated Capital Finance Plan. *See City of Nashua,* Order No. 25,292 (November 23, 2011) (approving the City of Nashua's acquisition of Pennichuck Corporation), and *Pennichuck Water Works, Inc.*, Order No. 25,734 (November 7, 2014) (approving PWW's 2014 financing petition).

Our approval of PWW's financing does not foreclose or limit our review of the prudence and used and usefulness of any specific cost financed (directly or indirectly) in a future rate case. RSA 378:28. The Commission and its Staff also retain the authority under RSA 374:4 to keep informed regarding PWW's use of the proceeds of this financing, independently and apart from any RSA 378:28 review. Such information may be used to consider PWW's capital improvements within the framework of RSA 378:28, and to assist in ongoing monitoring of PWW's financial health and physical plant status. Moreover, our finding that this financing is in the public good does not absolve PWW from its ongoing responsibility to continue to manage its capital structure and physical plant prudently.

We issue this order on a *nisi* basis to ensure that all interested parties receive notice of our determination and have the opportunity to request a hearing.

Based upon the foregoing, it is hereby

ORDERED *NISI*, that subject to the effective date below, authority to undertake the proposed financing, under the terms and conditions contained in PWW's petition, and for the purposes as outlined herein, is hereby **APPROVED**; and it is

FURTHER ORDERED, that PWW shall cause a summary of this Order *Nisi* to be published once in a statewide newspaper of general circulation or of circulation in those portions of the state where operations are conducted, such publication to be no later than September 11, 2015, and to be documented by affidavit filed with this office on or before September 23, 2015; and it is

FURTHER ORDERED, that all persons interested in responding to this Order *Nisi* be notified that they may submit their comments or file a written request for a hearing which states the reason and basis for a hearing no later than September 17, 2015, for the Commission's consideration; and it is

FURTHER ORDERED, that any party interested in responding to such comments or request for hearing shall do so no later than September 23, 2015; and it is

FURTHER ORDERED, that this Order *Nisi* shall be effective September 25, 2015, unless PWW fails to satisfy the publication obligation set forth above or the Commission provides otherwise in a supplemental order issued prior to the effective date.

By order of the Public Utilities Commission of New Hampshire this second day of September, 2015.

Martin P. Honigberg Chairman	Robert R. Scott Commissioner	Kathryn M. Bailey Commissioner

Attested by:

Kimberly Nolin Smith
Assistant Secretary