

THE STATE OF NEW HAMPSHIRE

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NHPUC 15EP15-012140

September 1, 2015

Debra A. Howland
Executive Director
New Hampshire Public Utilities Commission
21 South Fruit Street, Suite 10
Concord, NH 03301

Re: DW 15-288, Pennichuck East Utility, Inc., and Pittsfield Aqueduct Co., Inc.
Joint Petition to Increase Short Term Debt Limit
Staff Recommendation for Approval with Modification

Dear Ms. Howland:

On July 23, 2015, Pennichuck East Utility, Inc. (PEU) and Pittsfield Aqueduct Company, Inc. (PAC), (together, the Companies) submitted, pursuant to Puc 203.02 (a) (1), a petition to increase their short-term debt levels above the limits set by RSA 369:7 and N.H. Code Admin. R. 608.05, which limit short term debt to 10% of net fixed plant. Pursuant to Puc 201.05, the Companies also seek a waiver, of Puc 608.05. In support of their petition, the Companies filed the testimony of Larry D. Goodhue, the Companies' Chief Financial Officer, and provided additional information in response to Staff discovery. A copy of the Company's response to discovery is attached to this letter.

After review of the filing and the attached discovery, Staff recommends the Commission approve the Companies' request for a short-term debt limit of 18% of net fixed plant, to be effective through June 30, 2019. Staff does not recommend, however, that the new short-term debt limit become permanent if the Commission does not rule otherwise prior to April 30, 2019. While Staff is supportive of the Companies' request for extended waivers of the short-term debt limit, Staff believes that it would be prudent to periodically re-examine the Companies need for a waiver. Thus, Staff recommends that the waivers expire automatically on June 30, 2019. PAC and PEU can request further waivers if conditions so warrant at or before that time. PAC and PEU concur with this recommendation.

Staff and the Companies have discussed the issue of short-term debt limits routinely since the City of Nashua's acquisition of Pennichuck Corporation. As explained in Mr. Goodhue's testimony, the three Pennichuck utilities are now financed almost entirely with debt capital. While debt capital is less costly than equity capital, providing a benefit to

customers, the lack of access to equity markets limits the Companies' options for financing capital expenditures. This limitation is aggravated by the Commission's restriction on the amount of short-term debt that can be outstanding at any one time.

Both PAC and PEU have requested waivers of the short-term debt limit since Nashua's acquisition. In Dockets DW 12-349 and DW 14-191 (PEU), and Docket DW 13-247 (PAC), the Companies requested and received Commission approval for increases in its level of outstanding short-term debt. In those dockets, the Commission acknowledged the limited financial flexibility of these two utilities, and that their need for short-term debt can fluctuate depending on earnings levels, capital improvements' budgets, the timing of expenses particularly property taxes, and the timing of securing new long-term financing. Rather than continuing to request waivers on an *ad hoc* basis, the Companies now seek a more durable resolution to the issue of the use of short-term debt by establishing a higher permitted level on a longer basis than previously granted by the Commission. Specifically, the Companies request a short-term debt limit of 18% of net fixed capital through June 30, 2019. The Companies also ask the Commission to make the higher limit permanent absent a Commission order pursuant to RSA 365:28, altering the order in this docket.

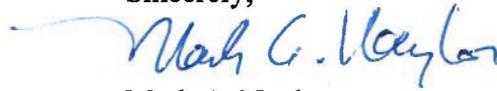
Of particular interest to Staff in its review of this filing are the forecasts of outstanding short-term debt attached to Mr. Goodhue's testimony. See Attachment LDG-2. While PAC is expected to have need for short-term debt in excess of 10% for most of the forecast period under the "worst case" scenario, PEU is currently projected to have need for short term debt which would only marginally exceeds 10% under its worst case scenario. In response to Staff data request 1-1, Mr. Goodhue provided additional information on why the Companies seek short-term debt limits of 18%. This includes the uncertainty of the timing of issuing new long-term debt, and the fact that State Revolving Loan Fund (SRF) monies, an important source of financing for both PEU and PAC, are allocated based on the merits of the projects submitted in what is essentially a competition with other water providers in the state. While both Companies have been successful in accessing SRF loans in recent years, this may not always be so. Coupled with uncertain consumption patterns and expense variations, the Companies have requested the level of 18% to fully incorporate the inevitable variability in cash flow needs from year to year.

In summary, Staff agrees with the analysis provided by PAC and PEU to support the 18% limit for short-term debt. Staff recommends that the Companies be granted the waiver of Puc 608.05 until June 30, 2019. The Companies have proposed, and Staff agrees and recommends, that the Commission approve and order written notification to Staff and the Office of the Consumer Advocate (OCA) in any month that short term debt exceeds 15% of net fixed capital. This notification can lead to discussions with the Companies, if appropriate.

Please contact me if there are any questions regarding this Staff recommendation.

DW 15-288 Pennichuck East Utility, Inc., and Pittsfield Aqueduct Co., Inc.
Joint Petition to Increase Short term Debt Limit
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Page 3 of 3

Sincerely,



Mark A. Naylor
Director, Gas & Water Division

Attachment
cc: Service list

DW 15-288
Pennichuck East Utility, Inc. and Pittsfield Aqueduct Company, Inc.
Joint Petition to Increase Short Term Debt Limit
Staff Data Request dated August 6, 2015

Date Request Received: 08/6/15

Date of Response: 08/19/15

Request No. Staff 1-1

Witness: Larry D. Goodhue

REQUEST:

Regarding attachment LDG-2, page 1. This sheet provides the 'best case' and 'worst case' calculated short term debt ratios for the June 2015 to December 2016 forecast period for PEU. For the best case ratios, PEU's ratio only exceeds 10% in one of the 19 months. In the worst case ratios, the forecasted short term debt ratio exceeds 10% in several months, but minimally. In light of this, are there other factors not considered in this analysis that would suggest a short term debt limit of 18% is appropriate, as requested?

RESPONSE:

It is important to note that the intent of this filing is to establish a short-term debt level that is commensurate with the size and circumstances of PEU and PAC for the long term, given their ownership arrangement and capital structure. The intent is to establish a new standard, above the current statutory level of 10%, which can be maintained on a permanent basis going forward, without causing concern for the Commission that customers may be negatively impacted by the level of short term debt the companies could incur without prior approval.

The forecast for the next 19 months takes into account certain known, measurable, and variable elements and metrics within that planning horizon. As explained below, the forecast does not contemplate certain circumstances that are possible or even probable over time, such as when PEU finances its investments in Net Utility Plant. Accordingly, the forecast is a conservative view of both how often the 10% threshold will be exceeded and by how much.

As it currently exists, PEU has two primary long term financing sources for its capital investments, i.e., SRF funding through the NHDES, and term loan funding from CoBank (or other similar banking institutions). SRF funding is only available for certain qualifying projects based upon the merits of the projects, the availability of funding from the NHDES, and the selection of PEU as a recipient of those funds (versus other entities in the state that might have a preferential rights to the funds over PEU). The term funding from Cobank and other banks is used to fill in the overall annual need for long term capital financing for the Company. We do not pursue this financing in advance of the year's projects because we only want to borrow to meet annual needs. This approach results in draws of short term funding from Pennichuck Corporation, which is the only source of short term debt for PEU and PAC. The draws are then repaid at market rates, pursuant to the Money Pool Agreement, on an annual basis upon receipt of the long term funding.

This dynamic, coupled with anomalies that may occur in short term working capital needs in any year, based upon consumption patterns and expense variations, can cause fluctuations in the short term debt levels. The current annual capital projects budget for PEU on an annual basis typically runs between \$2.5-3.0 million, which will increase with inflation in the future. In recent years, between \$0.5-1.0 million of this has been funded with SRF monies, which facilitate cash draws during a project on 30-60 day increments. The remaining \$1.5-2.5 million of funding can result in short term debt levels increasing in that magnitude awaiting an annual funding event from CoBank or other banking source.

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RESPONSE (continued):

Even though the 19-month forecast does not fully show this impact, in the years that follow, the impact of this dynamic alone can be in the range of 5-6% of Net Utility Plant. If in a given year SRF funding is not available, funding a full year's capital investment at the \$3.0 million level could reach as high as 7-8% of Net Utility Plant. As such, future years could experience periods where the short term debt limit reaches the 15-18% level, absent any impact from the effects of water consumption or expense variations, as well as the twice annual payments of property taxes (which are significant in nature on their own).

The 18% requested level is based upon these facts and variability risks, in seeking to establish a level that has the opportunity to be durable. Conceptually, since the sole source of PEU and PAC short term debt is from the parent through the approved Money Pool Agreement at market rates, a short term debt limit above 18% might be appropriate. That being said, given the analysis presented above, if the 18% level causes concern, an alternative level of 16% might, for the most part, prove sufficient to obviate recurring requests for waivers.

SERVICE LIST - EMAIL ADDRESSES - DOCKET RELATED

Pursuant to N.H. Admin Rule Puc 203.11 (a) (1): Serve an electronic copy on each person identified on the service list.

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Docket #: 15-288-1 Printed: September 01, 2015

FILING INSTRUCTIONS:

- a) Pursuant to N.H. Admin Rule Puc 203.02 (a), with the exception of Discovery, file 7 copies, as well as an electronic copy, of all documents including cover letter with:

DEBRA A HOWLAND
EXECUTIVE DIRECTOR
NHPUC
21 S. FRUIT ST, SUITE 10
CONCORD NH 03301-2429

- b) Serve an electronic copy with each person identified on the Commission's service list and with the Office of Consumer Advocate.
- c) Serve a written copy on each person on the service list not able to receive electronic mail.