STATE OF NEW HAMPSHIRE

BEFORE THE

PUBLIC UTILITIES COMMISSION

Petition of Pennichuck East Utility, Inc. for Approval of Refinancing of CoBank, ACB Balloon Maturity (T4) Note

DW 23-___

DIRECT PREFILED TESTIMONY OF GEORGE TORRES

March 7, 2023

Q. What is your name and what is your position with Pennichuck East Utility, Inc.?

A. My name is George Torres and I am the Chief Financial Officer, Treasurer and Corporate Controller of Pennichuck East Utility, Inc. (the "Company" or "PEU"). I have been employed with the Company since February 2006, when I initially served as the Corporation's Accounting Manager. In 2015, I assumed the role of Director of Accounting and Corporate Controller, and was named and appointed as Treasurer in May 2020, in addition to those roles. I have assumed the role of Chief Financial Officer of the Company as of January 1, 2023. I also serve as the Chief Financial Officer, Treasurer and Corporate Controller of the Company's parent, Pennichuck Corporation ("Pennichuck").

Q. Please describe your educational background.

A. I have a Bachelor of Science degree in Business Administration with a major in Accounting from Montclair State University in Montclair, New Jersey.

Q. Please describe your professional background.

A. Prior to joining the Company, I held Controller and Senior Accountant positions for several subsidiaries for the global human resource company Vedior North America, now known as Randstad USA from October 2002 to February 2006. My duties included all financial, accounting, and reporting functions for the subsidiaries, as assigned. Prior to joining Vedior N.A., I held various senior accounting positions for several companies in the retail, energy services, and manufacturing sectors.

Q. What are your responsibilities as Chief Financial Officer, Treasurer, and Corporate Controller of Pennichuck?

A. I am responsible for the overall financial management of the Company including financing, treasury, accounting and budgeting functions. My responsibilities also include issuance and repayment of debt, as well as quarterly and annual financial and regulatory reporting and compliance. The performance of these responsibilities is on the behalf of Pennichuck Corporation and all its subsidiaries. And, in this capacity, I work with both the Chief Executive Officer (CEO) of the Company, and other members of the senior management team, in the performance of my duties.

Q. Have you previously testified before this or any other regulatory commission or governmental authority?

A. Yes. I have submitted written testimony in the following dockets before the New Hampshire Public Utilities Commission (the "Commission"):

- Modification of Accounting Treatment of Leases for Pennichuck Water Works, Inc. – Docket No. DW 21-137;
- Waiver/Increase of Short-term Debt Limit for Pittsfield Aqueduct Company, Inc. – Docket No. DW 22-075.

Q. What financings are proposed by the Company in its petition in this proceeding (the "Proposed Financing").

A. The Company is proposing the essential and necessary refinancing of a currently outstanding note payable to CoBank, which matures on June 20, 2023.

The maturing obligation was first put in place in 2013, for a term of 10 years, with a 25-year amortization, and a balloon payment due as of June 20, 2023 (as approved in Docket No. DW 13-017). That approval was for the refinance of an intercompany loan from Pennichuck approved in Order No. 24,480 (March 27, 2013), which related to capital dollars for capital improvements in the North Country water systems of Locke Lake (Barnstead) and Birch Hill (North Conway) completed in 2007.

This current refinancing approval will replace the balloon maturity payment due in June 2023, of approximately $1.025 million, with a new fully amortizing 10-year obligation for the remainder of the term of repayment of the debt. In the aggregate the financing will be 20 years and have a term less than the overall aggregate useful lives of those initially funded capital projects, and less than the originally approved term of the loan approved in Docket No. DW 13-017, which was a 25-year term of amortization.

Q. Why is this loan needed at this time, and what makes this a critical and timely approval being sought?

A. It is vitally important to note, that regardless of the overall aggregate tenor of the term of repayment of the combined expiring debt and the new loan, it is imperative to have this refinancing approved and in place prior to June 20, 2023. Since the expiring loan has a balloon maturity obligation of approximately $1.025 million dollars due as of June 20, 2023, absent a term loan to refinance and re-term this obligation, the Company does not have funds available from its current approved revenues to pay this obligation at the due date. This would therefore result in a default on this obligation, as well as all of the other outstanding debt obligations the Company maintains with CoBank.

Q. Please describe CoBank and its relationship with the Company.

A. CoBank is a federally chartered bank under the Farm Credit Act of 1971, as amended. Unlike commercial banks and other financial institutions, CoBank is restricted to making loans and leases and providing financial solutions to eligible borrowers in the agri-business and rural utility industries, as well as certain related entities as defined under the Farm Credit Act of 1971. The characteristics of the Company's service territory are consistent with CoBank's charter and mission, and CoBank can therefore provide short, intermediate and long-term loans to the Company in connection with its capital requirements.

The Company entered into a Master Loan Agreement with CoBank effective February 9, 2010 (the "Master Loan Agreement"), which provides the framework for CoBank to make loans to the Company from time to time. The Master Loan Agreement was filed with the Commission in Docket No. DW 09-134. In March 2010, the Company utilized CoBank to replace $4.5 million of maturing debt and to establish a $1.5 million revolving line of credit pursuant to Order No. 25,041 in Docket No. DW 09-134. The $1.5 million revolving line of credit expired in March 2012. Additionally, in May 2013, the Company entered into two new loans with CoBank, in the amount of $925,000 and $1,723,150, for terms of 20 years and 10 years, respectively, pursuant to Order No. 25,480 in Docket No. DW 13-017. Also, the Company entered into a new loan with CoBank in March 2015, in the amount of $625,000, for a term of 25 years, pursuant to Order No. 25,746 in Docket No. DW 14-282; another loan with CoBank for $2.2 million for a term of 25 years, pursuant to Order No. 25,890 in Docket No. DW 16-234; another loan with CoBank for $350,078 for 25 years, pursuant to Order No. 26,117 in Docket No. DW 17-157; another loan with CoBank for $1,153,000 for 25 years, pursuant to Order No. 26,253 in Docket No. DW 19-069; and another loan with CoBank for $800,122 for 25 years, pursuant to Order No. 26,418 in Docket No. DW 20-081; and another loan with CoBank for $1,135,409 for 25 years, pursuant to Order No. 26,507 in Docket No. DW 21-102; and one more loan with CoBank for $2,546,632 for 25 years, pursuant to Order No. 26,538 in Docket No. DW 21-129.

CoBank is a Government Sponsored Enterprise ("GSE") owned by its customers, who consist of agricultural cooperatives, rural energy, communications and water companies and other businesses that serve rural America. As a GSE, CoBank issues its debt securities with the implicit full faith and credit of the US Government and uses these low-cost funds to make loans to businesses like the Company that meet its charter requirements. As a result of the implicit backing of the US Government, CoBank's borrowing costs are less than commercial banks and financial institutions and the lower costs are passed on to its borrowers. In addition to the lower rates, CoBank loans generally have fewer covenants or restrictions as compared to loans from commercial banks and other financial institutions.

Q. What are the basic terms of the proposed CoBank term loan financing?

A. While the final terms and interest rates are subject to change based on CoBank's due diligence (which is in progress) and market conditions as of the date of closing upon this financing, the Company requests approval to obtain a $1,025,000 term loan with a 10-year amortization, with level monthly principal and interest payments at an interest rate to be determined and "locked" as of closing (currently estimated at 7.20% interest per annum). Like all of the other existing loans approved and entered into with CoBank, by the Company, the new CoBank loan will be secured by (i) a security interest in the Company's equity interest in CoBank (consisting of the Company's $312,618 equity investment in CoBank and the Company's right to receive patronage dividends described below) and (ii) the unconditional guarantee of the Company's obligations to CoBank by Pennichuck pursuant to the Guarantee of Payment by Pennichuck in favor of CoBank dated as of February 9, 2010 (the "Guaranty"), a copy of which was also filed with the Commission in Docket No. DW 09-134. The Company's equity investment in CoBank consists of an initial $1,000 investment pursuant to the Master Loan Agreement cited earlier, as well as the accumulation of the equity portion of the annual patronage earned by the Company, associated with its existing debt obligations with CoBank. A confidential copy of CoBank's Non-Binding Summary of Terms and Conditions is attached as Exhibit GT-8.

The proceeds from this new CoBank loan will be used to refinance the balloon maturity payment due on June 20, 2023, and replace that balloon payment with a new loan and a fully amortizing term of repayment. As described above, the requested approval for financing is essential since the Company's current rate structure does not generate excess funds that would allow the Company to extinguish the balloon debt obligation at maturity without a refinancing of this obligation. Moreover, by re-terming the existing $1.025 million balloon maturity, it will allow the aggregate period of debt repayment amortization, inclusive of this new obligation to match more closely with the useful lives of the underlying capital assets of the Company.

Q. **Are there any other important terms or benefits related to borrowing from CoBank?**

A. As stated above, CoBank is organized as a cooperative which means it is owned and controlled by its members who use its products or services (i.e. its borrowers). A key cooperative principle is the return to customers of a portion of net margins based upon their use of the bank. This is accomplished through the distribution of "patronage refunds" which are a distribution to patronage customers of net margins remaining after payment of preferred stock dividends, deducting operating and interest expenses and amounts retained as core surplus. While not guaranteed, each year the Board of Directors of CoBank targets a distribution amount which is returned (in the subsequent year) to its borrower/members based on the annual average accruing loan volume. While these "patronage" payments are not guaranteed, the Company expects to reflect the patronage refunds in rates in future test years based on the receipt of the payments. The Company's patronage refunds from CoBank for the last five years, is as follows:

- 2018: $26,359
- 2019: $30,575
- 2020: $62,574
- 2021: $99,492
- 2022: $93,618

The patronage refunds are a mix of cash and equity, for which the Company accounts for the cash portion as a reduction in interest expense in accordance with GAAP. The equity portion is accounted for as a deferred debit on the balance sheet.

Q. **What other options has the Company considered other than the proposed CoBank financings?**

A. The Company has explored options with several potential funding agencies over the past ten plus years.

- The Company has determined that tax exempt debt bond financing through the Business Finance Authority of New Hampshire ("BFA") lending is not available, as the overall borrowing levels for the Company do not meet the minimum bonding threshold amounts, even when aggregated over a three-year "aggregate needs" analysis.
- The Company has been able to access some funding from the State Revolving Fund (SRF) or the Drinking Water and Groundwater Trust Fund (DWGTF), for certain eligible and qualifying capital projects. However, not all projects qualify for SRF funding or DWGTF financing.
- As a result, the options to finance the remainder of the Company's capital projects are limited to term loan debt from banks or other financial institutions.
- With regards to banks as a source of term loan financing, the Company has determined over these past several years that there are a limited number of truly eligible lending candidates due to considerations including the financial structure of the Company with respect to normally required debt-equity ratios, the overall capital borrowing needs, meeting normal financial covenants, or due to acceptable credit ratings. After exploring these potential lenders, the Company has determined that these are not available sources of term debt financing, as either banks have declined to offer lending capability to the

Company or would impose requirements (covenants, capital structure and coverage levels) that the Company is unable to meet.

- At the end of the process, CoBank has become the only viable option currently available to the Company to finance these capital funding needs.

Q. What are the estimated issuance costs for these CoBank loans?

A. The anticipated issuance costs total less than $10,000 and relates primarily to legal costs which will be incurred to (i) review the necessary loan documentation prepared by CoBank, and (ii) obtain Commission approval of the loans. The issuance costs will be amortized over the life of the CoBank loans.

Q. Please explain Schedule GT-1, entitled "Balance Sheet for the Twelve Months Ended December 31, 2022".

Schedule GT-1, pages 1 and 2, presents the actual financial position of the Company as of December 31, 2022, and the pro forma financial position reflecting certain adjustments pertaining to the proposed CoBank $1,025,000 balloon maturity refinancing.

Q. Please explain the pro forma adjustments on Schedule GT-1.

A. Schedule GT-1, page 1, reflects the pro forma adjustments needed to record the additional interest expense (net of the income tax impact) associated with replacing the June 2023 maturing CoBank Balloon Maturity ("T4") loan, with a new fully amortizing 10-year note with CoBank at an estimated annual interest rate of 7.20%. This schedule also reflects the net income impact on retained earnings related to costs associated with the financing, as reflected on Schedule GT-1. page 2 and Schedule GT-2.

Q. Please explain Schedule GT-2 entitled "Operating Income Statement for the Twelve Months Ended December 31, 2022."

A. The issuance costs associated with the financing are not expected to be significant and are not reflected in Schedule GT-2, page 1. Schedule GT-2, page 1, presents the pro forma impact of this financing on the Company's income statement for the twelve-month period ended December 31, 2022.

Q. Please explain the pro forma adjustments on <u>Schedule GT-2.</u>

A. Schedule GT-2, page 1, contains the estimated increase in interest expense related to the re-terming of the expiring balloon maturity with a new 10-year fully amortizing note at an estimated interest rate of 7.20% per annum, as well as the impact on income taxes related to that incremental interest expense.

Q. Please explain <u>Schedule GT-3</u> entitled "Proforma Capital Structure."

A. Schedule GT-3 illustrates the Company's pro forma impact on the Company's existing Capital Structure as of December 31, 2022.

Q. Please explain <u>Schedule GT-4A</u> entitled "Projected Rate Impact on Single Family Residential Home."

A. Schedule GT-4A illustrates the Company's pro forma impact from this financing on the average single-family residential home's water bill, as it pertains to the rates that were approved by Order No. 26,586 (February 18, 2022) in Docket No. DW 20-156.

Q. Please explain <u>Schedule GT-4B</u> entitled "Proforma Cost of Long-Term Debt."

A. Schedule GT-4B illustrates the Company's pro forma impact on the Company's Weighted Average Cost of Long-Term Debt as of December 31, 2022.

Q. What is the status of the required corporate approvals for CoBank Financings?

A. The CoBank financing were submitted for approval to the Company's and Pennichuck's Boards of Directors in October 2022, for which the certified resolutions are attached hereto as Exhibit GT-5. The approval required from Pennichuck's sole shareholder, the City of Nashua, was requested concurrently with this petition filing, the letter to the City is attached as Exhibit GT-6. The Company will supplement its Petition with documentation showing the City's approval when available in mid-to-late April 2023. The Company also notified its senior corporate lender, TD Bank, NA, of this refinancing activity, a copy of which is attached as Exhibit GT-7.

Q. Do you believe that the CoBank Financings will be consistent with the public good?

A. Yes. The terms of the financing through the CoBank loans are favorable compared to other alternatives, especially as this refinance is essential and there are no other sources of debt funding to replace the expiring balloon maturity term loan. As such, this will result in lower financing costs than would be available through any other current debt financing options, and/or an event of default if this balloon maturity debt cannot be repaid upon maturity. The Company's inability to refinance this debt upon maturity, regardless of the initial intercompany loan financing and refinancing done in 2013, would put the Company in a state of "default" on its debt obligations with CoBank. This would be harmful to the utility and its customers, and as such, avoidance of that fact is truly in the public good. The projected impact of the proposed financing on upon a Single-Family Residential Home, as demonstrated in Schedule GT-4A is de minimus, as it relates to the overall rate impact, and far less costly than the unintended consequences that would occur if this refinance was not approved and any resulting default.

Q. Is there anything else that is of vital importance that the Commission should know, related to this filing?

A. Yes. As this refinancing must occur by the due date of the balloon maturity debt on June 20, 2023, it is essential that this filing be given due consideration and an Order is received timely, such that the Company is authorized to close upon the new loan on or before that due date. Given that fact, the Company respectfully requests an Order *NISI* by May 20, 2023 or a final Order without a public comment period, such that the Company can execute the closing of the new loan before the due date cited.

Q. Mr. Torres, does this conclude your testimony?

A. Yes, it does.