STATE OF NEW HAMPSHIRE

BEFORE THE

PUBLIC UTILITIES COMMISSION

Petition of Pennichuck East Utility, Inc. for Approval of Financing From CoBank, ACB

DW 24-064

DIRECT PREFILED TESTIMONY OF

GEORGE TORRES

April 18, 2024
Revised July 10, 2024

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 and Treasurer 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 and of the Company's parent, Pennichuck Corporation ("Pennichuck").

Q. Please describe your educational background.

A. I have a Bachelor's in 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 and Treasurer 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 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.
- Refinance of CoBank T4 Note for Pennichuck East Utility, Inc. – Docket No. DW 23-024
- Renewal of FALOC for Pennichuck Water Works, Inc. – Docket No. DW 23-040
- Renewal of FALOC for Pennichuck East Utility, Inc. – Docket No. DW 23-049
- Restructure of ST Debt to LT for Pittsfield Aqueduct Company, Inc. – Docket No. DW 23-061

- Joint Petition for Consolidation by PWW, PEU, and PAC – Docket No. DW No. DW 23-101

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

A. The Company is proposing one new debt financing: a term loan of $1,890.931 from CoBank, ACB ("CoBank") to fund 2023 capital projects not funded by State Revolving Fund ("SRF") or Drinking Water and Groundwater Trust Fund ("DWGTF") loans or grants, as a repayment and refinance of amounts borrowed under the Company's Fixed Asset Line of Credit ("FALOC") for those projects during 2023, and as included in the Company's QCPAC filing with the Commission in Docket No. DW 24-029.

Q. Did you supervise the preparation of the Company's petition for authority to issue long term debt?

A. Yes.

Q. Does the Company have on file with the Commission a certification statement in its Annual Report with respect to its book, papers and records?

A. Yes.

Q. Please explain the purpose of the proposed CoBank term loan financing.

A. During 2023, $1,890,931 of capital improvements were made by PEU for a number of specific projects, routine maintenance capital projects, and other non-recurring capital expenditures, which were either not funded by the 0.1 DSRR account or did not qualify for SRF or DWGTF funding. An overview of these projects is further described in the testimony of the Company's CEO & Chief Engineer, John Boisvert, included with the Company's annual QCPAC filing, DW 24-029,which provides the details regarding the scope and need for these completed projects. This term loan financing with CoBank is needed to repay the amounts drawn on the Company's FALOC for these projects completed and used and useful during 2023. This amount is consistent with the amounts included on the schedules submitted for PEU's QCPAC filing under Docket No. DW 24-029.

Q. Mr. Torres, before explaining the details of the proposed financings, would you like to provide some history regarding the ownership of PEU and how that history supports this request for financing approval?

A. Yes. Currently, PEU is a wholly owned subsidiary of Pennichuck, which is, in turn, wholly owned by the City of Nashua, New Hampshire (City). The City acquired its ownership of Pennichuck on January 25, 2012, pursuant to this Commission's Order No. 25,292 (November 23, 2011) (Approving Acquisition and Settlement Agreement). Prior to this acquisition by the City, Pennichuck's shares were traded on a public stock exchange (the NASDAQ exchange). This change in the ultimate ownership of PEU's parent, Pennichuck, from a publicly traded shareholder ownership to ownership by the City has had important consequences for the operation of PEU.

One of the consequences is that PEU, after the City's acquisition of Pennichuck, no longer has access to private equity markets, thru its parent company, as a method of financing its capital needs. As contemplated by deliberations during the Commission's proceeding to approve the City's acquisition of Pennichuck in DW 11-026, after the acquisition, PEU was expected to finance its on-going capital needs entirely through the issuance of debt. One result of this anticipated debt financing is that the weighted average cost of PEU's capital is significantly lower than it was prior to the City's acquisition. This lower cost of capital has direct benefits for PEU's customers. Under the dockets for DW 17-128 and DW 20-156, the Company provided support for its existing capital structure, for which approval was granted for a modified rate setting methodology in Order No. 26,179, and further enhanced in Order No. 26,586. This financing petition is directly related to the Company's current debt needs for the reimbursement financing for its investment in capital projects that were completed and used and useful during 2023, converting short term borrowings under its Fixed Asset Line of Credit to long term debt with a fixed interest rate and term to maturity, consistent with the rate structure approved in the referenced Orders, and in conformity with the Company's annual QCPAC filings.

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, it is restricted to making loans and leases and providing financial solutions to eligible borrowers in the agribusiness and rural utility industries and 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; another loan with CoBank for $1,135,409 for 25 years, pursuant to Order No. 26,507 in Docket No. DW 21-102; another loan with CoBank for $2,546,632 for 25 years, pursuant to Order No. 26,538 in Docket No. DW 21-129; and the Company is currently seeking NHPUC approval on the refinancing of its CoBank 10 year, 25-year amortizing, $1.025 million balloon maturity in Docket No. 23-024.

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, the Company expects to obtain a $1,890,931 term loan with a 25-year amortization, with level monthly principal and interest payments with an interest rate to be determined based on market conditions (currently estimated at 7.50% per annum). The proceeds from this new CoBank loan will be used to paydown and refinance amounts used to fund 2023 capital expenditures, not funded by SRF or DWGTF loans/grants or 0.1 DSRR funds. The new CoBank loan will provide permanent financing for these long-lived assets. 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 $287,202 equity investment in CoBank and the Company's right to receive patronage dividends) 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 copy of CoBank's Non-Binding Summary of Terms and Conditions is attached as Exhibit GT-5.

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

A. Yes, 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 "patronage refunds" which includes the 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 experience with patronage refunds associated with all of the current amounts borrowed from CoBank, as highlighted earlier in this testimony, is as follows:

- 2010 earned patronage of $37,355,
- 2011 earned patronage of $43,108,
- 2012 earned patronage of $41,482,
- 2013 earned patronage of $57,351,
- 2014 earned patronage of $63,638,

- 2015 earned patronage of $66,012,
- 2016 earned patronage of $ 71,432,
- 2017 earned patronage of $20,706,
- 2018 earned patronage of $26,359,
- 2019 earned patronage of $30,575,
- 2020 earned patronage of $62,574,
- 2021 earned patronage of $99,492,
- 2022 earned patronage of $93,618,
- 2023 earned patronage of $123,639, and
- 2024 earned patronage of $121,915.71.

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 when received 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 issuance financing, issued by the Company through the Business Finance Authority of New Hampshire ("BFA") 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 estimated issuance costs total less than $10,000 and relates primarily to legal costs which will be incurred to (i) review and revise the necessary loan documentation prepared by CoBank, and (ii) obtain Commission approval of the loans. The issuance costs will and amortized over the life of the CoBank loans. The annual amortization expense of $400, associated with the issuance costs, has not been reflected in Schedules GT-1 through 4, in Exhibits GT 1-4B due to its immateriality with respect to the overall analysis and impact of this proposed financing.

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

A. Schedule GT-1, pages 1 and 2, presents the actual financial position of the Company as of December 31, 2023 and the pro forma financial position reflecting certain adjustments pertaining to the proposed CoBank $1,890,931 term loan financing.

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

A. Schedule GT-1, page 1, reflects the pro forma adjustments to record the net assets related to the capital projects funded by the CoBank term loan, and to record the net amount needed to record a full year of depreciation (as an adjustment to the half-year convention already booked for the assets as of 12/31/2023); there are no amounts reflected to adjust Plant Assets for the $1,890,931 cost of the net assets or to reflect the Cost of Removal, of $206,854 as the actual amounts for these entries and projects have already been included in the 12/31/2023 financial statements for these used and useful assets as of year-end.

Schedule GT-1, page 2 (Asset Line of Credit funds), establishes the total CoBank loan of $1,890,931, as well as the repayment of $1,890,931 of FALOC advances related to the 2023 capital improvements that were funded out of the Company's working capital and intercompany borrowings from Pennichuck. And, this schedule also reflects the income impact on retained earnings related to costs associated with the financings, as reflected on Schedule GT-2. Schedule GT-1, page 2, also records the use of a small amount of intercompany funds to support some of the related expenses.

Q. Mr. Torres, please explain <u>Schedule GT-2</u> entitled "Operating Income Statement for the Twelve Months Ended December 31, 2023".

A. As indicated previously, the issuance costs associated with the financing are not expected to be significant and are not reflected in <u>Schedule GT-2</u>, page 1. <u>Schedule GT-2</u>, page 1, presents the pro forma impact of this financing on the Company's income statement for the twelve-month period ended December 31, 2023.

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

A. <u>Schedule GT-2</u>, page 1, contains three adjustments. The first adjustment records the estimated increase in interest expense related to additional debt raised at interest rates of 7.50% per annum. The second adjustment records the estimated depreciation and property taxes on the new assets. The third adjustment records the income tax effect of the additional pro forma interest expense, depreciation and property tax expenses, using an effective combined federal and state income tax rate of 27.00%.

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

A. <u>Schedule GT-3</u> illustrates the Company's pro forma impact on the Company's existing Capital Structure as of December 31, 2023.

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

<u>A.</u> <u>Schedule GT-4A</u> 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, 2023.

Q. Mr. Torres, are there any covenants or restrictions contained in the Company's other bond and debt agreements which would be impacted by the issuance of debt under this proposed financing?

A. Yes. Section 6(c) of the Loan Agreement between Pennichuck and TD Bank, NA (the "Bank") prohibits Pennichuck or its subsidiaries from incurring additional indebtedness without the express prior written consent of the Bank, except for certain allowed exceptions. One of the listed exceptions, in Section 6(c)(v) the Company may incur new indebtedness up to $1.5 million per annum, on an unsecured basis, with CoBank, ACB or equivalent lender, provided that TD Bank, N.A. is provided at least 30 days prior to written notice related to said indebtedness. The Company providing written notice to TD Bank contemporaneous with this filing and attaches a copy of that as Exhibit GT-6. The Company received consent from TD Bank, NA on May 23, 2024, an email copy is attached as Exhibit GT-11.

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

A. The CoBank financing has been approved by the Company's and Pennichuck's Boards of Directors as documented in Exhibit GT-7 and Exhibit GT-8 and was submitted on March 1, 2024 for approval by Pennichuck's sole shareholder, the City of Nashua (as exhibit GT-9). The Company supplements its Petition with documentation showing the City's approval via Resolution 24-14 dated March 26, 2024, a copy attached as Exhibit GT-10.

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

A. Yes. The CoBank loan will enable PEU to continue to provide safe, adequate and reliable water service to PEU's customers. For the reasons described in Mr. Boisvert's direct testimony to the QCPAC docket reference earlier in this testimony, the projects funded by the CoBank loans, will provide the most cost-effective solutions, in support of this overall benefit for PEU's customers. The terms of the financing through the CoBank loans are very favorable compared to other alternatives and will result in lower financing costs than would be available through all other current debt financing options.

Q. Is there anything else that you wish to add?

A. Yes. I respectfully ask the Commission to issue an Order in this docket by July 31, 2024, if at all possible, such that the Order can be effective no later than the end of August. This will allow the Company to close upon the term loan as a requirement in establishing the final surcharge under the Company's QCPAC filing in pendency in Docket No. DW 24-029. Timely closing on the CoBank term loan, will allow the Company to include the actual impact of this loan in its QCPAC surcharge under Docket No. DW 24-029.

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

A. Yes, it does.