

STATE OF NEW HAMPSHIRE

Inter-Department Communication

NHPUC 17MAR17PM2:20

DATE: March 17, 2017
AT (OFFICE): NHPUC

FROM: Stephen Frink ^{SAF}
Assistant Director – Gas & Water Division
John Clifford
Staff Attorney

SUBJECT: DG 17-019
Northern Utilities, Inc.
Petition for Approval to Issue Securities

TO: Commissioners
Docket File
Service List

SUMMARY OF STAFF RECOMMENDATION

The Commission should approve (Northern or Company) to issue senior unsecured notes of up to \$75,000,000 at coupon rates not to exceed 5.50% by order *Nisi* and require Northern to file an updates with the Commission with the amount of the issue and pricing parameters when established and upon final closing and funding of the issuance.

BACKGROUND - NORTHERN PETITION & TESTIMONY

On February 1, 2017, Northern Utilities, Inc. filed a petition pursuant to RSA chapter 369 for authority to issue securities. Northern proposes to issue and sell at par, by private sale, unsecured promissory notes not to exceed \$75 million. Northern's petition included the direct testimony of David Chong, Director of Finance and Treasurer for Unitil Service Corporation, which provides various professional and administrative services to Northern.

Northern is seeking Commission approval to issue up to \$75 million, to be sold at par by private placement to institutional investors. Northern is targeting a mix of 10-year and 30-year issuances with fixed coupon rates not to exceed 5.50% and with projected financing costs of \$537,000 if the full \$75 million is issued. Northern states that the mix of maturities allows for the Company to match the long-lived assets with the long-term average life of the securities while achieving an attractive and market-based overall weighted yield and that the issuance of mixed maturities diversifies financial risk as refinancing is not tied to single point in time. Northern anticipates several investors participating in this offering.

Based on credit spreads for comparably rated utilities Northern anticipates all-in coupon rates in the range of 3.58-3.83% for a 10 year maturity and 4.40-4.65% for a 30 year maturity. The anticipated coupon rates are related to U.S. Treasury rates as of January 20, 2017.

Mr. Chong testified that the Company's net debt-to-net capitalization ratio will remain the same on an actual pro forma basis, since the net proceeds of the offering will be used to repay short-term debt and that issuance will lower the weighted cost of long-term debt from 6.16% to 5.96%. The analysis assumes an issuance of \$75 million at the maximum coupon rate.

Northern's last long-term debt financing was in October 2014 when it issued \$50 million of senior notes, approved by Commission Order 25,670 issued May 23, 2014 (Docket DG 14-101). Northern has spent \$112 million on distribution system capital expenditures since its last long-term financing and has \$42 million of capital expenditures budgeted for 2017. Northern uses internally generated funds and short-term borrowing to fund capital expenditures and when the Company's short-term balance builds to sufficient levels it seeks a long-term financing to reduce short-term debt and to appropriately match the long-term utility asset lives with long-term financing. The proceeds from this issuance will be used to refinance short-term debt (\$37 million as of December 31, 2016), meet sinking fund requirements of \$10 million in 2017 and fund 2017 capital expenditures. Any excess cash will be used for other general corporate purposes.

INVESTIGATION

Staff issued three sets of discovery, reviewed the Maine Public Utilities Commission (MPUC) proceeding (Docket 2017-00019) on Northern's proposed financing, reviewed Commission orders and dockets related to prior Northern debt issuances and compared current U.S. Treasury rates with those referenced in the Northern filing.

FINDINGS

Northern has requested approval to issue up to \$75 million of unsecured long-term debt but the Company's tentative plans are to issue \$50-60 million in equal tranches of 10-year and 30-year debt which would result in an average coupon rate of ranging from 3.99 to 4.24% based on indicative all-in coupon rates as of January 20, 2017. The difference between the high end of the indicative coupon rate for a 10-year and 30-year maturity and the proposed maximum coupon rate of 5.50% is 1.67% and 0.85%, respectively. There has been minimal change in the U.S. Treasury rate underlying the indicative rates, on January 20, 2017 the 10-year rate was 2.48% and 30-year rate 3.05% and as of March 15, 2017 the rates were 2.51% and 3.11%, respectively.

In addition to using the funds from the issuance to refinance short-term debt and the \$10 million 2017 sinking fund requirement and to fund its \$42 million 2017 capital budget, the funds will be used to refinance Northern's \$10 million 2018 sinking fund requirement and to fund its \$50 million 2018 capital budget.

Northern testified that the debt-to-equity ratio would remain the same based on the its pro forma analysis, that analysis netted the amount of cash in excess of short term debt refinancing against total debt. Traditionally, when considering a utilities capital structure when setting rates, cash is not netted against debt. Northern Exhibit NU-7 of the filing shows the pro forma capitalization without netting of the debt and cash and the current debt-to-equity ratio of 54:46 is 59:41 when additional debt of \$75 million added.

On March 10, 2017, the MPUC proceeding, MPUC Staff filed a Recommendation Decision in the form of a draft Commission Order approving Northern's request to issue senior unsecured notes up to an aggregate amount of \$75 million in tranches with maturities of up to 30 years and coupon rates not to exceed 5.50%.

Northern expects to market and price the offering in March 2017 subject to regulatory approval and that there will be a two-part closing process, with a paper execution in June and final closing and funding in October.

Northern also sought a protective order and confidential treatment of unaudited financial statements for a limited period of time up until the Company distributes its audited financial statements for 2016 with its debt holders on, or about, March 31, 2017. During discovery, the Company also submitted a copy of a letter agreement with its placement agents that disclosed the compensation arrangement between and among the Company and its placement agents with respect to the issuance and funding of the notes. It requested confidential treatment of this letter agreement as submitted.

STAFF POSITIONS

Staff believes the financing is routine in that the proposed use of funds is appropriate, the amount is not excessive, the cost of the financing is reasonable and the expected interest rate is consistent with that of other entities with similar credit ratings. There should be minimal impact on Northern's weighted average cost of capital (current rate of 7.22% compared pro forma rate of 7.42%) and the pro forma change in the debt-to-equity ratio is identical that resulting from the Northern debt issuance approved by in Docket DG 09-239 (Order 25,068 issued January 22, 2010) and comparable to what the ratio would be if Northern meet its funding requirement using short term debt. Furthermore, tentative Company plans are for an offering of \$50-60 million, which would result in a more balanced debt-to-equity ratio than if the maximum amount is issued.

Staff also supports the Company's request for limited confidential treatment of the unaudited financial information until such time as the audited financial statements are distributed. Staff believes that the letter agreement between the Company and its

placement agents disclosing payment arrangements represents confidential and commercial information such that its public disclosure could cause harm to the competitive position of the person(s) from whom the information is sought.

STAFF RECOMMENDATIONS

Staff supports Northern's financing request and recommends Commission approve Northern's petition by order nisi.

Staff also supports the Company's request for limited confidential treatment of certain unaudited financial information until such time as the audited financial statements are distributed and confidential treatment of the letter agreement between the Company and its placement agents. If the audited financial statements are materially different from the unaudited statements, Staff expects the Company to amend its filing accordingly.

In addition to approving the financing request, Staff recommends that the Commission require Northern file updates when the final pricing parameters are established and following the final closing and funding.

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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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
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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.