

Exhibit No. \_\_\_\_\_  
Issue: Cost of Capital (Debt)  
Witness: Phil Kain  
Type of Exhibit: Direct Testimony  
Sponsoring Party: Raccoon Creek  
Case No.: SR-2016-0202  
Date: September 30, 2016

**Missouri Public Service Commission**

**Direct Testimony**

**of**

**Phil Kain, Managing Partner, Rush Street Capital**

**On Behalf of**

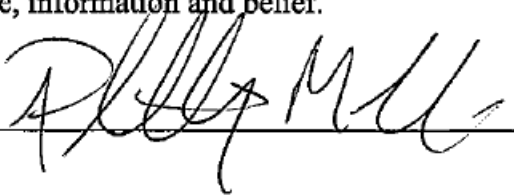
**Raccoon Creek Utility Operating Company, Inc.**

**September 30, 2016**

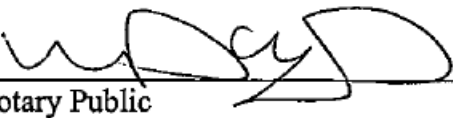
**AFFIDAVIT**

STATE OF ~~MISSOURI~~ ILLINOIS )  
COUNTY OF DUPAGE ) ss

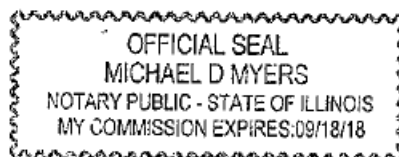
I, Phil Kain, state that the answers to the questions posed in the attached Direct Testimony are true to the best of my knowledge, information and belief.



Subscribed and sworn to before me this 30 day of September, 2016.

  
Notary Public

My Commission Expires: 9-18-2018



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**DIRECT TESTIMONY OF  
PHIL KAIN**

**WITNESS INTRODUCTION**

1

2 **Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.**

3 A. My name is Phil Kain, Managing Partner of Rush Street Capital. My business  
4 address is 233 S. Wacker Drive, 84<sup>th</sup> Floor, Chicago, IL 60606.

5 **Q. PLEASE DESCRIBE YOUR FORMAL EDUCATION.**

6 A. I received a Bachelor's degree from the University of Michigan in 1990, and a  
7 Master's Degree from the University of Nevada in 1995. In 2004, I became a  
8 Chartered Financial Analyst.

9 **Q. PLEASE DESCRIBE YOUR CURRENT POSITION.**

10 A. Currently, I am the Managing Partner of Rush Street Capital, which operates a  
11 Debt Capital Markets desk in Chicago. At Rush Street Capital, we find debt  
12 solutions for small to medium-sized businesses throughout the United States.

13 **Q. WHAT EXPERIENCE DO YOU HAVE IN CORPORATE BANKING AND**  
14 **LENDING?**

15 A. I have over 22 years of professional experience in corporate banking and  
16 leveraged lending. I worked for commercial banks from 1996 through 2014, in all  
17 aspects of commercial lending, underwriting and loan administration. I have  
18 closed well over 200 middle market debt transactions during my career. I have  
19 expertise in commercial lending, asset-based lending, banking regulation of

1 commercial loans, analyzing financial statements, sourcing and structuring debt  
2 for lower middle market companies.

3 **Q. WHAT EXPERIENCE DO YOU HAVE IN REGARD TO THE FINANCING OF**  
4 **PUBLIC UTILITIES?**

5 A. I have reviewed several transactions for financing public utilities during my  
6 banking career. I have recently attempted to source bank financing for a similar  
7 utilities company and have sourced non-bank financing for similar companies.

8  
9 **PURPOSE**

10 **Q. WHAT IS THE PURPOSE OF YOUR DIRECT TESTIMONY?**

11 A. I will discuss the non-availability of traditional financing for sewer utilities such as  
12 Raccoon Creek Utility Operating Company, Inc. (Raccoon Creek), and the  
13 reasons therefore, as well as the reasonableness of the debt rate being charged  
14 to Raccoon Creek.

15  
16 **COST OF CAPITAL (DEBT)**

17 **Q. WHAT DOCUMENTS HAVE YOU REVIEWED IN PREPARATION FOR YOUR**  
18 **TESTIMONY?**

19 A. I have reviewed the Direct Testimony of Josiah Cox; historical financial  
20 statements of Raccoon Creek as of and for the period from inception to  
21 December 31, 2015, and as of and for the six months ended June 30, 2016; a file  
22 created by Raccoon Creek entitled "Raccoon Creek Credit Risk Profile with  
23 Contingent Liabilities"; Missouri Department of Natural Resources (MDNR)

documents with respect to the Missouri Clean Water Law and related civil penalties; Construction Loan and Security Agreement Between Raccoon Creek Utility Operating Company, Inc. and Fresh Start Venture LLC; "Small Utility Return on Equity/Rate of Return Methodology" prepared by the financial Analysis Department of the Utility Services Division of the Missouri Public Service Commission dated September 2010; Missouri Office of the Public Counsel Small Utility Rate Case Tutorial" prepared by Ted Robertson, CPA; "Water & Sewer Operating Revenue, Expenses, and Statistics" for "WPC&WSS&Villages" for the calendar year January 1 – December 31, 2013; "West 16<sup>th</sup> Sewer Company-W/O Additions Case No. SM-2015-0014 Test Year Ended 12/31/13 Updated to 6/30/14 Plant in Service"; "SR-2016-0065 Raccoon Creek Rate Base Worksheet Source: SR-2016-0202 EMS"; "Raccoon Creek Utility Operating Company, Inc. Weighted Cost of Capital for Raccoon Creek Utility Operating Company, Inc." and related schedules; "Report and Order File No. WR-2016-0064 et al. in the Matter of the Water Rate Request of Hillcrest Utility Operating Company, Inc.

**Q. WHAT DO YOU UNDERSTAND IS RACCOON CREEK'S ACTUAL COST OF DEBT?**

**A.** Fourteen percent (14%).

**Q. DOES THAT DEBT COST SURPRISE YOU?**

**A.** No, not at all. Traditional financing, such as that provided by banks, is not available small wastewater systems and there is no viable option for financing available in the debt markets that is below this cost of capital.

**Q. WHY NOT?**

1 A. There are several critical aspects of small wastewater companies that make  
2 traditional financing from a commercial bank very difficult to obtain and in most  
3 cases, unavailable:

- 4 • Potential issues with lien perfection, which could jeopardize the lender's standing  
5 as Senior secured lender;
- 6 • Lack of sufficient current income and cash flow to repay the debt;
- 7 • Lack of secondary or tertiary sources of repayment; and,
- 8 • Inability to verify creditworthiness of end users which are consumers and form  
9 the basis of the company's accounts receivable.

10 **Q. IN YOUR EXPERIENCE, DOES THE INDIVIDUAL FINANCIAL**  
11 **WHEREWITHAL OF AN ENTITY'S PRESIDENT, SUCH AS MR. COX, IMPACT**  
12 **THIS SITUATION?**

13 A. No – a lender would look to the characteristics of the business and its risk without  
14 regard to the president's good or bad credit history.

15 A commercial bank would be subject to regulatory criticism if it used the  
16 individual financial wherewithal of the wastewater company's managing officer as  
17 the primary reason to approve a loan or as the primary source of repayment of  
18 an approved loan.

19 **Q. WHY IS THAT?**

20 A. Individuals are only supposed to be viewed as tertiary sources of repayment for a  
21 commercial loan from regulated commercial banks. Only the cash flow and  
22 operating income of the business are supposed to be used as a primary source  
23 of repayment for loans.

1 **Q. DO YOU HAVE AN OPINION AS TO WHETHER TRADITIONAL FINANCING**  
2 **IS AVAILABLE TO A SMALL SEWER UTILITY SUCH AS RACCOON CREEK?**

3 A. Traditional financing from commercial banks is not available to a small sewer  
4 utility such as Raccoon Creek.

5 **Q. WHAT TYPES FINANCING MIGHT BE AVAILABLE TO RACCOON CREEK?**

6 A. Financing would be available from non-bank finance companies, Mezzanine  
7 debt, or private credit funds.

8 **Q. WHAT IS THE INTEREST RATE FOR THESE TYPES OF FINANCING?**

9 A. Typical interest rates for distressed companies from non-bank finance  
10 companies, Mezzanine debt, or private credit funds are between 14% and 20%.  
11 These rates are required due to fact that the capital has been raised from  
12 investors who require certain returns on their capital and understand the risk  
13 associated with these types of companies. Accordingly, these rates represent  
14 the market's assessment and perception of the return required to match the risk  
15 associated with lending money to this type of distressed utility company.

16 **Q. DO YOU HAVE AN OPINION AS TO THE REASONABLENESS OF THE 14%**  
17 **INTEREST RATE ASSOCIATED WITH RACCOON CREEK'S FINANCING?**

18 A. Based on my review of the financial statements and business overview  
19 information for Raccoon Creek, it is my opinion that the 14% interest rate  
20 associated with Raccoon Creek's financing is reasonable.

21 **Q. DOES THIS CONCLUDE YOUR DIRECT TESTIMONY?**

22 A. Yes, it does.