

MEMORANDUM

TO: Missouri Public Service Commission Official Case File
Case No. WF-2014-0211, Roy-L Utilities, Inc.

FROM: Shana Atkinson, - Project Coordinator, Financial Analysis

Shana Atkinson 02/24/2014
Project Coordinator / Date

Alexander Antal 02/24/2014
Staff Counsel's Office / Date

SUBJECT: Staff Recommendation to conditionally approve the Application of Roy-L Utilities, Inc. for authority to issue up to and including an aggregate of \$73,000 of secured indebtedness.

DATE: February 24, 2014

Roy-L Utilities, Inc.

1. (a) **Type of Issue:** Secured Debt.
- (b) **Amount:** Not to exceed \$73,000.
- (c) **Rate:** The initial interest rate of 5% is locked during the term of the initial construction loan and until the 5th anniversary of the 10-year note refinancing the construction loan. The 10-year note's interest rate will be subject to change annually thereafter with a maximum annual change of 2% and a maximum life time change of 6%. The maximum interest rate will not exceed 11% during the life of the 10-year note. The rate at the 5-year anniversary will be based on the HNB Commercial Rate at the time as determined by the Bank each month.
2. **Date of Transaction:** December 11, 2013 for construction loan and June 11, 2014 for 10-year note
3. (a) **Statement of Purpose of the Transaction:** The Applicant proposes to apply the proceeds from the loan (a) to make needed physical and operational improvements to the pump house; (b) to purchase and install a new water pressure tank, and (c) to make Missouri Department of Natural Resources-mandated improvements to a sewage lagoon.
- (b) **From a financial perspective, does Staff deem this purpose reasonable?**

Yes X No
4. **Type of Transaction:** The Applicant obtained a loan disbursement authorization from HNB National Bank for a term loan providing monthly principal and interest payments based on a ten year amortization. This loan is for \$73,000 and will result in a first lien on substantially all of the properties currently owned and subsequently acquired by Applicant, including its certificates of convenience and necessity. The Applicant has attached to their application the loan documents for the construction loan maturing on June 11, 2014. Upon refinancing of the construction loan, the Applicant will receive loan documentation for a loan with a final maturity date to occur in 2024.

5. **Copies of executed instruments defining terms of the proposed transaction:**

- (a) Loan has been executed and terms and conditions have been filed with this application
- X (b) If such instruments have not been executed at the time of filing, a commitment to provide the terms and conditions of the instruments when they are available has been made.
- (c) If no such instruments are either executed or to be executed, a statement of how the securities are to be sold.

6. **Certified copy of resolution of the directors of applicant, or other legal documents authorizing the proposed transaction reviewed:**

Yes X No

7. **Capital expenditure schedule reviewed:**

Yes X No

8. **Journal entries are required to be filed by the Company to allow for the Fee Schedule to be applied:**

Yes X No

9. **Recommendation of the Staff:**

- Grant by session order (see Comments)
- X Conditional Approval (see Comments)
- Require additional and/or revised data before approval can be granted (see Comments)
- Formal hearing required (see Comments)
- Recommend dismissal (see Comments)

COMMENTS:

Roy-L Utilities, Inc. ("Roy-L", "Applicant", or "Company") is a Missouri water and sewer corporation with its principal office and place of business at 366 Hwy., F, High Hill, Missouri, 63350. The Applicant is in the business of providing sewer collection and treatment services and water supply and distribution services as a public utility in Montgomery County, Missouri.

Roy-L filed an Application requesting that the Commission authorize an already executed secured loan in the amount of \$73,000 (construction loan). Although not specified in the Application, Roy-L is also requesting Commission authority to refinance the construction loan with a 10-year note and also continue to pledge Roy-L's assets for this purpose. Roy-L provided a letter from HNB Bank outlining the general

terms and conditions of the 10-year note (see Attachment 1). Staff's recommendation for approval of Roy-L's application is contingent on the terms of the 10-year note being consistent with the terms outlined in the letter. Roy-L's use of the proceeds from this financing, along with the terms of the financing, are currently being addressed in Roy-L's rate cases, Case Nos. WR-2013-0543 & SR-2013-0544. The Company stated in its rate case application:

The specific reasons for the requested increases in the Company's annual operating revenues for sewer service include: Missouri Department of Resources (DNR) mandated chlorinator and dechlorinator system to be installed at the lagoon. This also would be the opportune time to rock the edge of the lagoon to prevent muskrat holes. Complete the fence around the new system as mandated by DNR.

The specific reasons for the requested increases in the company's annual operating revenues for water service include: To erect a new building as the existing building is not adequate. With the new building it will cover the reserve tank so the concrete will not corrode by being exposed to the weather. Replace the pressure tank as the existing tank has corrosion and is leaking. Need to replace the rock floor with concrete. Need to replace some of the pipes and improve the electric system. DNR recently inspected the pump house and has many "strong recommendations" which include these changes.

In regards to the sewer system, DNR is requiring Roy-L to install a chlorinator and dechlorinator system and install fencing around the utility's lagoon. DNR identified several deficiencies during its inspection of Roy-L's water system on June 13, 2012. These include that the wellhead should be located inside of the well house, the well house roof needs to be repaired or replaced, the well casing is corroded and needs to be repaired or replaced, the well house floor needs to be replaced with a concrete floor, the equipment inside of the well house is showing corrosion and the surface of the hydro pneumatic tank ("pressure tank") is showing rust and corrosion.

For the water system, this loan will allow the Company to rebuild the well house, put a roof on the well house and put a new electrical system in the well house, replace main water valves, replace the pressure tank, put in 25 new meters, and inspect and clean out the water storage tank. For sewer service, this loan will allow the Company to put fencing around the lagoon and install a chlorinator and dechlorinator system at the lagoon. After making these system improvements, the Company will provide all invoices related to these improvements to Staff.

Roy-L filed its Application pursuant to Section 393.180, 393.190 and 393.200 RSMo. Staff has historically applied the standard of "not detrimental to the public interest" in such instances. Staff's primary concern in this case was whether the funds were ultimately used for system investment. Staff's recommendation is not intended to be an endorsement of Roy-L's capacity and/or willingness to meet its obligations. Roy-L collected bids to estimate how much the water and sewer system improvements would cost and provided these bids to Staff. The amount of the loan of \$73,000 is reasonable compared to the estimated amount shown on the bids provided to Staff. Staff has relied on the Company's representation that the funds authorized under this financing were and will be used for Roy-L's regulated water and sewer utility operations.

Staff recommends the Commission approve the Application with the conditions below because Staff concludes that the funds from the proposed transaction were and will be used to fund system investment that is necessary for the Company to continue to provide safe and adequate service.

OTHER ISSUES:

Staff has verified that the Company has filed its annual report and is not delinquent on any assessment.

RECOMMENDED CONDITIONS:

Staff recommends that this Application be approved with the following conditions:

1. That nothing in the Commission's order shall be considered a finding by the Commission of the value of this transaction for rate making purposes, which includes, but is not limited to, the capital structure, and that the Commission reserves the right to consider the rate making treatment to be afforded these financing transactions, and their effect on cost of capital, in any later proceeding.
2. That the Company shall be required to file with the Commission all final terms and conditions of the 10-year note issued to refinance the construction loan that matures on June 11, 2014. If these final terms and conditions are not consistent with the general terms and conditions HNB National Bank represented in its February 20, 2014 letter, then Roy-L shall be required to file a new Application with the Commission for its authority.