

**BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI**

In the Matter of the Application of Emerald Pointe)
Utility Company for Authority to Issue Up To and) **File No. SF-2013-0346**
Including \$1,000,000 of Indebtedness)

STAFF RECOMMENDATION TO APPROVE APPLICATION

COMES NOW the Staff of the Missouri Public Service Commission (Staff) and, for its recommendation on the application of Emerald Pointe Utility Company (Emerald Pointe or Company) that initiated the above case, states:

1. On December 27, 2012, Emerald Pointe filed an application seeking an order from the Missouri Public Service Commission (Commission) granting the Company authority to issue up to \$1,000,000 of secured indebtedness for the construction of a sewer line and the conversion of an existing wastewater treatment facility to a lift station.

2. On December 28, 2012, the Commission issued an *Order Directing Staff to File Recommendation and Establishing Time to Respond to Staff's Recommendation*, which ordered Staff to file its recommendation on Emerald Pointe's application by no later than February 5, 2013. The Commission directed that any party wishing to respond to Staff's recommendation do so no later than February 11, 2013.

3. On January 22, 2013, Emerald Pointe filed a *Supplement to Application*, which sought Commission approval for additional indebtedness in the amount of \$62,000 to purchase two commercial power generators for placement at two lift stations along the sewer line.

4. Emerald Pointe has provided all necessary information for consideration of its application, pursuant to Commission rules 4 CSR 240-3.320 and 3.615.

5. In its Memorandum, attached hereto as Appendix A, Staff, for the reasons stated therein, recommends the Commission conditionally approve Emerald Pointe's supplemented application.

WHEREFORE, Staff recommends the Commission approve Emerald Pointe's application for authority to issue up to \$1,000,000 of secured indebtedness for the construction of a sewer line and the conversion of an existing wastewater treatment facility to a lift station and \$62,000 for installing power generators at two lift stations along the sewer line.

Respectfully submitted,

/s/ Amy E. Moore

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CERTIFICATE OF SERVICE

I hereby certify that copies of the foregoing have been mailed with first-class postage, hand-delivered, transmitted by facsimile or electronically mailed to all counsel of record this 5th day of February, 2013.

/s/ Amy E. Moore

MEMORANDUM

TO: Missouri Public Service Commission
Official Case File, Case No. SF-2013-0346
Emerald Pointe Utility Company

FROM: Zephania Marevangeo, Financial Analysis Unit

/s/ Zephania Marevangeo 02/5/13 /s/ Amy Moore 02/5/13
Project Coordinator/Date Staff Counsel's Office/Date

SUBJECT: Staff's Recommendation to Conditionally Approve Emerald Pointe Utility Company's (Emerald Pointe or Company) Supplement to Application for Authority to Issue Up to \$1,062,000 of Long-term Secured Indebtedness.

DATE: February 5, 2013

1. (a) **Type of Issue:** Long-term Secured Debt.
- (b) **Amount:** Total not to exceed *\$1,062,000 of long-term secured debt.
(* Two (2) separate loans - \$1,000,000 and \$62,000)
- (c) **Rate:** (i) 5.5 percent fixed rate on the \$1,000,000 loan; and
(ii) 3.15 percent rate on the \$62,000 loan.
- (d) **Other Provisions:** The \$1,000,000 loan is a 5-year loan with monthly principal and interest payments based on a 20-year amortization. Parties to this transaction are Hawthorn Bank (Lender) and Emerald Pointe (Borrower).

The \$62,000 loan is a 5-year loan with monthly principal and interest payments based on a 5-year amortization. Parties to this transaction are White River Valley Electric Cooperative, Inc. (Lender) and Emerald Pointe (Borrower).

Further terms and provisions including provisions for prepayment and redemption will be determined at the time of issuance.

2. **Proposed Date of Transaction:** As soon as the Commission so authorizes.

3. (a) **Statement of Purpose of the Issuances:** Proceeds from the \$1,000,000 loan will be used to (i) complete the construction and connection of a new sewer line from the City of Hollister to Emerald Pointe (authorized in Case No. SA-2012-0362), (ii) pay off existing debt to principals for funding of prior sewer line construction and (iii) eliminate existing wastewater treatment facility and convert it to a lift station.

Proceeds from the \$62,000 loan will be used to purchase two (2) commercial power generators for placement at two (2) of the Company's lift stations.

(b) **From a financial perspective, does Staff deem this purpose reasonable?**

Yes, assuming the Commission orders compliance with all proposed listed conditions.

4. **Copies of executed instruments defining terms of the proposed securities:**

___ (a) If such instruments have been previously filed with the Commission, a reference to the Case Number in which the instruments were furnished.

X (b) If such instruments have not been executed at the time of filing, a statement of the general terms and conditions to be contained in the instruments which are proposed to be executed.

___ (c) If no such instruments are either executed or to be executed, a statement of how the securities are to be sold.

5. **Certified copy of resolution of the directors of applicant, or other legal documents authorizing the issuance of the securities reviewed:**

Yes X No

6. **Pro-forma Balance Sheet and Income Statement 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 Financial Analysis Department:**

 Grant by session order (see Comments)

 X Conditional Approval granted pending receipt of definite terms of issuance (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:

Company and “Sewer Line Project” Background:

Company Background

Emerald Pointe is a public regulated utility engaged in the business of providing water and sewer services to members of the public located in an area south of Branson, Missouri, in the Emerald Pointe and Branson Canyon developments.

The Company originally obtained a Certificate of Convenience and Necessity (CCN) to provide water and sewer service in Case No. WA-96-96 and expanded its service areas for both water and sewer in Case Nos. WA-2004-0581, SA-2004-0582, WA-2005-0306, SA-2005-0307 and SA-2012-0362.

“Sewer Line Project” Background

On May 1, 2012, Emerald Pointe filed an Application, in Case No. SA-2012-0362, with the Commission seeking a CCN to construct, install, own, operate, manage and maintain a sewer system and sewer line in Taney County, Missouri. The CCN application indicated the Company’s intent to construct a sewer line from Emerald Pointe’s existing service area to a wastewater treatment plant owned and operated by the City of Hollister (“Sewer Line Project”).

Staff’s analyses and recommendation in the CCN case established that the “Sewer Line Project” would not be detrimental to the public. Instead, it would improve Emerald Pointe’s service area by eliminating a sewage treatment facility and allow the system to grow and provide environmental benefits to another area close by (Table Rock Lake).

On July 11, 2012, the Commission filed an order granting Emerald Pointe the CCN. Thus, Emerald Pointe embarked on a “Sewer Line Project,” which the Company seeks to finance and/or refinance with the long-term debt issuances contemplated in the Company’s Financing Application.

Case Background:

On December 27, 2012, Emerald Pointe filed Financing Case No. SF-2013-0346, pursuant to Sections 393.180 and 393.190 RSMo and Commission Rules 4 CSR 240-2.060, 2.080, 3.320, 3.615 and 4.020(2)(B), an Application with the Commission for authority to issue up to \$1,000,000 in Long-Term Secured Debt.

Based on the discussions between Staff and the Company and information provided in the Company's supplemental application, Emerald Pointe also encountered a need to obtain additional financing for purposes of funding a Department of Natural Resources (DNR) requirement to install two (2) power generators at two of its lift stations along the sewer line system. Thus, Emerald Pointe consulted several investors seeking funding for the generators.

After White River Valley Electric Cooperative, Inc. (White River) agreed to provide the additional \$62,000 financing needed for the acquisition of the two (2) power generators, Emerald Pointe conferred with Staff and, on January 22, 2013, filed a supplement to its initial financing application. Consequently, Emerald Pointe is now requesting authority to issue up to \$1,062,000 in long-term secured indebtedness.

Uses of the Requested Financing

The Company stated on page two (2) of its Application that it intends to use proceeds from the \$1,000,000 debt issuance to complete the construction and connection of a new sewer line from Emerald Pointe to the City of Hollister, pay off existing debt to principals for funding of prior sewer line construction and eliminate the existing wastewater treatment facility and convert it to a lift station.

The Company also stated on page one (1) of the supplement to Application that it intends to use proceeds from the \$62,000 loan to purchase two (2) power generators as part of the sewer line project.

Scope of Staff's Analyses and Impact of the Proposed Debt Issuance

Scope of Staff's Analyses

Staff's scope in this financing case is limited to assessing the ability of the Company, through its financial statements and the resulting key credit metrics,¹ to absorb the proposed debt issuance

¹ The first three (3) key credit metrics are the same credit metrics published by S&P to assist users in estimating a potential rating assuming certain business risk classifications.

without causing a significant deterioration to the Company's creditworthiness. All else equal, it is highly probable that a significant deterioration to the Company's creditworthiness might result in increased capital costs, which could end up being borne by ratepayers if allowed in rates. Additionally, to the extent a company requests the use of debt leverage to a point that it impairs the ability of the company to raise additional capital to maintain safe and adequate service, close scrutiny must be applied to the amount of the proposed debt financing.

Staff will discuss in the following section the impact of the proposed debt issuances (\$1,062,000) on the Company's key credit metrics based on the 2013 pro forma financial statements that the Company provided as attachments to its "Supplement to Application." The key credit metrics reviewed include: (1) Debt to Capital ratio, (2) Funds From Operations (FFO) to Total Debt, (3) Debt to Earnings Before Interest, Taxes, Depreciation and Taxes (EBITDA) and (4) Debt Service Coverage.

S&P's credit metric benchmarks are derived from the financial statements of larger utilities that tend to be required to file audited financial statements with the Securities and Exchange Commission. In Staff's experience, the balance sheets of small water and sewer companies are not as reliable for purposes of determining a reasonable amount of leverage for operations. For that matter, Staff often does not rely on small water and sewer companies' balance sheet capital balances for purposes of estimating a reasonable ratemaking capital structure.

Impact of the Proposed Debt Issuance

The Company provided current financial statements (i.e. as of September 30, 2012) and 2013 projected financial statements in order to show the estimated impact of issuing the proposed \$1,062,000 of long-term debt.

Based on the Company's September 30, 2012 financial statements, Emerald Pointe does not have any legitimate third-party debt. Instead, it has funds loaned to the Company by the principals. The Company communicated to Staff that the principals have not drafted official loan documents to require payments to the principals. Consequently, Staff viewed the loans, in this case, as

equity infusions for purposes of evaluating financial risk. Based on that approach, Emerald Pointe does not carry long-term debt; and as a result, Emerald Pointe's current credit metrics show no financial risk.

Using the Company's 2013 projected financial statements, which are based on Emerald Pointe's assumed amount of a rate increase in its pending rate case before the Commission, a \$1,062,000 long-term debt issuance is indicative of the following ratios: (1) Debt to Capital ratio of 69 percent, (2) FFO to Total Debt ratio of 18 percent, (3) Debt to EBITDA of 6x and (4) Debt Service Coverage of 2x.

A Debt to Capital ratio of 69 percent simply indicates that the Company's Capital Structure is financed by 69 percent debt and 31 percent equity. Based on Standard and Poor's financial benchmarks, this capital structure is considered to be "Highly Leveraged", which is the highest level of financial risk categorization under S&P's rating criteria.

An FFO to Total Debt ratio of 18 percent simply represents the Company's free cash flows when expressed as a percentage of the Company's total debt. The Company's projected FFO to Debt ratio of 18 percent befits the benchmark for an "Aggressive" S&P financial risk categorization. All else equal, the higher the FFO to Debt ratio the lower the financial risk, and vice versa. According to Standard and Poor's financial risk benchmarks, a FFO to Debt ratio of less than twelve (12) percent is classified as "Highly Leveraged," and a ratio greater than sixty (60) percent is classified as "Minimal" financial risk.

The Company's projected Debt to EBITDA ratio of 5.5x indicates the size of its total debt as it relates to its available cash flows. In this case, the Company's total debt is 5.5 times the size of its projected cash flows for the 2013 time period. According to S&P's financial benchmarks, a ratio less than 1.5x represents minimal financial risk and a ratio greater than 5x represents the "Highly Leveraged" rating categorization or the highest level of financial risk.

Debt Service Coverage ratio measures the number of times the Company's cash flows, for a given time period, can pay the principal and interest due in that same given time period. The

Company's ratio of 2x indicates that the Company's projected cash flows would be two (2) times the size of the projected principal and interest obligations for the 2013 time period.

While the Company's projected key credit metrics range from "highly leveraged" to "minimal" financial risk, Staff believes, based on a projected debt to capital ratio of 69 percent and analyses in the recommendation made by Staff in Case No. SA-2012-0362, Emerald Pointe can issue the proposed debt (\$1,062,000) and still ensure safe and adequate service.

Debt Issuance and Due Diligence

\$1,000,000 proposed debt from Hawthorn Bank

Staff was concerned as to why Emerald Pointe chose to issue a 5-year loan based on a 20-year amortization rather than issuing a 20-year loan based on a 20-year amortization. There is a greater refinancing risk, given such an arrangement, because absent the Company making an equity infusion to make the balloon payment at the end of five years, the Company will have to seek additional debt financing to make the balloon payment to pay off the loan at the end of year five (5). Hence, the Company faces the risk of refinancing at higher rates than those that currently exist.

In its responses to Staff Data Request Nos. 3 and 4, the Company indicated that Emerald Pointe consulted with several commercial lending institutions active in lending for Branson businesses, including but not limited to institutions that provide Small Business Administration (SBA) and United States Development Agriculture (USDA) loan products. Emerald Pointe failed to meet the criteria for these special loan products.

Hawthorn Bank agreed to loan \$1,000,000 of the proposed debt financing, but as a 5-year loan based on a 20-year amortization. Thus, Principal and Interest (P&I) bear the characteristics of a 20-year loan (i.e. lower than P&I for a 5-year loan based on a 5-year amortization).

\$62,000 proposed from White River Valley Electric Cooperative, Inc.

Based on the communication between Staff and the Company, Emerald Pointe realized after it had already filed its Application that, as part of the sewer line project, it is required by DNR to install power generators at two (2) lift stations along the sewer line. Thus, Emerald Pointe consulted with several investors seeking funding for the generators. White River agreed to commit the loan to the Company at a favorable 5-year loan with an interest rate of 3.15 percent.

Conclusion

Staff is aware that the “Sewer Line Project,” which the Company intends to finance with proceeds from the loans contemplated in this financing case, was addressed and authorized by the Commission in Case No. SA-2012-0362. While the Company’s financial risk, as it relates to debt coverage ratios, ranges from “Aggressive” to “Highly Leveraged,” Staff believes the Company’s assets can support the level of debt contemplated in this case.

Recommendation

As a result of its investigation, Staff recommends approval of this *Application* with the following conditions:

1. That the Company shall file with the Commission, within 30 days from the transaction date, all final terms and conditions of the proposed financing, including, but not limited to, the aggregate proceeds received, price information, and estimated expenses.
2. That nothing in the Commission’s order shall be considered a finding by the Commission of the value of this transaction, including, but not limited to, Emerald Pointe’s capital structure for ratemaking purposes, and that the Commission reserves the right to consider the ratemaking treatment of these financing transactions and their effect on cost of capital in any later proceeding.

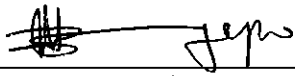
BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI

In the Matter of the Application of Emerald)
Pointe Utility Company, for Authority to)
Issue up to and Including \$1,000,000 of)
Indebtedness) Case No. SF-2013-0346

AFFIDAVIT OF ZEPHANIA MAREVANGEPO

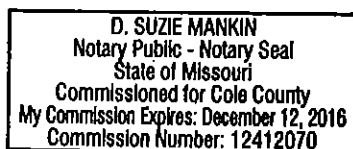
STATE OF MISSOURI)
) ss.
COUNTY OF COLE)


Zephania Marevangepo, of lawful age, on his oath states: that he has participated in the preparation of the foregoing Staff Recommendation in memorandum form, to be presented in the above case; that the information in the Staff Recommendation was developed by him; that he has knowledge of the matters set forth in such Staff Recommendation; and that such matters are true and correct to the best of his knowledge and belief.



Zephania Marevangepo

Subscribed and sworn to before me this 4th day of February, 2013.





Notary Public