BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI

In the matter of the application of The Raytown Water Company for an Order Authorizing Issuance of Water Facilities Refunding and Improvement Bonds Series 2008.	))))	Case No. WF-2008-0356

STAFF'S RECOMMENDATION

COMES NOW the Staff of the Missouri Public Service Commission (Staff), and respectfully files this Staff Recommendation with the Missouri Public Service Commission (Commission). For its Recommendation, Staff respectfully states as follows:

Procedural History

1. On April 30, 2008, the Raytown Water Company filed an Application for authority to issue Water Facilities Refunding and Improvement Bonds, Series 2008 (Application).

2. On May 7, 2008, the Commission issued its Order Directing Staff to File a Recommendation by no later than June 6, 2008. On June 6, 2008, the Commission subsequently issued an order extending this deadline to June 20, 2008.

3. On June 20, 2008, Staff filed a Status Report which indicated Staff could not proceed with its investigation until Raytown supplemented its Application by filing Exhibit D in a proper form.

4. On June 20, 2008, Raytown filed a revised Exhibit D, within which Staff found discrepancies, and on July 9, 2008, Raytown filed a further corrected copy of Exhibit D for the record.

5. On June 27, 2008, the Commission issued its Order Directing Filing, setting a new filing deadline of July 10, 2008, for Staff's Recommendation or a further status report.

Staff's Recommendation

6. Staff's Recommendation is attached hereto as Appendix A.

7. Staff recommends approval of Raytown's Application, noting Raytown will not be issuing notes, but borrowing a principal sum not to exceed $970,000, at a rate not to exceed 4.75 percent, from the Missouri Environmental Improvement and Energy Resources Authority (EIERA).

8. Raytown proposes to apply the proceeds to: (a) refund, at a more favorable interest rate, the remaining balance of its Series 1999 EIERA bonds; (b) construct new and larger water mains; (c) pay for new trucks and other plant equipment required to operate and maintain its water facilities; (d) fund any required debt service fund; and (e) pay the costs and expenses associated with the EIERA's issuance of the bonds.

9. Staff evaluated the potential impact of the proposed financing on Raytown's financial risk by analyzing the estimated pro forma impacts on three financial ratios: Funds From Operations (FFO) Interest Coverage, FFO as a Percentage of Average Total Debt, and Total Debt to Total Capital. The resources used and Staff's results are found in Attachments A and B, respectively.

10. Attachment A contains an article, "U.S. Utilities Ratings Analysis Now Portrayed in the S&P Corporate Ratings Matrix," which discusses the changes in assigning business risk profiles to utility companies.

11. Attachment B shows Staff's results for its calculations for each of the three ratios listed in paragraph nine (9) above, indicating the proposed financing causes minimal financial risk to Raytown.

Conditions of Recommendation

12. Staff recommends the Commission approve Raytown's Application with the following conditions:

a) 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;

b) Raytown shall file with the Commission all final terms and conditions of the proposed financing, which shall include, but not be limited to, the executed Loan Agreement, the Promissory Note, the Deed of Trust and Security Agreement, the Water Facilities Refunding and Improvement Bonds and the Bond Trust Indenture;

c) Raytown shall file with the Commission, upon refunding any outstanding debt, the net present value calculations indicating the amount of interest cost savings;

d) Raytown shall submit to the Commission's Budget and Fiscal Services department a verified report documenting the issuance of the note, the use of any associated proceeds, and the applicability and measure of fees under Section 386.300.2. RSMo (Supp. 2007);

e) the Commission is not providing authority for the issuance of the EIERA Bonds, only the authority for Raytown to take all necessary steps to execute the proposed loan transaction with the Missouri Environmental Improvement and Energy Resources Authority; and

f) that all future funds acquired by Raytown through issuance of securities under this Application shall be used exclusively for the benefit of Raytown's regulated operations.

WHEREFORE, Staff recommends the Missouri Public Service Commission approve Raytown's Application to borrow a principal sum not to exceed $970,000 from the Missouri Environmental Improvement and Energy Resources Authority on the conditions specified in paragraph twelve (12), a through f above.

Respectfully submitted,

/s/Jennifer Hernandez
Jennifer Hernandez
Legal Counsel
Missouri Bar No. 59814

Attorney for the Staff of the
Missouri Public Service Commission
P. O. Box 360
Jefferson City, MO 65102
(573) 751- 8706 (Telephone)
(573) 751-9285 (Fax)
jennifer.hernandez@psc.mo.gov

CERTIFICATE OF SERVICE

I hereby certify that copies of the foregoing have been mailed, hand-delivered, transmitted by facsimile or electronic mail to all counsel of record this 10th day of July, 2008.

/s/ Jennifer Hernandez

MEMORANDUM

TO: Missouri Public Service Commission Official Case File
Case No. WF-2008-0356, Raytown Water Company

FROM: David Murray, Financial Analysis Department

/s/ David Murray 07/10/08	**/s/ Jennifer Hernandez 07/10/08**
Project Coordinator / Date	General Counsel's Office / Date

SUBJECT: Staff Recommendation to approve the Application of Raytown Water Company for authority to borrow a principal sum not to exceed $970,000 from the Missouri Environmental Improvement and Energy Resources Authority ("Authority"), which will issue Water Facilities Refunding and Improvement Bonds Series 2008 ("2008 EIERA Bonds") to obtain the proceeds to lend to Raytown Water Company.

DATE: July 10, 2008

Raytown Water Company

1. (a) **Type of Issue:** Loan Agreement, Promissory Note and Deed of Trust and Security Agreement in Conjunction with Water Facilities Refunding and Improvement Bonds Series 2008 to be issued by the Authority.

   (b) **Amount:** Not to exceed $970,000.

   (c) **Rate:** The interest rate on the loan will not exceed 4.75 percent.

2. **Proposed Date of Transaction:** As soon as approvals from the Commission and the Authority are received.

3. (a) **Statement of Purpose of the Transaction:** The Applicant proposes to apply the proceeds from the loan to (a) refund at a more favorable interest rate the remaining balance of the outstanding Series 1999 EIERA Bonds; (b) for the construction of a new water main in the Applicant's service territory inside of Raytown, Missouri to be installed upon, and attached to a new bridge being constructed in the City of Raytown across 63rd Street, which bridge construction requires the relocation of the Applicant's main in that area to the new bridge location; and, Applicant will construct a new and larger main than the existing one serving that area; (c) to pay for new trucks and other related plant and equipment required to operate and maintain the water facilities; (d) to fund any debt service reserve fund that may be required, and (e) to pay the costs and expenses of the issuance of the Bonds.

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

   Yes _X_ No

Appendix A

4. **Type of Transaction:** The Applicant will enter a Loan Agreement with the Authority and the Authority will issue and sell for cash a principal amount not to exceed $970,000 of tax-exempt EIERA Bonds. The Loan Agreement will bear the same terms as the EIERA Bonds. The Loan Agreement will be secured by a mortgage from the Applicant.

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

___ (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 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 granted pending receipt of definite terms of transaction (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:

Raytown Water Company (Raytown, Applicant, or Company) is a Missouri water corporation with its principal place of business at 9820 East 63rd Street, Raytown, Missouri 64133. The business of the Applicant is the retail sale of water as a public utility in portions of the cities of Raytown and Kansas City, in Jackson County, Missouri.

Raytown has filed an Application requesting that the Commission authorize the issuance of EIERA Bonds. Although EIERA Bonds will need to be issued as part of the overall process to procure the $970,000 of funds requested in Raytown's Application, Raytown is not the entity that will actually issue the EIERA Bonds. The Authority is the entity that will issue the EIERA Bonds and then the Authority lends these proceeds to Raytown bearing the same terms as the EIERA Bonds. Therefore, Staff recommends the Commission only authorize Raytown to enter a loan with the Authority, which consists of the Loan Agreement, a Promissory Note and a Deed of Trust and Security Agreement (collectively referred to as the "loan documents"). This loan will allow the Company to borrow up to $970,000 in aggregate principal amount from the Authority in conjunction with its request of the Authority to issue EIERA Bonds. The Authority will issue EIERA Bonds to investors and then lend these proceeds to Raytown by executing the loan documents. The Deed of Trust and Security Agreement provides the Authority a security interest in Raytown's assets. The Authority is authorized to issue EIERA Bonds and loan the proceeds to a corporation for the purpose of construction, reconstruction, enlargement, improvement, furnishing, equipping, maintaining, repairing, operating, leasing, financing and selling any facility constituting a "project" under Section 260.005 through 260.125, RSMo (Supp. 2007).

The EIERA Bonds are tax-exempt, which makes the cost of the bonds lower than if they were traditional taxable bonds, because the investor does not require a higher return to offset the taxes normally due on investment income. The interest rate applicable to the remaining $440,000 of principal outstanding on the Series 1999A bonds is 5.62 percent. Although the body of the Application indicates the interest rate will not exceed 4.75 percent, Exhibit B attached to the Application indicates the anticipated interest rate on the new loan is 4.35 percent. According to page 5 of Exhibit B, the stand-alone benefit of refinancing the current $440,000 of principal outstanding would be a positive 1.641 percent. Although Staff did not analyze the specifics of this calculation, Staff verified with the trustee, UMB Bank, that the incremental costs associated with refunding the $440,000 was approximately $2,750. Consequently, the present value of the savings for refinancing at a lower interest rate would need to be at least $2,750 for this decision to create value for the Company. The other closing costs do not need to be considered in this decision because Raytown would incur these costs for the "new money" of $530,000 it needs for investment in plant and equipment. This assessment assumes there are no significant changes to other terms of the loan. No changes are assumed as Raytown proposes to use the 1999 loan instruments.

Raytown filed its Application pursuant to Section 393.200 RSMo (Supp. 2007). Staff has historically applied the "standard of not detrimental to the public interest" in such instances. Staff's primary concern is whether the proposed transaction will impair the Company's ability to attract capital to ensure continued safe and reliable service. Although Staff's analysis focuses on the possible impact on the Company's creditworthiness, Staff's recommendation is not intended to be an endorsement of Raytown's capacity and/or willingness to meet its obligations. Additionally, Staff did not conduct an audit or cost review with regard to the proposed capital expenditures. Staff with expertise in this area decided that an appropriate time for review of the prudency of such capital expenditures would be in the context of a rate case. Staff has relied on the Company's representation that the funds authorized under this financing will be used for Raytown's regulated water utility operations.

Staff evaluated the potential impact of Raytown's proposed financing on its financial risk by analyzing the estimated pro forma impacts of the financing on three financial ratios, Funds From Operations (FFO) Interest Coverage, FFO as a Percentage of Average Total Debt, and Total Debt to Total Capital. Benchmarks for these ratios are published by S&P for guidance to users on possible credit quality impacts of financial decisions given an estimated business risk profile. On November 30, 2007 Standard and Poor's (S&P) published an article, "U.S. Utilities Ratings Analysis Now Portrayed in the S&P Corporate Ratings Matrix" (see Attachment A) that discusses the change to assigning business risk profiles (BP) to utility companies. S&P's previous methodology utilized a BP scale of 1 to 10, with 1 being the least risky and 10 being the most risky. S&P's new scale now assigns BPs according to the following categories: "Excellent," "Strong," "Satisfactory," "Weak," and "Vulnerable." The BPs are evaluated along with a company's Financial Risk Profile (FRP) of "Minimal," "Modest," "Intermediate," "Aggressive," and "Highly Leveraged" to estimate a possible credit rating.

Attachment B shows results for Staff's calculations for each of the three ratios using the financial information Raytown provided in Exhibit B attached to its Application. Staff calculated the three ratios using the actual financial information for the year ending December 31, 2007, and the ratios after the pro forma adjustments were made to the actual December 31, 2007 financial information. Staff compared the results of its calculations to the benchmark guidelines for at least a BBB- credit rating for a company with a BP of "Strong." If a company has a BP of "Excellent," then these benchmarks are indicative of the guidelines for a BBB credit rating. Because Raytown is not rated by S&P, it does not have an assigned BP. However, it would be reasonable to assume that Raytown's BP would be no less than "Strong" because, to Staff's knowledge, S&P has not assigned a BP weaker than "Strong" for any utility company whose principal business encompasses Missouri utility operations. As can be seen from Attachment B, even after considering the pro forma impacts of the proposed financing, Raytown's financial ratios indicate minimal financial risk.

OTHER ISSUES:

The Staff has verified that the Company has filed its annual report and is not delinquent on any assessment. The Staff's Budget and Fiscal Services Department has reviewed the circumstances in this finance case and believes that it is appropriate to condition the approval of the Company's financing on the submission of appropriate journal entries to determine if the fee schedule should apply, as set forth in Section 386.300 RSMo (Supp. 2007), in accordance with 4 CSR 240-3.615(1)(F).

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 file with the Commission all final terms and conditions of the proposed financing, which shall include, but not be limited to, the executed Loan Agreement, the Promissory Note, the Deed of Trust and Security Agreement, the Water Facilities Refunding and Improvement Bonds and the Bond Trust Indenture.

3. That the Company file with the Commission, upon refunding of any outstanding debt, the net present value calculations indicating the amount of interest cost savings.

4. That the company submit a verified report to the Commission's Budget and Fiscal Services department documenting the issuance of the note, the use of any associated proceeds, and the applicability and measure of fees under Section 386.300.2. RSMo (Supp. 2007).

5. That the Commission is not providing authority for the issuance of the EIERA Bonds. The Commission is providing authority for The Raytown Water Company to take all necessary steps to execute the proposed loan transaction with the Missouri Environmental Improvement and Energy Resources Authority.

6. That all future funds acquired through issuance of securities under this application shall be used exclusively for the benefit of The Raytown Water Company's regulated operations.

BEFORE THE PUBLIC SERVICE COMMISSION

OF THE STATE OF MISSOURI

In the matter of the application of The Raytown Water Company for an Order Authorizing Issuance of Water Facilities Refunding and Improvement Bonds Series 2008	)))))	Case No. WF-2008-0356

AFFIDAVIT OF DAVID MURRAY

STATE OF MISSOURI)
) ss.
COUNTY OF COLE)

David Murray, 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.

David Murray

David Murray

Subscribed and sworn to before me this 10th day of July, 2008.

NIKKI SENN
Notary Public - Notary Seal
State of Missouri
Commissioned for Osage County
My Commission Expires: October 01, 2011
Commission Number: 07287016

Nikki Senn

Notary Public

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November 30, 2007

U.S. Utilities Ratings Analysis Now Portrayed In The S&P Corporate Ratings Matrix

Primary Credit Analysts:
Todd A Shipman, CFA, New York (1) 212-438-7676; todd_shipman@standardandpoors.com
William Ferara, New York (1 212-438-1776; bill_ferara@standardandpoors.com
John W Whitlock, New York (1) 212-438-7678; john_whitlock@standardandpoors.com

Secondary Credit Analyst:
Michael Messer, New York (1) 212- 438-1618; michael_messer@standardandpoors.com

Attachment A

U.S. Utilities Ratings Analysis Now Portrayed In The S&P Corporate Ratings Matrix

The electric, gas, and water utility ratings ranking lists published today by Standard & Poor's U.S. Utilities & Infrastructure Ratings practice are categorized under the business risk/financial risk matrix used by the Corporate Ratings group. This is designed to present our rating conclusions in a clear and standardized manner across all corporate sectors. Incorporating utility ratings into a shared framework to communicate the fundamental credit analysis of a company furthers the goals of transparency and comparability in the ratings process. Table 1 shows the matrix.

Table 1

Business Risk/Financial Risk

	Financial Risk Profile				
Business Risk Profile	**Minimal**	**Modest**	**Intermediate**	**Aggressive**	**Highly leveraged**
Excellent	AAA	AA	A	BBB	BB
Strong	AA	A	A-	BBB-	BB-
Satisfactory	A	BBB+	BBB	BB+	B+
Weak	BBB	BBB-	BB+	BB-	B
Vulnerable	BB	B+	B+	B	B-

The utilities rating methodology remains unchanged, and the use of the corporate risk matrix has not resulted in any changes to ratings or outlooks. The same five factors that we analyzed to produce a business risk score in the familiar 10-point scale are used in determining whether a utility possesses an "Excellent," "Strong," "Satisfactory," "Weak," or "Vulnerable" business risk profile:

- Regulation,
- Markets,
- Operations,
- Competitiveness, and
- Management.

Regulated utilities and holding companies that are utility-focused virtually always fall in the upper range ("Excellent" or "Strong") of business risk profiles. The defining characteristics of most utilities--a legally defined service territory generally free of significant competition, the provision of an essential or near-essential service, and the presence of regulators that have an abiding interest in supporting a healthy utility financial profile--underpin the business risk profiles of the electric, gas, and water utilities.

As the matrix concisely illustrates, the business risk profile loosely determines the level of financial risk appropriate for any given rating. Financial risk is analyzed both qualitatively and quantitatively, mainly with financial ratios and other metrics that are calculated after various analytical adjustments are performed on financial statements prepared under GAAP. Financial risk is assessed for utilities using, in part, the indicative ratio ranges in table 2.

Table 2

Financial Risk Indicative Ratios - U.S. Utilities

(Fully adjusted, historically demonstrated, and expected to consistently continue)

	Cash flow		Debt leverage
	(FFO/debt) (%)	(FFO/interest) (x)	(Total debt/capital) (%)
Modest	40 - 60	4.0 - 6.0	25 - 40
Intermediate	25 - 45	3.0 - 4.5	35 - 50
Aggressive	10 - 30	2.0 - 3.5	45 - 60
Highly leveraged	Below 15	2.5 or less	Over 50

The indicative ranges for utilities differ somewhat from the guidelines used for their unregulated counterparts because of several factors that distinguish the financial policy and profile of regulated entities. Utilities tend to finance with long-maturity capital and fixed rates. Financial performance is typically more uniform over time, avoiding the volatility of unregulated industrial entities. Also, utilities fare comparatively well in many of the less-quantitative aspects of financial risk. Financial flexibility is generally quite robust, given good access to capital, ample short-term liquidity, and the like. Utilities that exhibit such favorable credit characteristics will often see ratings based on the more accommodative end of the indicative ratio ranges, especially when the company's business risk profile is solidly within its category. Conversely, a utility that follows an atypical financial policy or manages its balance sheet less conservatively, or falls along the lower end of its business risk designation, would have to demonstrate an ability to achieve financial metrics along the more stringent end of the ratio ranges to reach a given rating.

Note that even after we assign a company a business risk and financial risk, the committee does not arrive by rote at a rating based on the matrix. The matrix is a guide--it is not intended to convey precision in the ratings process or reduce the decision to plotting intersections on a graph. Many small positives and negatives that affect credit quality can lead a committee to a different conclusion than what is indicated in the matrix. Most outcomes will fall within one notch on either side of the indicated rating. Larger exceptions for utilities would typically involve the influence of related unregulated entities or extraordinary disruptions in the regulatory environment.

We will use the matrix, the ranking list, and individual company reports to communicate the relative position of a company within its business risk peer group and the other factors that produce the ratings.

Selected Pro Forma Financial Ratios
for Raytown Water Company

RATIO ANALYSIS	Ratios as of 12-31-07	Pro-Forma Ratios	S&P Benchmark Bounds for Investment Grade Credit Rating[1]
Funds From Operations Interest Coverage:	9.58 x	8.66 x	2.0 x
Funds from Operations to Total Debt:	68.71%	43.80%	10 %
Total Debt to Total Capital:	16.53%	23.65%	60 %

Source:

1. Standard & Poor's RatingsDirect, "U.S. Utilities Ratings Analysis Now Portrayed In The S&P Corporate Ratings Matrix", November 30, 2007.