

## AMENDED MEMORANDUM

**TO:** Missouri Public Service Commission Official Case File  
Case No. WF-2022-0066, Missouri-American Water Company

**FROM:** Peter Chari, Senior Utility Regulatory Auditor, Financial Analysis Department

/s/ Seoung Joun Won, PhD, 11/23/2021                      /s/ Kevin Thompson, 11/23/2021  
Financial Analysis Department / Date                      Staff Counsel's Office / Date

**SUBJECT:** Staff Recommendation Concerning the Application of Missouri-American Water Company ("MAWC," "Company," or "Applicant"), for Authority to Issue up to \$11,500,000 in long-term mortgage debt ("New Indebtedness") to the Missouri Department of Natural Resources ("DNR").

**DATE:** November 23, 2021

1. (a) **Type of Issue:** 20-year Long-term Mortgage Secured Debt from The DNR, in cooperation with the Safe Drinking Water Commission ("SDWC") of the State of Missouri.
- (b) **Amount:** Up to \$11,500,000.
- (c) **Rate:** The New Indebtedness will bear interest rate that is equal to 30% of the Revenue Bond Index as published in The Bond Buyer most recently prior to the date of closing of the loan, plus a 0.5% administration fee.
- (d) **Other Provisions:** In order to secure the loan from the DNR, Applicant will be required to place a mortgage, lien, or encumbrance on certain properties in the State of Missouri in accordance with a Master Trust Indenture, a copy of which in substantially final form is attached to MAWC's Application as Appendix 2.
2. **Proposed Date of Transaction:** The parties are prepared to execute the agreement immediately after the Commission issues an order authorizing MAWC to enter into an agreement with the DNR, as provided in Appendix 1 to MAWC's Application and Motion for Waiver ("Application"). The parties expect to close the transaction within 60 days.
3. (a) **Statement of Purpose of the Issue:** Applicant and the DNR are entering into this loan agreement for the purpose of financing improvements to certain drinking water treatment facilities. More specifically, the proceeds of the loan will be used to provide funds for the replacement and upgrade of a clear well and high service pump station and related improvements, as more specifically described in the definition of the "Project" in

Article 1 of the Loan Agreement. Thus, the net proceeds from the loan will be used to fund the acquisition of property; the construction, completion, extension or improvement of Applicant's plant or system; the improvement or maintenance of its service; or the reimbursement of moneys actually expended from income as permitted by Section 393.200, RSMo. 2016.

**(b) From a financial perspective, does Staff deem this Statement of Purpose of the Issue reasonable?**

Yes, with conditions imposed by the Commission as indicated below at page 5.

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

Such instruments have not been executed, but a statement of the general terms and conditions were included in the Application.

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

Yes.

**6. Pro-forma Balance Sheet and Income Statement reviewed:**

Yes.

**7. Capital expenditure schedule reviewed:**

Yes.

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

Yes, Applicant's report will include a statement identifying the portion of the issuance of long-term indebtedness that is subject to the fee schedule set forth in Section 386.300, RSMo., in accordance with 20 CSR 4240-10.125(1)(F).

**9. Recommendation of the Staff:**

Conditional Approval granted (see Comments and Recommended Conditions below).

**COMMENTS:**

MAWC is a public utility engaged in providing water and sewer utility services to approximately 470,000 and 15,000 customers, respectively, in portions of Missouri under the jurisdiction of this Commission.

On August 30, 2021, MAWC filed an Application with the Commission requesting approval for authority to issue up to \$11,500,000 aggregate principal amount of secured indebtedness to the DNR by placing a mortgage upon its property.

MAWC states in its Application at page 3, Paragraph 12:

The Missouri Department of Natural Resources, in cooperation with the Safe Drinking Water Commission of the State of Missouri, has developed and implemented the State of Missouri Direct Loan Program for the purpose of making loans and grants to political subdivisions and other eligible entities of the State of Missouri. In this case, the Safe Drinking Water Commission has approved a loan in the maximum principal amount of \$11,500,000 to Applicant to be made by the Missouri Department of Natural Resources pursuant to a Loan Agreement, a copy of which, in substantially final form is attached hereto as Appendix 1.

The Applicant further states in its Application at page 2, Paragraph 13. that:

In order to secure the loan from the Missouri Department of Natural Resources, Applicant will be required to place a mortgage, lien or encumbrance on certain properties in the State of Missouri in accordance with a Master Trust Indenture, a copy of which in substantially final form is attached hereto at Appendix 2.

According to the Company's Application, on pages 6 to 7, the proposed debt will bear interest at a rate that is equal to 30% of the Revenue Bond Index published in The Bond Buyer's most recent date prior to the date of closing of the loan, plus a 0.5% administration fee. As of September 2, 2021, the Revenue Bond Index indicates an annual cost of 1.3% for the proposed indebtedness.<sup>1</sup> The cost of the proposed debt is lower than 2.30% and 3.25% interest rates for debts issued by American Water Capital Corporation on May 14, 2021,<sup>2</sup> and is much lower than MAWC's embedded cost of debt of around 4.8% in 2020, as reported in MAWC's most recent rate cases.<sup>3</sup>

---

<sup>1</sup> MAWC Response to Staff Data Request No. 0016.

<sup>2</sup> S&P Capital IQ, American Water Capital Corp. Securities Summary.

<sup>3</sup> MAWC Response to Staff Data Request No. 0041 in Case No. WR-2020-0344.

Staff applies the “not detrimental to the public interest” standard to financing applications. In reviewing requests for long-term financing authority, Staff analyzes the requested amount as it relates to the stated uses to ensure that the amount requested is reasonable and generally supports long-term capital investment. Staff also analyzes the pro forma impact the requested financing may have on the company’s credit metrics, which may include the estimated impact on the parent company’s credit metrics if the subject company’s rating is influenced by the parent company’s financial risk.

MAWC states in its Application at page 4, Paragraph 15 that the proceeds will be used for:

[I]mprovements to certain drinking water treatment facilities. More specifically, the proceeds of the loan will be used to replace and upgrade a clear well and high service pump station and make related improvements, as more specifically described in the definition of the “Project” in Article 1 of the Loan Agreement. Thus, the net proceeds from the loan will be used for the acquisition of property; the construction, completion, extension or improvement of Applicant’s plant or system; the improvement or maintenance of its service; or the reimbursement of moneys actually expended from income as permitted by §393.200 RSMo. 2016.

Staff has verified that MAWC’s projected capital expenditure plan supports the need for the \$11.5 million long-term debt.<sup>4</sup> MAWC’s 2022 total projected capital expenditures totaled just over \*\* [REDACTED] \*\*, equating to roughly \*\* [REDACTED] \*\* of expenditures per month.<sup>5</sup> MAWC currently projects that it needs \*\* [REDACTED] \*\* of capital expenditures for the period 2021 to 2025.<sup>6</sup>

The pro forma impact of MAWC’s proposed debt financing on MAWC’s balance sheet as of June 30, 2021, is as follows:

<u>MAWC:</u>	<u>As of June 30, 2021</u>	<u>Pro Forma</u>
Common Equity	51.25%	50.93%
Long-Term Debt	48.75%	49.07%
Total	100.00%	100.00%

<sup>4</sup> MAWC Response to Staff Data Request No. 0015.1.

<sup>5</sup> See page 4 of the Capital Plan filed in Case WR-2017-0285 on January 27, 2021. The project is FP Number I17-120007 and is described as “JFC-WTP Clearwell & HSPS (A-4).”

<sup>6</sup> Ibid.

The above capital structure ratios imply a modest net increase (0.32%) in long-term debt for MAWC. Funds From Operations to Total Debt (“FFO/Debt”) for MAWC is projected to decrease slightly from 17.93% to 17.69%. Total Debt to Earnings Before Interest, Taxes, Depreciation, and Amortization (“Debt/EBITDA”) for MAWC is projected to increase modestly from 5.55x to 5.63x. To the extent that MAWC’s credit metrics do not change substantially, Staff finds that MAWC’s financial risk profile will not be significantly changed by the approval of this Application.<sup>7</sup> Because the size of the proposed debt (\$11,500,000) relative to the size of AWWC’s long-term debt (\$10,346,000,000) is very small (0.11%), Staff does not expect any significant change to AWWC’s financial risk profile as a result of approval of this Application.<sup>8</sup>

### **RECOMMENDED CONDITIONS:**

Staff recommends that the Commission approve the Application submitted by MAWC in this case as not detrimental to the public interest, subject to 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, and that the Commission reserve the right to consider the rate making treatment to be afforded the financing transaction and its impact on cost of capital, in any later rate proceeding;
2. That the Company shall file with the Commission within thirty (30) days of issuance of any financing authorized pursuant to a Commission order in this proceeding, a report including the amount of secured indebtedness issued, date of issuance, interest rate (initial rate if variable), maturity date, redemption schedules or special terms, if any, use of proceeds, estimated expenses, and loan or indenture agreement concerning each issuance. In addition, the Company shall also provide the analysis, to include but not be limited to, indicative pricing information provided by investment banks it performed to determine that the terms for the debt it decided to issue were the most reasonable at the time;
3. That the Company shall file with the Commission any information concerning communication with credit rating agencies concerning any such issuance;

---

<sup>7</sup> Summary, Staff’s Workpaper.

<sup>8</sup> 10-Q, August 2, 2021, Securities and Exchange Commission.

4. That the Company shall file with the Commission as a non-case related submission in EFIS under “Resources” - “Non-Case Related Query” - “Ordered Submission” any credit rating agency reports published on MAWC’s or AWWC’s corporate credit quality or the credit quality of its securities;
5. That MAWC be required to file a five-year capitalization expenditure schedule in future finance cases; and,
6. That the Commission’s grant of authority shall expire one year from the effective date of the order in this proceeding.