

## MEMORANDUM

**TO:** Missouri Public Service Commission Official Case File  
File No. WF-2022-0161, Missouri-American Water Company

**FROM:** Randall Jennings, Utility Regulatory Auditor, Financial Analysis Department

/s/ Seoung Joun Won, PhD, 02/15/2022  
Financial Analysis Department / Date

/s/ Karen Bretz, 02/15/2022  
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 \$650,000,000 in unsecured debt ("New Long-Term Debt") to American Water Capital Corp ("AWCC") to extend to December 31, 2024.

**DATE:** February 15, 2022

1. (a) **Type of Issue:** Long-term (not to exceed 50 years) Unsecured Debt from AWCC and/or financing through special low cost government programs.
  - (b) **Amount:** Up to \$650,000,000 (\$650 Million).
  - (c) **Rate:** The New Long-Term Debt, including any applicable discount, will bear an interest rate consistent with similar securities of comparable credit quality and maturities issued by other companies.<sup>1</sup>
  - (d) **Other Provisions:** The Applicant also requests authority to enter into agreements in order to use, at its discretion, derivative instruments such as interest rate swaps, treasury locks, forward-starting swaps, caps, collars or other derivatives, to manage the risk associated with interest rate fluctuations and other financial exposures that may occur before the issuance of the New Long-Term Debt.<sup>2</sup>
2. **Proposed Date of Transaction:** The Applicant is seeking approval to engage in a variety of unsecured debt financings during an approximately three (3) year period following the effective date of the order, The Applicant requests that Commission approval, if granted, extend to December 31, 2024.

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<sup>1</sup> MAWC Response to Staff Data Request No. 0013.

<sup>2</sup> Paragraph 19 in the Application.

**\*\* Denotes Confidential Information \*\***

**Appendix A**

3. (a) **Statement of Purpose of the Issue:** Applicant is seeking to borrow funds for the purpose of the acquisition of property; the construction, completion, extension or improvements or additions to its facilities; and other capital investments. Some of the proceeds from the debt issuances will be used to replace maturing or other long-term debt at market rates and replace short-term borrowings accrued during the period of time Applicant's financing plan is in effect.

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

Yes, with Staff's recommended conditions 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 for the AWCC loan agreement 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 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.

9. **Recommendation of the Staff:**

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

**COMMENTS:**

MAWC, a wholly-owned subsidiary of American Water Works Company (“AWW”), is a utility engaged in providing water and sewer utility services to approximately 471,000 and 15,000 customers, respectively, in portions of Missouri under the jurisdiction of this Commission. AWCC is also a subsidiary of AWW, and is an affiliate of MAWC. AWCC was established in June 2000 to provide financial services to AWW and its 25 utility subsidiaries, which includes MAWC.

On December 15, 2021, MAWC filed an Application with the Commission requesting approval for authority to issue up to \$650,000,000 of long-term indebtedness payable to AWCC. The notes evidencing the indebtedness will not be secured by a mortgage, lien, or encumbrance on Applicant's properties in the State of Missouri.

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

Pursuant to the terms of a Financial Services Agreement ("Agreement") with American Water Capital Corp. ("AWCC"), Applicant proposes to issue notes in one or more series evidencing up to \$650.0 million of long-term indebtedness payable to AWCC (the "New Long-Term Debt"). The notes evidencing the indebtedness will not be secured by a mortgage, lien, or encumbrance on Applicant's properties in the State of Missouri. A form of the note evidencing the New Long-Term Debt is attached here as Appendix 1.

The Applicant further states in its Application at page 4, Paragraph 13, that:

The purpose and general terms of the Agreement as between Applicant and AWCC, a wholly-owned subsidiary of AWW and an affiliate of Applicant, were more particularly set forth in Applicant's Application to the Commission filed on May 30, 2002 and docketed as Case No. WF-2002-1096. These general descriptions and parameters can be found in paragraphs 13-25 of that Application. In accordance with Commission Rule 20 CSR 4240-3.615(1)(C), Applicant incorporates by reference the copy of the Agreement filed with the Commission as Appendix 2 to Applicant's Application in Case No. WF-2002-1096.

According to the Company's Application, on page 4, the proposed New Long-Term Debt to be issued pursuant to the Agreement with AWCC will be issued as promissory notes whose terms will be determined based on market conditions applicable at the time of issuance. The maturities will not exceed fifty (50) years at market interest rates. The interest rate for notes evidencing

New Long Term Debt, including any applicable discounts, will bear interest at a rate consistent with similar securities of comparable credit quality and maturities issued by other companies. The Agreement with AWCC does not prohibit or restrict the Applicant from borrowing from other parties or obtaining financial services from other parties including special low cost government programs whenever and on whatever terms the Applicant deems appropriate.

In addition, MAWC is in the process of securing funding under the Water Infrastructure Finance and Innovation Act (“WIFIA”) program. Under this program, the debt is unsecured, but AWCC will be the borrower, not MAWC. MAWC will then borrow the funds from AWCC at the same WIFIA rate. That borrowing will appear as new long term debt from AWCC on MAWC’s books. MAWC is expecting to borrow approximately \$80,000,000.00 (\$80 Million), via AWCC, through the WIFIA program.<sup>3</sup> Another source of low cost financing through government programs is the State Resolving Fund (“Fund”). Any loans from the Fund would be secured debt and MAWC will file for specific authority to obtain future secured borrowing from this source. These two programs were discussed in the Application in case number WF-2019-0206, and were described in the Application in this case in the event MAWC can obtain unsecured borrowing directly from WIFIA or the Fund without assistance from AWCC.<sup>4</sup>

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 7, Paragraph 20 that the proceeds will be used for:

[T]he acquisition of property, the construction, completion, extension or improvements or additions to its facilities, other capital investments, all of which shall be necessary and proper for the rendition of public water supply and wastewater service, the improvement or maintenance of its service, the discharge or lawful refunding of indebtedness outstanding and to reimburse its treasury for any costs heretofore incurred. Some of the proceeds from the debt issuances will be used to replace maturing or other long-term debt at market rates and replace short-term borrowings accrued during the period of time Applicant’s financing plan is in effect.

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<sup>3</sup> MAWC’s Response to Staff Data Request No. 0020.

<sup>4</sup> Ibid.

Staff has verified that MAWC’s projected capital expenditure plan supports the need for the \$650 million long-term debt.<sup>5</sup> MAWC's 2022 total projected capital expenditures total just over \*\* [REDACTED] \*\*, equating to roughly \*\* [REDACTED] \*\* of expenditures per month.<sup>6</sup> MAWC currently projects that it needs \*\* [REDACTED] \*\* of capital expenditures for the period 2022 to 2026.<sup>7</sup>

The pro forma impact of MAWC’s proposed debt financing on MAWC’s and AWW’s balance sheet as of September 30, 2021, is as follows:<sup>8</sup>

<b><u>MAWC:</u></b>	<b><u>As September 30, 2021</u></b>	<b><u>Pro Forma</u></b>
Common Equity	49.58%	48.97%
Long-Term Debt	50.42%	51.03%
Total	100.00%	100.00%

<b><u>AWW:</u></b>	<b><u>As September 30, 2021</u></b>	<b><u>Pro Forma</u></b>
Common Equity	39.88%	40.40%
Proffered Stock	0.02%	0.02%
Long-Term Debt	60.11%	59.58%
Total	100.00%	100.00%

The above capital structure ratios imply a modest net increase (0.61%) and a net decrease (0.53%) in long-term debt for MAWC and AWW, respectively. Funds From Operations to Total Debt (“FFO/Debt”) for MAWC is projected to decrease slightly from 17.12% to 15.35%. Total Debt to Earnings Before Interest, Taxes, Depreciation, and Amortization (“Debt/EBITDA”) for MAWC is projected to increase modestly from 5.83x to 6.12x. Debt to Capital is projected to increase slightly from 50.42% to 51.03%. 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>9</sup> and for this reason, Staff finds that the Application is not detrimental to the public interest.

<sup>5</sup> MAWC Response to Staff Data Request No. 0015.

<sup>6</sup> Ibid.

<sup>7</sup> Ibid.

<sup>8</sup> Summary, Staff’s Workpaper.

<sup>9</sup> Ibid.

**RECOMMENDED CONDITIONS:**

Staff recommends that because MAWC's Application is not detrimental to the public interest, the Commission approve it, 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 reserves 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 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 be given authority to enter into agreements in order to use, at its discretion, derivative instruments, such as interest rate swaps, treasury locks, forward-starting swaps, caps, collars or other derivatives, to manage the risk associated with interest rate fluctuations and other financial exposures that may occur before the issuance of the New Long-Term Debt;
4. That the Company shall file with the Commission any information concerning communication with credit rating agencies concerning any such issuance;
5. 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 AWW's corporate credit quality or the credit quality of its securities;
6. That MAWC be required to file a five-year capitalization expenditure schedule in future finance cases;

7. That the Commission's grant of authority shall expire three years from the effective date of the order in this proceeding; and
8. That MAWC, independently or through AWCC, shall apply for and utilize special low cost government program funding for projects as applicable when the funding is available, and is less expensive than alternative sources including long-term debt with AWCC. If AWCC utilizes special low cost government program funding, MAWC shall borrow funds from AWCC at the same rate AWCC pays while utilizing the government programs.

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

In the Matter of Missouri-American Water            )  
Company for Authority to Issue up to                )  
\$650,000,000 of Long-Term, Unsecured Debt        )     File No. WF-2022-0161

**AFFIDAVIT OF RANDALL JENNINGS**

STATE OF MISSOURI        )  
  ) ss  
COUNTY OF COLE         )

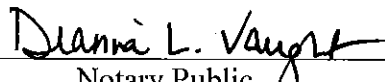
**COMES NOW** Randall Jennings and on his oath states that he is of sound mind and lawful age; that he contributed to the foregoing *Staff Recommendation in Memorandum form*; and that the same is true and correct according to his best knowledge and belief.

Further the Affiant sayeth not.

  
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RANDALL JENNINGS

**JURAT**

Subscribed and sworn before me, a duly constituted and authorized Notary Public, in and for the County of Cole, State of Missouri, at my office in Jefferson City, on this 15<sup>th</sup> day of February, 2022.

  
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Notary Public

DIANNA L. VAUGHT Notary Public - Notary Seal State of Missouri Commissioned for Cole County My Commission Expires: July 18, 2023 Commission Number: 15207377
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