

MEMORANDUM

TO: Missouri Public Service Commission Official Case File
File No. WF-2023-0023, Confluence Rivers Utility Operating Company, Inc.

FROM: Kelli McKinley, Financial Analyst, Financial Analysis Department

/s/ Seoung Joun Won, PhD, 10/07/2022 /s/ Ron Irving, 10/07/2022
Financial Analysis Department / Date Staff Counsel's Office / Date

SUBJECT: Staff Recommendation Concerning the Application of Confluence Rivers Utility Operating Company, Inc. ("Confluence Rivers," "Company," or "Applicant"), for authority to issue up to \$7,200,000 in senior secured, amortizing term loan ("New Long-Term Debt" or the "Loan") to CoBank, ACB ("CoBank").

DATE: October 7, 2022

1. (a) **Type of Issue:** Long-term (not to exceed 20 years) Secured Debt from CoBank by a statutory lien on all equity Confluence Rivers may own now or hereafter acquire, and a perfected priority lien on and security interest in all real and personal, tangible and intangible, present and future assets of Confluence Rivers.
- (b) **Amount:** Up to \$7,200,000 (\$7.2 Million).
- (c) **Rate:** The New Long-Term Debt, including any applicable discount, is anticipated to bear an interest rate fixed per annum estimated to range between 4.5% and 7% per annum with final rate determined by CoBank.¹
- (d) **Other Provisions:** No special provisions were indicated for the New Long-Term Debt.²
2. **Proposed Date of Transaction:** The anticipated closing date of the proposed New Long-Term Debt is 11/30/22.³

¹ Confluence Rivers' Response to Staff Data Request Nos. 0010 and 0010.1.

² Confluence Rivers' Response to Staff Data Request No. 0012.

³ Confluence Rivers' Response to Staff Data Request No. 0009.

3. (a) **Statement of Purpose of the Issue:** Applicant is seeking to borrow funds for the purpose of refinancing existing debt.⁴

(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 on pages 6-7.

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 a draft of the CoBank 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 Confluence Rivers to allow for the Fee Schedule to be applied:**

None, because this financing is for the purpose of refinancing existing debt, Confluence Rivers believes that this issuance of long-term indebtedness is not subject to the fee schedule set forth in Section 386.300, RSMo.⁵

9. **Recommendation of the Staff:**

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

⁴ Page 3, Paragraph 9 of the application.

⁵ Page 4, Paragraph 16 of the application.

COMMENTS:

Confluence Rivers, a wholly-owned subsidiary of Central States Water Resources, Inc. (“CSWR”), is a utility company engaged in providing water and sewer utility services to approximately 4,400 customers and sewer only service to approximately 4,600 additional customers in the State of Missouri under the jurisdiction of this Commission.

As outlined below, within the past four years, Confluence Rivers has expanded its water and sewer services in Missouri through a series of mergers and acquisitions.

- On February 14, 2019 the Commission approved Confluence Rivers’ acquisition of the water and sewer systems of Roy-L Utilities, Inc., Gladlo Water & Sewer Co, Inc., The Willows Utility Company, and Majestic Lakes Homeowners Association, Inc.; the water systems of Smithview H2O and Evergreen Lake Water Company; and the sewer systems of M.P.B., Inc. and Mill Creek Sewers, Inc.⁶
- On August 26, 2020, the Commission approved Confluence Rivers’ application to acquire the Port Perry Service Company water and sewer systems.⁷
- On December 9, 2020, the Commission approved Confluence Rivers’ application to acquire the water and sewer systems of Branson Cedars Resort Utility Company, LLC; the water systems of Fawn Lake Water Corp. and Prairie Heights Water Company; the sewer systems of Freeman Hills Subdivision Assoc. and DeGuire Subdivision; and expand its existing service territory for sewer service in the Villa Ridge Subdivision.⁸
- On January 13, 2021, the Commission granted authority to Confluence Rivers to acquire the water and sewer systems of Terre Du Lac Utilities Corporation.⁹
- On October 14, 2021, the Commission approved the merger of six CSWR subsidiaries, with Confluence Rivers being the surviving corporation. These subsidiaries are Confluence Rivers, Hillcrest Utility Operating Company, Inc., Elm Hills Utility Operating Company, Inc., Osage Utility Operating Company, Inc., Raccoon Creek Utility Operating Company, Inc., and Indian Hills Utility Operating Company, Inc.¹⁰

⁶ Order Approving Stipulation and Agreement and Granting Certificates of Convenience and Necessity, February 14, 2019, WM-2018-0116 and SM-2018-0117.

⁷ Report and Order, August 26, 2020, WA-2019-0299 and SA-2019-0300.

⁸ Order Approving Acquisition of Water and Sewer Assets and Granting Certificates of Convenience and Necessity, January 13, 2021, WM-2020-0282 and SM-2020-0283.

⁹ Order Approving Stipulation and Agreement and Granting Certificates of Convenience and Necessity, January 13, 2021, WM-2020-0403 and SM-2020-0404.

¹⁰ Order Approving Merger, October 14, 2021, WM-2021-0412 and SM-2021-0413.

- On December 15, 2021, the Commission approved Confluence Rivers' application to acquire the water and sewer systems of Cedar Green Land Acquisition, LLC and The Missing Well Homeowners Association; the water system of Ozark Clean Water Company's Spring Branch Subdivision; and the sewer systems of Shelton Estates Sewer Company, Clemstone Sewer District of Platte County, and Prairie Heights Subdivision.¹¹
- On September 14, 2022, the Commission approved Confluence Rivers' application to acquire the unregulated sewer system of Deer Run Estates Property Owners' Association.¹²

As of today's date, Confluence Rivers has five applications before the Commission requesting permission to acquire water and sewer assets.¹³

On August 1, 2022, Confluence Rivers filed an Application with the Commission requesting approval for authority to issue up to \$7,200,000 of long-term indebtedness payable to CoBank. The notes evidencing the indebtedness will be secured by a statutory lien on all equity Confluence Rivers may own now or hereafter acquire as well as a perfected priority lien on and security interest in all real and personal, tangible and intangible, present and future assets of Confluence Rivers.

According to the Company's Application, on page 3, the proposed New Long-Term Debt to be issued pursuant to the Agreement with CoBank will require a mortgage, lien, or encumbrance to be placed on its equity and certain properties in accordance with the Credit Agreement, and related documents.¹⁴ Loan maturity is not to extend beyond twenty (20) years at a per annum fixed interest rate to be set at a future date.¹⁵

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.

Confluence Rivers states in its Application that the proceeds will be used for refinancing existing debt.¹⁶ By refinancing the existing high interest debt, Confluence Rivers seeks to obtain a lower

¹¹ Order Granting Certificates of Convenience and Necessity, December 15, 2021, WA-2021-0425 and SA-2021-0426.

¹² Order Granting Certificate of Convenience and Necessity, September 14, 2022, SA-2022-0299.

¹³ These cases are WA-2023-0003, WA-2023-0026, SA-2023-0027, WA-2023-0092, and SA-2023-0093.

¹⁴ Paragraph 8, the Application.

¹⁵ Page 2 of Appendix A-C in the Application.

¹⁶ Page 5, Part D, the Application.

interest rate.¹⁷ Confluence Rivers estimates the loan interest rate will decrease from its current 14% per annum to a range of 4.5% to 7% per annum.¹⁸ An interest rate decrease in this range will allow Confluence Rivers to pay roughly 50% to 68% less on payments, which equates to roughly ** [REDACTED] ** less in interest expenses annually.¹⁹

Staff has verified that Confluence Rivers' projected capital expenditure plan supports the need for refinancing the \$7.2 million long-term debt at a lower interest rate.²⁰ Confluence Rivers' 2023 total projected capital expenditures total just over ** [REDACTED] **, equating to roughly ** [REDACTED] ** of expenditures per month.²¹ Confluence Rivers currently projects that it needs an additional ** [REDACTED] ** of capital expenditures for the period 2024 to 2027.²²

The pro forma impact of Confluence Rivers' proposed debt financing on Confluence Rivers' and CSWR's balance sheet as of June 30, 2022, is as follows:²³

Confluence Rivers:

	<u>As June 30, 2022</u>			<u>Pro Forma</u>		
Common Equity	**	[REDACTED]	**	**	[REDACTED]	**
Long-Term Debt	**	[REDACTED]	**	**	[REDACTED]	**
Total	**	[REDACTED]	**	**	[REDACTED]	**

CSWR:

	<u>As June 30, 2022</u>			<u>Pro Forma</u>		
Common Equity	**	[REDACTED]	**	**	[REDACTED]	**
Long-Term Debt	**	[REDACTED]	**	**	[REDACTED]	**
Total	**	[REDACTED]	**	**	[REDACTED]	**

The above capital structure ratios imply minor changes in capital structure wherein the Common Equity for Confluence Rivers and CSWR increase by ** [REDACTED] ** respectively as a result of this transaction. Funds from Operations to Total Debt ("FFO/Debt") for Confluence Rivers is projected to also have no change and remain at ** [REDACTED] **. Debt to Capital is

¹⁷ Confluence Rivers' Response to Staff Data Request No. 0014.

¹⁸ Confluence Rivers' Response to Staff Data Request Nos. 0010.1 and No. 0014.

¹⁹ Rate Change, Staff's Workpaper.

²⁰ Confluence Rivers' Response to Staff Data Request Nos. 0021 and No. 0021.1.

²¹ Ibid.

²² Ibid.

²³ Summary, Staff's Workpaper.

projected to have a significant decrease from ** [REDACTED] **. Total Debt to Earnings Before Interest, Taxes, Depreciation, and Amortization (“Debt/EBITDA”) for Confluence Rivers is additionally projected to decrease from ** [REDACTED] **. Despite the fact that Confluence Rivers’ ratios do not appear favorable at first glance, further review of the factors that make up the ratios reveals that the apparent decrease in ratios is due to the Total Debt improving from ** [REDACTED] ** and the Retained Earnings improving from ** [REDACTED] **. To the extent that Confluence Rivers’ credit metrics do not change substantially, Staff finds that Confluence Rivers’ financial risk profile will not be significantly changed by the approval of this Application.²⁴ For this reason, Staff finds that the Application is not detrimental to the public interest.

RECOMMENDED CONDITIONS:

Staff recommends that, the Commission approve Confluence Rivers’ Application in this case as the transaction is not detrimental to the public interest. Staff recommends that Commission approval be subject to the following conditions:

1. That the interest rate on the final financing from CoBank not exceed a rate of 7% fixed per annum;
2. 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;
3. 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;

²⁴ Ibid.

4. 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;
5. That the Company shall file with the Commission any information concerning communication with credit rating agencies concerning any such issuance if there is any;
6. That Confluence Rivers 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 Confluence Rivers 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 CoBank.

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

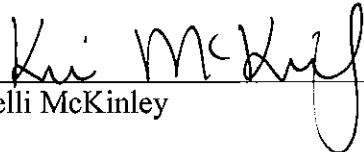
In the Matter of Application of Confluence)	
Rivers Utility Operating Company, Inc., for)	<u>File No. WF-2023-0023</u>
Authority to Issue Long-Term Debt and to)	
Secure Same with a Lien on its Property)	

AFFIDAVIT OF KELLI MCKINLEY

STATE OF MISSOURI)
) ss
COUNTY OF COLE)

COMES NOW Kelli McKinley, and on her oath states that she is of sound mind and lawful age; that she contributed to the foregoing *Staff Recommendation in Memorandum form*; and that the same is true and correct according to her best knowledge and belief.


Further the Affiant sayeth not.



Kelli McKinley

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 7th day of October, 2022.



Notary Public

