

MEMORANDUM

TO: Missouri Public Service Commission Official Case File
Case No. EF-2017-0242, Kansas City Power and Light Company

FROM: Jeffrey Smith, Utility Regulatory Auditor I

/s/ David Murray 4/28/2017
Financial Analysis Unit / Date

/s/ Steven Dottheim 4/28/2017
Staff Counsel Department / Date

SUBJECT: Staff's Recommendation Regarding Kansas City Power & Light's (Company, Applicant, or KCPL), Application for Authority to issue up to \$1,100,000,000 (\$1.1 billion) principal amount of debt securities through June 30, 2019. Applicant also requests Authority to enter into interest rate hedging instruments in conjunction with the debt securities to be issued under the requested authorization.

DATE: April, 28 2017

1. (a) **Type of Issue:** Senior or subordinated debt and either unsecured or secured debt. If secured debt, this debt will be issued under the Applicant's existing general mortgage indentures. The debt may also take the form of "fall-away" mortgage debt in which it is initially secured, but then converts to unsecured.
- (b) **Amount:** Up to \$1,100,000,000 (\$1.1 billion).
- (c) **Rate:** Interest rates on the debt securities, represented by either (i) the coupon on fixed rate debt securities or (ii) the initial rate on any variable debt securities, will not exceed nine percent (9%).
- (d) **Other Provisions:** The terms of maturity for the various series of indebtedness will range from one (1) year to forty (40) years.
2. **Proposed Date(s) of Transaction(s):** Any time from the effective date of the Commission's authorization Order until June 30, 2019 for the total \$1,100,000,000 (\$1.1 billion). The Company is hoping that the Commission will issue an Order granting approval at its May 3, 2017, Agenda Session because of the impending need to refinance.

3. (a) **Statement of Purpose of the Issue:** The Applicant states the funds will be used to refinance outstanding long-term and short-term debt used for capital expenditures outlined in Exhibit 6 to the Application. The Anticipated 2017-2019 Financing Plan Summary illustrates that of the \$1,100,000,000 (\$1.1 billion) proposed debt financing, ** _____ ** will be used for refinancing ** _____ ** of senior note due June 15, 2017, ** _____ ** of tax-exempt bonds due July 1, 2017, and ** _____ ** of short-term debt, ** _____ ** will be used to refinance senior notes due March 1, 2018, ** _____ ** will be used to refinance mortgage bonds due April 1, 2019, and ** _____ ** will be used for issuance expense. The Applicant states it will issue such debt, up to the authorized amount, through one of a number of offerings to be determined from time to time by the Applicant.

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

Yes, but because of the financing decisions that Great Plains Energy (“GPE”) may need to make, due to the April 19, 2017 Order of the Kansas Corporation Commission (“KCC”), which may impact KCPL’s financing considerations, the Commission’s grant of Authority should be limited to the \$350.0 million, which KCPL requires to meet its impending financing needs for 2017. Staff has advised KCPL of its proposed recommendation to the Commission. Based on KCPL’s Application and what KCPL has recently related to Staff about its plans and financing needs, KCPL will likely file another Application in the latter half of 2017 for ** _____ ** for financing needs for 2018 and an Application for ** _____ ** in 2018 for financing needs for 2019, or one Application in the latter half of 2017 for ** _____ ** to cover its financing needs for 2018 and 2019. The KCC’s April 19, 2017 Order in KCC Docket No. 16-KCPE-593-ACQ stated that the parties had 15 days from the date of electronic service (April 19, 2017) to petition for reconsideration. Since the 15 days have not run (May 4, 2017), it is Staff’s opinion that it would be most prudent for the Commission to limit the Authority it grants to KCPL to \$350.0 million for its identified financing needs for 2017, until (1) the question of whether any petitions for reconsideration are filed in KCC Docket No. 16-KCPE-593-ACQ, (2) the KCC addresses any such petitions for reconsideration, and (3) GPE-KCPL have an opportunity to otherwise act respecting the April 19, 2017 Order of the KCC.

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 the 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 the Company to allow for the Fee Schedule to be applied:**

Yes

9. **Recommendation of Staff:**

Conditional Approval granted pending receipt of definite terms of issuance
(see Comments and Recommended Conditions below)

COMMENTS:

KCPL is a wholly owned subsidiary of GPE, and is headquartered in Kansas City, Missouri. KCPL is an integrated, regulated electric utility that engages in the generation, transmission, distribution and sale of electricity at retail and wholesale in Missouri and Kansas. On March 22, 2017, KCPL filed an Application requesting that the Commission authorize KCPL to issue debt securities in an aggregate principal amount of \$1,100,000,000 (\$1.1 billion) as either unsecured or secured indebtedness under indentures previously filed with the Commission. KCPL states in Paragraph 13 of its Application:

The debt securities will have maturities of one year to 40 years and will be issued by the Applicant or through agents or underwriters for the Applicant in multiple offerings of differing amounts with different interest rates (including

variable interest rates) and other negotiated terms and conditions. Interest rates on the debt securities, represented by either (i) the coupon on fixed rate debt securities or (ii) the initial rate on any variable debt securities, will not exceed nine percent (9%).

Regarding the use of requested funds raised through the requested debt authority, KCPL further states the following in Paragraph 15 of its Application:

Applicant also requests authority to enter into interest rate hedging instruments in conjunction with debt securities to be issued under this authorization. Applicant anticipates potentially using such hedging instruments for two purposes: (1) to “lock in” the key underlying rate of all or a portion of an upcoming debt issuance in advance of the issuance itself; and/or (2) at the time of debt issuance, to change the interest rate mode on the issued security from floating to fixed or vice versa, depending on Applicant’s desired mix of fixed and floating rate debt.

Recommendation:

At the time KCPL met with Staff to discuss its proposal to request Commission Authority to issue up to \$1.1 billion of debt through 2019, GPE had executed significant financings in anticipation of acquiring Westar Energy Inc. (“Westar”). As the Commission is aware, on April 19, 2017, the KCC rejected GPE’s proposed acquisition of Westar. The KCC’s April 19, 2017 Order in KCC Docket No. 16-KCPE-593-ACQ stated that the parties had 15 days from the date of electronic service (April 19, 2017) to petition for reconsideration. Since the 15 days from the date of electronic service (April 19, 2017) of the KCC’s April 19, 2017 Order in KCC Docket No. 16-KCPE-593-ACQ have not run, it is Staff’s opinion that it would be most prudent for the Commission to limit the Authority it grants to KCPL to \$350.0 million for its identified financing needs for 2017, until (1) the question of whether any petitions for reconsideration are filed in KCC Docket No. 16-KCPE-593-ACQ, (2) the KCC addresses any such petitions for reconsideration, and (3) GPE-KCPL have an opportunity to otherwise act respecting the April 19, 2017 Order of the KCC. Considering Staff’s recommendation is to limit KCPL’s financing Authority to \$350.0 million, Staff’s financial analysis of the proposed financing is limited to this amount

Use of Funds:

According to Exhibit 6 attached to the Application, ** _____ ** of the proposed debt securities will be used to refinance 5.85% Senior Notes due to mature on June 15, 2017, ** _____ ** will be used to refinance 1.25% State EIARA of the State of Missouri tax-exempt bonds due to mature on July 1, 2017, ** _____ ** will be used to refinance and convert 0.98% short-term debt, used to fund capital expenditures, to long term-debt. This amounts to approximately \$340 million. Consequently, if the Commission authorizes KCPL \$350.0 million of debt Authority, this will be sufficient for refinancing debt in 2017.

Although Staff is recommending the Commission not approve the remaining amounts, at this time, the Application states that the additional Authority would be used as follows: (1) ** _____ ** will be used to refinance 6.375% Senior Notes due to mature on March 1, 2018, (2) ** _____ ** will be used to refinance 7.15% Mortgage Bonds due to mature on April 1, 2019, and (3) the remaining ** _____ ** will be used for Debt Issuance Expenses.

Terms of Debt:

Paragraphs 13 and 14 of KCPL's Application indicate the range of terms and conditions that KCPL plans to consider when issuing debt under the requested Authority. Specifically, Paragraph 14 indicates the debt may be "either unsecured or secured under the Applicant's existing general mortgage debt indentures, depending on cost differentials and market conditions at the time of issuance." Staff issued Data Request Nos. 5, 6 and 7 to inquire as to the type of information and analysis KCPL and/or its investment bankers would consider when determining whether to issue secured or unsecured debt and the proper maturity. KCPL indicated that it would work with its investment bankers in evaluating indicative pricing when deciding on the most advantageous terms. Specifically, Staff is interested in cost differentials for secured as compared to unsecured debt. Staff proposes the Commission condition its approval of the requested financing Authority on KCPL filing information with the Commission upon the closing of the financing that includes not only the final terms of the indebtedness, but also the information KCPL and its investment bankers evaluated before deciding on the most reasonable terms for the debt issuance.

The debt securities may be senior or subordinated and may be either unsecured or secured under the Applicant's existing general mortgage debt indentures, depending on cost differentials and market conditions at the time of issuance. The debt may also take the form of "fall-away" mortgage debt in which it is initially secured, but then converts to unsecured based on certain conditions.

Financial Ratio Analysis

Staff's assessment of financing Applications typically involves evaluating the anticipated impact of the proposed financing on the subject company's credit quality. Staff does so by analyzing the relative impact the proposed financing may have on the company's financial risk. A basic definition of financial risk is the amount of leverage a company has in its capital structure. However, because the amount and consistency of cash flows generated by a company ultimately determine the ability of a company to service its debt, rating agencies' assessment of financial risk is measured primarily by comparing a company's cash flow as it relates to the amount of debt and the coverage of the fixed obligations arising from that debt.

Staff's assessment of the impact of the proposed financing on KCPL's financial risk is based on Staff's analysis of the pro forma impact of the proposed financing on KCPL's financial statements for the twelve months ended December 31, 2016. Because these pro forma financial statements do not reflect the additional cash flow the company may receive during the period of

the financing authority, to the extent this analysis shows a dramatic increase in financial risk, it may be necessary to also analyze projected financial statements as well as the pro forma impact on actual financial statements.

For purposes of assessing the relative impact of the proposed issuance of \$350.0 million of debt on KCPL's financial risk, Staff relied on the Company's representations made in the financial statements it provided to Staff. The pro forma financial statements anticipate the issuance of a maximum of \$1.1 billion in debt, whether secured or unsecured, through 2019. Again, because Staff is just recommending the Commission grant Authority for the issuance of \$350.0 million of debt, Staff evaluated the impact of this amount on the primary financial ratios Standard and Poor's ("S&P") considers when evaluating an entity's credit profile. S&P's assessment of a company's financial risk profile centers on two primary ratios: funds from operations to total debt ("FFO/total debt"); and total debt to earnings before interest, taxes, depreciation and amortization ("total debt/EBITDA"). The Company's pro forma figures relied on conservatism and assumed a 9% interest rate on newly issued debt. Typically the information companies provide to rating agencies use a rate near the market rate. These differences may lead to some discrepancies in the absolute figures, but because Staff is just evaluating the relative change in the ratios, Staff is not overly concerned with these differences. Additionally, because KCPL's proposed use of the proceeds is to refinance existing debt, other than differences in the interest expense, there are no other material differences.

Schedule 1 attached to this recommendation shows the pro forma impact on KCPL's key credit metrics assessed by S&P. Because of the significant uncertainty related to GPE's financial risk profile going forward, Staff does not believe it is useful to analyze GPE's pro forma credit metrics. Because KCPL is planning to refinance existing debt with new debt, both the FFO/total debt and total debt/EBITDA ratios don't change significantly because the total amount of debt is consistent. However, there is a slight increase in interest expense due to KCPL's assumed 9% interest rate so the FFO is slightly less in the pro forma estimates. The primary risk to KCPL's S&P credit rating is the uncertainty related to GPE's future strategy and financing activities.

RECOMMENDED CONDITIONS:

Staff recommends that, at this time, the Commission approve KCPL's Application, but limit the authority to \$350.0 million, subject to the conditions set forth below.

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 future proceeding;
2. That the Company shall file with the Commission within ten (10) days of the 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 the lead 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 interest rate for any debt issuance covered by the Application is not to exceed the greater of (i) nine percent (9%) or (ii) a rate that is consistent with similar securities of comparable credit quality and maturities issued by other issuers;
4. That the Company shall file with the Commission in EFIS in this case any information concerning communication with credit rating agencies concerning this 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 KCPL’s or GPE’s corporate credit quality or the credit quality of its securities;
6. That the amount of secured debt KCPL can issue be limited to an amount not to exceed net additions to plant in service; construction work in progress to the extent this is intended to be added to plant in service; and refinancing of existing long-term debt.
7. That to the extent that any non-regulated investments made by KCPL or GPE and affiliated companies may potentially impact KCPL’s credit quality and resulting credit ratings, KCPL shall notify Staff of such possibility and provide a status report to the Commission regarding the amount of financing used under this authority and the intended use of any remaining authorized but unissued funds;
8. That for the Authority to issue up to the remaining \$750.0 million in principal amount of debt securities and Authority to enter into interest rate hedging instruments in conjunction with the debt securities to be issued under the authorization originally requested by KCPL in this proceeding, KCPL will need to file one or more additional financing applications after (1) the question of whether any petitions for reconsideration are filed in KCC Docket No. 16-KCPE-593-ACQ, (2) the KCC addresses any such petitions for reconsideration, and (3) GPE-KCPL have had an opportunity to otherwise act respecting the April 19, 2017 Order of the KCC.

BEFORE THE PUBLIC SERVICE COMMISSION

OF THE STATE OF MISSOURI

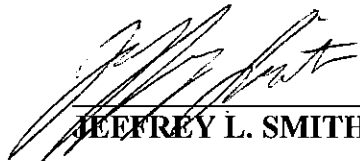
In the Matter of the Application of Kansas City)
Power & Light Company For Authority to)
Issue Debt Securities) File No. EF-2017-0242

AFFIDAVIT OF JEFFREY L. SMITH

STATE OF MISSOURI)
)
COUNTY OF COLE) ss.

COMES NOW JEFFREY L. SMITH and on his oath declares 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.

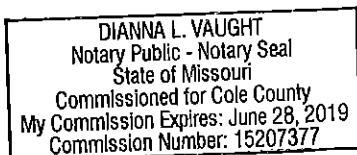
Further the Affiant sayeth not.

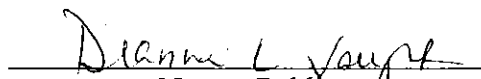


JEFFREY L. SMITH

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 28th day of April, 2017.





Notary Public

This Schedule has been deemed
Highly Confidential.