MEMORANDUM

To: Missouri Public Service Commission Official Case File
Case No. EF-2018-0114, Kansas City Power & Light Company

From: Jeffrey Smith, Financial Analysis

/s/ David Murray 01/03/2018	/s/ Steve Dottheim 01/03/2018
Financial Analysis Dept. / Date	Staff Counsel's Office / Date

SUBJECT: Staff's Recommendation regarding Kansas City Power & Light Company's (Company, Applicant, or KCPL), *Application And Request For Waiver* ("*Application*")for authority to issue up to $750,000,000 ("$750 million") principal amount of debt securities through September 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: January 3, 2018

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 $750 million.

   (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 September 30, 2019 for the total $750 million.

3. (a) **Statement of Purpose of the Issue:** The Applicant states the funds will be used to refinance outstanding long-term debt used for capital expenditures outlined in Exhibit 6 to the Application. The Applicant's anticipated 2018-2019 Financing Plan Summary illustrates that of the $750 million proposed debt financing, ** __________ ** will be used to refinance Senior Notes due March 1, 2018,

and ** __________ ** will be used to refinance Mortgage Bonds due April 1, 2019. 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

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)

<u>COMMENTS:</u>

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 December 1, 2017, KCPL filed an Application requesting that the Commission authorize KCPL to issue debt securities in an aggregate principal amount of $750 million 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.

<u>Use of Funds</u>:

According to Exhibit 6 attached to the Application, ** __________ ** of the proposed debt securities will be used to refinance 6.375% Senior Notes due to mature on March 1, 2018, and ** __________ ** of the proposed debt securities will be used to refinance 7.15% Mortgage Bonds due to mature on April 1, 2019. This amounts to $750 million, the amount sought by the Company to be authorized by the Commission. If the Commission authorizes KCPL $750 million of debt authority, this will be sufficient for refinancing Company debt through September 30, 2019.

<u>Terms of Debt:</u>

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. 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."

Staff issued Data Request Nos. 5, 6 and 7 to inquire about the cost and benefit analysis KCPL performs to determine whether to issue secured or unsecured debt. Staff's interest in this matter was prompted by reports KCPL filed with the Commission subsequent to issuing $350 million of debt the Commission authorized in KCPL's last financing application, EF-2017-0242. The information KCPL provided indicated an estimated cost saving of 15 - 20 basis points[1] if KCPL had issued secured debt rather than unsecured debt. Because Staff is unaware of any benefit to KCPL's regulated utility operations to not pledging its assets as collateral to obtain lower cost debt, Staff was interested in KCPL's reluctance to issue secured debt to reduce capital costs it requests be charged to its ratepayers. In response to the Staff Data Requests, KCPL acknowledges that benefits of lower interest rates could be realized on newly issued securitized bonds, while noting that no savings would be realized on current outstanding bonds. However, KCPL did not provide specific figures for cost analysis, reiterating that "all existing unsecured bonds issued by KCPL would need to be collateralized in conjunction with the issuance of a new secured bond in order to prevent subordination of all outstanding debt."[2] KCPL states that to perform the analysis required to assess the costs of collateralizing all current outstanding bonds would likely take several months due to significant legal assistance required to review all existing debt agreements, insurance policies, and an itemization of properties to be mortgaged. Although Staff does not recommend the Commission withhold its approval of KCPL's requested financing authority due to this issue, Staff emphasizes that the Commission should continue to condition KCPL's financing authority on not being binding for ratemaking purposes particularly if there is question regarding KCPL not seeking least cost debt financing. This is covered in Staff's first recommended condition and is a standard recommendation of the Staff. Staff intends to review this KCPL matter in future KCPL rate cases.

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.

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[1] Estimated savings derived from indicative pricing presentations made to KCPL by BNP Paribas in assessment of anticipated debt issuance pursued pursuant to financing authority of $350 million granted to KCPL in File No. EF-2017-0242.

[2] Company response to Staff Data Request No. 0007.

For purposes of assessing the relative impact of the proposed issuance of $750 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 $750 million in debt, whether secured or unsecured, through 2019. Standard & Poor's ("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 KCPL is planning to refinance existing debt with new debt both the FFO/total debt and total debt/EBITDA ratios do not change significantly. However, there is a slight improvement in projected debt/EBITDA ratios. As such, the proposed finance authority is not detrimental to the public interest.

Recommendation Regarding Conditions:

It is Staff's opinion that it would be prudent for the Commission to grant authority to KCPL to issue $750 million of debt for identified refinancing needs through September 30, 2019, contingent on Staff's recommended conditions below. The Company presumptively acquiesced to these recommended conditions in its own *Application* in paragraph 11 on pages 3 and 4. The conditions proposed below by the Staff are the same as those agreed to by KCPL in its *Application* except for the second sentence in condition 2 below which does not appear in condition 11.b. in KCPL's *Application*.[3]

RECOMMENDED CONDITIONS:

Staff recommends that the Commission approve KCPL's Application, granting authority to issue $750 million of debt, 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;

[3] The conditions that KCPL shows in paragraph 11 on pages 3 and 4 of its *Application* are seven (7) of the eight (8) conditions that it agreed to in File No. EF-2017-0242 (In the Matter of the Application of Kansas City Power & Light Company For Authority to Issue Debt Securities). Condition 2 in File No. EF-2017-0242 contains the second sentence shown in condition 2 in this Staff Recommendation.

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, EO-2018-0114, 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.

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-2018-0114**

AFFIDAVIT OF JEFFREY SMITH

STATE OF MISSOURI)
) ss
COUNTY OF COLE)

COMES NOW Jeffrey Smith 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.

Jeffrey 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 24 day of January, 2018.

Dianna L. Vaught
Notary Public

DIANNA L. VAUGHT
Notary Public - Notary Seal
State of Missouri
Commissioned for Cole County
My Commission Expires: June 28, 2019
Commission Number: 15207377