

MEMORANDUM

TO: Missouri Public Service Commission Official Case File
Case No. WF-2024-0353, Missouri-American Water Company

FROM: Randall Jennings, Financial Analysis Department

/s/ Seoung Joun Won, PhD July 22, 2024
Financial Analysis Department / Date

SUBJECT: Staff Recommendation concerning the Application of Missouri-American Water Company (“MAWC,” “Company,” or “Applicant”), for Authority to engage in a variety of secured debt financings with the Missouri Department of Natural Resources (“MO DNR”), not to exceed an aggregate principal amount of Four Hundred Five Million Dollars (\$405,000,000), by placing a mortgage upon its property.

DATE: July 22, 2024

FINDING OF FACTS:

1. (a) **Type of Issue:** Variety of secured debt financings with the MO DNR, not to exceed an aggregate principal amount of Four Hundred Five Million Dollars (\$405,000,000), by placing a mortgage upon its property with a 20-year term.¹
- (b) **Amount:** Up to \$405,000,000.
- (c) **Rate:** annual 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.²
- (d) **Other Provision:** In order to secure the loans from the MO 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.³

¹ Paragraph 14, the Application.

² Ibid.

³ Paragraph 13, the Application.

2. **Proposed Date(s) of Transaction:** During an approximate three (3) year period following the effective date of an order approving the Applicant's proposed financing in this case extended to December 31, 2027.⁴

3. (a) **Statement of Purpose of the Issue:** Applicant proposes to use the net proceeds from the loans 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.⁵

(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 page 7.

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

No, MAWC and the MO DNR have not yet entered into any agreements for the proposed financing contained within this Application.⁶ Copies of MAWC's applications for funds from the Lead Service Line Funding and funds from the Drinking Water State Revolving Fund have been supplied.⁷

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.

⁴ Paragraph 11, the Application.

⁵ Paragraph 15, the Application.

⁶ Staff Data Request No. 0012.

⁷ Staff Data Request No. 0016.

7. **Capital expenditure schedule reviewed:**

Yes.

8. **Journal entries required to be filed by Missouri-American Water to allow for the Fee Schedule to be applied:**

Yes, the Applicant states its Supplemental Report of Financing Activity will include a statement identifying the portion of the issuances of long-term indebtedness that are subject to the fee schedule set forth in § 386.300 RSMo., in accordance with 20 CSR 4240-10.125(1)(F).⁸ The Company stated the following:

The issuances contemplated in this application are for new debt, and not refinancing of existing debt, and could be subject to the fee schedule. The entry to record any fees would be to increase the Unamortized Debt Expense regulatory asset on the balance sheet. The fees could be amortized over the life of the debt issuance.⁹

As the Company states the issuances are for new debt, the proposed new issuances will be subject to the fee schedule, totaling One Hundred Four Thousand Two Hundred Fifty Dollars (\$104,250).

9. **Recommendation of the Staff:**

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

COMMENTS:

Missouri-American Water is a Missouri corporation with its principal office and place of business at 727 Craig Road, St. Louis, MO 63141. The Applicant provides water service to

⁸ Paragraph 21, the Application.

⁹ Staff Data Request No. 0020.

approximately 483,000 customers and sewer service to approximately 24,000 customers in several counties throughout State of Missouri.¹⁰

On May 31, 2024, MAWC submitted an application requesting approval to enter into a variety of secured debt financings with the MO DNR, not to exceed an aggregate principal amount of \$405 million, by placing a mortgage, lien or encumbrance on certain properties in the State of Missouri¹¹ with a 20-year term.¹² The Applicant proposes to use the net proceeds from the loans 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.¹³

MAWC's total five-year capital expenditure plan, ** [REDACTED] **¹⁴, is greater than the amount of the proposed financing. This total expenditure amount is divided between Recurring Projects and Investment Projects; ** [REDACTED] ** respectively. The \$405 million in financings requested in the Application will be split between the two with ** [REDACTED] ** going toward Recurring Projects and ** [REDACTED] ** going toward Investment Projects.¹⁵ In addition to the financings requested in the Application, the Company anticipates obtaining \$400 million in internally generated funds.¹⁶ MAWC stated that this amount represents increases to equity capital from either retained earnings generated monthly from net income, less any dividends paid to equity investors, or through equity infusions from its parent company, American Water Works Company, Inc. ("AWWC").¹⁷

Staff applies the "not detrimental to the public interest" standard to financing applications. In reviewing requests for issuing financing, Staff analyzes the requested amount as it relates to the

¹⁰ Paragraph 2, the Application.

¹¹ Paragraph 13, the Application.

¹² Paragraph 14, the Application.

¹³ Paragraph 15, the Application.

¹⁴ Staff Data Request No. 0015, Attachment 4.

¹⁵ Staff Data Request No. 0019.

¹⁶ Appendix 5, Page 2, the Application.

¹⁷ Staff Data Request No. 0018.

stated uses to ensure that the amount requested is reasonable, and that it generally supports long-term capital investment.

Important in Staff's analysis of stated uses is determining whether the stated uses match the allowable purposes of investment in long-term capital, improvement and maintenance of service, and refunding of maturing short-term and or long-term obligations used for allowable purposes.¹⁸ Staff has verified that MAWC's future capital expenditures support the need to obtain additional debt financing.¹⁹

The Company did not conduct a formal study to compare financing alternatives such as issuing common equity, third party debt, or other governmental programs against the cost efficiency of the financing requested in the Application.²⁰ MAWC stated "The heavily subsidized nature of the State Revolving Fund ("SRF") loans will make them more cost efficient than unsubsidized loans."²¹ MAWC anticipates obtaining the requested financings at an approximate interest rate of 1.75%.²² In comparison, the average short-term debt interest rate, based on commercial paper rates, paid by MAWC for the 12-month period ending March 31, 2024, was 5.38%.²³ Pursuant to financing approved in case number WF-2022-0161, on May 15, 2024, MAWC issued promissory notes to American Water Capital Corp ("AWCC") in the amount of \$115 million with a 10-year term at a coupon rate of 5.15% and \$115 million with a 30-year term at a coupon rate of 5.45%.²⁴

Staff analyzed the pro forma impact the requested financing may have on the company's capital structure. The projected capital structures are investigated and presented in Staff's workpaper as

¹⁸ The allowable purposes of long-term financing authorization authorized by statute, Section 393.200.1, are listed in page 9 of Report and Order, issue date June 16, 2010, of case No. GF-2009-0450.

¹⁹ Staff Data Request No. 0016.

²⁰ Staff Data Request No. 0017.

²¹ Ibid.

²² Staff Data Request No. 0013.1.

²³ Staff Data Request No. 0008.

²⁴ WF-2022-0161 Compliance Filing – May 2024.

well. The pro forma impact of MAWC’s proposed debt on MAWC’s balance sheet as of March 31, 2024, is as follows:

	<u>As of March 31, 2024</u> ²⁵	<u>Pro Forma</u> ²⁶
Common Equity	54.07%	53.09%
Preferred Stock	0.00%	0.00%
Long Term Debt	45.93%	46.91%

The impact of the issuance of the proposed long-term debt on MAWC’s balance sheet is a negligible shift from Common Equity to long-term debt by 0.98%. Consequently, the impact of the proposed issuance on MAWC’s financial risk is manageable.

Staff also analyzed the pro forma impact on MAWC’s financial ratios such as the company’s Debt to Capital ratio, the company’s Debt to earnings before interest, taxes, depreciation and amortization (“EBITDA”) ratio, and its percentage of funds from operations (“FFO”) to Debt. In the pro forma, there was little change to each financial benchmark.²⁷

Having a total five-year capital expenditure plan of ** [REDACTED] **, the requested long-term debt of \$405,000,000 represents ** [REDACTED] ** of the total.

Staff understands that MAWC needs to obtain this new financing 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.

For these reasons, Staff concludes that the Application would not be detrimental to the rate payers given the recommended conditions listed below.

²⁵ Staff Data Request No. 0006.

²⁶ Ibid.

²⁷ Staff’s Workpaper.

RECOMMENDED CONDITIONS:

Staff recommends that the Commission approve the Application submitted by MAWC in this case 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 including the cost of the preferred stock, in any future proceeding;
2. That the Company be authorized to enter into a variety of secured debt financings with the MO DNR, not to exceed an aggregate principal amount of Four Hundred Five Million Dollars (\$405,000,000), by placing a mortgage, lien or encumbrance on certain properties in the State of Missouri with a 20-year term provided that the proceeds from the issuance of the indebtedness will be used by MAWC for the exclusive benefit of MAWC's regulated operations;
3. That the money, property or labor to be procured or paid for by MAWC through the issuance of the long-term debt is reasonably required and necessary for the purposes set forth and will be used therefore, and such purposes are not, in whole or in part, reasonably chargeable to operating expense or to income, as required by Section 393.200 RSMo;
4. That the Company shall file with the Commission within ten (10) days of issuance of any financing authorized pursuant to a Commission order in this proceeding, a report including the amount of long-term debt issued, date of issuance, interest rate (initial rate if variable), and other general and special terms, if any, including the use of proceeds and estimated expenses. 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 long-term debt it obtained was the most reasonable at the time;

5. That the Company 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 three years from the effective date of the order in this proceeding or December 31, 2027, whichever is later.

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

In the Matter of the Application of Missouri-)
American Water Company for Authority to) **Case No. WF-2024-0353**
Issue Up to \$405 Million of Long-Term Debt)
And Secure Same with a Mortgage on its)
Property)

AFFIDAVIT OF RANDALL T. 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.

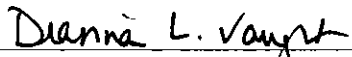


RANDALL T. JENNINGS

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 17th day of July 2024.

DIANNA L. VAUGHT
Notary Public - Notary Seal
State of Missouri
Commissioned for Cole County
My Commission Expires: July 18, 2027
Commission Number: 15207377



Notary Public