

DW 03-189

LAKES REGION WATER COMPANY, INC.

Petition for Authority to Issue Long Term Debt

Order Nisi Approving Petition Subject to Certain Conditions

O R D E R N O. 24,254

December 19, 2003

I. PROCEDURAL HISTORY AND BACKGROUND

The petitioner, Lakes Region Water Company, Inc. (Lakes Region or the Company), is a New Hampshire public utility as defined in RSA 362:2 and 362:4. On September 30, 2003, Lakes Region filed a petition with the New Hampshire Public Utilities Commission (Commission), pursuant to RSA 369, requesting authorization to issue up to \$935,000 in long term debt for the purposes of refinancing existing long term debt, financing the construction of new plant and obtaining working capital. On December 1, 2003, the Company submitted additional information which included an additional request for financing in the amount of \$24,045 for the purchase of a dump truck.

Lakes Region owns and operates several water systems throughout central New Hampshire which together serve approximately 1,139 customers. In 2002 the Company sought a general rate increase for its systems. On July 29, 2003 the Commission issued Order No. 24,196 in Docket No. DW 02-156 approving a Settlement Agreement which resulted in an increase in

rates. In that order, the Commission expressed concern with regard to the Company's relatively high cost of debt and ordered the Company to pursue replacement of its existing debt with lower cost financing and to periodically report to the Commission on its efforts to reduce its overall cost of debt. As a result, the Company entered into negotiations with the Bank of New Hampshire, a division of Banknorth, N.A. (BNH), to refinance three existing bank loans as well as a loan from Thomas and Barbara Mason, the Company's principals. In addition to the refinancing, the Company and BNH also negotiated a loan for new construction as well as a line of credit.

BNH initially approved three distinct financing arrangements for the Company which total \$935,000. BNH issued a letter of commitment on September 16, 2003 outlining the terms and conditions for each of these arrangements. However, this letter of commitment also indicated that if the loans were not closed by October 31, 2003, BNH's commitment to lend would automatically become void unless extended in writing. In correspondence to the Commission received on December 1, 2003, the Company indicated that BNH had agreed to extend its commitment under the terms and conditions expressed in the September 16, 2003 letter.

The first borrowing (Request #1) is a commercial term loan in the amount of \$500,000 with which the Company intends to

refinance approximately \$487,066 of existing debt. The loans to be refinanced include three existing loans with BNH totaling \$352,079 which are due to mature between the years 2006 and 2011. The interest rate on these existing BNH loans is currently 5.25%, adjustable monthly and annually. The Company also intends to refinance an existing loan from Thomas and Barbara Mason in the amount of \$134,987 with a current interest rate of 10.00%, adjusted monthly.

The terms and conditions of Request #1 include a maturity date of 10 years from the date of closing and an interest rate equal to the Federal Home Loan Bank of Boston 5-year Classic Rate (FHLBB) plus 3.00%. Currently, the interest rate on this loan would be approximately 6.62%. This rate will remain fixed for five years at which time it will be adjusted to the then current FHLBB plus 3.00%. The payment of principal and interest based on a 15-year amortization will commence 30 days from the date of closing.

The second borrowing (Request #2) is a commercial construction loan for \$385,000 which is intended to finance a majority of new construction projects planned by the Company for 2003 and 2004. The total cost of these projects is anticipated to be \$515,000 and includes the purchase of land and the construction of additional storage at the Paradise Shores system (\$350,000), the construction of a new pumphouse and the

replacement of 1,600 feet of mains at the Brake Hill system (\$75,000), the construction of a new garage/storage building (\$60,000) as well as the purchase and installation of equipment at various other locations (\$30,000).

The Company recently completed negotiations with the Property Owners Association at Suissevale, Inc. (Suissevale) for the purpose of obtaining a commitment of contributed capital towards the Paradise Shores water storage project. On December 1, 2003, the Company filed with the Commission a letter from Suissevale dated November 25, 2003 indicating Suissevale's commitment to contribute a proportionate share of the total cost of this project subject to certain terms and conditions. The Company's original filing anticipated a contribution from Suissevale in the amount of \$130,000, however, the Company is now anticipating that this contribution may be as much as \$185,500 depending on the final cost of the project. The Company also filed a letter from the New Hampshire Department of Environmental Services (NHDES) dated November 17, 2003 indicating its support of the proposed plans for the Paradise Shores water storage project. Suissevale consumes approximately 53% of the available water produced by the Paradise Shores system.

The terms and conditions for Request #2 include two phases: a construction phase and a permanent phase. The commitment of BNH to fund construction advances (construction

phase) will expire 12 months from the date of closing. The permanent financing (permanent phase) will have a term of 10 years from the date of commitment expiration. The interest rate during the construction phase will be equal to the Banknorth, N.A. Base Rate plus 1.00% adjusted on a daily basis. The current Banknorth, N.A. Base Rate is approximately 4.00% making the current interest rate for the construction phase approximately 5.00%. At the time of the conversion to a permanent financing, as with Request #1, the interest rate will be equal to the FHLBB 5-year Classic Rate plus 3.00% for 5 years. Currently, that interest rate is approximately 6.62%. On the fifth anniversary of the permanent financing, the interest rate will be adjusted to the then FHLBB plus 3.00%. Payments of interest only will be due monthly beginning 30 days from the date of closing during the construction phase of the loan. Payments of principal and interest based on a 15-year amortization will be due monthly during the permanent financing stage.

The third borrowing (Request #3) is a revolving line of credit for \$50,000 for working capital. This line of credit is due to mature on May 31, 2004. The interest rate will be equal to the Banknorth, N.A. Base Rate plus 1.00% adjusted on a daily basis. The current Banknorth, N.A. Base Rate is approximately 4.00% making the current interest rate for the line of credit approximately 5.00%. Payments of interest only will be due

monthly beginning 30 days from the date of closing. The Company is required to bring the revolving line of credit to a zero balance and maintain that zero balance for a minimum of 30 days each year.

On December 1, 2003, the Company submitted a request for approval of an additional financing in the amount of \$24,045 for the purchase of a new dump truck. The Company indicated that it had experienced mechanical problems with its current dump truck but had decided to replace this truck after an evaluation of repair costs. The cost of the new dump truck is \$35,461, of which \$24,045 is to be financed. The Company negotiated a vehicle loan with BNH with a 5-year term at 6.90%. The monthly payments including principal and interest will be approximately \$476. In support of this additional request for financing approval, the Company submitted copies of the bill of sale as well as documents relative to the vehicle financing dated October 24, 2003. The Company asked that the Commission grant authority to borrow this \$24,045 as part of the instant docket.

In support of its petition for approval of the entire financing (\$935,000 plus \$24,045), Lakes Region avers that the proposed financing is in the public interest and consistent with the public good because it enhances the Company's ability to provide safe and reliable drinking water to its customers in its franchise areas at a reasonable cost. Further, the Company

asserts that the system improvements being proposed as well as the estimated costs of those improvements are reasonably necessary to provide such service to its customers.

Staff conducted discovery with regard to the Company's filing and propounded data requests. On December 16, 2003, Staff filed a memorandum recommending that the Commission approve the Petition by issuance of an order nisi.

II. COMMISSION ANALYSIS

Pursuant to the provisions of RSA 369:1, public utilities engaged in business in this State may issue evidences of indebtedness payable more than 12 months after the date thereof only if the Commission finds the proposed issuance to be "consistent with the public good." The New Hampshire Supreme Court has further provided that the public good consideration involves looking beyond actual terms of the proposed financing to the use of the proceeds of those funds and the effect on rates to insure the public good is protected. See *Appeal of Easton*, 125 N.H. 205 (1984).

In the case at hand, Lakes Region has requested authorization to borrow an amount up to \$959,045 comprised essentially of four financing arrangements. The first, referred to as Request #1, is a commercial term loan from the Bank of New Hampshire (BNH) in the amount of \$500,000 which is intended to refinance approximately \$487,066 of existing debt. This

financing appears to be in response to our concerns regarding the Company's relatively high cost of debt that were expressed in Order No. 24,196 in Docket No. DW 02-156. Request #1 essentially replaces three existing loans with BNH with adjustable interest rates currently at 5.25% as well a loan from the Company's principals, Thomas and Barbara Mason, which has an adjustable interest rate currently at 10.00%. The interest rate for Request #1 is approximately 6.62%, but will remain fixed for a period of 5 years. We note from the testimony provided by Lakes Region that this financing will enable the Company to eliminate the principals' high cost of debt as well as stabilize the present repayment terms on the other loans and replace the shorter lengths of the present repayment terms with a 15-year amortization which will result in a lower monthly payment.

The second financing, referred to as Request #2, is a commercial construction loan with BNH for a total of \$385,000 which is intended to finance a major portion of new construction planned by the Company for 2003 and 2004. This includes the construction of a water storage tank at its Paradise Shores system. The total cost of this project, which includes the purchase of land, is anticipated to be \$350,000. We note that an agreement was reached between the Company and Suissevale, whereby Suissevale, which consumes approximately 53% of the available water of the Paradise Shores system, agrees to contribute a

proportionate share of the total cost of this project subject to certain terms and conditions and that this contribution may be as much as \$185,500. We also note the New Hampshire Department of Environmental Services' support for this project as expressed in its letter dated November 17, 2003.

In addition to the Paradise Shores project, the Company is also planning construction of a new pump house and the replacement of 1,600 feet of mains at its Brake Hill system at a cost of \$75,000, the construction of a new garage/storage building at a cost of \$60,000 as well as the purchase and installation of various equipment at other locations at a cost of \$30,000. The Brake Hill system improvements as well as the installation of other equipment at various locations are part of the Company's continuing efforts to improve water quality and minimize lost water throughout its systems. These issues were also contemplated in Commission Order No. 24,196 in Docket No. DW 02-156. With regard to the proposed garage/storage building, the Company indicated through discovery that this facility was necessary in order to protect its equipment and inventory from the elements during periods of non-use.

Financing Request #2 is in two phases. Initially, there will be a 12 month construction phase with interest only payable at the rate of approximately 5.00%. This will be followed by the permanent phase with a term of 10 years. The

interest rate during the permanent phase is currently estimated to be 6.62% which will remain fixed for 5 years.

The third financing, or Request #3, is a revolving line of credit for \$50,000 for the purpose of obtaining necessary working capital. It is the understanding of this Commission that such working capital infusions previously had been provided through the note payable from the principals that is to be refinanced as part of Request #1. The interest rate for Request #3 is approximately 5.00% as opposed to the 10.00% interest rate on the current shareholder loan.

Finally, the Company requested approval to borrow \$24,045 from BNH for the purchase of a new dump truck. The new truck will replace an existing vehicle which the Company determined was not cost effective to repair. The particulars of this loan include a 5-year term at an interest rate of 6.90%. Payments of principal and interest will be made monthly in the amount of \$476.

Our review of the petition must consider possible effects on the Company's overall cost of capital to ratepayers, we must also review that aspect of the financings. We note from the Company's testimony that it did not attempt to obtain financing for the construction projects from the State Revolving Fund because it did not believe that its projects would reach a high enough priority in order to obtain such funding. Under the

circumstances, we believe that the interest rates proposed under these financings are favorable rates for a utility of this size and nature. The proposed interest rates are comparable to recent financing approvals granted by this Commission for other small water companies. The Company's filing indicates that these financings will have a significant impact on the Company's capitalization ratio. Currently, the Company's capitalization ratio consists of approximately 66% debt to 34% equity. However, with the addition of the proposed debt, the Company's capitalization ratio will become approximately 76% debt to 24% equity. While we have some concerns with regard to the increased risk posed by the increased debt, these concerns are alleviated somewhat by the knowledge that the Company has recently received approval for a general rate increase, which should lessen the difficulty of paying off the debt. Further, we appreciate the Company's expeditious efforts to lower its cost of debt in response to concerns raised in our Order No. 24,196 in DW 02-156. Nonetheless, the Company should be advised that its capitalization ratio will be a matter of close scrutiny in any subsequent financing requests brought before this Commission.

Under the circumstances, we find that the terms and conditions of the loans are just and reasonable and the proposed use of the funds to be prudent and in the public good.

Based upon the foregoing, it is hereby

ORDERED NISI, that, authority to undertake the financings proposed by Lakes Region, upon the terms and conditions proposed in the Company's petitions and as set forth in the letter of commitment from the Bank of New Hampshire dated September 16, 2003 as well as the vehicle financing documents dated October 24, 2003, and subject to the terms and conditions specified in this Order, is hereby granted; and it is

FURTHER ORDERED, that the Petitioner shall cause a summary notice of this Order Nisi, a copy of which has been separately provided to the Petitioner by the Commission, to be published once in a statewide newspaper of general circulation or of circulation in those portions of the state where operations are conducted, such publication to be no later than December 26, 2003 and to be documented by affidavit filed with this office on or before January 9, 2004; and it is

FURTHER ORDERED, that the Petitioner shall make a copy of this Order Nisi available to any customer that requests a copy; and it is

FURTHER ORDERED, that all persons interested in responding to this petition be notified that they may submit their comments or file a written request for a hearing on this matter before the Commission no later than January 2, 2004; and it is

FURTHER ORDERED, that any party interested in responding to such comments or request for hearing shall do so no later than January 7, 2004; and it is

FURTHER ORDERED, that this Order Nisi shall be effective January 9, 2004, unless the Petitioner fails to satisfy the publication obligation set forth above or the Commission provides otherwise in a supplemental order issued prior to the effective date; and it is

FURTHER ORDERED, that the Petitioner shall file true copies of the loan documents executed or otherwise finally issued in connection with the closing of the transactions contemplated hereby.

By order of the Public Utilities Commission of New Hampshire this nineteenth day of December, 2003.

Thomas B. Getz
Chairman

Susan S. Geiger
Commissioner

Graham J. Morrison
Commissioner

Attested by:

Debra A. Howland
Executive Director & Secretary