STATE OF NEW HAMPSHIRE

Inter-Department Communication

DATE: April 16, 2019
AT (OFFICE): NHPUC

TJF

FROM: Jay E. Dudley, Utilities Analyst IV

SUBJECT: DE 19-045 Public Service Company of New Hampshire d/b/a Eversource Energy Petition for Approval of Financing Transaction

TO: Commission
Debra A. Howland, Executive Director
Tom Frantz, Director Electric Division

On March 1, 2019, Public Service Company of New Hampshire d/b/a Eversource Energy (PSNH or Company), filed a petition for authority to issue long term debt not to exceed an aggregate principal amount of $300 million. PSNH's filing comprised testimony and attachments including information provided by Form F-4 under Rule Puc 308:12(b). Staff recommends that the petition be approved as submitted.

Description of Proposed Financing

PSNH proposes to issue and sell up to $300 million in aggregate principal amount long term debt in the form of first mortgage bonds (the Bonds) during the period from the date of the Commission's order in this docket through December 31, 2019. The Company seeks authority to: (i) replace and refinance existing long term debt in the amount of $150 million (2009 Series P) that is set to mature on December 1, 2019; (ii) to refinance PSNH's existing short-term debt balance of $46.6 million (as of September 30, 2018)[1]; and (iii) to fund, in part, approximately $320 million in planned capital expenditures for 2019. As such, a portion of the request, approximately $196.6 million, does not represent new indebtedness for PSNH since it constitutes the refinancing of existing debt, whereas the remainder of approximately $100.0 million (after deducting $3.31 million in estimated issuance costs) constitutes new debt. The maturity of the Bonds will range from 1 to 30 years. The Company proposes to price the Bonds at a fixed rate based on either the 10-year or 30-year U.S. Treasury rate plus a credit spread not to exceed three hundred basis points (3.00%) to be determined at the time of closing. PSNH anticipates that the ultimate rate for the Bonds will be consistent with current market rates; however, because its financing plan will be effective through December 31, 2019, the Company requests approval of the proposed credit spread of 3.00% in order to provide sufficient flexibility in the event of unanticipated widening of credit spreads due

[1] As of December 31, 2018, PSNH's short-term debt balance was $57 million. O'Neil/Dzialo at Bates 12.

to uncertainty or volatility in the capital markets. The final financing structure, terms and conditions, amounts, documentation, and rate will be determined at the time of issuance.

The Company provided its Form F-4 dated September 30, 2018, along with attachments to show the impact of the proposed financing on PSNH's balance sheet (Attachment 3), income statement (Attachment 4), capitalization (Attachment 5), and cost of debt (Attachment 2). PSNH estimates the cost of the bond issuance to be $3.3 million which includes ratings fees and an underwriting fee of 0.875%. PSNH calculates, on a pro forma basis, that the new debt of $100 million, plus the refinance of the 46.6 million in short-term debt, will result in an increase in annual interest expense of approximately $4.5 million for a total of $60.8 million, as compared with its current interest expense amount of $56.3 million.[2] The combined effect of the debt issuance fee and the increase in interest expense results in a small reduction to PSNH's retained earnings of $3.3 million. However, despite the addition of new debt of $100 million, PSNH projects that after giving effect to the resulting pro forma adjustments, the proposed financing will not have a significant impact on the Company's current capital structure of 46% debt and 54% equity, resulting in 47.6% debt and 52.37% equity. PSNH represents that it expects to maintain a post-issuance equity ratio of 54% through additional earnings and capital contributions from Eversource Energy in 2019.

Staff's Recommendation

Staff has reviewed the Company's petition and supporting documents and believes that PSNH's filing is complete and meets all requirements of Puc 308.12. However, Staff notes the following concern: During discovery in this docket, Staff learned that on February 12, 2019, Standard & Poor's (S&P) issued a research update revising its outlook on all credit ratings for Eversource Energy, Connecticut Light & Power Co., NSTAR Electric, and PSNH from "stable" to "negative."[3] The basis for S&P's revised outlook involves a decline in Eversource's FFO-to-debt ratio to 14.6% which is just below S&P's threshold for downgrade of 15%. S&P anticipates that Eversource's FFO-to-debt will remain at or below the 15% level through the 2018-2020 period primarily due to the Company's rising capital spending (which includes Eversource's $225 million investment in the Orsted offshore wind project) and the impact of the Federal Tax Cut and Jobs Act. S&P's negative outlook reflects the potential for a downgrade of one or two notches over the next six to twelve months if improvement is not detected, but S&P does not recommend a downgrade of Eversource's or PSNH's current credit ratings at this time. PSNH represents that Eversource will maintain its stable outlook by pursuing regulatory cost recovery on a timely basis, continue rigorous cost control and budgeting, and generate cash proceeds through the future issuance of additional equity. PSNH also asserts that S&P's revised outlook will not prevent the Company from obtaining satisfactory terms and rates for the proposed financing.

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[2] PSNH did not provide a projected rate impact for the increase in interest expense of $4.5 million, but indicated that the increase would be included in the cost-of-service components to be filed by the Company in its upcoming rate case in DE 19-057.

[3] PSNH's response to STAFF 1-001, including the S&P report, is attached as Attachment A.

Staff has studied the S&P report and PSNH's data responses involving this issue. Given that S&P has decided to leave PSNH's current credit rating unchanged, Staff will provide a favorable recommendation as outlined below concerning PSNH's request for financing. However, Staff recommends the continued monitoring of this situation by the PUC by requiring PSNH to report to the Commission on any subsequent changes to S&P's outlook through December 31, 2020.

Accordingly, it is Staff's opinion that, based on the current total of outstanding long term debt reported by PSNH of approximately $894.1 million, the proposed refinance of existing debt in the amount of $196.8 million, plus new debt of $100 million, will have a modest impact on PSNH's capital structure, and the Company's cost of debt and revenue requirement. As such, Staff supports the Company's position that approval of the petition would be in the public good, and in conformance with the review standards of RSA Chapter 369. Therefore, Staff recommends that the Commission authorize PSNH to issue $300 million in long term debt, according to the proposed terms, amounts, and interest rate outlined above, for the purposes of refinancing and replacing a portion of its existing debt, and to include the issuance of new debt to fund planned capital expenditures for 2019. Staff would support the issuance of an Order *Nisi* for the approval of this petition.

Public Service of New Hampshire d/b/a Eversource Energy
Docket No. DE 19-045

Date Request Received: 03/15/2019 **Date of Response: 03/27/2019**
Request No. STAFF 1-001
Request from: New Hampshire Public Utilities Commission Staff

Witness: Michael Dzialo, Emilie G. O'Neil

Request:
Re: Testimony of O'Neil/Dzialo at Bates 13: "PSNH's senior secured debt is currently rated 'AA- 'by S&P Global Ratings.... Also, re: Eversource Energy's recent Form 10-K filing with the Securities Exchange Commission for fiscal year ending December 31, 2018 (e-filed with the PUC on March 7, 2019), at page 32: "Credit Ratings: On February 12, 2019, S&P changed the outlook on all credit ratings for Eversource, CL&P, NSTAR Electric and PSNH from stable to negative." This indicates the likelihood of a future downgrade from that agency. a. Please provide a detailed explanation of the reasons for the negative rating outlook along with a complete copy of the S&P report outlining the negative outlook decision. b. What impact will the revised outlook have on PSNH obtaining favorable terms and rates (within the maximum target spread of 300 basis points) for the proposed financing? c. What is PSNH's plan to return the S&P outlook to stable?

Response:

a. On February 12, 2019, Standard & Poor's ("S&P") issued a research update, revising its outlook on Eversource Energy and its subsidiaries from stable to negative, while affirming all of its ratings on the Eversource companies. Attachment STAFF 1-001 provides a copy of the research update issued by S&P.

The S&P research update cites the Orsted investment and also specifically notes that the triggering concern is the financial ratios in existence prior to this investment (Attachment STAFF 1-001, at highlighted passages). As a result, this statement by S&P affirms the focus that the credit-rating agencies place on cash flow for utility operations.

Although S&P's revised outlook was issued following the announcement of Eversource Energy's planned investment in Orsted projects, it was not only the Orsted investment that triggered S&P's change in outlook. During the April 2018 rating process, S&P voiced concerns with Eversource Energy regarding its financial ratios (particularly the FFO-to-debt ratio). The distribution industry is capital intensive and changes that were made as part of the Federal Tax Cut and Jobs Act ("TCJA") have substantially and specifically affected the distribution industry, reducing cash flow by significant margins. The reduction in cash flow associated with the TCJA arises from (1) the reduction of customer rates to reflect the lower corporate income tax rate and refund of excess deferred taxes to customers; and (2) the loss of bonus depreciation associated with capital investments. In particular, the loss of bonus depreciation beginning January 1, 2018 is a significant setback to electric and gas distribution utilities given their ever-growing capital requirements.

Eversource Energy will invest approximately $13 billion in transmission and distribution infrastructure across its electric and gas distribution operations over the next five years. Therefore, the impact of the TCJA and other business requirements are a dominating factor in the Company's cash-flow metrics.

b. S&P's revised outlook will have no impact on PSNH obtaining favorable terms and rates for the proposed financing. As noted in S&P's research update, S&P has affirmed all of its ratings on the Eversource operating companies. The negative outlook will have no effect on the operating company borrowing costs because their rating is among the highest ratings for utility companies even with the changed outlook.

c. There are several factors that influence the rating outlook of a company. The primary factors are credit metrics, regulatory environment and the ability to earn sufficient returns on our investments. Accordingly, Eversource Energy is taking the following steps to maintain a stable outlook:

1. For its regulated operations, Eversource Energy will continue to pursue regulatory outcomes that demonstrate the ability to recover costs on timely basis, with the opportunity to achieve authorized rates of return. The Company's cash flow and ability to maintain stable earnings levels is critical to the credit rating outcome.

2. Eversource Energy is currently planning to issue up to approximately $2 billion of equity over the next five years. Equity issuances will generate cash proceeds to assist in funding core distribution and transmission infrastructure projects for the Eversource's operating companies. The issuance of equity generates cash proceeds without adding debt. Therefore, the issuance of equity will improve the Company's credit metrics and will be perceived positively by the rating agencies.

3. Eversource Energy will continue to rely on its rigorous cost control processes and annual budget process to drive efficiencies across the organization. Where costs are controlled, both cash flow and earnings are improved, helping to improve credit metrics.

S&P Global
Ratings

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Research Update:

Eversource Energy And Subsidiaries Outlooks Revised To Negative On Announcement Of Offshore Wind Joint Venture

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Research Update:

Eversource Energy And Subsidiaries Outlooks Revised To Negative On Announcement Of Offshore Wind Joint Venture

Rating Action Overview

- Eversource Energy announced that it is entering into a 50-50 joint venture (JV) partnership with Orsted to develop offshore wind energy generation, under which it will pay about $225 million for a 50% interest in Orsted's Revolution Wind and South Fork Wind Farm projects and 257-square miles of ocean tracts off the coasts of Massachusetts and Rhode Island.
- We believe this announcement signifies a possible shift in Eversource's strategy. Specifically, we believe it demonstrates management's willingness to invest in higher-risk offshore wind generation activities, which will increase the company's business risk.
- In addition, Eversource's financial measures remain weak with little or no cushion at the current rating level.
- We are revising our outlook on Eversource Energy and all of its rated subsidiaries to negative from stable and are affirming all of our ratings on the companies.
- The negative outlook reflects the potential for a downgrade of one or more notches over the next 6-12 months due to the possible shift in Eversource's growth strategy toward higher-risk offshore wind generation. The negative outlook also incorporates our view that the company's financial measures may weaken below our downgrade threshold of 15%.

Rating Action Rationale

We revised our outlook on Eversource to negative following the company's announcement of a JV transaction with Orsted to jointly develop offshore wind energy generation projects off the coasts of Massachusetts and Rhode Island. This announcement followed the company's prior JV investment for the Bay State Wind development project, another offshore wind farm. We view these transactions as signifying a potential shift in the company's strategy toward focusing on higher-risk offshore wind generation. We view contracted offshore wind as having considerably higher risks than the rest of Eversource's portfolio. These risks include elevated construction, operational, and counterparty credit risks. Furthermore, we expect Eversource's financial measures to remain weak through 2020. Specifically, we expect that its funds from operations (FFO)-to-debt ratio will stay at or below 15% over this period.

Our current assessment of Eversource's business risk profile incorporates the company's large size, operational and regulatory diversity, low-operating-risk business, and effective management of regulatory risk. The company's businesses include electric distribution (about 50% of EBITDA), electric transmission (regulated by the Federal Energy Regulatory Commission; about 35% of EBITDA), gas distribution (about 10% of EBITDA), and water distribution (about 5% of EBITDA). Eversource's lower-risk electric, water, and natural gas transmission and distribution (T&D) operations operate under generally constructive, transparent, and predictable regulatory frameworks. Furthermore, Eversource's subsidiaries use various regulatory mechanisms, including formula rates, forward test years, storm recovery mechanisms, and revenue decoupling, to effectively manage their regulatory risk. Because of these supportive factors, we currently consider Eversource's business risk profile to be at the stronger end of the range when compared with those of its peers.

We evaluate Eversource's financial measures using our low-volatility benchmarks, which reflect the company's low-risk utility operations and its effective management of regulatory risk. Eversource's 2017 financial measures were below our downgrade threshold with a FFO-to-debt ratio of 14.6%. We expect Eversource's FFO-to-debt ratio in 2018-2020 to be at or below 15%, primarily reflecting the company's rising capital spending and the impact of U.S. tax reform. Our revised higher capital spending projections incorporate the offshore wind development projects, which could weaken Eversource's financial measures and offset our previous expectation that the company's credit metrics would begin to improve in 2020. Absent any countermeasures by the company to preserve its credit quality, we expect its FFO-to-debt ratio to remain consistently at or below our current downside threshold.

Outlook

The negative outlook on Eversource reflects the potential for a downgrade of one or more notches over the next 6-12 months due to the possible shift in the company's growth strategy toward higher-risk offshore wind generation. The negative outlook also incorporates our view that the company's FFO-to-debt ratio may weaken below our downgrade threshold of 15%.

Downside scenario

We could lower our ratings on Eversource and its subsidiaries by one or more notches over the next 6-12 months if the company's growth strategy suggests an acceleration of its offshore wind development activities. We could also lower our ratings on Eversource over this same period if the company fails to take adequate countermeasures to bolster its credit metrics so that its FFO-to-debt remains consistently above 15%.

Upside scenario

We could affirm our ratings on Eversource and revise our outlook to stable over the next 6-12 months if we conclude that the company's offshore wind generation investments are very limited and believe that management will take steps to improve its financial measures such that its FFO-to-debt ratio remains consistently above 15% with no adverse changes in its management of regulatory risk.

Company Description

Eversource is a holding company that primarily engages in the energy delivery business through its wholly owned regulated utility subsidiaries. Eversource's subsidiaries comprise the electric utilities Connecticut Light and Power Co., NSTAR Electric Co., and Public Service Co. of New Hampshire; the natural gas utilities Yankee Gas Services Co. and NSTAR Gas Co.; and the water utility Aquarion Co. Eversource provides energy delivery and/or water service to approximately four million customers in Connecticut, Massachusetts, and New Hampshire.

Our Base-Case Scenario

Our base-case scenario assumes continued regulatory cost recovery through periodic rate cases and trackers, annual capital spending of about $2.5 billion, annual dividends of about $650 million, increased current taxes, the effects of U.S. tax reform, and proceeds from the divestiture of the company's generation assets.

Liquidity

We assess Eversource's liquidity as adequate to cover its needs over the next 12 months. We expect the company's liquidity sources to exceed its uses by 1.1x or more and anticipate that it will also meet our other requirements for an adequate liquidity designation. Eversource's liquidity benefits from its stable cash flow generation, the ample availability under its revolving credit facilities, and its manageable debt maturities over the next few years. The assessment also reflects the company's likely ability to absorb high-impact, low-probability events with limited need for refinancing, its generally prudent risk management, and its satisfactory standing in the credit markets.

Principal liquidity sources:

- Revolving credit facilities of roughly $2.2 billion;
- Annual FFO of about $2.3 billion;
- Cash and cash equivalents of about $64 million; and
- Proceeds from its generation asset sales.

Principal liquidity uses:

- Debt maturities of about $1.6 billion, including outstanding commercial paper (CP);

- Annual maintenance capital spending of about $1.6 billion; and
- Annual common stock dividends of about $650 million.

Issue Ratings - Subordination Risk Analysis

Capital structure

- Eversource Energy's consolidated capital structure consists of roughly $14 billion of debt issued by the parent and various subsidiaries and about $4 billion of senior unsecured debt issued at the parent level. The company also has a $1.45 billion CP program.

Analytical conclusions

- We rate Eversource's senior unsecured debt one notch below our issuer credit rating because it ranks behind a significant amount of secured debt and priority unsecured debt issued by the company's subsidiaries. We rate Eversource's CP program 'A-1' based on our long-term issuer credit rating on the company.

Ratings Score Snapshot

Issuer Credit Rating: A+/Negative/A-1

Business risk: Excellent
- Country risk: Very low
- Industry risk: Very low
- Competitive position: Excellent

Financial risk: Intermediate
- Cash flow/Leverage: Intermediate

Anchor: a+

Modifiers
- Diversification/Portfolio effect: Neutral (no impact)
- Capital structure: Neutral (no impact)
- Financial policy: Neutral (no impact)
- Liquidity: Adequate (no impact)
- Management and governance: Strong (no impact)
- Comparable rating analysis: Neutral (no impact)

Stand-alone credit profile: a+
- Group credit profile: a+

Related Criteria

- Criteria - Corporates - General: Reflecting Subordination Risk In Corporate Issue Ratings, March 28, 2018
- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings , April 7, 2017
- Criteria | Corporates | General: Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Dec. 16, 2014
- General Criteria: Group Rating Methodology, Nov. 19, 2013
- General Criteria: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- Criteria | Corporates | General: Corporate Methodology, Nov. 19, 2013
- General Criteria: Methodology: Industry Risk, Nov. 19, 2013
- Criteria - Corporates - Utilities: Key Credit Factors For The Regulated Utilities Industry, Nov. 19, 2013
- Criteria | Corporates | General: Corporate Methodology: Ratios And Adjustments, Nov. 19, 2013
- Criteria | Corporates | Utilities: Collateral Coverage And Issue Notching Rules For '1+' And '1' Recovery Ratings On Senior Bonds Secured By Utility Real Property, Feb. 14, 2013
- General Criteria: Methodology: Management And Governance Credit Factors For Corporate Entities And Insurers, Nov. 13, 2012
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009
- Criteria - Insurance - General: Hybrid Capital Handbook: September 2008 Edition, Sept. 15, 2008

Ratings List

Ratings Affirmed; CreditWatch/Outlook Action

	To	From
Eversource Energy		
NSTAR Electric Co.		
Issuer Credit Rating	A+/Negative/A-1	A+/Stable/A-1
Aquarion Co.		
Yankee Gas Services Co.		
Public Service Co. of New Hampshire		
NSTAR Gas Co.		
Issuer Credit Rating	A+/Negative/--	A+/Stable/--
Connecticut Light & Power Co.		

Issuer Credit Rating	A+/Negative/--	A+/Stable/--

Ratings Affirmed

Eversource Energy	
Senior Unsecured	A
Commercial Paper	A-1
Aquarion Co.	
Senior Unsecured	A
Connecticut Light & Power Co.	
Senior Secured	AA-
Recovery Rating	1+
Preferred Stock	A-
NSTAR Electric Co.	
Senior Unsecured	A+
Preferred Stock	A-
Commercial Paper	A-1
NSTAR Gas Co.	
Senior Secured	AA-
Recovery Rating	1+
Public Service Co. of New Hampshire	
Senior Secured	AA-
Recovery Rating	1+

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.standardandpoors.com for further information. Complete ratings information is available to subscribers of RatingsDirect at www.capitaliq.com. All ratings affected by this rating action can be found on S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column.

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