

STATE OF NEW HAMPSHIRE

Inter-Department Communication

DATE: July 2, 2020
AT (OFFICE): NHPUC

FROM: Stephen Frink /s/ *SF*
Assistant Director – Gas & Water Division
Mary Schwarzer /s/ *MS*
Staff Attorney – Legal Division

SUBJECT: DG 20-078
Northern Utilities, Inc.
Petition for Authority to Issue Securities

TO: Commissioners
Docket File
Service List

SUMMARY OF COMMISSION STAFF’S RECOMMENDATION

Commission Staff recommends that the Commission approve Northern’s request to issue senior unsecured notes of up to \$50,000,000 at coupon rates not to exceed 5.25 percent, and that the Commission require Northern to file an updated Exhibit NU-7 with the Commission upon final closing and funding of the issuance.

BACKGROUND - NORTHERN PETITION & TESTIMONY

On May 21, 2020, Northern Utilities, Inc. (Northern or the Company) filed a petition pursuant to RSA chapter 369 for authority to issue securities. Northern proposes to issue and sell at par, by private sale, unsecured promissory notes not to exceed \$50 million. Northern’s petition includes the direct testimony of Mr. Todd R. Diggins, Treasurer and Director of Finance for Unitil Service Corporation (USC), and Mr. Andre F. Francoeur, Senior Financial Analyst for USC. USC provides various professional and administrative services to Northern and USC’s other utility subsidiaries.

Northern is seeking Commission approval to issue up to \$50 million in promissory notes, to be sold at par by private placement to institutional investors. The Company is targeting up to a 30-year issuance at a fixed coupon rate not to exceed 5.25 percent with a projected financing cost of \$375,000. Northern states that long-term security matches the long-lived nature of the utility assets while achieving an attractive interest rate as a result of historically low treasury yields. Northern anticipates several investors participating in this offering.

Based on credit spreads for comparably rated utilities, Northern anticipates an all-in coupon rate in the range of 4.07-4.27 percent for a 30-year maturity. The anticipated coupon rates are related to U.S. Treasury rates as of May 7, 2020.

Northern testified that the Company's debt-to-net capitalization ratio should not materially change, as the long-term debt will largely replace short-term debt. Based on pricing related to current treasury yields, Northern states that the issuance will lower Northern's weighted cost of long-term debt by 19 basis points. If issued at the maximum coupon rate, the weighted cost of long-term debt would increase from 5.16 percent to 5.19 percent.

Northern's last long-term debt financing was in 2019 when it issued \$50 million of senior notes, approved by Commission Order 26,269 issued July 2, 2019 (Docket DG 19-090). Northern spent \$70 million on capital expenditures in 2019 and has over \$57 million of capital expenditures budgeted for 2020. Northern uses internally generated funds and short-term borrowing to fund capital expenditures. When the Company's short-term balance builds to sufficient levels it seeks long-term financing to reduce short-term debt and to appropriately match the long-term utility asset lives with long-term financing. The proceeds from this issuance will be used to refinance short-term debt (\$28.3 million as of March 31, 2020) and fund 2020 capital expenditures. Any excess cash will be used for other general corporate purposes.

STAFF INVESTIGATION

Commission Staff (Staff) issued discovery, reviewed the Maine Public Utilities Commission (MPUC) proceeding (Docket 2020-00153) on Northern's proposed financing, reviewed Commission orders and dockets related to prior Northern debt issuances, and compared current U.S. Treasury rates with those referenced in the Northern filing.

STAFF FINDINGS

Northern requests approval to issue up to \$50 million of unsecured long-term debt with a targeted maturity of up to 30-years and expected coupon rates ranging between 4.07 to 4.27 percent based on indicative all-in coupon rates as of May 7, 2020. As of mid-June, the Company's tentative plan is to issue \$40 million of unsecured long-term debt with a 20-year maturity. **See Staff Attachment 1 (Company Response to Staff DR 2-1 and DR 2-1 Attachment 2, Revised Exh. NU-7).**¹

The Company's decision to issue debt with a 20-year maturity was made to reduce exposure to refinancing a significant amount of debt at a single point in time. The

¹ By way of clarification, Northern's "Staff DR 2-1, Attachment 2" was filed with the reference "SDR Set 2-1 Attachment 1" (sic) in the upper right-hand corner.

Company's maturing debt schedule has a window between 2039 and 2043 where there is currently no long-term debt scheduled to mature and the proposed financing would be mature within that period. *See id.* Market conditions and the advice of the Company's placement agent also suggest that a 20-year term will be well received and generate more investor interest than a longer maturity.

On June 16, 2020, the Company made its initial pricing, offering \$40,000,000 of 20-year senior unsecured notes at a rate of 3.78 percent. This rate consists of a credit spread of 245 basis points plus a quoted treasury yield of 1.33 percent. As priced, the pro forma weighted cost of capital is 7.19 percent, which is lower than Northern's revised Exhibit NU-7 pro forma weighted cost of capital rate of 7.27 percent. **See Staff Attachment 1 (Revised Exh. NU-7).**

Northern testified that following the issuance of these securities, the debt-to-equity ratio would remain the same based on the its pro forma analysis, that analysis netted the amount of cash in excess of short term debt refinancing against total debt. Traditionally, when considering a utility's capital structure when setting rates, cash is not netted against debt. Northern's Revised Exhibit NU-7 shows the pro forma capitalization without netting of the debt and cash. *See id.* The current debt-to-equity ratio of 46:54 becomes 51:49 when \$40 million of long-term debt is added, resulting in a more balanced capital structure than currently exists or than would be the case if Northern issued \$50 million of long-term debt. Nonetheless, were Northern to issue \$50 million, the maximum amount requested in its petition, the debt-to-equity ratio would be 52:48 and result in a more balanced capital structure than is currently the case.

In addition to using the funds from the issuance to refinance short-term debt, Northern will also be using a portion of the funds to finance its \$57 million 2020 capital budget. The 2020 capital budget is well in excess of the financing proceeds remaining after refinancing short-term debt.

Northern is in the process of marketing its offer. Subject to regulatory approval, Northern expects a final closing and funding to take place in September.

The Northern financing requires regulatory approval from both this Commission and from the Maine Public Utilities Commission (MPUC). Northern filed for MPUC approval on May 20, 2020, and requested a Commission decision by July 20, 2020. The MPUC Examiner issued data requests on June 22, 2020, and the Company submitted responses on June 25, 2020. To date, the MPUC has not issued an Examiner Report or Order.

Pursuant to RSA 91-A, and N.H. Admin R. Puc 203.08, Northern also seeks a protective order and confidential treatment of unaudited financial statements for a limited period of time, i.e. until the Company distributes its audited financial statements for the first quarter of 2020 with its debt holders on, or about, March 31, 2021. *See Northern's Motion for Confidential Treatment (May 21, 2020).*

Pursuant to the same authorities, the Company also seeks permanent confidential treatment of material it submitted in the course of discovery: a copy of a letter agreement with its placement agents that discloses the compensation arrangement between and among the Company and its placement agents with respect to the issuance and funding of the notes. Finally, the Company seeks permanent confidential treatment of Unitil Corporation's *S&P* and *Moody's* credit ratings, and analysis in support of those ratings, including Northern's credit ratings. The ratings and the underlying analyses were also filed as part of the Company's discovery responses. *See* Northern's Motion for Confidential Treatment (July 1, 2020).

STAFF POSITIONS

Staff believes the financing is routine in that the proposed use of funds is appropriate, the amount is not excessive, the cost of the financing is reasonable and the expected interest rate is consistent with that of other entities with similar credit ratings. The financing proceeds will be to refinance short-term debt used to fund prior capital spending and to fund Northern's 2020 capital budget. The capital spending was, and is, for improvement and expansion of Northern's distribution system. There should be minimal impact on Northern's weighted average cost of capital (current rate of 7.50 percent compared pro forma rate of 7.19 percent in the Revised Exhibit NU-7) and this impact is comparable to what the ratio would be if Northern met its funding requirement using short-term debt.

Staff believes the parameters of Northern's proposed financing and current plan to issue \$40,000,000 in securities with a 20-year maturity is reasonable.

Staff also supports the Company's request for limited confidential treatment of the unaudited financial information in Exhibits NU-4, NH-5, and NU-11, until such time as the audited financial statements are distributed, for the reasons stated in Northern's May 21, 2020 motion. Until the information is audited and disclosed in the noteholder financing statements, making the information public may have an unwelcome impact upon the markets in which Northern's securities are traded. Granting the unaudited statements temporary confidential status will protect the integrity and proper functioning of markets in which Northern's offerings compete, and the public will have access when protection is no longer needed.

Staff also supports the Company's request for permanent confidential status of the Company's letter agreement with placement agents, produced in Staff DR 1-5, Attachment 1, for the reasons stated in Northern's July 1, 2020 motion. In short, Staff believes the letter agreement is commercial and financial information exempt from disclosure pursuant to RSA 91-A. Disclosure of the letter agreement would put the placement agent at a competitive disadvantage by exposing terms under which the agent won a competitive bid. Disclosure would also make it difficult for the Company to conduct competitive bids in the future, and would potentially limit the Company's future ability to obtain the best placement agents at the lowest price.

Staff supports the Company's request for permanent confidential treatment of the *S&P* and *Moody's* analysis contained in the credit reports, which were produced during discovery as Staff DR 1-4 Attachment 1 and 2, for the reasons stated in Northern's July 1, 2020 motion. Staff agrees that the analysis in both reports is proprietary financial and commercial information, and that making the analyses public would be detrimental to *S&P*, to *Moody's* and to the Company's ability to obtain valuable information from those entities in the future, and thus damaging to the Company and to its customers. However, the Company itself made at least some ratings public. See Petition, Testimony of Diggins and Francoeur, p. 7. Accordingly, Staff recommends that the Company be directed to file a redacted copy of Staff DR 1-5 Attachments 1-2, the *Moody's* and *S&P* credit report, showing the ratings "BBB+" and "Baa1" respectively.

STAFF RECOMMENDATIONS

Staff supports Northern's financing request and recommends that the Commission approve Northern's petition for authority to issue securities of up to \$50,000,000 with a long-term maturity of up to 30 years. Northern's filing is a routine financing request that will have no discernable impact on rates and will not adversely affect capitalization. The proceeds of the financing are being used to refinance short-term debt used to fund recent system improvements and expansion of Northern's distribution system and to fund 2020 improvements and expansion and therefore in the public good. RSA 369:4; see *Appeal of Easton*, 125 N.H. 205, 211 (1984).

In addition to approving the financing request, Staff recommends that the Commission require Northern to file an updated Weighted Average Cost of Debt (Revised Exh. NU-7) following the final closing and funding and no later than March 31, 2021.

Staff also supports the Company's request for limited confidential treatment of certain unaudited financial information contained in Northern Exhibits NU-4, NU-5, and NU-11, until such time as the audited financial statements are distributed. If the audited financial statements are materially different from the unaudited statements, Staff recommends that the Commission require the Company to amend its filing in this docket accordingly.

Staff also supports Northern's request for permanent confidential treatment of the letter agreement between the Company and its placement agents, produced during the course of discovery as Staff DR 1-5, Attachment 1.

Staff supports the Company's request for permanent confidential treatment of the *analysis* contained in the *S&P* and *Moody's* credit ratings reports, produced in the course of discovery as Staff DR 1-4 Attachments 1 and 2. However, Staff recommends that the Commission direct the Company to file redacted copies of the discovery responses at issue, showing the ratings that were recited in Northern's testimony.

Northern Utilities d/b/a Unitil
Docket No: DG 20-078
Petition for Authority to Issue Securities
Staff Discovery Requests - Set 2

Request No. Staff 2-1:

Ref. Staff DR 1-2: Please provide a supplement response when a decision on the issuance amount(s) and maturity date(s) is made in the next couple of weeks and provide a revised Exhibit NU-7 (in both PDF and Excel) based on the issuance amount(s), maturity(ies) and the indicative rate(s) based on the treasury yield(s) at that time.

Response:

On June 16th the Company priced \$40,000,000 of 20 year senior unsecured notes at a rate of 3.78%. This rate consisted of a credit spread of 245 basis points plus a quoted treasury yield of 1.33%.

Attachment 1 is a working excel file of Exhibit NU-7 adjusted for the actual amount of debt, the interest rate of 3.78%, and 20 year tenor. The Company's Pro Forma weighted cost of capital is 7.19%. This is lower than the as-filed Exhibit NU-7 Pro Forma weighted cost of capital rate of 7.27% and an actual 12/31/19 weighted cost of capital rate of 7.50%.

Attachment 2 is a PDF file of Attachment 1.

Person Responsible: Andre Francoeur & Todd Diggins

Date: June 25, 2020

NORTHERN UTILITIES, INC.
WEIGHTED AVERAGE COST OF DEBT
Proformed for the Issuance and Sale of \$40,000,000 Senior Unsecured Notes

(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)	(11)	(12)	(13)	(14)	(15)
Description of Debt	Interest Rate	Maturity Date	Term	Date Issued	Face Value	Outstanding Amount	Issuance Costs	Net Proceeds Ratio [(6)-(8)/(6)]	Unamortized Issuance Costs ⁽²⁾	Net Proceeds Outstanding (7)-(10)	Annual Issuance Cost	Annual Interest Cost (2)* (7)	Total Annual Cost (12)+(13)	Cost Rate Based on Net Proceeds (14)/[(7)-(10)]
Existing Debt														
Long Term Debt														
Sr. Notes	7.72%	12/3/2038	30 Yrs	12/3/2008	50,000,000	50,000,000	435,899	99.13%	274,934	49,725,066	14,534	3,860,000	3,874,534	7.79%
Sr. Notes	4.42%	10/15/2044	30 Yrs	10/15/2014	50,000,000	50,000,000	482,981	99.03%	399,130	49,600,870	16,099	2,210,000	2,226,099	4.49%
Sr. Notes	3.52%	11/1/2027	10 Yrs	11/1/2017	20,000,000	20,000,000	148,352	99.26%	116,209	19,883,791	14,835	704,000	718,835	3.62%
Sr. Notes	4.32%	11/1/2047	30 Yrs	11/1/2017	30,000,000	30,000,000	222,528	99.26%	206,456	29,793,544	7,418	1,296,000	1,303,418	4.37%
Sr. Notes	4.04%	9/12/2049	30 Yrs	9/12/2019	40,000,000	40,000,000	208,040	99.48%	205,727	39,794,273	6,954	1,616,000	1,622,954	4.08%
Total Long Term Debt					\$ 190,000,000	\$ 190,000,000	\$ 1,497,800		\$ 1,202,456	\$ 188,797,544	\$ 59,840	\$ 9,686,000	\$ 9,745,840	5.16%

Pro Forma Debt

Long Term Debt

Sr. Notes	7.72%	12/3/2038	30 Yrs	12/3/2008	50,000,000	50,000,000	435,899	99.13%	274,934	49,725,066	14,534	3,860,000	3,874,534	7.79%
Sr. Notes	4.42%	10/15/2044	30 Yrs	10/15/2014	50,000,000	50,000,000	482,981	99.03%	399,130	49,600,870	16,099	2,210,000	2,226,099	4.49%
Sr. Notes	3.52%	11/1/2027	10 Yrs	11/1/2017	20,000,000	20,000,000	148,352	99.26%	116,209	19,883,791	14,835	704,000	718,835	3.62%
Sr. Notes	4.32%	11/1/2047	30 Yrs	11/1/2017	30,000,000	30,000,000	222,528	99.26%	206,456	29,793,544	7,418	1,296,000	1,303,418	4.37%
Sr. Notes	4.04%	11/2/2047	30 Yrs	11/2/2017	40,000,000	40,000,000	208,040	99.48%	205,727	39,794,273	6,954	1,616,000	1,622,954	4.08%
New Sr. Notes ⁽¹⁾	3.78%	Q3 - 2040	20 Yrs	Q3 - 2020	40,000,000	40,000,000	375,000	99.06%	375,000	39,625,000	18,750	1,512,000	1,530,750	3.86%
Total Long Term Debt					\$ 230,000,000	\$ 230,000,000	\$ 1,872,800		\$ 1,577,456	\$ 228,422,544	\$ 78,590	\$ 11,198,000	\$ 11,276,590	4.94%

Weighted Average Cost of Capital

	Actual (12/31/19)				Adjustment Amount	Pro Forma (12/31/19)			
	Amount	Percent of Total	Cost Rate	Weighted Cost Rate		Amount	Percent of Total	Cost Rate	Weighted Cost Rate
Common Equity	\$ 225,080,042	54%	9.48%	5.14%	\$ -	\$ 225,080,042	49%	9.48%	4.69%
Long Term Debt	190,000,000	46%	5.16%	2.36%	40,000,000	230,000,000	51%	4.94%	2.50%
Total	\$ 415,080,042			7.50%	\$ 40,000,000	\$ 455,080,042			7.19%

(1) Assumes the issuance of \$40 million 20-year notes at 3.78%

(2) Unamortized Issuance Costs as of 12/31/2019

Executive.Director@puc.nh.gov

amanda.noonan@puc.nh.gov

jayson.laflamme@puc.nh.gov

Mary.Schwarzer@puc.nh.gov

ocalitigation@oca.nh.gov

steve.frink@puc.nh.gov

taylorp@unitil.com