

**STATE OF RHODE ISLAND AND PROVIDENCE PLANTATIONS  
DIVISION OF PUBLIC UTILITIES AND CARRIERS  
89 JEFFERSON BOULEVARD  
WARWICK, RHODE ISLAND 02888**

IN RE: Narragansett Bay Commission :  
Application For Authority to Incur Debt : Docket No. D-13-143

**REPORT AND ORDER**

On October 11, 2013, the Narragansett Bay Commission (“NBC”), One Service Road, Providence, Rhode Island, filed an application with the Rhode Island Division of Public Utilities and Carriers (“Division”) seeking approval to issue long-term debt for both a Rhode Island Clean Water Finance Agency (“RICWFA”) borrowing and an open market issue for a total not to exceed \$90,000,000. The application was filed in accordance with the requirements contained in Section 39-3-15 of the Rhode Island General Laws.

In response to the application filing, the Division conducted a duly noticed public hearing on November 8, 2013. The hearing was conducted in the Division’s hearing room, located at 89 Jefferson Boulevard in Warwick. The following counsel entered appearances:

For the NBC: Joseph A. Keough, Jr., Esq.

For the Division’s  
Advocacy Section: Christy Hetherington, Esq.  
Special Assistant Attorney General

The NBC proffered pre-filed direct testimony from two witnesses in support of its application. The witnesses were identified as Ms. Karen L. Giebink, the NBC’s Director of Administration and Finance; and Mr. William J.

Fazioli, Senior Managing Consultant with Public Financial Management, Inc. (“PFM”).

Ms. Giebink testified that the NBC is requesting Division approval to enter into long-term debt and issue revenue bonds for an amount not to exceed \$90 million. However, unlike in most other filings where NBC has requested the Division to approve a specific bond issue, as either a subsidized loan from the RICWFA or an open market issue, Ms. Giebink testified the NBC is instead requesting approval to issue long-term debt for both a RICWFA borrowing and an open market issue for a total not to exceed \$90 million for the two transactions; specifically, \$45 million in open market revenue bonds, and \$45 million from the RICWFA. Ms. Giebink compared the instant request with the NBC’s last filing with the Division, filed on February 7, 2013, wherein NBC first requested Division support for this type of combination borrowing.<sup>1</sup>

Ms. Giebink testified that the bond issue planned for this November is a fixed rate issue, which will enable NBC to take advantage of relatively low long-term interest rates.<sup>2</sup> Ms. Giebink also testified that this financing plan “also contemplates a modification to the existing amortization of NBC’s outstanding 2008 Series A VRDBs.” She related that shifting the amortization to slightly defer principal, frees up capacity in the early years and will allow NBC to wrap new debt service around the fixed 20-year amortizations of all RICWFA loans. Ms. Giebink testified that under this plan, “no additional rate increases will be required to support the issuances in this application.”

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<sup>1</sup> NBC Exhibit 1, Giebink Testimony, p. 2-4.

<sup>2</sup> *Id.*, p. 2.

Ms. Giebink also related that the NBC worked with its financial advisor to size the bond issues so that NBC can meet its contractual commitments for the CSO Phase II Facilities, Nitrogen Removal, estimated costs of the Regulatory Compliance Building, the CSO Phase III Reassessment and other projects in progress or to be initiated through June 30, 2015. She noted that additional funding will be required for the other unfunded components of NBC's Capital Improvement Program and will be addressed by the NBC once those project costs and schedules are more certain.<sup>3</sup>

Ms. Giebink explained that there are several factors which the NBC must take into consideration as part of its capital financing strategy. She proffered the following list:

1. NBC must complete certain capital improvements to meet permit and comply with Consent Agreements.
2. NBC must ensure that it can meet its contractual commitments and the RICWFA does not have sufficient capacity to meet NBC's capital needs.
3. There is a significant financial benefit to NBC ratepayers from maximizing debt issuance at historic low interest rates.
4. Not all of NBC's capital projects are eligible for RICWFA funding.
5. There is financial benefit to NBC ratepayers from accessing the market for a fixed rate issue prior to November 28, 2013....
6. NBC must not exceed the debt service and debt service coverage allowances authorized by the PUC.<sup>4</sup>

Ms. Giebink next related that although NBC projects it will need approximately \$27.3 million less in fiscal years 2013 and 2014 than was projected a year ago, and \$8.6 million less than previously projected for FY

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<sup>3</sup> Id., p. 3.

<sup>4</sup> Id., pp. 3-4.

2015, the NBC's capital needs remain high, at more than \$147 million over the balance of the FY 2014 and FY 2015 period. Ms. Giebink also provided details on NBC's available capital funds, which stood at \$49.4 million as of September 30, 2013.<sup>5</sup>

Going forward, Ms. Giebink testified that NBC has unfunded cash flow needs of \$108.2 million for the period October 1, 2013 through June 30, 2015. She related that it is assumed by NBC that RICWFA will have the capacity to loan NBC \$45 million in FY 2014 and that NBC will need to go to the open market for the balance of its approximately \$45 million in funding needs.<sup>6</sup>

Ms. Giebink testified that the NBC's authorizing resolution provides that the proceeds of this loan may be used for:

*“... financing the acquisition, design, evaluation, inspection, construction, improvement, installation, cleaning, rehabilitation, furnishing and equipping of: the Phase I Combined Sewer Overflow (CSO) Facilities, the Phase II CSO Facilities, the Phase III CSO Facilities, the Field's Point Wastewater Treatment Facility Nitrogen Removal Facilities, Bucklin Point Biogas Reuse, Field's Point Wind Turbines, the upgrade of the Field's Point Operations Building and other miscellaneous improvements at various locations, the Bucklin Point Wastewater Treatment Facility Nitrogen Removal Facilities, the Bucklin Point Wastewater Treatment Facility Improvements, Floatables Control Facilities, the Regulatory Compliance Building, Fire Code Compliance, New Interceptor Maintenance (IM) Facilities, System-Wide Facilities Plan, River Model Development, Field's Point Tunnel Pump Station Improvements, Receiving Water Quality Study, The Providence River Siphon Replacement, and Field's Point Utility Reliability Enhancement and Commission Interceptors and Interceptor Easements and other projects of the*

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<sup>5</sup> *Id.*, p. 4.

<sup>6</sup> *Id.*, pp. 4-5, as amended during hearing.

*Commission, capitalized Interest and Financing Costs,  
the Funding of an Account in the Debt Service Reserve  
Fund.*<sup>7</sup>

Ms. Giebink noted that although the loan proceeds are authorized for all the projects listed above, preliminary projections show that 72% of the proceeds will be used to finance construction of the CSO Phase II Facilities; and that 11% of the proceeds are projected to be used to finance the Biological Nutrient Removal projects at Field's Point and Bucklin Point, 16% for the Regulatory Compliance Building and 1% for the CSO Phase III Reevaluation.<sup>8</sup>

Ms. Giebink next identified the status of the requirements necessary to close on the open market revenue bond issue. She related that NBC's Board of Commissioners passed the Authorizing Resolution for the Issuance of up to \$80,000,000 in Revenue Obligations at their June 25, 2013 Board meeting.<sup>9</sup> Ms. Giebink additionally related that the Preliminary Official Statement (POS), related to the instant borrowing, is currently being finalized in anticipation of mailing on November 14, 2013. Ms. Giebink further testified that, predicated upon the modification of the amortization of the 2008 Series A Issue, NBC has sufficient coverage to meet the debt service and debt service coverage requirements for the proposed open market revenue bond issuance.<sup>10</sup>

Ms. Giebink next turned her attention to the status of the requirements necessary to close on the \$45 million borrowing from RICWFA. She testified that the NBC submitted its loan application with the RICWFA on April 17,

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<sup>7</sup> *Id.*, pp. 5-6.

<sup>8</sup> *Id.*, p. 6.

<sup>9</sup> *Id.*, and Giebink Exhibit KG-1.

<sup>10</sup> *Id.*, pp., 6-7 and Giebink Exhibit KG-2.

2013. Ms. Giebink related that on September 20, 2013 NBC received notification from the RICWFA that its loan request was approved at a level of \$25 million. However, during the hearing, she testified that the RICWFA had recently increased its approval to a level of \$45 million. Ms. Giebink stated that although the NBC's Board of Commissioners passed a resolution authorizing the NBC to borrow an amount not to exceed \$25 million for the RICWFA on December 3, 2012, it is expected that the Board will pass an amended resolution in December 2013 authorizing the increased borrowing.<sup>11</sup> Ms. Giebink added that the NBC has sufficient coverage for the \$45 million bond issuance based upon the rates approved by the Public Utilities Commission on June 13, 2013.<sup>12</sup> Ms. Giebink also noted that the Loan Agreement included with the instant application is not final. She explained that the NBC has included a draft loan agreement that is similar to the loan agreements executed by the NBC as part of the traditional subsidized RICWFA loan program.<sup>13</sup>

Before discussing the instant loan proposal, Mr. William Fazioli offered some background information on PFM and on the independent financial advisory services that PFM provides to public entities. Mr. Fazioli related that over the last 37 years PFM has grown into a national firm with over 500 employees in 34 offices across the United States. He testified that for the "15<sup>th</sup> consecutive year, PFM has maintained its position as the number one financial advisor in the industry, providing financial advisory services in more than 900

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<sup>11</sup> Id., p. 7 and Giebink Exhibit KG-3.

<sup>12</sup> Id., p. 7 and Giebink Exhibit KG-2.

<sup>13</sup> Id., p. 7.

transactions for a total par amount in excess of \$56.8 billion in 2012.” Mr. Fazioli added that in terms of wastewater issuers, “PFM has been the top ranked financial advisor in this sector for several years as well while representing other large wastewater operators including the Massachusetts Water Resources Authority and the DC Water and Sewer District.”<sup>14</sup> Mr. Fazioli testified that PFM was appointed in 2012 to serve as Financial Advisor to the NBC by its Board of Commissioners.

With respect to the instant matter, Mr. Fazioli indicated that he has been asked to provide testimony in support of NBC’s application and to address the current interest rate environment. At the outset, Mr. Fazioli related that NBC’s lowest cost of borrowing has traditionally been through subsidized loans from the RICWFA. He stated that NBC has used the RICWFA loans to finance its Capital Improvement Program (“CIP”) “to the extent that funds were available.” Mr. Fazioli related, however, that since RICWFA has a limited capacity to make subsidized loans to the NBC for its various projects, the NBC must issue open market revenue bonds to supplement its capital funding needs.<sup>15</sup>

Mr. Fazioli next testified that based upon a review of cash flows, NBC has determined that it will need additional capital funds as early as November 2013, well before the RICWFA transaction, which is scheduled to “close in the first quarter of 2014.” He related that as of mid-October 2013, NBC will have expended the proceeds of its \$71.48 million 2013 Series A bond issue; and projects that the proceeds of its \$25.0 million 2013 Series B loan will be fully

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<sup>14</sup> NBC Exhibit 1, Fazioli Testimony, pp. 1-2.

<sup>15</sup> Id., p. 2.

expended in November, 2013. Mr. Fazioli noted that because the \$45 million RICWFA loan will not be available until next year, NBC must supplement the funding of ongoing capital commitments through the issuance of open market revenue bonds. Mr. Fazioli related that NBC estimates that it will need additional deposits into its project fund of approximately \$45 million to meet capital needs through June 15, 2015.<sup>16</sup>

Mr. Fazioli next testified that in order to mitigate rate impacts “we examined ways for NBC to level out its debt service.” He observed that the assets that NBC finances through its capital program typically have a useful life of 30-50 years, while the RICWFA structures its loans with level debt service for a term no longer than 20 years. Mr. Fazioli related that as a result, NBC’s debt is “front-loaded” and assets do not necessarily match up with liabilities. Mr. Fazioli also observed “that NBC has historically issued its revenue bonds with 30 year maturities and an amortization that ‘wrapped’ around the shorter maturity loans from the RICWFA to address this issue.<sup>17</sup> In view of this historical debt structuring, Mr. Fazioli related that he has advised NBC to modify the amortization schedule of the 2008 Series A variable rate refunding bonds, so that the NBC “can issue all of the debt proposed in this application within approved rates.”<sup>18</sup>

Mr. Fazioli also explained that to date NBC has not needed to fund a debt service reserve fund on any of its revenue bond issues. He explained that the

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<sup>16</sup> Id., p. 3, as amended during hearing.

<sup>17</sup> Id.

<sup>18</sup> Id.



municipal bond market has been such that this did not adversely impact pricing, as he related, was the case with NBC's March 21, 2013 Series A Issue. He explained, however, that since that time, "we have received feedback through NBC's investment bankers that investors are now penalizing bonds issued without debt service reserve funds by requiring higher interest rates." Mr. Fazioli also confirmed that the pricing advantage associated with a debt service reserve fund outweighs the negative carry of the debt service reserve fund.<sup>19</sup>

Mr. Fazioli provided the details of his interest rate assumptions for the open market revenue bond issue in an exhibit attached to his pre-filed testimony. He related that because the actual debt service schedules will depend on the final structure and then-current market conditions and therefore will likely differ somewhat.<sup>20</sup>

As for the structure and interest rate assumptions associated with the RICWFA borrowing, Mr. Fazioli related that the revenue bonds are amortized over 20 years with the final maturity in or about 2034 and will be structured as level debt with the traditional RICWFA subsidy of 1/3 of market rate. Mr. Fazioli provided a draft debt service schedule with his pre-filed testimony.<sup>21</sup>

Mr. Fazioli next provided an update on current market rates, the yield curve, NBC's credit rating and how these factors influence NBC's options. He testified that interest rates remain relatively low and the credit spreads remain

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<sup>19</sup> *Id.*, pp. 4-5.

<sup>20</sup> *Id.*, p. 5 and Fazioli Exhibit WJF-2.

<sup>21</sup> *Id.*, p. 5 and Fazioli Exhibit WJF-3.

narrow for high credit quality issuers with the yield curve for a “AA” credit rating only 19 basis points higher than a “AAA” credit rating as of October 10, 2013. Mr. Fazioli related that the value of a “AA-” credit rating is tangible and will result in cost savings for ratepayers compared to a lower quality credit. He added, while the yield curve has steepened in recent months, the yield curve remains extremely flat at the long end of the curve with the spread between 20- and 30-year interest rates at about 24 basis points for a “AA” credit.<sup>22</sup> Mr. Fazioli offered a graphic to demonstrate these variations in the yield curve.<sup>23</sup>

In his concluding comments, Mr. Fazioli opined that it would be to NBC’s advantage to price its bonds prior to November 28, 2013, prior to the traditional year-end surge of bond issuances in the public markets. He related that to facilitate this timing, Division approval is needed by November 13, 2013 so that the POS can be mailed to investors on November 14, 2013. Mr. Fazioli related that ideally the bonds would be priced on November 21, 2013 with the closing on or about December 5, 2013.<sup>24</sup>

In response to the instant filing, the Division’s Advocacy Section sponsored a memorandum from Mr. Thomas S. Catlin, of Exeter Associates, Inc., a rate consultant who has appeared as an expert witness for the Division in NBC rate proceedings before the Public Utilities Commission. In the memorandum, Mr. Catlin concludes that the NBC has sufficient debt service in

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<sup>22</sup> Id., p. 5.

<sup>23</sup> Id.

<sup>24</sup> Id., p. 6.

its rates to cover the proposed borrowings.<sup>25</sup> After a brief cross-examination of the NBC's witnesses, the Advocacy Section stated for the record that it was satisfied from the evidence presented, that the NBC had met the requisite burden of proof set forth in R.I.G.L. §39-3-15, et seq. and that the proposed borrowings are in the public interest.

### FINDINGS

Predicated on a thorough examination of the record in this matter, the Division finds that the NBC's application seeking approval to issue long-term debt for both a RICWFA borrowing and an open market issue for a total not to exceed \$90,000,000 (specifically, \$45 million in open market revenue bonds, and \$45 million from the RICWFA), is reasonable and in the best interest of ratepayers.

Now, therefore, it is

(21239) ORDERED:

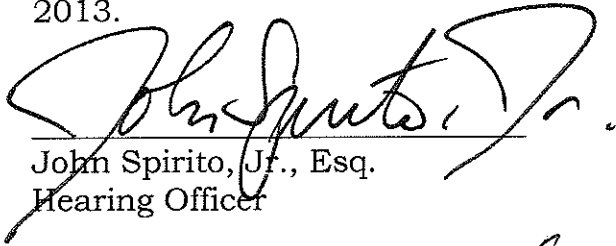
1. That the Narragansett Bay Commission's October 11, 2013 application, as amended during the November 8, 2013 hearing, seeking approval to issue long-term debt for both a RICWFA borrowing and an open market issue for a total not to exceed \$90,000,000 (specifically, \$45 million in open market revenue bonds, and \$45 million from the RICWFA), is hereby approved as filed.
2. That the Division hereby makes this approval contingent upon the NBC's use of the debt service allowance previously approved by the Public Utilities

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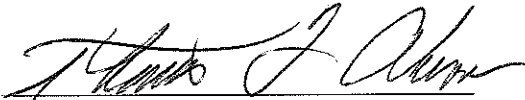
<sup>25</sup> Advocacy Section Exhibit 1.

Commission, or if subsequently required, by additional debt service allowances approved by the Public Utilities Commission.

DATED AND EFFECTIVE AT WARWICK, RHODE ISLAND ON NOVEMBER 12, 2013.



John Spirito, Jr., Esq.  
Hearing Officer

APPROVED:   
Thomas F. Ahern  
Administrator