Case No.: 2005-00174
Questions From: Public Service Commission – September 9, 2005
Response from: Hopkinsville Water Environment Authority
Sponsoring Witness: Lennis Franklin Hale

INFORMATION REQUEST NO. 5.

At page 7 in his Direct Testimony, Mr. McKinley, states: "The parity bond test requires HWEA must have debt service coverage of at least 130 percent on the maximum annual debt service for existing bonds and the proposed bonds in 12 consecutive months of the 18 months immediately preceding the issuance of the proposed bonds."

a. Provide a complete copy of the bond ordinance(s) requiring HWEA to maintain a 1.3x debt service coverage for existing and new bonds. Highlight the section(s) of the bond ordinance(s) that require the 1.3x coverage.

RESPONSE:

Copies of the Series 1993, 2002, 2005A and 2005B Bond Ordinances are attached as Exhibit No. 5a. All of the Bond Ordinances are similar and were prepared by the law firm of Ruben and Hays. Section 12 of the Bond Ordinances explains the debt service requirements for these Bonds.

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INFORMATION REQUEST NO. 5.

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b. State whether these bond ordinance(s) require HWEA to adjust operating revenues and/or expenses (e.g., eliminate depreciation expense) when calculating HWEA's actual debt service coverage. List all adjustments required by the bond ordinances and provide references to the sections that require those adjustments.

RESPONSE:

Please refer to the definitions of Net Revenues and Operating Expenses in Section 12 of the Bond Ordinances referred to in HWEA's Response to the Commission Information Request No. 5a.

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INFORMATION REQUEST NO. 5.

At page 7 in his Direct Testimony, Mr. McKinley, states: "The parity bond test requires HWEA must have debt service coverage of at least 130 percent on the maximum annual debt service for existing bonds and the proposed bonds in 12 consecutive months of the 18 months immediately preceding the issuance of the proposed bonds."

c. Refer to "Report on Revenue Requirements, Costs of Service and Rates for Water Service" ("Cost-of-Service Study") at 18. HWEA states that the water division is responsible for two existing Kentucky Infrastructure Authority loans. State whether the debt service payments for the KIA loans are included in the 1.3x parity coverage calculation required by the bond ordinances. If yes. Identify the requirement in the bond ordinance that requires the inclusion of the KIA loan payments.

RESPONSE:

The KIA loans are subordinate to the Revenue Bonds and only require revenues to meet principal and interest demands and O&M cost. The debt service requirement for the KIA loans are not included in the 1.3x parity coverage calculations.

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INFORMATION REQUEST NO. 5.

At page 7 in his Direct Testimony, Mr. McKinley, states: "The parity bond test requires HWEA must have debt service coverage of at least 130 percent on the maximum annual debt service for existing bonds and the proposed bonds in 12 consecutive months of the 18 months immediately preceding the issuance of the proposed bonds."

d. State debt service coverage requirements that the KIA loan agreements specify.

RESPONSE:

Please see HWEA's Response to Commission Information Request No. 5c.

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INFORMATION REQUEST NO. 5.

At page 7 in his Direct Testimony, Mr. McKinley, states: "The parity bond test requires HWEA must have debt service coverage of at least 130 percent on the maximum annual debt service for existing bonds and the proposed bonds in 12 consecutive months of the 18 months immediately preceding the issuance of the proposed bonds."

e. Provide for fiscal years 2003, 2004, and 2005, HWEA's calculations showing that it is in compliance with 1.3x debt service requirement of the bond ordinances.

RESPONSE:

The Audits for FY 2002, 2003 and 2004 show that HWEA is in compliance with its debt service requirement. On page 18, last sentence of the FY 2004 Audit, York, Neel and Company states, "HWEA is in compliance with all significant financial requirements as of June 30, 2004 and 2003." The same statement by the auditor is presented on page 18 of the FY 2003 Audit and on page 12 of the FY 2002 Audit. These Audits were provided in the July 7, 2004 and August 11, 2005 Responses to the Commission filed by HWEA. A copy of the applicable pages of the Audits referenced herein is attached as Exhibit No. 5e.

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INFORMATION REQUEST NO. 6.

At page 7 of his Direct Testimony, Mr. McKinley refers to a "companion covenant" which requires a debt service coverage of 1.15 percent on a combined water and sewer utility basis.

a. Provide a complete copy of the bond ordinance(e) requiring HWEA to maintain a combined 1.15x debt service coverage for its water and sewer divisions. Highlight the section of the bond ordinance requiring the 1.15x coverage.

RESPONSE:

The Bond Ordinances are attached as Exhibit No. 5a. Section 12 of these Bond Ordinances contains the requirement for 1.15x coverage.

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Sponsoring Witness: Lennis Franklin Hale

INFORMATION REQUEST NO. 6.

At page 7 of his Direct Testimony, Mr. McKinley refers to a "companion covenant" which requires a debt service coverage of 1.15 percent on a combined water and sewer utility basis.

b. State whether these bond ordinance(s) require HWEA to adjust operating revenues and/or expenses (e.g., eliminate depreciation expense) when calculating HWEA's actual debt service coverage. List all adjustments required by the bond ordinances and provide references to the sections that require those adjustments.

RESPONSE:

Please see HWEA's Responses to Commission Information Request Nos. 5a. and 5b. Section 12 of the Bond Ordinances referred to in HWEA's Response to Commission Information Request No. 5a. provides a description of all necessary adjustments.

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INFORMATION REQUEST NO. 6.

At page 7 of his Direct Testimony, Mr. McKinley refers to a "companion covenant" which requires a debt service coverage of 1.15 percent on a combined water and sewer utility basis.

c. Provide fiscal years 2003, 2005, and 2005, HWEA's calculations showing that it is in compliance with the 1.15x debt service requirement of the bond ordinances.

RESPONSE:

Please see HWEA's Response to the Commission Information Request No. 5e.

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Response from: Hopkinsville Water Environment Authority
Sponsoring Witness: Jennings Rowe McKinley II

INFORMATION REQUEST NO. 7.

a. At page 7 of his Direct Testimony, Mr. McKinley states that HWEA's target coverage for the combined water and sewer divisions is 1.25x. State the basis for HWEA's 1.25x coverage target.

RESPONSE:

Please see the discussion of Coverage Requirements on pages 20 and 21 of the B&V Report in which it is explained that for planning purposes and to allow for possible revenue and expense fluctuations it is reasonable to use 125% for rate designs purposes.

If debt service coverage is the controlling factor in establishing adequate levels of rate revenue (as contrasted to the level of annual "cash expenditure" requirements), prudent financial planning and oversight by the financial community (including underwriters, financial advisors, rating agencies, and potential investors) essentially require that debt service coverage targets above the bare minimum coverage requirements established by the utility's revenue bond ordinance or bond indenture be utilized by the utility in its rate setting practices.

Targets which provide a margin of safety above the minimum required coverage levels enable the utility to weather unexpected decreases in revenues and/or increases in costs, while maintaining its required debt service coverage levels. Such margins are intended to prevent the utility from experiencing a technical default of its debt covenants, which could create problems in the utility's ability to issue future bonds at market based pricing levels. The degree of the margin above minimum required coverage levels varies with the potential for wide swings in revenues and/or expenses with which a particular utility may be faced. A safety margin of 5 to10 percentage points above the minimum required debt service coverage levels are not uncommon in the industry. Therefore, the targeted level of 125% versus the required level of 115% for annual debt service coverage, or a margin of 10%, is within the range of reasonableness for the municipal utility industry.

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Sponsoring Witness: Jennings Rowe McKinley II

INFORMATION REQUEST NO. 7.

b. At page 21 of the Cost-of-Service study there is a reference to a debt service coverage target of 1.35x. Provide an explanation for the apparent discrepancy between the target coverage in the direct testimony with the target coverage from the Cost-of-Service study.

RESPONSE:

There is no discrepancy in the B&V Report and the testimony of Mr. McKinley on this issue. The 135% targeted level of debt service coverage discussed at the bottom of page 21 of the B&V Report, as well as on page 7, lines 6 and 7 of Mr. McKinley's testimony, is relative to the 130% required level of debt service coverage for the parity bond coverage test, or a margin of 5% above the required level. The 125% debt service coverage discussed at the bottom of page 20 and the top of page 21 of the B&V Report, as well as on page 7, lines 15 and 16 of Mr. McKinley's testimony, is related to the required annual debt service coverage test of 115%, or a margin of 10% above the required level.

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INFORMATION REQUEST NO. 8.

According to a statement at page 21 of the Cost-of-Service Study, Mr. McKinley projects that HWEA will not meet its targeted debt service coverage of 1.25x until fiscal year 2007. Describe the effect, if any, of this failure on HWEA's 2005 bond issuance of approximately $27.18 million.

RESPONSE:

While for the water utility, the targeted annual debt service coverage level of 125% is not projected to be met until FY 2007, the required annual debt service coverage level (for the water utility only) is projected to be met in FY 2006. On a combined water and sewer utility basis, the required annual debt service coverage is also met in FY 2005 according to the financial advisors for HWEA. Accordingly, the HWEA Series 2005 Bond issue was not negatively impacted, since the debt service coverage requirements, by bond indenture stipulation, are to be computed on a combined utility basis.

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Sponsoring Witness: Lennis Franklin Hale

INFORMATION REQUEST NO. 9.

At page 18 of the Cost-of-Service study, Mr. McKinley states that the debt service on the proposed bonds is based on an average interest rate of 4 percent and a 20-year maturity schedule. At page 6 of his Direct Testimony, Mr. McKinley states that the bond issue was originally projected to $25.75 million, but the amount of actual bonds issued for the construction projects was $25.635 million plus an additional $1.545 million for bond refunding.

a. Provide the actual annual interest rate and bond term of the bond issues.

RESPONSE:

The actual annual interest rate and bond term of the Series 2005A Bond is attached as Exhibit No. 9a.

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Response from: Hopkinsville Water Environment Authority
Sponsoring Witness: Lennis Franklin Hale

INFORMATION REQUEST NO. 9.

At page 18 of the Cost-of-Service study, Mr. McKinley states that the debt service on the proposed bonds is based on an average interest rate of 4 percent and a 20-year maturity schedule. At page 6 of his Direct Testimony, Mr. McKinley states that the bond issue was originally projected to $25.75 million, but the amount of actual bonds issued for the construction projects was $25.635 million plus an additional $1.545 million for bond refunding.

b. Provide a comparison of the projected and the actual amortization schedules for the proposed bonds.

RESPONSE:

The projected amortization schedule for the Series 2005A Bond (used to finance the Lake Barkley project) is presented in Table 9, page 17 and Table 10, page 19 of the B&V Report. The actual amortization schedule for Series 2005A Bond is attached as Exhibit No. 9b.

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INFORMATION REQUEST NO. 9.

At page 18 of the Cost-of-Service study, Mr. McKinley states that the debt service on the proposed bonds is based on an average interest rate of 4 percent and a 20-year maturity schedule. At page 6 of his Direct Testimony, Mr. McKinley states that the bond issue was originally projected to $25.75 million, but the amount of actual bonds issued for the construction projects was $25.635 million plus an additional $1.545 million for bond refunding.

c. Identify the bonds that were refunded.

RESPONSE:

The Series 2005B Bonds refunded the Series 1996 Bonds, which were used to finance the Moss Water Treatment Plant ("WTP").

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INFORMATION REQUEST NO. 9.

At page 18 of the Cost-of-Service study, Mr. McKinley states that the debt service on the proposed bonds is based on an average interest rate of 4 percent and a 20-year maturity schedule. At page 6 of his Direct Testimony, Mr. McKinley states that the bond issue was originally projected to $25.75 million, but the amount of actual bonds issued for the construction projects was $25.635 million plus an additional $1.545 million for bond refunding.

d. Calculate the effect that the actual debt service and the bond refunding will have on the Cost-of-Service study and HWEA's proposed increase in the rates charged to Christian County Water District ("CCWD"). State all assumptions, show all calculations, and provide all workpapers used to make this calculation.

RESPONSE:

Based on a comparison of projected debt service and actual debt service reflecting the refunding of the Series 1996 Bonds for the test year, line 2 of Table 12 on page 24 of the B&V Report would decrease by approximately $118,600. This reduction in capital costs would decrease the total cost of service to be recovered in the test year and accordingly the cost of service allocated to each customer class. The resulting proposed rates would reflect this decrease in cost of service.

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Questions From: Public Service Commission – September 9, 2005
Response from: Hopkinsville Water Environment Authority
Sponsoring Witness: Jennings Rowe McKinley II and Lennis Franklin Hale

INFORMATION REQUEST NO. 10.

Provide a revised Cost-of-Service study using the financial information for the fiscal year ending June 30, 2005 with adjustments for known and measurable changes. State all assumptions, show all calculations, and provide all workpapers used to prepare this revised cost-of-service study.

RESPONSE:

HWEA is unable to provide the information required to complete this request at this time because its 2005 Fiscal Year Audited Financial Statements are not available.