

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

ELECTRONIC APPLICATION OF THE ADAIR)	
COUNTY WATER DISTRICT TO ISSUE)	
SECURITIES IN THE APPROXIMATE)	
PRINCIPLE AMOUNT OF \$5,405,000 FOR)	CASE NO.
THE PURPOSE OF REFUNDING CERTAIN)	2020-00148
OUTSTANDING OBLIGATIONS OF THE)	
DISTRICT PURSUANT TO THE PROVISIONS)	
OF KRS 278.300 AND 807 KAR 5:001)	

ORDER

On May 18, 2020, Adair County Water District (Adair District) filed an application (Application) seeking Commission authority to refinance certain debt of up to \$5,405,000 with the Kentucky Rural Water Finance Corporation (KRWFC) via an Assistance Agreement (KRWFC Loan). There are no Intervenor in this case, and the matter is submitted to the Commission for a decision based upon the evidentiary record.

Before addressing the substance of the application, the Commission notes that Adair District reported a water loss of 15.0206 percent in its 2018 Annual Report. Commission regulations state that for ratemaking purposes a utility's water loss shall not exceed 15 percent of the total water produced and purchased, excluding water consumed by a utility in its own operations. The Commission is placing greater emphasis on monitoring utilities that consistently exceed the 15 percent water loss threshold and strongly encourages Adair District to pursue reasonable actions to reduce its water loss. Failure by Adair District to make progress towards reducing water loss may cause the Commission to pursue additional action with the utility.

Further, Commission records indicate that Adair District has not sought a base rate adjustment, except for adjustments pursuant to KRS 278.023, since at least 1985. The Commission's review of records in a case filed pursuant to KRS 278.023, which requires the Commission to approve certain rate adjustments made to comply with an agreement between a water utility and certain federal agencies, is limited and very different from the comprehensive review of a utility's total financial stability and operational viability that takes place when a utility files an application for a general rate adjustment or an alternative rate adjustment. Thus, the practical result of Adair District only adjusting its base rates pursuant to KRS 278.023 is that Adair District has managed to avoid Commission review of its financial records and operational structure for more than 35 years.

In Commission Case No. 2019-00041 and the resulting investigative report, the Commission discussed the problems that can occur when utilities intentionally avoid a review of their financial records by relying solely on financing cases to increase rates.¹ A key recommendation from that investigative report was that water districts should monitor the sufficiency of their base rates closely and, in general, apply for base rate adjustments on a more frequent basis.² The Commission notes that, according to Adair District's audit reports the district has a negative net income that continues to grow, a cash basis income

¹ See Case No. 2019-00041, *Electronic Investigation into Excessive Water Loss by Kentucky's Jurisdictional Water Utilities* (Ky. PSC Nov. 22, 2019), Order at 6 (incorporating the Commission's findings of its investigative report regarding water utilities, attached as Appendix L to the Order (PSC Investigative Report)); see also PSC Investigative Report at 19–20, 24 (indicating that the Commission is concerned that water utilities are increasing rates pursuant to KRS 278.023 to avoid scrutiny and discussing some of the issues that causes).

² PSC Investigative Report at 25.

that is increasingly lower, and is decreasing, not increasing. Its depreciation reserve for the years 2016 through 2018 are shown below.³

Year	2016	2017	2018
Net Income	\$ (406,564)	\$ (597,614)	\$ (675,083)
Add: Depreciation Expense	1,518,854	1,516,359	1,515,247
Cash Basis Income	\$ 1,112,290	\$ 918,745	\$ 840,164
Cash and Cash Equivalents	\$ 68,365	\$ 202,626	\$ 91,366
Depreciation Reserve	2,067,860	2,060,734	2,049,738
Net Increase (Decrease) in Cash	(17,609)	(56,005)	(71,911)

The lack of insight into Adair District’s financial records as well as the analysis discussed above, leads the Commission to find that Adair District should file an application for a general rate adjustment pursuant to 807 KAR 5:001, Section 16 or an application for an alternative rate adjustment pursuant to 807 KAR 5:076 within one year of the date of this Order to ensure its revenue is sufficient to support adequate and reliable service.

With respect to the application for financing approval at issue in this matter, Adair District intends to use the proceeds from the proposed KRWFC Loan to refinance and discharge \$5,405,000 of outstanding indebtedness to the U.S. Department of Agriculture, acting through Rural Development (RD). The outstanding RD balance consists of six fixed-rate debts with the original principal amounts of \$495,000 carrying an interest rate of 4.25 percent per annum, \$1,238,000 carrying an interest rate of 4.25 percent per

³ Adair District’s Audit Reports can be found on the Commission’s website at:
https://psc.ky.gov/Utility_Financial_Reports_Net/uploaded/support/SD_9003500_2016_1.pdf
https://psc.ky.gov/Utility_Financial_Reports_Net/uploaded/support/SD_9003500_2017_1.pdf
https://psc.ky.gov/Utility_Financial_Reports_Net/uploaded/support/SD_9003500_2018_1.pdf

annum, \$3,480,000 carrying an interest rate of 4.375 percent per annum, \$752,000 carrying an interest rate of 4.25 percent per annum, \$300,000 carrying an interest rate of 4.375 percent per annum, and \$115,000 carrying an interest rate of 4.125 percent per annum.⁴ The outstanding balance for the prior bonds held by RD is approximately \$5,405,000.⁵ The total amount to be refinanced is \$5,405,000 via a loan with a 28-year term funded by bonds that will be issued at interest rates that will vary between 2.9 percent and 3.45 percent per annum.⁶

Adair District stated that the KRWFC loan would provide the funds necessary to refund the RD indebtedness and pay the fees and expenses incident to the issuance of the loan.⁷ Adair District provided a cash flow analysis that indicates that the refinancing would save \$710,317 over the life of the proposed loan, resulting in a positive net present value (NPV) cash flow of \$638,283.⁸

The Commission has reviewed the proposed refinancing and finds Adair District's proposal to be reasonable due to the lower effective interest rate and cash flow savings Adair District would realize over the period of the loan. However, in the event that the new interest rate on the proposed refinancing is higher than the range of interest rates set forth in the Application, Adair District should not proceed with the refinancing unless the NPV of the refinancing results in positive cash flow. The Commission commends

⁴ Application at 2–3, paragraph 5.

⁵ *Id.*, Exhibit B.

⁶ *Id.*, Exhibit A.

⁷ *Id.* at 3, paragraph 7.

⁸ *Id.*, Exhibit C.

Adair District for taking advantage of the financing alternatives available to it, thereby securing savings for itself and its customers.

After consideration of the evidence of record and being sufficiently advised, the Commission finds that the proposed loan from KRWFC is for lawful purposes within the Adair District's Application is necessary, appropriate for, and consistent with the proper performance by the utility of its service to the public. This will not impair Adair District's ability to perform that service which is reasonable, necessary, and appropriate for such purposes, and should be approved. The Commission also finds that the final amounts of the RD payoff, the legal fees, and the new KRWFC loan will not be known until the refinancing transaction is finalized, and therefore, Adair District should provide the Commission an updated version of Exhibit C to the Application reflecting the cash flow analysis of the new KRWFC loan within ten days of finalizing the transaction.

IT IS THEREFORE ORDERED that:

1. Adair District is authorized to borrow from KRWFC an amount up to \$5,405,000, but no more than the total amount needed to pay off the RD indebtedness proposed to be refinanced as identified in the Application on the condition that the final NPV of the savings, determined upon closing, generate positive cash flow. The loan maturity date and interest rate shall be in accordance with the KRWFC assistance program as described in Adair District's Application.

2. The proceeds from the loan authorized herein shall be used only for the lawful purposes set out in Adair District's Application.

3. Adair District shall only execute the KRWFC loan documents to the extent their terms and conditions are consistent with the loan described in Adair District's Application, except as otherwise authorized or required herein.

4. Adair District should file the loan documents and an updated version of Exhibit C to the Application reflecting the cash flow analysis of the new KRWFC loan in this matter within ten days of the execution of the new KRWFC loan documents.

5. Any documents filed in the future pursuant to finding paragraph 4 shall reference this case number and shall be retained in the post-case correspondence file of this case.

6. Adair District shall file for an adjustment in base rates or file for an alternative rate filing within one year of the date of filing of this Order to ensure that its rates are sufficient.

7. This case is closed and removed from the Commission's docket.

Nothing contained herein shall be deemed a warranty or finding of value of securities or financing authorized herein on the part of the Commonwealth of Kentucky or any agency thereof.

By the Commission



ATTEST:



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