

COMMONWEALTH OF KENTUCKY  
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

ELECTRONIC APPLICATION OF MOUNTAIN	)	
WATER DISTRICT TO ISSUE SECURITIES IN	)	
THE APPROXIMATE PRINCIPAL AMOUNT OF	)	
\$5,930,000 FOR THE PURPOSE OF	)	CASE NO.
REFINANCING CERTAIN OUTSTANDING	)	2021-00412
OBLIGATIONS OF THE DISTRICT PURSUANT	)	
TO THE PROVISIONS OF KRS 278.300 AND 807	)	
KAR 5:001	)	

ORDER

On October 29, 2021, Mountain Water District (Mountain District) submitted an application seeking Commission approval to refinance certain outstanding debt to Kentucky Rural Water Finance Corporation (KRWFC) (Prior KRWFC Loan) and other district bonds pursuant to KRS 278.300 and 807 KAR 5:001. On November 1, 2021, the application was deemed filed. Mountain District proposed to borrow funds of approximately \$5,930,000 for the refinancing via an Assistance Agreement (KRWFC Loan) with KRWFC. There are no intervenors in this case, and the matter now stands before the Commission for a decision based upon the evidentiary record.

LEGAL STANDARD

KRS 278.300 requires Commission approval before a utility may “issue any securities or evidences of indebtedness, or assume any obligation or liability in respect to

the securities or evidences of indebtedness of any other person.”<sup>1</sup> The legal standard contained in KRS 278.300(3) establishes the purview of Commission review, stating:

The commission shall not approve any issue or assumption unless, after investigation of the purposes and uses of the proposed issue and proceeds thereof, or of the proposed assumption of obligation or liability, the commission finds that the issue or assumption is for some lawful object within the corporate purposes of the utility, is necessary or appropriate for or consistent with the proper performance by the utility of its service to the public and will not impair its ability to perform that service, and is reasonably necessary and appropriate for such purpose.

PROPOSED REFINANCING

Mountain District proposed to borrow funds pursuant to the KRWFC Loan in the approximate amount of \$5,930,000 (subject to adjustment of up to 10 percent) for the purposes of refinancing existing outstanding indebtedness as follows:<sup>2</sup>

<u>Loan/Bond Series</u>	<u>Original Amount</u>	<u>Interest</u>	<u>Case Number</u>
Mountain Water District Waterworks Revenue Bonds, Series 2001	\$800,000	3.25%	2001-00339
Mountain Water District Sewer System Revenue Bonds, Series 2003	\$426,000	4.50%	2002-00099
Mountain Water District Sewer System Revenue Bonds, Series 2004	\$740,000	4.125%	2004-00194
Mountain Water District Waterworks Revenue Bonds, Series 2005	\$1,650,000	4.125%	2005-00436
Mountain Water District Waterworks Revenue Bonds, Series 2008	\$650,000	4.50%	2008-00052
KRWFC Public Projects Refunding Revenue Bonds, Series 2012E	\$6,270,000	3.57% (average)	2012-00317

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<sup>1</sup> KRS 278.300(1).

<sup>2</sup> Application at 2–3, paragraph 5.

The refinancing is comprised of a single loan agreement, with an approximate 25-year term, funded by bonds that will be issued at interest rates that will vary between 2.20 percent and 5.20 percent per annum.<sup>3</sup> Under current interest rates, the refinancing is estimated to yield net present value (NPV) savings to the district of approximately \$1,166,784 through 2047.<sup>4</sup> Mountain District stated that the final principal amount of the KRWFC Loan will be based upon interest rates at the date of sale.<sup>5</sup> However, Mountain District clarified that no refinancing will occur if interest rates shift so that NPV debt service savings can no longer be achieved.<sup>6</sup> Mountain District stated that the KRWFC Loan would provide the funds necessary to refinance the Prior KRWFC Loan and other district bonds and to pay the fees and expenses incident to the issuance of the KRWFC Loan.<sup>7</sup>

#### DISCUSSION AND FINDINGS

The Commission notes that Mountain District's last general rate case occurred in 2014, where the Commission approved a 17 percent increase to its water division revenues and a 169 percent increase to its sewer division revenues.<sup>8</sup> Other rate increases have resulted from purchased water adjustments (PWA) commensurate with

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<sup>3</sup> *Id.*, Exhibit A.

<sup>4</sup> *Id.* at 4, paragraph 9; see also Exhibit C.

<sup>5</sup> *Id.* at 4, paragraph 10.

<sup>6</sup> *Id.*

<sup>7</sup> *Id.*, at 3, paragraph 7.

<sup>8</sup> Case No. 2014-00342, *Application of Mountain Water District for an Adjustment of Water and Sewer Rates* (Ky. PSC Oct. 9, 2015) at 30–31.

increases in Mountain District's wholesale water costs from the city of Pikeville as recent as 2020.<sup>9</sup>

In the 2014 rate case, the Commission discussed concerns over Mountain District's high level of water loss. Mountain District attributed the excessive water loss to inaccurate meters, theft of service, and infrastructure failure caused by climate, soil corrosion, and improper installation.<sup>10</sup> Furthermore, in its responses to Staff's Third Request for Information, Mountain District set a goal to reduce its water loss to 25 percent in five years (2019) and to reduce water loss to 20 percent in ten years (2024), provided the funding could be acquired.<sup>11</sup> Mountain District's 2020 annual water loss was 30.42 percent as of its 2020 annual report.<sup>12</sup> In Case No. 2021-00172, Mountain District provided notice of intent to file an application for a surcharge to finance water loss control efforts on or about May 28, 2021. As of the date of this final Order, Mountain District's application for the surcharge has not been filed.

The cost of Mountain District's water loss at 30.42 percent is approximately \$791,189.<sup>13</sup> Commission regulation 807 KAR 5:066(6)(3) states that for ratemaking purposes a utility's water loss shall not exceed 15 percent of total water produced and purchased, excluding water consumed by a utility in its own operations. Reduction of

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<sup>9</sup> Case No. 2020-00068, *Electronic Purchased Water Adjustment Filing of Mountain Water District* (Ky. PSC Apr. 2, 2020).

<sup>10</sup> Case No. 2014-00342, *Mountain Water District* (Ky. PSC Oct. 9, 2015) at 11.

<sup>11</sup> Case No. 2014-00342, *Mountain Water District* (filed Mar. 27, 2015) Mountain Water District's Responses to Staff's Third Request for Information, Item 15b.

<sup>12</sup> *Annual Report of Mountain District to the Public Service Commission* (Annual Report of Mountain District) for the Year Ended December 31, 2020 at 57.

<sup>13</sup> 2020 Annual Report of Mountain District at 50. Mountain District's 2020 purchased water, power, and chemical expense totaled \$2,600,781; multiply by 2020 water loss of 30.42%: \$2,600,781 x 30.42% = \$791,189 (rounded).

Mountain District’s unaccounted-for water loss to 15 percent would result in an approximate \$401,072 decrease to its cost of water.<sup>14</sup> The Commission has established precedent for greater monitoring of utilities that consistently exceed the 15 percent unaccounted-for water loss threshold and strongly encourages Mountain District to continue to pursue reasonable actions to reduce its unaccounted-for water loss, which has exceeded the 15 percent limit for the past five years.<sup>15</sup>

Year	<u>2016</u>	<u>2017</u>	<u>2018</u>	<u>2019</u>	<u>2020</u>
Water Loss (%)	36.56	32.32	37.45	36.88	30.42

In addition, Commission Staff has reviewed Mountain District’s annual and audit reports, filed with the Commission, where available. It is apparent that Mountain District has been consistently operating with negative net income over the last five years.<sup>16</sup> Consequently, the Commission is concerned that Mountain District is using non-cash items such as depreciation and maintaining a heavy reliance on grant money to fund their operations and meet operating costs. Mountain District has been granted CPCNs

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<sup>14</sup> 2020 Annual Report of Mountain District at 50. Mountain District’s 2020 purchased water, power, and chemical expense totaled \$2,600,781; multiply by 2020 water loss in excess of 15 percent: \$2,600,781 x (30.42% - 15.00%) = \$401,072 (rounded).

<sup>15</sup> 2020 Annual Report of Mountain District at 57; 2019 Annual Report of Mountain District at 57; 2018 Annual Report of Mountain District at 57; 2017 Annual Report of Mountain District at 56; 2016 Annual Report of Mountain District at 56.

<sup>16</sup> 2020 Annual Report of Mountain District at 20–21; 2019 Annual Report of Mountain District at 20–21; 2018 Annual Report of Mountain District at 20–21; 2017 Annual Report of Mountain District at 19–20; 2016 Annual Report of Mountain District at 19–20.

approving water and sewer improvement projects in 2019,<sup>17</sup> 2018,<sup>18</sup> 2017,<sup>19</sup> and 2016<sup>20</sup> which included the issuance of additional bonds and the receiving of additional grant monies through several sources.

Year:	<u>2016</u>	<u>2017</u>	<u>2018</u>	<u>2019</u>	<u>2020</u>
Net Income Before Contributions	\$(181,351)	\$(1,045,221)	\$(1,841,276)	\$(2,673,291)	\$(1,778,199)
Add: Depreciation Expense	\$2,717,413	\$2,765,443	\$2,909,685	\$3,015,541	\$2,765,443
Cash Basis Income	\$2,536,062	\$1,720,222	\$1,068,409	\$342,250	\$987,244

For the reasons set forth above, the Commission directs Mountain District to file for a general adjustment in base rates or ARF by December 28, 2022. In addition, the Commission strongly advises Mountain District exercise prudence and begin reviewing its finances on an annual basis to determine when future rate cases become necessary.

Mountain District provided a debt service schedule comparison that indicated the refinancing would save \$1,414,235 over the life of the KRWFC Loan, resulting in a positive NPV cash flow savings of \$1,166,784.<sup>21</sup> However, in the event that the new

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<sup>17</sup> Case No. 2019-00346, *Application of Mountain Water District for a Certificate of Public Convenience and Necessity to Construct a Water Improvements Project and an Order Authorizing the Issuance of Securities Pursuant to KRS 278.023* (KY. PSC Oct. 7, 2019).

<sup>18</sup> Case No. 2018-00400, *Application of the Mountain Water District for a Certificate of Public Convenience and Necessity to Construct a Sewer Improvements Project and an Order Authorizing the Issuance of Securities Pursuant to KRS 278.023* (KY. PSC Dec. 21, 2018).

<sup>19</sup> Case No. 2017-00150, *Application of the Mountain Water District for the Issuance of a Certificate of Public Convenience and Necessity to Construct and Finance a Sewer System Improvements Project Pursuant to the Provisions of KRS 278.020, KRS 278.300, 807 KAR 5:001 And 807 KAR 5:071* (KY. PSC June. 12, 2017).

<sup>20</sup> Case No. 2016-00356, *Application of Mountain Water District for the Issuance of a Certificate of Public Convenience and Necessity to Construct and Finance a System Improvements Project Pursuant to the Provisions of KRS 278.020, KRS 278.300 And 807 KAR 5:001* (KY. PSC Jan. 31, 2017).

<sup>21</sup> Application, Exhibit C.

interest rate on the proposed refinancing is higher than the range of interest rates set forth in the application, the Commission finds that Mountain District should not proceed with the refinancing unless the NPV of the refinancing results in positive cash flow.

The Commission further finds that Mountain District satisfied the legal standards established in KRS 278.300 to refinance the Prior KRWFC Loan and district bonds, previously approved by the Commission, for the reasons that follow. First, the lawful object of Mountain District's purpose is to provide safe, adequate, and reliable water service to the public. The refinancing meets the lawful object of the utility's purposes because it is intended to strengthen the financial position of Mountain District through substantial NPV debt service savings. Second, the refinancing is appropriate for the proper performance by the utility and will not impair its ability to perform that service because the KRWFC Loan is exclusively for the purposes of refinancing existing debt and achieving debt service NPV savings. No other aspects of Mountain District's operations or finances will change, except those related to the refinancing of existing debt as outlined in the application and this Order. Third, the refinancing is a reasonably appropriate option for Mountain District to meet its statutory duty to provide safe, adequate, and reliable service because the current low interest rate environment will allow Mountain District to achieve such savings.

For the reasons set forth above, the Commission finds Mountain District's proposal to be reasonable due to the lower effective interest rate and cash flow savings realized over the period of the KRWFC Loan, and Mountain District should be authorized to enter into the KRWFC Loan in order to refinance its existing debt obligations outlined in the application.

After consideration of the evidence of record and being sufficiently advised, the Commission finds that:

1. The KRWFC Loan is for lawful objects within the corporate purposes of Mountain District, is necessary and appropriate for and consistent with the proper performance by the utility of its service to the public; will not impair its ability to perform that service; is reasonable, necessary, and appropriate for such purposes; and should be approved.

2. Mountain District shall execute its note as security for the KRWFC Loan in the manner described in its application.

3. The final amount of the KRWFC Loan, legal expenses, and interest rates will not be known until the refinancing transaction is finalized. Therefore, Mountain District shall provide the Commission an updated version of the debt service schedule in Exhibit A, reflecting the cash flow analysis of the proposed KRWFC Loan within ten days of finalizing the transaction.

4. Within ten days of the execution of the KRWFC Loan documents, Mountain District shall file with the Commission an electronic version of the loan documents.

5. The proceeds from the KRWFC Loan shall be used only for the lawful purposes set out in Mountain District's application.

6. The terms and conditions of the KRWFC Loan shall be consistent with the loan proposal as described in Mountain District's application.

IT IS THEREFORE ORDERED that:

1. Mountain District is authorized to enter into the KRWFC Loan to borrow no more than the amount proposed in the application needed to pay off and refinance the



Prior KRWFC Loan indebtedness and district bonds on the condition that the final NPV of the savings, determined upon closing, generate positive cash flow. The loan amount, maturity date, and interest rate shall be in accordance with the KRWFC Loan as described in Mountain District's application.

2. Mountain District shall execute the KRWFC Loan documents as authorized herein.

3. Mountain District shall comply with all matters set out in the findings paragraphs 2 through 6 above as if they were individually ordered.

4. Any documents filed in the future pursuant to the findings paragraphs 3 and 4 above shall reference this case number and shall be retained in the post-case correspondence file.

5. Mountain District shall file an application for an adjustment in base rates by December 28, 2022, to ensure that its rates are sufficient

6. 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

ENTERED  
DEC 13 2021  
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KENTUCKY PUBLIC  
SERVICE COMMISSION

ATTEST:



Executive Director

Case No. 2021-00412

\*Carrie Hatfield  
Mountain Water District  
P. O. Box 3157  
Pikeville, KY 41502

\*Kristen Millard  
Raymond James Financial Services  
300 West Vine Street  
Lexington, KENTUCKY 40507

\*Mountain Water District  
6332 Zebulon Highway  
P. O. Box 3157  
Pikeville, KY 41502-3157

\*Honorable W. Randall Jones  
Attorney at Law  
Rubin & Hays  
Kentucky Home Trust Building  
450 South Third Street  
Louisville, KENTUCKY 40202