

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

IN RE: Providence Water Supply Board :
Application for Authority to : Docket No. D-08-16
Issue Debt :

REPORT AND ORDER

On April 15, 2008, the Providence Water Supply Board ("PWSB") filed an application with the Rhode Island Division of Public Utilities and Carriers ("Division") seeking authority to borrow from the Drinking Water State Revolving Fund ("DWSRF") an amount not to exceed \$35,000,000. The application was filed in accordance with the requirements contained in Section 39-3-15 of the Rhode Island General Laws and Rule 14 of the Division's Rules of Practice and Procedure.

In response to the application filing, the Division conducted a duly noticed public hearing on May 15, 2008. The hearing was conducted in the Division's hearing room, located at 89 Jefferson Boulevard in Warwick. The following counsel entered appearances:

For the PWSB: Michael R. McElroy, Esq.

For the Division's
Advocacy Section: William K. Lueker, Esq.
Special Assistant Attorney General

The PWSB proffered four witnesses in support of its application. The witnesses were identified as Ms. Jeanne Bondarevskis, the PWSB's Director of Finance; Mr. Paul J. Gadoury, the PWSB's Director of Engineering; Ms.

Maureen E. Gurghigian, Managing Director, First Southwest Company, 652 George Washington Highway, Lincoln, Rhode Island; and Karen S. D. Grande, Esq., bond counsel to the City of Providence and the PWSB.

Ms. Jeanne Bondarevskis testified that the PWSB is requesting borrowing authority in order fund two essential and time-sensitive infrastructure replacement projects. She explained that the first project is connected to a 2006 Notice of Violation from the Rhode Island Department of Health (“DOH”) “concerning our lead sampling.” Ms. Bondarevskis testified that based on lead testing results, the DOH has imposed a mandatory “accelerated replacement of 7% of our water system’s lead services each year, for approximately the next fifteen years.”

Additionally, Ms. Bondarevskis cited a November 2006 report from the Maguire Group wherein the PWSB’s engineering consultant recommended that the PWSB upgrade all the filters at its treatment plant. Ms. Bondarevskis testified that due to the financial effect of these unforeseen changes on the PWSB’s Infrastructure Replacement (IFR) plan, the PWSB is facing an approximately \$83,000,000 IFR-related deficit over the next twenty years.¹ Ms. Bondarevskis added that the Rhode Island Public Utilities Commission (“Commission”) approved a \$2,000,000 rate increase in the PWSB’s IFR funding on December 13, 2007 (in Docket No. 3832) to facilitate the instant proposed

¹ PWSB Exhibit 1, Bondarevskis pre-filed testimony, pp. 3-4.

borrowing.² She testified that the PWSB's Board and the Providence City Council have also approved the proposed bond issue.³

Ms. Bondarevskis next presented a pro forma capital structure showing the effects of the security issue. The related exhibit reflected that the PWSB's total capitalization would increase to about \$49 million after the bond issue.⁴ The exhibit further shows that the PWSB's debt to total assets ratio will be 19.59%, and debt to net utility plant will be 25.16%. Ms. Bondarevskis opined that "this is still well below 38%, which is the Standard and Poor's median for 'A' rated credits..."⁵

Ms. Bondarevskis testified that the PWSB requested funding through the Rhode Island Clean Water Finance Agency ("RICWFA"). She related that the RICWFA Board approved the borrowing and sent the PWSB a commitment letter on February 29, 2008. Described as a significant change, Ms. Bondarevskis noted that the proposed RICWFA loan requires a "bond indenture" that "will change some of Providence Water's restricted funds". She added that the PWSB "*may have to transfer restricted funds from our accounts to a Trustee. The Trustee will then pay vendors on our behalf. This will be done for our debt service payments.*" Ms. Bondarevskis noted, however, that "the final details are still being worked out."⁶

² *Id.*, p. 4.

³ *Id.*, pp. 4-5.

⁴ *Id.*, p.6 and attached "Exhibit D."

⁵ *Id.*

⁶ *Id.*, p. 7.

Ms. Bondarevskis included several documents with her pre-filed testimony as additional support for the proposed borrowing. These documents included: (1) PWSB's Resolutions authorizing the borrowing and future reimbursement of expenditures, (2) approved Bond Ordinance (without draft Indentures), (3) PWSB's request to have the project on DOH's Project Priority List, (4) a pro-forma capitalization schedule, (5) RICWFA's commitment letter, (6) RICWFA's loan policies and procedures, (7) a comparison of interest rates and draft debt service schedules, and (8) DOH Rules and Regulations.⁷ After presenting these documents, Ms. Bondarevskis related that the Loan Agreement and Bond Indenture documents are still being prepared and will be available when finalized.

Ms. Bondarevskis next summarized the terms and conditions attached to the instant borrowing. She testified that the City of Providence, acting for the PWSB, would borrow up to \$35,000,000 under the borrowing proposal. She related that a portion of the borrowing would be used for the costs of issuance (estimated at approximately \$450,000), debt service reserve (equal to one year's debt service), loan origination fees (equal to 1% or \$35,000) and underwriter's discounts.⁸ Ms. Bondarevskis indicated that "based on the estimated debt service schedules provided by...First Southwest, total interest payments will vary from approximately \$17,621,944 to \$22,270,948, depending on the final interest rate."⁹ Regarding the interest rate, which Ms. Bondarevskis expected

⁷ *Id.*, pp. 7-8 and attached Exhibits A through H.

⁸ *Id.*, pp. 8-9.

⁹ *Id.*, p. 9.

would be approximately 25% below the PWSB's projected market rate at the closing date, she testified that First Southwest "assumed subsidized rates of between 4.5391% and 5.5562%."¹⁰ Ms. Bondarevskis also testified that the term of the loan would be approximately twenty years, a term she described as preferable in view of the large size of the principal amount involved. She added that the twenty-year term is also consistent with the service life of the treatment plant and distribution system improvements planned under the proposed borrowing.¹¹

In her final comments, Ms. Bondarevskis requested expedited consideration from the Division. She related that the RICWFA "is ready to issue a pooled bond and is waiting for Division approval of Providence Water's request in order to price and close."¹²

Mr. Paul Gadoury was proffered by the PWSB to describe the IFR projects in issue and explain why the expeditious completion of the projects is necessary. Addressing the lead services replacement project first, Mr. Gadoury testified that approximately 25,600 or 36% of the service lines in the PWSB water system are lead. He related that the PWSB had planned to replace these lead services over the next twenty years, but this plan has "now been significantly altered by the issuance to us, based on our latest lead level sampling results, of a regulatory order from the...[DOH] Office of Drinking Water Quality...mandating an accelerated schedule for lead service

¹⁰ Ms. Bondarevskis testified that the interest rate will not be fixed until such time as the PWSB receives authorization to proceed and RICWFA prices their bonds. *Id.*, p. 10.

¹¹ *Id.*, p. 10.

¹² *Id.*, p. 12.

replacements in accordance with the requirements of the federally legislated Lead and Copper Rule.”¹³

Mr. Gadoury explained that the Lead and Copper Rule, under U.S. Environmental Protection Agency (EPA) enforcement, requires certain standards that must be met concerning lead levels at consumers’ water taps within their homes. He related that the legislation mandates that certain response actions must be taken by water utilities when more than “10% of ‘first draw’ samples taken from selected home test sites exceed a lead level of 15 parts per billion (ppb).”¹⁴ Mr. Gadoury testified that until recently the PWSB was below this lead ‘action level’, and had been since the implementation of the Lead and Copper Rule back in 1991. Mr. Gadoury testified that this changed in August 2006, when sampling results exceeded this limit. The witness explained that the new results triggered a mandatory action response, whereby the PWSB is now required to annually replace 7% of its lead services, or 1,792 lead services each year.¹⁵

Mr. Gadoury related that this lead service replacement mandate “has a very substantial cost impact on our [IFR] program.”¹⁶ He testified that the PWSB’s currently approved 20-year IFR program included \$42 million for lead service replacements. He said that this program would have replaced approximately one half of the lead services in the PWSB’s water system over the 20-year period. Mr. Gadoury related that because the PWSB must now replace

¹³ *Id.*, Gadoury pre-filed testimony, pp. 3-4.

¹⁴ *Id.*, p. 4.

¹⁵ *Id.*, pp. 4-5.

¹⁶ *Id.*, p. 5.

all 25,600 lead services in its water system within the next fifteen years, the cost has increased from \$42 million over the next twenty years to \$120 over the next fifteen years. He noted that for the short-term, 2008 through 2010, the cost has increased from a previously planned \$300,000 to now \$30 million.¹⁷

Mr. Gadoury next discussed the Treatment Plant Filter Rehabilitation Project. He testified that the PWSB's IFR program originally included plans to rebuild 16 of the treatment plant's 18 filters over the next six years at an estimated cost of \$25 million.¹⁸ Mr. Gadoury explained that the funds were to be used to replace the "mono-media sand systems with new anthracite/sand dual-media beds; installing new low profile non-gravel underdrain systems; air-scour backwashing; and filter-to-waste capabilities."¹⁹ He added that some of the funds were also be used for modifications and improvements to the piping, valves, metering, and control systems associated with the filtration process, as well as repairs to the below grade concrete slab roofs of the filters to attempt to seal out the leakage of rainwater and groundwater into the filters.²⁰ Mr. Gadoury testified, however, that this plan changed in October 2006 after the associated design work on the project uncovered that the present structural configuration of the existing filter beds "precluded their being able to be brought up to modern design standards relative to recommended minimum depths of filter media to be used in the filtration process."²¹

¹⁷ Id.

¹⁸ Id., pp. 5-6. Mr. Gadoury explained that 2 of the 18 filters have been recently rehabilitated and were consequently not included as part of the planned project.

¹⁹ Id., p. 6.

²⁰ Id.

²¹ Id., pp. 6-7.

Mr. Gadoury testified that based on the evaluation connected to the design work, the PWSB's engineering consultant recommended "more substantial modifications to the filters than had originally been envisioned" which, according to the witness, included a recommendation to not only increase the depth of the filter media to acceptable design standards, but also modifications that would provide the flexibility and opportunity for the future incorporation of granular activated carbon (GAC) into the PWSB's filtering process.²²

To accomplish the necessary filtration upgrades, Mr. Gadoury explained that the filters would require more extensive structural modifications, including the "demolition of the multiple existing cast-in-place concrete filter troughs within each filter and the construction of new troughs at a higher elevation." Mr. Gadoury added that increasing the depth of the filters in this manner would also require that the existing below-grade underground filter roof slabs be demolished and removed and that new building structures be constructed over the filters."²³

Mr. Gadoury fully supported the consultant's recommended filtration process modifications and also espoused several reasons why the PWSB believes these enhancements are worth the additional investment.²⁴ Mr. Gadoury related that these improvements have been projected to add approximately \$15 million in design, construction, and inspection costs to the

²² Id., p. 7.

²³ Id.

²⁴ Id., pp. 7-9.

previously estimated project cost of \$25 million over the project's expected six-year implementation period.²⁵

In closing, Mr. Gadoury announced that the PWSB submitted an amended IFR plan to the DOH on May 14, 2007, which included the two needed projects described in this filing. Mr. Gadoury reported that the amended IFR plan has been approved by the DOH.²⁶

Ms. Maureen Gurghigian testified that First Southwest Company provides financial advisory services to issuers of municipal debt, primarily in the State of Rhode Island. She related that she has supervisory responsibility for First Southwest's involvement with borrowings by the State of Rhode Island, numerous public agencies and 30 Rhode Island municipalities, including the PWSB. She related that First Southwest Company serves approximately 2000 municipal issuers, including more than 400 in New England. She added that the Rhode Island office assists clients with the origination of more than \$800 million in public financing issues each year.²⁷

Ms. Gurghigian related that she is providing assistance to the PWSB and its financing team with respect to the issuance of debt through the RICWFA. She related that her role in this docket is to provide information on the PWSB's debt service requirements for the proposed borrowing and to respond to related questions.²⁸

²⁵ Id., p. 9.

²⁶ Id.

²⁷ Id., Gurghigian pre-filed testimony, p. 1.

²⁸ Id., p. 2.

Ms. Gurghigian next described the financing structure of the proposed \$35 million borrowing. She explained that the financing structure involves the use of subsidized loans from the RICWFA secured solely by water rates and charges. She related that the DWSRF, which is administered by the RICWFA, uses federal capitalization grants and state matching funds to provide subsidized (25% below market-rate) loans to water suppliers for qualifying projects listed on the Project Priority List maintained by the DOH. Ms. Gurghigian testified that in this borrowing, a market rate of 5.85% and a subsidized rate of 4.54% have been used. She testified that under the proposed plan of finance, the RICWFA-administered DWSRF would provide the funding for the PWSB's amended IFR program. She explained that the funding will come from the RICWFA selling bonds in the public market and subsequently loaning the proceeds to the PWSB pursuant to a loan agreement. She testified that "it is anticipated that the revenue bonds will be sold in early May 2008."²⁹

In her introductory remarks, Karen S. D. Grande, Esq. related that she has served as bond counsel to the City of Providence and the PWSB in connection with its water bond issues since 1990, including previous loans from the RICWFA. Ms. Grande testified that she has proffered direct testimony in this matter for the purpose of "addressing certain legal documents associated with the City's proposed \$35,000,000 revenue obligation."³⁰

²⁹ Id., p. 3.

³⁰ Id., Grande pre-filed testimony, pp. 1-2.

Ms. Grande began her testimony by describing the need for and content of the Bond Ordinance, Trust Indenture and First Supplemental Indenture. She explained that the Bond Ordinance authorizes the City to issue the revenue obligations in an amount not to exceed \$35,000,000 and execute a Trust Indenture and First Supplemental Trust Indenture. She noted that the Bond Ordinance was approved by the City Council on March 20, 2008.³¹

Ms. Grande next explained that the Trust Indenture is a contract between an issuer and a bond trustee for the benefit of bondholders. Ms. Grande related that the Trust Indenture creates a security interest in water system revenues and typically sets forth the flow of funds, reserve requirements, rate covenants and the bond lien status. Ms. Grande related that the City has not been required to enter into a formal trust indenture on any of its previous water borrowings. She explained that the RICWFA is “now requiring that revenue bond issuers borrowing more than \$3,000,000 enter into a Trust Indenture.”³² She also related that the covenants in the Trust Indenture would supercede the covenants in the City’s present Loan Agreements.³³

Ms. Grande further explained that the First Supplemental Indenture is specifically for the \$35,000,000 revenue bonds presented in this filing before the Division. She related that additional Supplemental Indentures would need

³¹ Id., p. 2.

³² Id.

³³ Id.

to be executed for each subsequent series of revenue bonds issued by the PWSB.³⁴

Ms. Grande testified that several funds and accounts would be established under the PWSB's Trust Indenture. She stated these funds and accounts would include "the restricted accounts required by the Public Utilities Commission," which she delineated as follows:

1. Project Fund;
 - (a) Infrastructure Replacement Account;
 - (b) Capital Improvements Account;
 - (c) Meter Replacement Account;
 - (d) Equipment Replacement Account; and
 - (e) Western Cranston Account.
2. Revenue Fund;
3. Operating Fund;
 - (a) Chemical and Sludge Account; and
 - (b) Water Quality Protection Administrative Charge Account.
4. Insurance Fund;
5. Debt Service Reserve Fund;
 - (a) Debt Service Account;
 - (b) Stabilization Account;
 - (c) Water Quality Protection Debt Service Account; and
 - (d) Debt Service Assistance Account.
6. Redemption Fund;
7. Debt Service Reserve Fund;
8. Operation and Maintenance Reserve Fund;
 - (a) Property Tax Refund Account; and
 - (b) PUC Restricted Operating Reserve Account.

³⁴ Id., pp. 2-3.

9. Rebate Fund;
10. Insurance Reserve Fund;
11. Water Quality Protection Fund;
 - (a) Watershed Land Acquisition Accounts; and
 - (b) Water Quality Improvement Capital Accounts.
12. Unrestricted Fund.³⁵

In her final comments, Ms. Grande emphasized that the documents involved in the proposed borrowing are “pretty standard.” She called them typical for revenue bond issuers. She testified that the accounts have been set up to accommodate the restricted accounts required by orders of the Commission.³⁶

The Division’s Advocacy Section did not proffer any witnesses in this docket. After an inspection of the filing and the presentation of the PWSB’s direct case, the Advocacy Section stated for the record that it was satisfied from the evidence presented, that the PWSB had met the requisite burden of proof set forth in R.I.G.L. §39-3-15, et seq. and that the proposed borrowing was in the public interest.

FINDINGS

Predicated on a careful examination of the record in this matter, the Division finds that the PWSB’s application seeking authority to borrow from the Drinking Water State Revolving Fund an amount not to exceed \$35,000,000, is reasonable and in the best interest of ratepayers.

³⁵ Id., pp. 3-4.

³⁶ Id., p. 4.

Now, therefore, it is

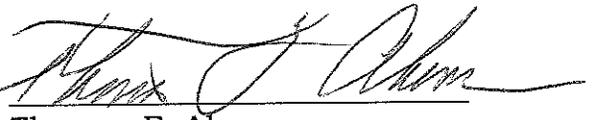
(19291) ORDERED:

1. That the Providence Water Supply Board's April 15, 2008 application, which seeks Division approval under R.I.G.L. §39-3-15, to borrow from the Drinking Water State Revolving Fund an amount not to exceed \$35,000,000, is hereby approved as filed.
2. That the Division hereby limits approval of the instant application to the terms and details identified in the record.
3. That the Division hereby makes this approval contingent upon the PWSB's use of the debt service allowance previously approved by the Commission, or if subsequently required, by additional debt service allowances approved by the Commission.

DATED AND EFFECTIVE AT WARWICK, RHODE ISLAND ON MAY 19, 2008.



John Spirito Jr., Esq.
Hearing Officer

Approved: 

Thomas F. Ahern
Administrator