

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

IN RE: City of Newport Water Division :
Application to Incur Long-Term Debt : Docket No. D-12-3

REPORT AND ORDER

On March 7, 2012, the City of Newport, acting by and through the Newport Water Division ("Newport Water") filed an application with the Rhode Island Division of Public Utilities and Carriers ("Division") seeking authority to enter into long-term debt and issue revenue bonds in an amount not to exceed \$53,100,000 as part of a Rhode Island Drinking Water State Revolving Fund ("DWSRF") loan from the Rhode Island Clean Water Finance Agency ("RICWFA"). The Newport Water application indicates that it seeks to borrow approximately \$53,100,000 from the RICWFA to finance the design and construction of a new treatment plant to replace the existing Lawton Valley Water Treatment Plant, improvements to the Station One Water Treatment Plant and other distribution improvements to its water system. The application was filed in accordance with the requirements contained in Section 39-3-15 of the Rhode Island General Laws and Section 14 of the Division's *Rules of Practice and Procedure*.¹

¹ The application was entered on the record as Newport Water Exhibit 1.

In response to the application filing, the Division conducted a duly noticed public hearing on April 5, 2012. The hearing was conducted in the Division's hearing room, located at 89 Jefferson Boulevard in Warwick. The following counsel entered appearances:

For Newport Water:	Joseph A. Keough, Jr., Esq.
For the Division's Advocacy Section:	Jon G. Hagopian, Esq. Special Assistant Attorney General

Newport Water proffered three witnesses in support of its application. The witnesses were identified as Ms. Julia Forgue, P.E., the Director of Utilities for the City of Newport; Ms. Maureen E. Gurghigian, Managing Director, First Southwest Company, 652 George Washington Highway, Lincoln, Rhode Island; and Mr. Harold J. Smith, Vice President of Raftelis Financial Consultants, Inc., 1031 South Caldwell Street, Charlotte, North Carolina, a consulting firm specializing in the areas of water and wastewater finance and pricing.

Utilities Director, Julia Forgue was proffered as a supporting witness to discuss why Newport Water has requested approval to borrow approximately \$53,100,000 from the RICWFA to finance the design and construction of a new treatment plant to replace the existing Lawton Valley Water Treatment Plant, improvements to the Station One Water Treatment Plant and other distribution improvements to its water system. Ms. Forgue began her testimony with some background information on the planned Treatment Plant Projects. Ms. Forgue related that Newport Water has been planning improvements to its two water treatment plants, Lawton Valley and Station One, for quite some time.

She stated that in 2004, the City of Newport conducted a comprehensive evaluation of the two water treatment plants to assess current and future regulatory compliance as well as the physical condition of the plants. Ms. Forgue testified that the most significant challenge for Newport Water is compliance with the Stage 1 and 2 Disinfectants/Disinfection Byproduct Rule, particularly compliance with Total Trihalomethanes (“TTHMs”). She explained that under the Stage 2 Rules “the current treatment processes at the two plants will not comply with the TTHM.”²

Ms. Forgue testified that due to previous violations of the TTHM Standard, the Rhode Island Department of Health (“RIDOH”) issued a Notice of Violation. She related that because of the violations, the City of Newport entered into a consent agreement with RIDOH to make certain physical improvements to the treatment plants to assure compliance with the Stage 1 and 2 Rules. Ms. Forgue also explained that the City of Newport has also entered into a consent agreement with the Rhode Island Department of Environmental Management whereby discharge from the Lawton Valley Plant to the Lawton Brook will cease.³

Ms. Forgue testified that long term recommendations were made to each facility based on these evaluations. She related that the long term recommendation for Lawton Valley was to replace, rather than rehabilitate, the 1943 facility. The Station One recommendation calls for an additional retreatment/clarification unit. However, before making any decisions about

² Newport Water Exhibit 1, Forgue Testimony, pp. 2-3.

³ Id., p. 3.

these projects, Newport Water engaged the services of CDM Smith (“CDM”), a consulting engineer to act as the City’s advisor throughout the bidding and construction process for the Treatment Plant Projects. Ms. Forgue characterized CDM’s scope of work as falling into the following five separate phases:

Phase 1 - (A) Utility Ownership/ Governance;

(B) Project Delivery Strategy;

Phase 2 - Utility Financing;

Phase 3 – Engineering Studies and Preliminary Design;

Phase 4 – Procurement Documents and Process; and

Phase 5 – Monitoring of Awarded Contract.⁴

Ms. Forgue testified that CDM has completed Phases 1 and 3 and continues working on various tasks in Phases 2, 4 and 5. With respect to Phase 1(A)’s “ownership” question, Ms. Forgue related that CDM examined all possible strategic options for ownership, financing and governance of the water system, and concluded that the City of Newport’s continued ownership, operation and governance of the system, with ratepayer financing, represents the “best long-term” option. She noted that Newport’s City Council has concurred with this conclusion.⁵ As for Phase 1(B), Ms. Forgue related that CDM recommended a single Design/Build (“DB”) Contract as the most cost effective project delivery method for the Treatment Plant Projects.⁶

⁴ Id., p. 4.

⁵ Id., p. 4.

⁶ Id., pp. 4-5.

Ms. Forgue testified that the City of Newport awarded the DB Contract to AECOM Technical Services, Inc. (design and engineering) and C.H. Nickerson & Company, Inc. (construction) as a joint venture (“AECOM/Nickerson”) to act as a single DB vendor. Ms. Forgue also provided a description of the process that led to the selection of AECOM/Nickerson. Ms. Forgue related that the DB contract has been executed and the Notice to Proceed was issued on February 22, 2012.⁷ Ms. Forgue added that Newport Water expects that both Treatment Plants will be operational by December 31, 2014.⁸

Ms. Forgue next discussed how the Treatment Plant Projects will be financed. She testified that the total cost of the Projects will be approximately \$85,000,000. Ms. Forgue explained that the instant \$53,100,000 DWSRF Loan will fund the FY12 costs of the Projects. She related that Newport Water plans additional DWSRF borrowings of \$26,900,000 and \$5,000,000 in FY13 and FY14, respectively.⁹ Ms. Forgue described the cost breakdown as follows:

- DB Contract - \$67,000,000
- City Advisor/Special Legal Counsel/Financial Advisor - \$9,100,000
- Borrowing Costs and Debt Service Reserve Fund - \$9,000,000

Next, in describing how Newport Water will use the funds from the proposed \$53,100,000 borrowing, Ms. Forgue testified that Newport Water will use the bond proceeds to pay for the work to be performed by

⁷ *Id.*, p. 5.

⁸ *Id.*, p. 6.

⁹ Ms. Forgue noted that if it is subsequently discovered that RICWFA cannot fully fund the Treatment Plant Projects, Newport will have to seek direct market financing at unsubsidized rates. Ms. Forgue testified that direct market bonds will not provided the same discounted interest rate as the DWSRF, but would allow Newport to obtain the necessary funding if the RICWFA has insufficient DWSRF lending capacity. *Id.*, p. 7.

AECOM/Nickerson and CDM through March 2013. She related that the \$53,100,000 also includes converting a \$5,100,000 short term Bond Anticipation Note into long term DWSRF borrowing. She explained that Newport Water needed the BAN to fund preliminary design and procurement work performed by CDM, special legal counsel and the financial advisor. Ms. Forgue added that the borrowing will also fund the financing costs and the required Debt Service Reserve Fund.¹⁰

In her final remarks, Ms. Forgue related that the Public Utilities Commission has recently approved Newport Water's request for a multi-year rate increase to support the debt associated with funding the Treatment Plant Projects.¹¹

As in previous related dockets, Ms. Maureen E. Gurghigian began her testimony by stating that First Southwest Company serves as financial advisor to many issuers of municipal debt in 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 city of Newport. She testified that the firm currently serves more than 2000 municipalities and agencies, including more than 400 in New England. Ms. Gurghigian noted that her office assists clients with the origination of more than \$800 million in public financing issues each year.¹²

¹⁰ Id., p. 7.

¹¹ Approved in Commission Docket No. 4243. Id., p. 8.

¹² PWSB Exhibit 1, Gurghigian Testimony, pp. 1-2.

Ms. Gurghigian related that she has served as financial advisor to Newport Water in previous bond approval cases before the Division. She related that she is currently providing assistance to Newport Water with respect to the planned loan from the RICWFA. She testified that the proposed \$53,100,000 borrowing from the RICWFA is needed to begin funding the construction of a new treatment plant at Lawton Valley and improvements to the Station One treatment facility. Ms. Gurghigian explained that of the \$53,100,000 loan amount, approximately \$48,600,000 will be available for project funds, and approximately \$3,830,000 will be set aside in the debt service fund. She stated that an additional \$631,000 is allocated for costs of issuance and the RICWFA origination fee.¹³

In describing how the financing works, Ms. Gurghigian explained that pursuant to the Safe Drinking Water Act Amendments of 1996, Rhode Island has created a Drinking Water State Revolving Fund (“DWSRF”) administered by the RICWFA to provide financial assistance to water suppliers. She related that the fund 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 Rhode Island department of Health. Ms. Gurghigian explained that the RICWFA sells bonds in the public market and loans the proceeds to its drinking water borrowers pursuant to loan agreements. Ms. Gurghigian emphasized that the DWSRF is

¹³ Id., p. 4.

providing a significant portion of the funding for Newport Water's capital program.¹⁴

Ms. Gurghigian testified that the term of the requested borrowing is 20 years. She explained that once the construction funds are fully drawn down, Newport Water will have 20 years to repay the loan. Ms. Gurghigian noted that the full term including the construction period is not expected to exceed 23 years.¹⁵ Ms. Gurghigian testified that based upon current market conditions, it is anticipated that the loan will not exceed a market rate of 4.40%, which, she related, would result in a subsidized rate of approximately 3.30%.¹⁶

Ms. Gurghigian testified that this borrowing is expected to close in April 2012. She explained that the RICWFA requires that all borrower approvals be in place prior to pricing loans. Ms. Gurghigian also testified that the pricing date for this loan has been established for early May and that a Division approval in early April would put Newport in a position to meet the RICWFA schedule.¹⁷

Ms. Gurghigian also proffered a debt service schedule with her pre-filed testimony. She testified that for the \$53,100,000 debt, annual debt service is expected to increase by approximately \$3,850,000 per year. She noted that for purposes of her debt service analysis, a market rate of 4.32% and a subsidized rate of 3.30% have been used.¹⁸

¹⁴ Id., p. 3.

¹⁵ Id., p. 3.

¹⁶ Id.

¹⁷ Id., p. 3 and Transcript.

¹⁸ Id., p. 4 and Schedule MG-1.

Mr. Harold Smith testified that the proposed borrowing, totaling \$53,100,000, would not have any impact on Newport Water's rates in Fiscal Year 2012. He related that Newport Water's current rates, approved in PUC Docket No 4243, were set to support the debt service resulting from the proposed borrowings.¹⁹ Mr. Smith explained that in Docket 4243, Newport Water requested a multi-year rate increase program to service the debt required for the new Lawton Valley Water Treatment Plant and the improvements to the Station One Facility. He testified that the Commission authorized increases in Fiscal Years 2012, 2013, 2014 and 2015; and that the \$1,589,369 allowed to service debt in FY12 (the Docket 4243 rate year) is sufficient to service the \$53,100,000 borrowing in FY 2012.²⁰

The Division's Advocacy Section did not present any witnesses in this case. It did, however, proffer a memorandum from a consultant that was retained by the Advocacy Section to evaluate the proposed borrowings.²¹ The consultant, Mr. Thomas S. Catlin, a principal in the consulting firm of Exeter – Consulting Economists, stated in the memorandum that after reviewing the application filing, he concurred with Newport Water's statement that the allowance for debt service included in Newport Water's rate is sufficient to cover the projected debt service associated with both the \$53,100,000 borrowing.

¹⁹ Id., Smith Testimony, p. 2.

²⁰ Id., pp. 2-3.

²¹ Advocacy Section Exhibit 1.

The Advocacy Section subsequently stated for the record that it was satisfied from the evidence presented, that Newport Water 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 instant application request is reasonable and in the best interest of ratepayers.

Now accordingly, it is

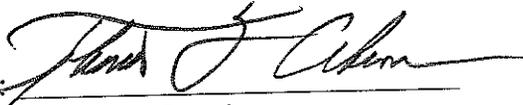
(20691) ORDERED:

1. That the March 7, 2012 application, filed by the City of Newport, acting by and through the Newport Water Division, which seeks Division approval, under R.I.G.L. §39-3-15, to enter into long-term debt and issue revenue bonds in an amount not to exceed \$53,100,000 to finance the design and construction of a new treatment plant to replace the existing Lawton Valley Water Treatment Plant, improvements to the Station One Water Treatment Plant and other distribution improvements to its water system, is hereby approved as filed.
2. That the Division hereby makes this approval contingent upon the Newport Water Division'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.

3. That the Division hereby limits approval of the instant application to the terms and details identified in the record.

Dated and Effective at Warwick, Rhode Island on April 9, 2012.


John Spirito, Jr., Esq.
Hearing Officer

APPROVED: 
Thomas F. Ahern
Administrator