State of New Jersey
DIVISION OF RATE COUNSEL
140 EAST FRONT STREET, 4TH FL
P.O. BOX 003
TRENTON, NEW JERSEY 08625

PHIL MURPHY
Governor

SHEILA OLIVER
Lt. Governor

STEFANIE A. BRAND
Director

January 13, 2021

Via Electronic Mail Only
Aida.Camacho@bpu.nj.gov
Ms. Aida Camacho-Welch, Secretary
Board of Public Utilities
44 South Clinton Avenue, 3rd Floor, Suite 314
Trenton, New Jersey 08625-0350

Re: In the Matter of the Petition of Shore Water Company for Authority to Enter into $540,000 Principal Amount of Debt with Manasquan Bank, And for Approval to Implement its Financial Plan Containing Several Interconnecting Aspects
BPU Docket No.: WF20100662

Dear Secretary Camacho-Welch:

Please accept for filing the comments of the Division of Rate Counsel ("Rate Counsel") regarding the petition filed by Shore Water Company ("Shore" or "the Company") in the above-captioned proceeding. Consistent with the March 19, 2020 Order the New Jersey Board of Public Utilities ("Board") in I/M/O the New Jersey Board of Public Utilities' Response to the COVID-19 Pandemic for a Temporary Waiver of Requirements for Certain Non-Essential Obligations, BPU Docket No. EO20030254, copies of this comment letter are being filed with the Secretary of the Board and provided electronically to each person on the service list by electronic mail only. No paper copies will follow. **Please acknowledge receipt of this comment letter.** Thank you for your consideration and attention to this matter.

Background

Shore is a family-owned and operated public water utility with an exclusive franchise to serve the South Seaside Park section of Berkeley Township, New Jersey.[1] Shore serves

[1] Petition, para. 1 and Shore's response to OE-8.

Tel: (609) 984-1460 • Fax: (609) 292-2923 • Fax: (609) 292-4991
http://www.nj.gov/rpa E-Mail: njratepayer@rpa.nj.gov

approximately 1,240 seasonal residential customers and approximately 24 small, low rise condominiums and commercial establishments.[2] Shore's 2019 revenues were $650,472. Until recently, Shore had no outstanding debt; it was entirely equity financed.[3]

On October 19, 2020, Shore filed a petition with the Board requesting authorization, among other things, to issue up to $540,000 of long-term debt. The proceeds of the debt issuance are intended to finance the first phase of Company's "Asset Management Plan," which identifies Shore's detailed plans to upgrade and improve its water system.[4]

In attempting to secure financing for its planned improvements, Shore encountered significant impediments from potential lenders.[5] Essentially, potential lenders were reluctant to lend money to the Company because of the existing ownership structure of the Company. Specifically, four separate Trusts collectively owned a 34.1675% minority interest in the Company (the "Trusts"). Those Trusts were reluctant to pledge their stock shares or trust assets as collateral for the loan.[6] The Trusts were concerned about the debt obligation they would be undertaking and its impact on their return on investment.[7]

To overcome the lenders' and the Trusts' concerns, Shore repurchased all the trusts' shares (136.666 shares). Thereafter, under Shore's Financial Plan, if approved by the Board, Shore's President, Gloria Stuart intends to purchase 37.58 shares of treasury stock to gain a majority interest in the Company.[8] Ms. Stuart would then own 154.246 shares of the Company's common stock.[9] Shore's remaining shareholder, Samuel Faiello, will own 146.668 shares of common stock if the Financial Plan is approved.

Shore proposes to implement its Infrastructure Improvement Loan program in two phases: a short-term construction loan followed by replacing the short-term debt with a long-term permanent financing loan. Under the existing short-term construction loan, Shore is able to periodically draw an amount equal to 60% of the total invoices due the contractor up to a

[2] Shore's response to OE-8.
[3] Shore's response to OE-6(c).
[4] Petition, para. 4.
[5] Petition, para. 19.
[6] _Id._
[7] Shores response to RCR-8.
[8] Petition, para. 21.
[9] Petition, para. 22.

maximum of $540,000.[10] The interest rate payable on the construction loan is 4 percent.[11] As of November 30, 2020, Shore had received two draws from the lender totaling $147,810.[12]

With the Board's approval, Shore plans to convert its construction draws into permanent financing through long-debt in July 2021. Manasquan Bank, a regional New Jersey bank with its home office located in Ocean County, New Jersey, who is currently providing Shore the construction funds, has committed to lend Shore up to $540,000 for a 15-year term. Repayment of the note will follow a fixed amortization schedule of principal and interest.[13] For the initial five years of the loan, the interest rate will be set at 3.9%, or just slightly lower than the current interest rate on the construction loan. Revised fixed-rate interest rates will be set at five-year intervals thereafter. The adjusted interest rates will be established based on the Federal Home Loan Bank's 5-year advance rate then in effect plus 200 basis points rounded to the nearest 1/8%.[14] The floor on any interest rate at the time of the adjustment is 3.9%.[15]

To implement Shore's change of control and financing plans, its Petition requests the following from the Board at this time:

(a) Grant authority for the company to proceed with the Infrastructure Improvement Loan;

(b) Find that the requirements of N.J.S.A. 48:3-9(a)(1) and N.J.A.C. 14:1-5.9 are met;

(c) Find that the requirements of any other relevant state statute or regulation have been met;

(d) Retain this matter for processing by the Board directly with a decision to be rendered both to permit the infrastructure improvements to proceed as soon as possible and the conversion of the construction loan into permanent financing; and

(e) Grant such other relief as may be reasonable and necessary.

Rate Counsel offers the following analyses and recommendations concerning Shore's requests.

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[10] Shore's response to RCR-4.
[11] _Ib_.
[12] _Ib_.
[13] Shore's response to RCR-3.
[14] Shore's response to RCR-2.
[15] _Ib._

Analysis

Shore developed an Asset Management Plan ("AMA") to identify facilities in need of replacement or repair to remain in compliance with the New Jersey Water Quality and Accountability Act.[16] The AMA identified significant and costly replacements that are now required. The size of Shore's proposed Infrastructure Improvement program, however, is beyond the Company's current financial capability. Therefore, Shore sought outside funding in the form of a secured loan.

Shore's initial contacts with prospective lenders were not favorable. Co-Bank, a national lending co-operative was not interested. Manasquan Bank also had serious concerns with Shore's ownership structure, the size of its operations, and its location in a flood zone. Of these three concerns expressed by Manasquan Bank, the ownership structure is the only one that is controllable by the Company. The lender was apprehensive that the Citta Trusts, who collectively owned 34% of the issued and outstanding stock, were unwilling to offer their holdings as collateral for a loan. Shore proposed to resolve this concern by buying back the outstanding shares of common stock held by the Citta Trusts.

The Board's regulatory authority over Shore's operations and rates will not be diminished following the change of ownership proposed by the Company. Moreover, the newly reconstituted ownership structure provides additional financing flexibility for Shore that was not available under the prior ownership model, as evidenced by the proposed loan agreement with Manasquan Bank. Therefore, Rate Counsel does not object to Shore's repurchase of treasury stock from the Citta Trusts, as proposed by the Company, or to Ms. Stuart gaining a controlling interest in the Company.

Next to consider is the impact of the proposed loan on Shore and ultimately its customers. Prior to now, Shore had no outstanding debt. Its operations were 100% equity financed through retained earnings. Following closing of the proposed $540,000 loan, Shore will nearly double its permanent capital. Its permanent capital structure will then consist of 42.16% debt and 57.84% common equity.[17] Shore will have no other outstanding long-term debt.

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[16] N.J.S.A. 58:31-1 to -7.
[17] *Ib*.

The loan agreement includes a requirement for Shore to maintain a 1.25x debt service coverage ratio commencing at the end of 2021.[18] The formula for determining the debt service coverage ratio, as defined in the loan agreement, is as follows: (Net Profit + Interest Expense + Depreciation and Amortization - Dividend Distributions) / Previous Year Portion of Long-term Debt). Based on Shore's anticipated 2021 debt costs, which are for only a partial year, and 2019 earnings, Shore's *pro forma* debt service coverage ratio under current rates is 4.15x.[19] This is well above the 1.25x minimum required under the loan agreement. If Shore's anticipated 2022 debt service costs are *pro formed* into the coverage formula, which reflects a full year of interest and principal payments, Shore's debt service coverage ratio will still exceed the minimum requirement even without additional rate relief. Shore's immediate plan, however, is to seek rate relief from the Board once it receives approval for its proposed financing and change of control.[20] While Rate Counsel cannot and will not pre-judge the necessity for and reasonableness of a rate adjustment at this time, additional revenues will serve to boost Shore's debt service coverage margin under the loan agreement. Based on these considerations, Rate Counsel is not opposed to Shore's proposed financing plan to enter into a $540,000 loan agreement with Manasquan Bank under the conditions expressed therein.

Recommendation

The Division of Rate Counsel has carefully reviewed the Petition and is not opposed to its approval. Shore is a family-owned and operated public water utility with an exclusive franchise to serve the South Seaside Park section of Berkeley Township, New Jersey. Shore serves approximately 1,240 seasonal residential customers and approximately 24 small, low rise condominiums and commercial establishments. Shore claims the proposed financing is necessary and appropriate to fulfill its requirement to provide safe, adequate, and reliable service to its New Jersey customers. Except for unforeseen and unanticipated circumstances, the proposed long-term debt should not jeopardize Shore's financial integrity. Based on recent financial information provided by the Company through discovery, it appears that Shore's current operations generate sufficient income to meet near-term debt service payment requirements without impinging on its ability to provide safe, adequate and reliable service to its customers.

[18] Shore's response to RCR-17.
[19] Petition, Exhibit E.
[20] Shore's response to RCR-18.

The Board's approval of the Petition, however, should not include authorization to include in rate base any specific assets that will be acquired from the proceeds of this financing. Nor should the prudence of the expenditures resulting from the proposed financing be addressed and approved in this proceeding. Prudence of Shore's expenditures should be addressed in its next base rate case. The approval of Shore's financing plan also should not be construed as the Board's acceptance for ratemaking purposes of the resulting capital structure and capital costs. The determination of any assets to be included in rate base and the ratemaking impact of serving customers, including the impact of the transaction(s) on Shore's capital costs, should be addressed in a future base rate proceeding.

In addition, Shore should be required to issue its planned long-term debt at the lowest reasonable cost.

The Company should be required to utilize a prudent and cost-effective capital structure and mix of capital to finance its utility rate base at the lowest reasonable cost.

The authority granted by the Board in this proceeding should be null and void for any portion of the Company's long-term debt financing plan that is not completed by December 31, 2021.

Finally, Rate Counsel reserves all rights to take appropriate positions in future Board proceedings involving the Company. Approval by the Board of these recommendations will satisfy the concerns of Rate Counsel that the Board's approval is limited to the transactions as herein described, does not indicate authorization to include any specific assets or amounts in rate base, does not indicate authorization for any other ratemaking treatment, and does not establish any precedent regarding approval of future financing petitions.

Respectfully Submitted,

Stefanie A. Brand, Esquire
Director, Rate Counsel

By: __*Susan E. McClure*_____
Susan E. McClure, Esquire

c: Service List