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May 5, 2021

**Via Electronic Mail Only**

Ms. Aida Camacho-Welch, Secretary  
Board of Public Utilities  
44 South Clinton Avenue, 3<sup>rd</sup> Floor, Suite 314  
Trenton, New Jersey 08625-0350

**Re: I/M/O the Petition of Middlesex Water Company for Authority to Issue up to \$45.5 million of First Mortgage Bonds and to Redeem Certain Outstanding First Mortgage Bonds BPU Docket No. WF21020622**

Dear Secretary Camacho-Welch:

Please accept for filing in the above-referenced matter the New Jersey Division of Rate Counsel's ("Rate Counsel") comments concerning Middlesex Water Company's ("Middlesex" or "the Company") February 25, 2021 petition to the New Jersey Board of Public Utilities ("Board") for authority to issue up to \$45.5 million of First Mortgage Bonds and to redeem a like amount of outstanding First Mortgage Bonds.

Consistent with the Order issued by the Board in connection with *In the Matter of the New Jersey Board of Public Utilities' Response to the COVID-19 Pandemic for a Temporary Waiver of the Requirements for Certain Non-Essential Obligations*, BPU Docket No EO20030254, dated March 19, 2020, these documents are being electronically filed with the Secretary of the Board and Middlesex. No paper copies will follow.

**A. Background**

Middlesex is a regulated public utility that provides water services to approximately 61,000 retail customers, primarily in eastern Middlesex County, New

Jersey.<sup>1</sup> In addition, Middlesex provides water under wholesale contracts to the City of Rahway, the Townships of Edison and Marlboro, the Borough of Highland Park and the Old Bridge Municipal Utilities Authority.<sup>2</sup> Middlesex also provides water service to approximately 300 customers in Cumberland County, New Jersey, through a separate system that is not interconnected with its main service territory.<sup>3</sup>

On February 25, 2021, Middlesex filed a petition (“Petition”) and supporting documents seeking approval from the Board to:

- a) Borrow up to \$45.5 million from and make, execute and deliver loan agreements therefor and to make, execute and deliver to the NJEDA and/or private placement agent as may be selected by negotiation, such contracts of purchase in connection therewith; and
- b) Make, execute, and deliver, if necessary, such Supplemental Indentures of Mortgage to the Company’s Indenture Trustee or other such securitization as needed; and
- c) Obtain the relief requested in subparagraphs (a) through (b) of this section herein without the requirement of further Board Order as to pricing; and
- d) Obtain such other relief as the Board determines is just and proper.

By way of background, Middlesex claims to have identified two series of outstanding First Mortgage Bonds totaling \$45.5 million issued in 2012 through the New Jersey Economic Development Authority (“NJEDA”) that if refunded and replaced with new First Mortgage Bonds, could result in lower costs to the Company and to its customers.<sup>4</sup>

If the two series of outstanding First Mortgage Bonds are refunded, Middlesex is considering alternate financing plans, including: a) issue \$45.5 million of NJEDA tax exempt bonds; b) borrow up to \$45.5 million in a negotiated private placement

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<sup>1</sup> Petition, para. 1.

<sup>2</sup> *Id.*

<sup>3</sup> Petition, para. 4.

<sup>4</sup> Petition, para 6.

transaction, from qualifying banks, other financial institutions, mutual funds, insurance companies and pension fund bonds; or 3) some combination of the above, whichever is more advantageous to the Company and its customers.<sup>5</sup>

In essence, the Petition requests Board authorization for Middlesex to replace two specific series of existing long-term debt with new, lower cost long-term debt. Middlesex is not requesting approval to increase its current total long-term debt authorization.

### **Rate Counsel's Analysis**

As of December 31, 2020, Middlesex had \$242.5 million of long-term debt outstanding.<sup>6</sup> The maturity dates of this debt ranges from August 2021 to August 2059.<sup>7</sup> Also as of December 31, 2020, Middlesex had a \$3 million balance of short-term debt outstanding.<sup>8</sup>

In the instant Petition, Middlesex seeks Board authorization to issue and sell up to \$45.5 million aggregate principal amount of long-term debt and to redeem a like amount of outstanding debt, specifically its outstanding Series RR and Series SS, which were both issued in 2012. The Company represents that present market conditions are such that redeeming and replacing these two series with new long-term debt, including appropriate consideration of all redemption and issuance costs, will result in savings to the Company and its customers. Middlesex is considering replacing Series RR and Series SS debt by issuing \$45.5 million of NJEDA tax-exempt bonds or to borrow up to \$45.5 million through a negotiated private placement, or some combination of both.

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<sup>5</sup> Petition, para. 7.

<sup>6</sup> Petition Exhibit C.

<sup>7</sup> *Id.*

<sup>8</sup> Middlesex response to RCR-5.

Standard and Poor's most recent credit analysis affirmed its previous A+ rating for Middlesex's long-term debt.<sup>9</sup> At the same time that it affirmed its rating in November 2020, however, Standard and Poor also revised its outlook for the Company to "negative" and warned of a possible one notch downgrade within the next 24 months due to the Company's increased leverage.<sup>10</sup>

Middlesex's target capitalization ratios are 47 percent long-term debt, 0.25 percent preferred stock, and 52.75 percent common equity.<sup>11</sup> These are the same ratios that were approved in Middlesex's 2017 base rate proceeding.<sup>12</sup> As of February 28, 2021, Middlesex's actual capital structure was 41.57 percent long-term debt, 0.35 percent preferred stock, and 58.08 percent common equity.<sup>13</sup> Because the Petition seeks to redeem \$45.5 million of existing long-term debt and replace it with the same amount of new long-term debt, the proposed transaction will not adversely impact Middlesex's capital structure. Nor will it improve Middlesex's capital structure.

Middlesex's outstanding long-term debt also has financial covenants that require the Company to maintain a minimum interest coverage ratio (i.e., the ratio of net operating earnings to annual interest charges including interest on the proposed new mortgage bonds) of at least 2x for the twelve consecutive calendar months within the fifteen calendar months prior to issuing the new mortgage bonds.<sup>14</sup> For the twelve-month period ended December 31, 2020, Middlesex's interest coverage ratio was 3.07, i.e., well above the minimum requirement.<sup>15</sup> To the extent that Middlesex is successful in lowering its cost of debt by redeeming and issuing the same amount of replacement debt, the Company's coverage ratio should improve as a result of the transaction, all else being equal. In short, the proposed transactions should not have an adverse impact on

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<sup>9</sup> Middlesex response to OE-1.

<sup>10</sup> *Id.*

<sup>11</sup> Middlesex response RCR-4.

<sup>12</sup> *Id.*, BPU Docket No. WR17101049.

<sup>13</sup> *Id.*

<sup>14</sup> Middlesex response RCR-6.

<sup>15</sup> Middlesex response RCR-7. ACSC's response to Rate Counsel Discovery Request RCR-6, Attachment.

Middlesex maintaining adequate interest coverage as required under its existing mortgage indenture.

The real concern for Rate Counsel is how likely it is that the proposed transactions will enable Middlesex to reduce its cost of debt. In Exhibit L of the Petition, Middlesex presents analyses intended to represent anticipated savings from the planned redemption and issuing new bonds. These analyses show a potential net present value savings of the proposed transactions of approximately \$5.4 million over the 30-year lives of the new bonds based on market conditions that existed when the analyses were undertaken in February 2021. Market conditions at the time of the proposed transactions, however, may not be as favorable as they were in February 2021. In fact, Middlesex now expects that interest rates on the new bonds may be up to thirty basis points higher than the rates shown in the Company's savings analyses.<sup>16</sup> Higher interest rates at the time of expected issuance may erode or even negate anticipated savings.

### **Findings and Recommendations**

Rate Counsel has carefully reviewed the Petition and is not opposed to its approval so long as the proposed transactions result in a positive net benefit to the Company and its customers. Assuming a net positive savings is attainable, the proposed financing is reasonable, beneficial, and appropriate as part of the Company's overall strategy to provide safe, adequate, and reliable service to its customers at the lowest possible cost. Except for unforeseen and unanticipated circumstances, the proposed refunding and new debt issues should not adversely impact Middlesex's financial integrity. On the contrary, if successful, the proposed refunding and issuance of replacement long-term debt should enhance the Company's financial integrity. Based on the Company's recent financial performance, it appears that Middlesex has adequate net operating income to meet anticipated debt service payment requirements without

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<sup>16</sup> Middlesex response to RCR-2.

jeopardizing the Company's ability to provide safe, adequate, and reliable service to customers.

The proposed transactions should not be undertaken, however, unless it can be convincingly demonstrated that the redemption and refunding of outstanding bond series will result in savings to Middlesex's customers. Thus, the Board should require Middlesex to prepare contemporaneous cost savings analyses based on then-current market conditions, like those provided in Exhibit L, immediately prior to undertaking the transactions. Moreover, approval of the Petition should not include authorization to include in rate base any specific assets that will be acquired as a result of this financing. Nor should it be construed as 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 Middlesex's capital costs should be addressed in a future base rate proceeding.

The Board approval should include the following conditions:

- The authority granted by the Board in this docket should be restricted to fund utility operations and investments only, not to fund affiliated entities.
- The Company should be obligated to issue its planned long-term debt at the lowest reasonable cost.
- The Company should be obligated to utilize a prudent and cost-effective capital structure and mix of capital to finance its utility rate base at the lowest reasonable cost.

- Finally, Rate Counsel reserves all rights to take appropriate positions in future Board proceedings involving the Company, including any such proceeding pending before the Board at this time.

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 with regard to approval of future financing petitions.

Respectfully Submitted,

Stefanie A. Brand, Esquire  
Director, Rate Counsel

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