

**BEFORE THE RATE COMMISSION OF THE
METROPOLITAN ST. LOUIS SEWER DISTRICT**

**AUGUST 19, 2011 SUBMITTAL OF SURREBUTTAL TESTIMONY
OF THE METROPOLITAN ST. LOUIS SEWER DISTRICT**

ISSUE: WASTEWATER RATE CHANGE PROPOSAL

WITNESS: JEANNE F. VANDA

SPONSORING PARTY: METROPOLITAN ST. LOUIS SEWER DISTRICT

DATE PREPARED: August 19, 2011

**Metropolitan St. Louis Sewer District
2350 Market Street
St. Louis, Missouri 63103**

METROPOLITAN ST. LOUIS SEWER DISTRICT

**MSD Rate Commission
2011 Wastewater Rate Change Proceeding**

AFFIDAVIT OF JEANNE FREDERICK VANDA

STATE OF MISSOURI)
)
COUNTY OF ST. LOUIS)

Jeanne Frederick Vanda, being of lawful age and duly affirmed, states the following:

1. My name is Jeanne Frederick Vanda. I am a Managing Director of Public Financial Management, Inc.
2. Attached hereto and made a part hereof for all purposes is my Surrebuttal Testimony consisting of 19 pages of documents and one Appendix filed on behalf of The Metropolitan St. Louis Sewer District, MSD Rate Commission, 2011 Wastewater Rate Change Proceeding.
3. I have reviewed the attached Surrebuttal Testimony and schedules and hereby affirm that my testimony is true and correct to the best of my knowledge and belief.

Jeanne Frederick Vanda
Jeanne Frederick Vanda

Duly affirmed before me this 19th day of August, 2011

Cristina Kuhn
Notary Public

My Commission expires on 8-12-14.



1 **Jeanne Vanda – Background**

2 **Q1. Ms. Vanda please describe your education and your firm’s experience in**
3 **public finance.**

4 A. I am a Managing Director at Public Financial Management, Inc., (“PFM”), with 28
5 years of experience working in public finance with issuers in the Midwest. I have a
6 Bachelors of Arts degree from Cornell College and earned a Masters of Arts degree
7 in Urban Planning and Policy Analysis from Harvard University in 1980. I worked for
8 three years as a Policy Analyst for the City of Dubuque, Iowa. In 1983, I joined the
9 Minneapolis based financial advisory firm of Ehlers and Associates. At Ehlers I was
10 focused on developing a local government financial advisory business in Minnesota
11 and Iowa. In 1993 I joined PFM, a financial advisory firm with a national scope of
12 business and opened their first Midwest office. I became a partner at PFM in 1995
13 and assumed leadership of PFM’s Midwest financial advisory practice, which now
14 focuses on the planning and execution of debt for state and local government
15 issuers throughout 10 states in the Midwest, including Missouri. Today, PFM is the
16 largest independent financial advisory firm in the United States, with over 450
17 employees in over 30 offices. In 2010, PFM acted as financial advisor on 988
18 issues, totaling \$57.5 billion in municipal bonds. We now have 7 offices and
19 approximately 70 employees throughout the Midwest, including our St. Louis, MO
20 office. For each of the last eight years PFM has led the market in terms of the
21 volume of municipal bond issuance. PFM also leads nationally in volume of Water
22 and Wastewater debt issues, with representative clients including: Austin (TX)
23 Water and Wastewater, Metropolitan Sewer District of Greater Cincinnati (OH), Clark

1 County (NV) Water Reclamation District, District of Columbia (DC) Water and Sewer
2 Authority, Miami-Dade (FL) Water and Sewer Department, Fairfax County (VA)
3 Integrated Sewer System, Massachusetts (Boston Metropolitan Area) Water
4 Resources Authority, Pittsburgh (PA) Water and Sewer Authority.

5

6 **Q2. Describe your personal experience advising issuers of municipal bonds?**

7 A. In addition to my PFM Midwest management responsibilities, I also work with a
8 number of larger Midwest issuers, concentrating on larger municipal clients as well
9 as state level agencies that issue revenue bond debt. Representative water and
10 wastewater clients I have worked with include the Des Moines (Iowa) Wastewater
11 Reclamation Authority (“DsmWRA”), Kansas City (Missouri) Department of Water
12 Services (Water and Sewer), as well as the Metropolitan St. Louis Sewer District.
13 State level clients include the State of Missouri Department of Transportation
14 (“MoDOT”), the State of Kansas Department of Transportation, the State of Michigan
15 Department of Transportation. The three state level transportation departments
16 issue State Highway Revenues Bonds that are secured solely and only by state
17 sales and gas taxes and a variety of vehicle registration fees and taxes. I also work
18 with the states of Iowa and Minnesota, advising on the issuance of a variety of
19 different revenue bond credits. I have advised on developing initial revenue credit
20 and security structures for a number of issuers, including MSD, DsmWRA and
21 MoDOT. I have advised on the structure, credit and pricing of individual revenue
22 bond issues in par amounts from \$1.0 million to over \$5.2 billion.

23

1 **Q3. How long have you worked with MSD and what is your role as Financial**
2 **Advisor?**

3 A. PFM has worked for MSD since 2000, and I have been on the engagement since
4 2003, and report through the MSD Secretary-Treasurer, Karl Tyminski.

5
6 As financial advisor to MSD, I worked with staff and other members of the finance
7 team to develop the master bond indenture that defines the security provisions and
8 flow of funds for payment of MSD's senior and subordinate lien revenue bonds. I
9 developed the initial credit rating strategy and presentation materials for introduction
10 of the MSD new revenue credit in 2004. I also worked with MSD staff to develop a
11 comprehensive debt management policy that was adopted by the Trustees in 2004. I
12 have subsequently been involved advising on the planning, credit discussions and
13 pricing of all MSD senior lien Wastewater Revenue Bonds as well as the structuring
14 and sale of the subordinate revenue bonds through the Missouri EI ERA sewer
15 revolving loan fund program.

16
17 I have also worked with MSD staff and their engineering advisor, Black and Veatch,
18 advising on pledged revenue requirements for the current rate commission
19 submission as well as for the rate commission processes in 2003 and 2008. PFM
20 keeps MSD informed as to current trends in the public finance market place, reviews
21 investment banking proposals, and advises on financial disclosure issues as well as
22 developing responses to periodic inquiries from rating agencies.

1 Bond Rating

2 **Q4. Q. Does the District currently have outstanding bonds?**

3 A. Yes

4

5 **Q5. What types of bonds are these?**

6 A. MSD issues municipal revenue bonds secured solely and only from a pledge of
7 wastewater revenues as defined in the 2004 Master Bond ordinance. MSD issues
8 tax-exempt debt and does not have any user contracts or other structural issues that
9 would necessitate the issuance of taxable municipal bonds.

10

11 **Q6. Q. What is the District's current bond rating?**

12 A. The District's current bond ratings are as follows:

13

14 Fitch: AAA

15 Moody's: Aa1

16 Standard & Poor's: AA+

17

18 These ratings reflect upgrades from the original ratings received in 2004 which were
19 Fitch, AA, Moody's, Aa2, and Standard and Poor's, AA. MSD is highly rated by each of
20 the three national rating agency firms, earning the highest rating possible from Fitch,
21 and the second highest rating possible from both Moody's and Standard and Poor's.

1 **Q7. How are these ratings determined?**

2 A. An issuer of municipal debt must request a credit rating from one or more of the
3 credit rating agencies that currently publish ratings on public debt. The three most
4 prominent rating agencies in the current market are Moody's Investors Service, Fitch
5 Ratings, and Standard and Poor's. Once a request is made, the issuer submits
6 materials and documents that allow the rating analysts to assess the ability and
7 willingness of the issuer to pay its debt obligations in full and on time.
8 Documentation includes audited financial statements, budgets, capital improvement
9 plans, and issuer policies related to debt management, economic and employment
10 data, bond indenture and disclosure documents. Generally, the issuer, with the
11 assistance of its financial advisor, will prepare a presentation that highlights the
12 credit strengths of the issuer. The rating analyst evaluates the submitted information
13 and uses internal rating agency data to compare the financial performance and debt
14 metrics to similar issuers with outstanding ratings. The rating agencies strive for
15 consistency and comparability among issuers at the same credit rating level. Once
16 this information is evaluated the rating analyst will develop a rating recommendation
17 and present it to a committee comprising senior analysts from the rating agencies.
18 This committee then develops consensus on the rating to be assigned, a report is
19 drafted and the rating is publicly released.

20 **Q8. What are the factors considered by the rating agencies to determine a bond**
21 **rating?**

22 A. There are four general drivers of credit quality: economy, legal and policy
23 constraints, financial performance, and quality of management. Economic factors

1 that highlight credit are: wealth indicators, property valuations, employment and
2 unemployment trends, and the type and diversity of employers. Legal and policy
3 constraints provide the framework for governmental operations. Constitutional,
4 statutory and regulatory provisions set limitations and obligations for government
5 operations and debt issuance. Financial performance and quality of management
6 are somewhat intertwined. Indicators include trends in establishing and maintaining
7 adequate reserves and demonstrated ability to deliver financial performance at
8 budgeted targets. For revenue supported debt, the impact of any larger customers
9 on pledged revenues is noted. The history of debt coverage as well as forecast
10 coverage levels are closely reviewed. The willingness of the governing entity to
11 impose adequate and timely adjustments to rates and charges and to fund capital
12 replacements to maintain the enterprise system is important.

13

14 **Q9. Q. How does the District’s current and projected financial condition impact**
15 **its bond rating?**

16 A. Once rating levels are established, the rating analysts look for consistency in
17 financial performance moving forward. Downgrades and upgrades to bond ratings
18 are driven by financial performance trends that emerge. MSD was upgraded in 2008
19 by two of the three rating agencies because it demonstrated the ability to grow
20 strong liquidity and maintain strong debt coverage while undertaking a significant
21 capital improvement program in anticipation of the consent decree obligations.

1 **Q10. What are the key financial components of the Rate Proposal that impact the**
2 **District's future bond rating?**

3 A. The outcome of the rate commission proceedings will substantially drive the amount
4 of revenue available to pay debt service in the near term and thus significantly
5 influence debt coverage and overall liquidity. Moreover, the outcome of the
6 proceedings will also signal to the rating agencies the commitment of a key
7 stakeholder to supporting MSD's ability to meet its obligations under the consent
8 decree.

9
10 **Q11. Does the District's Rate Proposal take into account these components?**

11 A. Yes.

12
13 **Q12. Why were these components taken into accounts?**

14 A. To allow MSD to position itself to maintain its existing premium ratings and hopefully
15 avoid any potential downgrade in the District's current bond rating associated with
16 the growth of the bond financing program reflected in the District's Rate Proposal.

17
18 **Q13. In what way were these financial components addressed in the Rate**
19 **Proposal?**

20 A. Mr. Barber structured the rate increases over the four year period to generate
21 minimum levels of debt coverage based in part on recommendations by PFM. PFM
22 also recommended the use of a 5.5% interest rate yield for projecting debt service
23 on bonds issued as part of the rate proposal. At PFM's, request, Mr. Barber also

1 made adjustments to the mix of Pay-Go and bond funding to build a stronger cash
2 position in 2012 and 2013. PFM has expressed a concern to MSD staff regarding
3 the potential rating implications of declining cash balances and liquidity since 2008.

4

5 **Q14. Is the District’s financial condition reflected during the last rate change**
6 **proceeding the same as in the current proceeding?**

7 A. No.

8

9 **Q15. What has changed?**

10 A. Overall, debt coverage is lower for this rate commission proceeding as compared to
11 debt coverage forecast in the 2003 and 2008 proceedings. This is due to two
12 primary factors. First, for the two prior rate commission proceedings MSD was
13 projecting an overall mix of 50% cash and 50% debt funding. This current
14 proceeding estimates 23% cash and 77% debt funding. Higher planned cash
15 funding of projects will generate higher levels of pledged revenue coverage of debt
16 issued. Reduced levels of cash funding for projects will lower annual pledged
17 revenue and coverage of debt service. Based on rates approved in 2008, MSD
18 projected pledged revenue coverage of debt service at over 3.50 times. The current
19 rate proposal forecasts pledged revenue coverage of debt service at approximately
20 2.35 times. Second, the pace and size of the bond transactions will accelerate, also
21 putting pressure on debt coverage.

22

1 **Q16. Could these changes impact the District’s bond rating?**

2 A. Yes.

3

4 **Q17. If so, how?**

5 A. One or more of the rating agencies may determine that the lower debt coverage
6 forecast and growing debt burden merit a credit downgrade. PFM believes that
7 while the debt coverage will decline, bond security remains comparable with high
8 “AA” credits. Furthermore, while the terms of the proposed consent decree have just
9 recently been publicly released, MSD has been consistently forthcoming in past
10 rating agency discussions about the likely scope of the capital program driven by the
11 consent decree.

12

13 **Q18. Do changes in bond ratings impact bond interest rates?**

14 A. Yes.

15

16 **Q19. Q. How do bond rating changes impact bond interest rates?**

17 A. Bond ratings influence the interest rate paid by issuers. Higher credit ratings mean
18 the rating agency assigns a low risk to late debt payments or defaults. Lower credit
19 ratings signal that the bonds issued by the government entity may carry a higher
20 level of risk. Risk translates in the market place to yield. Higher ratings mean lower
21 risk and lower yields. A rating change signals a change in the assessment of the
22 risk associated with the debt. A ratings downgrade may then trigger the need to

1 price bonds at relatively higher yields to attract investors. A ratings upgrade should
2 allow more aggressive pricing and lower yields to attract investors.

3

4 **Q20. Will a downgrade in the District Bond rating increase or decrease the**
5 **average residential customer's bill?**

6 A. A rating downgrade will eventually increase a residential customer's bill.

7

8 **Bond Interest Rate**

9 **Q21. Were assumptions made in the May 10, 2011 Rate Proposal (Exhibit MSD 1)**
10 **regarding the interest rate applied to proposed bonds?**

11 A. Yes. The District assumed a 5.5 % interest rate for all bonds anticipated to be
12 issued over the four years of the Rate Proposal.

13

14 **Q22. Does the District's Rate Proposal assume the issuance of revenue or**
15 **general obligation bonds?**

16 A. The District assumes the use of revenue bonds. The District's total outstanding debt
17 consists of 100% revenue bonds.

18

19 **Q23. Are there other types of bonds?**

20 A. Yes

21

22 **Q24. What are these other types of bonds?**

23 A. Bonds issued through the Build America Program

1 **Q25.** How do these types of bonds differ?

2 A. The Build America bonds were issued under a limited duration federal program
3 where bonds were sold in the corporate market at taxable interest rates and the
4 federal government subsidized the interest rate by 35%.

5

6 **Q26. Is there a correlation between the interest rates of different types of bonds?**

7 A. Yes, all debt denominated in US dollars is traditionally based on the shape of the
8 yield curve for debt securities of the United States government. The different classes
9 of securities such as municipal or corporate debt issues will sell for (provide a yield)
10 based on a spread to the US Treasury yield curve. This spread is usually stated in
11 terms of “basis points” which is 1/100 of 1%. The spread can change based on the
12 number of years to maturity. Usually the greater time frame to maturity the greater
13 the spread to the US Treasury yield curve which is a plot of US Treasury yields
14 versus time to maturity. One has to think of the market for debt securities as being
15 segregated by debt class and an economic or political condition can impact one
16 class more severely than another. Generally in times of economic distress such as
17 those seen since 2008 the spreads between the US Treasury securities and the
18 municipal debt securities will narrow or decline, causing the municipal debt to be
19 more expensive on a relative basis as compared to the US Treasury’s debt.

20

21 **Q27. Do financial market conditions impact the level of bond interest rates?**

22 A. Yes. It is important to recognize however that Federal Open Market Committee
23 (“FOMC”) action to influence rates is really focused on the short end of the U.S.

1 Treasury yield curve. The FOMC recently announced its intent to keep short-term
2 interest rates low through 2013. This does not necessarily mean that either long-
3 term U.S. Treasuries or municipal tax-exempt interest rates will remain at current
4 interest rates levels. The yields of U.S. Treasuries are moved by investors'
5 perception of long term risk in the broader marketplace as well as expectations for
6 inflation. The current treasury yield curve is fairly steep. The yield curve could
7 further steepen (short-term rates low and long-term rates increase) if inflation
8 becomes a concern or it could flatten (short-term rates low and long-term rates
9 decline) if large amounts of monies flow into Treasuries as a safe haven from the
10 volatility of the stock market. The municipal market runs parallel to the Treasury
11 market but not necessarily in lockstep with it. While the FOMC can influence U.S.
12 Treasury yields, particularly at the short end by monetary policy, the municipal
13 market is more influenced by the volume of municipal debt in the marketplace and
14 investors' willingness to accept municipal yield levels. While municipals should
15 logically trade at lower yields than U.S. Treasuries based on the Federal tax
16 exemption, in low interest rate markets municipal yields can rise above comparable
17 U.S. Treasuries if municipal investors demand higher yields to place orders. In the
18 last couple of weeks municipal yields have in fact exceeded U.S. Treasuries at
19 certain points of the yield curve.

20

21 **Q28. How might changes in market condition impact municipal revenue bond**
22 **interest rates?**

1 A. Future municipal revenue bond yields will be impacted both by potential
2 congressional action on individual income tax rates as well as by the economy and
3 by investors' perception of risk. The value of the municipal tax exemption is directly
4 related to Federal tax rates on individuals. If Congress chooses to further extend the
5 Bush administration tax cuts or if tax rates are cut the value of tax exemption
6 declines and municipal interest rates will rise. As noted earlier, the municipal bond
7 market moves in parallel to the U.S. Treasury market in reaction to economic news
8 and expectations related to inflation. Once economic activity picks up, rates will rise.
9 Finally, municipal market yields are influenced by perceptions of risk. In the five
10 year period prior to the fall 2008 market dislocation, market spreads between "AAA"
11 and "A" credits had narrowed to approximately 20 basis points as investors were
12 more accepting of risk. After the 2008 market dislocation, the credit spreads
13 increased significantly, with a rating in the "AA" category becoming more valuable.
14 Market yield spreads between "AAA" and "A" credits widened to 100 basis points.
15 While credit spreads have come down from the 2009 high levels, credit spreads do
16 remain a significant factor influencing bond pricing in the current market.

17

18 **Q29. Taking into account these factors, what is the basis for bond interest rate**
19 **assumption used in the District's Rate Proposal?**

20 A. PFM looks at historic tax exempt yields, reviewing a number of both revenue bond
21 and general obligation bond indices. The most common index we use to benchmark
22 bond pricing is the Municipal Market Data, ("MMD"), AAA General Obligation Yield
23 Curve, which is published daily. MMD also publishes other indices but the AAA

1 MMD remains the most widely used index for benchmarking bond pricing, for both
2 general obligation and revenue bonds, and for gauging market movements over
3 time. A number of considerations go into longer range interest rate projections;
4 credit spreads, market spreads, duration of the forecast time period, historic market
5 movement and volatility, and future issuer credit ratings. The graphic in Appendix
6 JFV-1 depicts the movement of the 25 year benchmark AAA MMD on a quarterly
7 basis since 1983. The "A" MMD is shown beginning in 1992 to highlight the change
8 in credit spreads over time. Between 1983 and July of 2011, the average yield for
9 the 25 year benchmark maturity is 5.88%. Credit Spread. Since revenue bonds
10 have a more limited pledge of revenues and are not secured by the full faith, credit,
11 and taxing power inherent in a general obligation credit, revenue bonds are
12 expected to price at some basis point spread, referred to as a "credit spread" to the
13 AAA MMD scale. That credit spread changes over time and across different market
14 dynamics. Credit spreads between highly rated revenue and general obligation
15 credits were fairly tight over the 5 year period prior to the fall 2008 market
16 dislocation. Through that period, MSD's credit spread to AAA MMD was fairly tight,
17 estimated in a range of 10 to 15 basis points. That means that MSD's highly rated
18 revenue bonds would be expected to price 10 to 15 basis points over or higher than
19 the AAA MMD scale. The 2008 market dislocation was substantially credit driven,
20 resulting in a significant widening of credit spreads that has lasted through the
21 current market. Consequently, I would estimate a current MSD credit spread of 40
22 to 50 basis points to AAA MMD. Credit spreads have further widened outside of the
23 "AA" credit category. Prior to the 2008 market dislocation, "A" credits were pricing at

1 credit spreads of 20-25 basis points over “AAA” credits. At the peak of the
2 municipal market disruption in October 2008, the spread between “A” and “AAA:
3 credits widened to 109 basis points. For most of September and October of 2008,
4 most larger issuers with “A” credit ratings simply did not have market access. That
5 is, there were simply not enough investors for the lower credit quality municipal
6 bonds. The MMD “A” and “AAA” G.O. indices currently show an 80 to 90 basis point
7 credit spread between “A” and “AAA” credits. MSD’s “AA” category credit remains
8 very valuable in the current market; dropping to a “single A” credit rating by any of
9 the three agencies would likely increase the credit spread substantially. I would
10 expect that in the current market MSD’s credit spread would widen to 80 to 90 basis
11 points if one agency downgraded MSD below the “AA” credit category.

12 **Market Spread and Time Period for Forecast.** When projecting interest rates in
13 advance of a bond sale or pricing we take into account the time frame between the
14 projection point in time and the anticipated sale date. The market spread refers to
15 an interest rate cushion that allows for market movement to higher interest rate
16 levels over the forecast period. The market spread tends to be lower for bonds to be
17 sold within three months and significantly higher if the bonds are to be sold over a
18 one to four year period. We benchmark our projections based on the average life of
19 the bonds to be sold. The average life calculation takes into account how principal is
20 paid over the entire maturity schedule. MSD has issued 30 year final maturity senior
21 lien bonds in the past and would likely issue 30 year bonds for the bonds
22 contemplated during this rate period. The average life of 30 year bonds tends to be
23 in the 18 to 25 year range depending on the structure of the principal payments.

1 MSD's average life tends to be longer because the senior lien bonds are structured
 2 to take into account debt service due on the subordinate SRF debt, which is limited
 3 to 20 years. We used a 25 year average life based on the average life of the senior
 4 lien bonds outstanding as follows:

| Bond Series | Average Life | Average Interest Rate |
|---------------------|--------------|-----------------------|
| Series 2004A | 22.012 years | 5.00% |
| Series 2006C | 25.769 years | 4.12% |
| Series 2008A | 25.966 years | 5.25% |
| Series 2010B (BABs) | 27.529 years | Not comparable |

5 **Historic Market Volatility.** PFM has highlighted four market troughs or low points
 6 for the 25 year yield, occurring January 1987, October 1993, October 1998, and
 7 January 2008. For each of these market troughs, we have then highlighted market
 8 changes for the next five years to illustrate the market volatility risk consideration.
 9 As you will note from the graph, the maximum spread after the 5 year low market
 10 point in 1987 was 255 basis points, for 1993 it was 125 basis points and it was 190
 11 basis points for 1998. For the most recent cycle, beginning in January 2008, the
 12 maximum spread to date is 180 basis points. The maximum spread illustrates the
 13 range of market volatility that can and has occurred for 25 year average life bonds.
 14 The average maximum spread for the three yield troughs is 190 basis points. The
 15 average spread from the 5 year low market point in 1987 was 85 basis points, in

1 1993 it was 52 basis points and in 1998 it was 105 basis points. We do not have a
2 five year period to calculate the average spread metric since the January 2008 low
3 market point. Using the more moderate average spread changes for the three yield
4 troughs, the average spread change was 81 basis points. Based on the last quarter
5 ending July 15 2011, the 25 year benchmark was 4.25%, likely signaling a new
6 market trough over the near term. Assuming the July quarterly rate of 4.25%, and
7 adding a 45 basis point credit spread and an 82 basis point market spread (the
8 average, not the maximum spread), we have an implied projected interest rate of
9 5.52%. -

10

11 **Q30. Does the District's 5.5% assumed bond interest rate apply only to the \$945**
12 **million additional debt reflected in the Rate Proposal?**

13 A. Yes.

14

15 **Q31. What is the interest rate structure of the District's current total of**
16 **outstanding bonds?**

17 A. The average interest rate for each of the senior lien bonds is provided in the average
18 life table.

19

20 **Q32. You have indicated that the recent 25 year AAA MMD yield was 4.25%;**
21 **assuming a 40 basis point credit spread, the current projected yield would be**
22 **4.65%. Why shouldn't this be used as an assumption for bond issuance**
23 **reflected in the Rate Proposal?**

1 A. As noted earlier, this rate does not reflect any market movement risk. This would
2 pose a problem for our discussions with rating agencies. It will be very important for
3 our next rating discussions to provide projections of the impact on debt coverage of
4 issuance of all authorized bonds. We will need to document our interest rate
5 assumptions. If the rate recommendations are based on current low interest rates,
6 the resulting debt coverage will be overstated in the event interest rates rise over
7 time. If we do not build in any market risk, the rating analysts will ask for a sensitivity
8 analysis that shows the impact of higher interest rates on debt coverage and
9 liquidity. Building in reasonable market risk will then result in lower debt coverage
10 and may impair MSD's ability to maintain the current ratings.

11 Impact of 1 Year Rate Freeze

12 **Q33. Do you understand that some of the interveners in these rate proceedings**
13 **currently recommend a 1 year rate freeze vs. the District's proposed 4 year**
14 **plan for rate increases?**

15 A. Yes.

16

17 **Q34. Would the recommended 1-year rate freeze impair the District's ability to**
18 **use bonds to fund the proposed CIRP as needed to comply with the Consent**
19 **Decree?**

20 A. Yes, unless that 1-year rate increase was exceptionally large. The rating agencies
21 look both at the most recent financial performance as well as the forecast of pledged
22 revenues based on authorized rate increases. If only a 1-year rate increase is
23 recommended and subsequently enacted by the Trustees, the forecast of pledged

1 revenues will reflect no additional rate adjustments. Under this scenario, pledged
2 revenues would likely decline over the forecast period as increases to operating and
3 maintenance expense could exceed growth in user charge revenues. MSD's near
4 term debt capacity will therefore be limited. Furthermore, the recommendation of a
5 1-year rate increase will be viewed by the rating agencies as a departure from the
6 focus on multi-year planning demonstrated by the two prior rate commission
7 processes. The short term rate focus would certainly be viewed as a negative
8 influence on MSD's credit position.

9

10 **Q35. Do you support such a recommendation?**

11 A. No.

12

13 **Q36. Does this complete your surrebuttal testimony today?**

14 A. Yes.

