

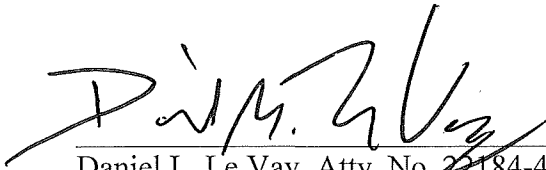
STATE OF INDIANA
INDIANA UTILITY REGULATORY COMMISSION

PETITION OF THE CITY OF FORT WAYNE,)
INDIANA, FOR AUTHORITY TO ISSUE) **CAUSE NO. 45125**
LONG-TERM DEBT TO FINANCE WATER)
SYSTEM IMPROVEMENTS AND TO ADJUST)
ITS RATES AND CHARGES FOR WATER)
SERVICE)

TESTIMONY
OF
EDWARD R. KAUFMAN, CRRA - PUBLIC'S EXHIBIT NO. 4
ON BEHALF OF THE
INDIANA OFFICE OF UTILITY CONSUMER COUNSELOR

OCTOBER 30, 2018

Respectfully Submitted,


Daniel L. Le Vay, Atty. No. 22184-49
Deputy Consumer Counselor

CERTIFICATE OF SERVICE

This is to certify that a copy of the foregoing *Office of Utility Consumer Counselor Testimony of Edward R. Kaufman, CRRA* has been served upon the following counsel of record in the captioned proceeding by electronic service on October 30, 2018.

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TESTIMONY OF OUCC WITNESS EDWARD R. KAUFMAN, CRRA
CAUSE NO. 45125
CITY OF FORT WAYNE

I. INTRODUCTION

1 **Q: Please state your name and business address.**

2 A: My name is Edward R. Kaufman, and my business address is 115 W. Washington
3 St., Suite 1500 South, Indianapolis, IN 46204

4 **Q: By whom are you employed and in what capacity?**

5 A: I am employed by the Indiana Office of Utility Consumer Counselor ("OUCC") as
6 the Assistant Director with the Water-Wastewater Division. My qualifications and
7 experience are set forth in Appendix A.

8 **Q: What have you done to prepare for your testimony?**

9 A: I read the Petition and testimony provided by Fort Wayne in this Cause. I reviewed
10 Petitioner's responses to written discovery. I reviewed Petitioner's 2017 IURC
11 annual report and the final order in Petitioner's last rate case, Cause No. 44162.

12 **Q: What is the purpose of your testimony?**

13 A: The purpose of my testimony is to respond to the City of Fort Wayne's ("Petitioner"
14 or "Fort Wayne") proposed financing request, which involves two debt issuances
15 and five proposed phased increases.

16 **Q: Please describe Petitioner's financing request.**

17 A: Petitioner requests authority to issue long term debt through two debt issuances
18 taking place in 2019 and 2022. To provide sufficient revenues for the proposed
19 debt issuances, Petitioner proposes implementing its rate increases in five phases.
20 The first rate increase would take place with the issuance of the final order in this

1 Cause, and the subsequent rate increases would take place every twelve months
2 thereafter.

3 **Q: Does the OUCC agree Petitioner should be authorized to issue the two**
4 **amounts of debt?**

5 A: Yes. However, the OUCC proposes the Commission include conditions on its grant
6 of authority to issue long term debt. Petitioner's proposed fourth and fifth phase
7 increases are in large part caused by their need for annual debt service on the
8 proposed 2022 debt issuance. Accordingly, Petitioner should not be permitted to
9 implement its Phase IV rates until it has made a filing in this Cause certifying that
10 its 2022 bond issuance will take place within 45 days of the filing and at terms
11 substantially the same as those described in its testimony. I also recommend that
12 Petitioner's second bond issuance be required to take place in 2022 as presented
13 and not sooner. Finally, I recommend restrictions be placed on Petitioner's debt
14 service reserve to ensure the funds are available as needed.

II. PETITIONER'S DEBT ISSUANCES

A. Introduction

15 **Q: Please describe Petitioner's two proposed debt issuances.**

16 A: First, Petitioner anticipates a 2019 borrowing of \$41,010,000 through the State
17 Revolving Fund ("SRF"). Petitioner is seeking a combined debt issuance where
18 \$25,920,000 would be amortized over 20 years and \$15,090,000 would be
19 amortized over 30 years.¹ Petitioner is proposing a single debt issuance with an

¹ Traditionally, the SRF only issued 20 year debt. However, recently the SRF started issuing 25, 30, and 35 year debt. The cost of SRF debt increases by 10 basis points for each additional five years of maturity past 20 years.

1 average interest rate of 2.69%.² Petitioner's proposed SRF debt also assumes
2 annual principal payments from December 1, 2020 through December 1, 2032, and
3 semi-annual principal payments from June 1, 2033 through December 1, 2048.

4 The terms of Petitioner's 2022 debt issuance are not as complex as its
5 proposed 2019 debt issuance. Petitioner anticipates that its second proposed debt
6 issuance will be through the open-market, and will be issued in 2022 for
7 \$44,560,000. This amortization schedule is based on interest rates ranging from
8 2.60% to 4.10%, annual payments from December 1, 2023 through December 1,
9 2032, and semiannual payments from June 1, 2033 through December 1, 2041.

B. 2019 SRF Debt Issuance

10 **Q: Do you agree the terms of Petitioner's proposed 2019 SRF debt issuance are**
11 **reasonable and should be approved?**

12 A: Yes. Subject to certain parameters that I describe below, I believe Petitioner's
13 proposed 2019 bond issuance should be approved.

14 **Q: Is it possible that the terms on Petitioner's proposed SRF debt will be different**
15 **than those provided in its proposed amortization schedule?**

16 A: Yes. The interest rate on Petitioner's amortization schedule is a blended interest
17 rate that averages SRF's 20-year and 30-year interest rate. However, as of this time
18 the SRF has not agreed to Petitioner's hybrid approach for the terms on its SRF
19 debt. Therefore, it is unknown whether Petitioner will obtain the financing terms in
20 its proposal. In response to OUCC Data Request Question 2.2 (Attachment ERK-
21 1), Petitioner said it will begin having conversations with the SRF in the Spring of
22 2019 regarding the amount of subsidized funds that will be available to individual

² Petitioner averages the 20 year and 30 year SRF interest rates.

1 applicants. Thus, the amortization schedule for Petitioner's anticipated SRF loan
2 is only an approximation of its estimated annual debt service costs. Because the
3 SRF has not agreed to Petitioner's described terms, the amortization schedule for
4 Petitioner's SRF debt as issued may end up being materially different than the one
5 Petitioner provided in this case to calculate its proposed revenue requirements.

6 **Q: Could any such material difference be addressed through a true-up?**

7 A: While debt true-ups are a good procedure to revise relatively minor changes in
8 interest rates, they should not be relied on to correct major changes in terms, such
9 as maturity or lender, of an anticipated debt issuance. Moreover, a utility should
10 not rely on a true-up where it presents multiple amortization schedules on a loan,
11 when its case presented a single amortization schedule.³ Doing so denies the
12 OUCC and the Commission of the ability to review the terms and evaluate the
13 reasonableness of the proposed loan. The OUCC's analysis and the Commission's
14 review can only be based on the terms presented by Petitioner in its case.
15 Petitioner's proposed SRF debt issuance can only be considered reasonable for
16 purposes of approval if it substantially conforms to the terms Petitioner provided
17 in its case-in-chief. If Petitioner is unable to issue its proposed 2019 debt on terms
18 substantially similar to that described in its testimony, if it has to issue multiple
19 debt issuances or rely on a lender(s) other than the SRF, these changes could have
20 a material impact on rates. Once Petitioner has discussions with the SRF and has a
21 better idea of the terms of its 2019 debt, it should inform the Commission and the

³ On page 16 of his testimony, Mr. Walsh states "The approximate 30-year repayment of debt is a combination of two underlying amortization schedules." If the SRF does not accept Petitioner's proposal, Petitioner may decide to break its proposed loan into two separate loans, each with its own amortization schedule.

1 OUCC whether it can in fact issue debt according to the terms described in its direct
2 testimony.

3 **Q: What should Petitioner be required to do if it cannot issue its proposed 2019**
4 **long term debt as it has presented in its testimony?**

5 A: I have reviewed and consider the terms of Petitioner's proposed 2019 long term
6 debt issuance to be reasonable. But material changes to the terms of Petitioner's
7 proposed 2019 long term debt may not be reasonable. If Petitioner cannot secure
8 the 2019 issuance according to the terms presented in its case, it should present
9 evidence and secure approval for authority to the extent the terms achieved are
10 materially different. Accordingly, if the SRF does not approve the plan presented,
11 before issuing 2019 long term debt, Petitioner should provide the Commission and
12 the OUCC revised amortization schedule(s), a revised "Schedule of Proposed
13 Combined Amortization" and "Pro Forma Annual Revenue Requirements and
14 Annual Operating Expenses" (pages 18 and 19 of Mr. Walsh's Accounting Report).
15 In such case, depending on whether the Commission has issued the final order in
16 this Cause, Petitioner should be required to seek to open the record in accordance
17 with 170 IAC 1-1.1-22 or seek a modification of its approved financing.

C. Timing of SRF Debt Issuance

18 **Q: Will there be a gap between the time Petitioner receives an order in this Cause**
19 **and when its proposed SRF debt is issued?**

20 A: Yes. Because of this timing gap Petitioner will have revenues without a
21 corresponding revenue requirement. Such moneys should be set aside and used to
22 offset the borrowing. Petitioner should reserve any funds collected in rates for its
23 2019 debt issuances, and use those funds to offset the amount it needs to borrow.

1 In the alternative, Petitioner should apply such funds to its debt service reserve. For
2 example, if a Petitioner issues its proposed debt three months after a final order in
3 this Cause, over which period it would have collected \$25,000 per month for its
4 proposed debt, then it should use the \$75,000 (3 * \$25,000) collected to reduce the
5 amount of debt that is issued (or to prefund its debt service reserve). This
6 mechanism is a means to match revenues collected for Petitioner's proposed bonds
7 with its actual bond expense. However, if the gap in timing between a Commission
8 order in this Cause and when Petitioner closes on its 2019 debt is less than 45 days,
9 then Petitioner need not apply the funds collected against its proposed debt.

D. Open Market Debt Issuance

10 **Q: Should Petitioner be authorized to issue its 2022 open market debt issuance on**
11 **terms similar to those described in its testimony?**

12 A: Yes.

13 **Q: Will Petitioner be able to issue its proposed 2022 long term debt on terms**
14 **similar to those described in its testimony?**

15 A: I cannot tell at this time. Petitioner anticipates not issuing its 2022 debt until June
16 15, 2022 -- approximately three years after an order has been issued in this Cause.
17 Petitioner is asking for authority to issue long term debt several years into the
18 future. Simply put, many factors could change that would influence a proposed
19 debt issuance so far into the future, and could materially affect Petitioner's
20 proposed debt issuance. For example, Petitioner's financial condition could be
21 different than it is today. The economy could be quite different in 3.5 years than it
22 is today. We do not know what types of lenders will be available in 3.5 years. New
23 lenders may require terms or restrictive covenants. For example, due to economic

1 conditions, Petitioner may only be able to issue debt at a variable interest rate, or it
2 might not be able to issue long term debt for a maturity over 10 years. While we
3 can attempt to build in safeguards against many of these concerns, it is not possible
4 to identify every factor that may affect the reasonableness of a debt issuance so far
5 in advance of its issuance.

6 **Q: What are some safeguards that can be built in to the Commission's authority**
7 **on Petitioner's 2022 debt?**

8 A: The maturity on Petitioner's 2022 long term debt must be between 18 to 22 years.
9 Petitioner cannot issue its 2022 debt at an interest rate above 6.5% or at a variable
10 interest rate. The debt must be issued at market rates. The principal payments
11 cannot be manipulated in such a manner to create wide variations in annual debt
12 service payments. Due to wrapping, Petitioner's proposed 2022 annual debt service
13 payments range from \$2,550,572 to \$4,046,585 -- a difference of approximately
14 \$1,500,000. The actual amortization schedule should not be permitted to have a
15 larger spread than the \$1,500,000 indicated in Petitioner's current 2022
16 amortization schedule.

17 **Q: What other concerns does Petitioner's 2022 debt issuance raise?**

18 A: Petitioner's proposed Phase IV and Phase V revenue requirements are in large part
19 driven to pay the increased annual debt service on its 2022 debt issuance. However,
20 the timing of Petitioner's Phase IV and Phase V rate increase, as proposed, are not
21 explicitly tied to its 2022 debt issuance. If Petitioner delays issuing its 2022 debt
22 but its Phase IV and Phase V rates go into effect when proposed, Petitioner will
23 over collect on both its Phase IV and Phase V rates. To ensure Petitioner does not
24 collect revenue requirements without a matching expense, Petitioner should be

1 prohibited from implementing its Phase IV increase any sooner than 45 days before
2 it has issued its 2022 debt. Moreover, if the Phase IV rate increase is delayed due
3 to a delay in issuing its 2022 debt issuance, the Phase V rates should similarly be
4 delayed. Petitioner's proposed Phase V rate increase is due in large part to pay the
5 increased annual debt service on its 2022 debt. Thus, a delay of the 2022 debt
6 issuance affects both of Petitioner's Phase IV and Phase V revenue requirements.
7 To best match Petitioner's actual debt service costs, Phase V rates should go into
8 effect one year after the Phase IV rates go into effect.

9 **Q: Are there additional factors that should influence the amount and annual debt**
10 **service of Petitioner's 2022 debt?**

11 A: Yes. Petitioner is proposing to implement a System Development Charge ("SDC").
12 Funds collected through a SDC are a future source of capital for Petitioner. These
13 funds will presumably be spent on future capital projects and should reduce the
14 need for Petitioner to borrow funds for future capital projects. Thus, Petitioner
15 should track the funds it collects through its SDC. Funds collected through
16 Petitioner's SDC can be used to fund plant improvements and should be used to
17 offset the amount Petitioner borrows for its 2022 long term debt.

III. TRUE-UP AND OTHER ISSUES

18 **Q: Should Petitioner be required to true-up its proposed annual debt service once**
19 **the interest rates on its proposed debts are known?**

20 A: Yes. The precise interest rates and annual debt service will not be known until
21 Petitioner's debt has been issued; therefore, on both Petitioner's 2019 debt and its
22 2022 debt, Petitioner's rates should be trued-up to reflect the actual cost of its debt
23 issuances. I recommend the Commission require Petitioner to file a report within

thirty (30) days after closing on each of its long term debt issuances explaining the terms of the new loan, the amount of debt service reserve and an itemized account of all issuance costs. The report should include a revised tariff, amortization schedule and also calculate the rate impact in a manner similar to the OUCC Schedules 1. For Petitioner's 2019 debt issuance, Petitioner should be required to include a calculation of any "over-collection" of revenues that results from the period of time between approval of the respective tariff in question and the closing on the issuance of the long term debt. Petitioner should use this amount of "over-collection" to reduce its debt issuance or its debt service reserve. I recommend Phase IV rates not go into effect until Petitioner provides notice of its proposed 2022 debt issuance. If the Commission adopts this recommendation, potential over-collection will not be an issue. However, a true-up is still necessary.

Q: How should disputes regarding Petitioner's true up report be identified?

A: The OUCC should have the opportunity to challenge Petitioner's proposed true-up by filing an objection within 14 days of the true-up report. Any true-up report should restate the time frames for objections or responses. Thereafter, the Commission should resolve the issue through a process that affords due process to Petitioner and the OUCC.

Q: Should there be any exceptions to the requirement for a true-up?

A: Yes. If after issuing its true-up Petitioner and the OUCC agree in writing that the increase or decrease would be immaterial, the true-up need not be implemented.

1 **Q: What other conditions should be placed on Petitioner's proposed debt**
2 **issuance?**

3 A: Unused financing authority should not continue indefinitely. Any unused financing
4 authority for Petitioner's 2019 debt should expire on January 1, 2020, and any
5 unused authority on Petitioner's 2022 debt should expire on January 1, 2023 (or six
6 months after the initial issuance, if the timing is delayed),

IV. DEBT SERVICE RESERVE

7 **Q: Do you agree with Petitioner's proposed debt service reserve?**

8 A: Yes.

9 **Q: Should there be any restrictions on Petitioner's proposed debt service reserve?**

10 A: Yes. Petitioner's debt service reserve should be placed in a restricted account.
11 Petitioner should notify the Commission and the OUCC if it spends any funds from
12 its debt service reserves for any reason other than to make the last payment on its
13 current or proposed debt issuances. Petitioner should be required to provide a
14 report to the Commission and the OUCC within five (5) business days of any such
15 transaction. The report should state how much Petitioner spent from its debt service
16 reserve, explain why it spent funds from its debt service reserve, provide a cite to
17 any applicable loan documents that allow it to spend funds from its debt service
18 reserve, describe its plans to replenish its debt service reserve, and explain any cost-
19 cutting activities it has implemented to forestall spending funds from its debt
20 service reserve.

V. OUCC RECOMMENDATIONS

1 **Q: Please state your recommendations.**

2 A: 1) Petitioner should be authorized to issue up to \$41,000,000 of long term debt
3 in 2019 at an interest rate of no more than 4.0%.

4 2) Petitioner should be authorized to issue up to \$44,560,000 of long term debt
5 in 2022 at an interest rate of no more than 6.5%.

6 3) I recommend the Commission include the following in its findings:

7 A. For its proposed debt 2019 debt issuance, Petitioner should
8 temporarily reserve the funds collected in rates for its 2019 debt
9 issuances and use those funds to offset/reduce the amount it
10 borrows. If the proposed debt is issued within 45 days after it has
11 filed a revised tariff with the Commission, the funds collected need
12 not be applied to its proposed debt issuance (or debt service reserve).

13 B. Petitioner's Phase IV rates cannot not go into effect until Petitioner
14 has filed a report in this cause that certifies that its proposed 2022
15 debt will be issued within 45 days. Petitioner's Phase V rates shall
16 go into effect one year after its Phase IV rates have gone into effect.

17 C. Petitioner shall record the amount of funds it collects through its
18 proposed SDC. Any funds collected through Petitioner's SDC prior
19 to the issuance of its 2022 debt shall be used to offset the amount it
20 borrows in its 2022 debt issuance.

21 D. Within thirty (30) days of closing on each of its long term debt
22 issuances, Petitioner shall file a report with the Commission and

1 serve a copy on the OUCC, explaining the terms of the new loan,
2 including an amortization schedule, the amount of debt service
3 reserve and all issuance costs. The report should include a revised
4 tariff and also calculate the rate impact in a manner similar to the
5 OUCC's schedules. The true-up for Petitioner's 2019 debt needs to
6 provide revised rates for Phases I, II and III, while the true-up on
7 Petitioner's 2022 debt needs to provide revised rates for Phases IV
8 and V. Petitioner's rates should be trued-up, to match its actual cost
9 of debt service.

10 E. If Petitioner spends any of the funds from its debt service reserves
11 for any reason other than to make the last payment on its proposed
12 2018 debt issuance, Petitioner shall provide a report (as described
13 above) to the Commission and the OUCC within five (5) business
14 days.

15 **Q: Does this conclude your testimony?**

16 **A: Yes.**

VI. APPENDIX A

QUALIFICATIONS

1 **Q: Please describe your educational background and experience.**

2 A: I graduated from Bentley College in Waltham, Massachusetts with a Bachelors
3 degree in Economics/Finance and an Associates degree in Accounting. Before
4 attending graduate school, I worked as an escheatable property accountant at State
5 Street Bank and Trust Company in Boston, Massachusetts. I was awarded a
6 graduate fellowship to attend Purdue University where I earned a Master of Science
7 degree in Management with a concentration in finance.

8 I was hired as a Utility Analyst in the OUCC's Economics and Finance
9 Division in October 1990. My primary areas of responsibility have been in utility
10 finance, utility cost of capital, and regulatory policy. I was promoted to Principal
11 Utility Analyst in August 1993 and to Assistant Chief of Economics and Finance
12 in July 1994. As part of an agency wide reorganization in July 1999, my position
13 was reclassified as Lead Financial Analyst within the Rates/Water/Sewer Division.
14 In October, 2005 I was promoted to Assistant Director of the Water/Wastewater
15 Division. In October 2012, I was promoted to Chief Technical Advisor. I have
16 participated in numerous conferences and seminars regarding utility regulation and
17 financial issues. I was awarded the professional designation of Certified Rate of
18 Return Analyst ("CRRRA") by the Society of Utility and Regulatory Financial
19 Analysts ("SURFA"). This designation is awarded based upon experience and the
20 successful completion of a written examination. In April 2012, I was elected to
21 SURFA's Board of Directors. I continue to serve on SURFA's board.

1 **Q: Have you previously testified before the Indiana Utility Regulatory**
2 **Commission?**

3 A: Yes. I have testified before the Indiana Utility Regulatory Commission
4 (“Commission”) in a number of different cases and on numerous issues. I have
5 testified in water, wastewater, natural gas, telecommunication and electric utility
6 cases. While my primary areas of responsibility have been in cost of equity, utility
7 financing, fair value, utility valuation and regulatory policy, I have also provided
8 testimony on trackers, guaranteed performance contracts, declining consumption
9 adjustments, and other issues.

STATE OF INDIANA
INDIANA UTILITY REGULATORY COMMISSION

PETITION OF THE CITY OF FORT WAYNE,)
INDIANA, FOR AUTHORITY TO ISSUE)
LONG-TERM DEBT TO FINANCE WATER)
SYSTEM IMPROVEMENTS AND TO ADJUST) CAUSE NO. 45125
ITS RATES AND CHARGES FOR WATER)
SERVICE)

FORT WAYNE MUNICIPAL WATER'S RESPONSE TO
OUCG DATA REQUEST SET NO. 2 DATED JULY 31, 2018

Fort Wayne Municipal Water ("Fort Wayne"), by counsel, responds and objects to the Second Set of Discovery Requests propounded by the Office of the Utility Consumer Counselor ("OUCC") as set forth below.

Q 2.1: On page 16 of his testimony Mr. Walsh states: "The approximate 30-year repayment of the debt is a combination of two underlying amortization schedules." Please provide a copy of each of the two underlying amortization schedules. If Excel was used to prepare the schedules, please provide a copy of the Excel worksheet with all formulas intact.

Response: The information responsive to this Data Request can be found on pages 86 to 89 of the workpapers filed on July 24, 2018.

Person(s) providing information: H.J. Umbaugh and Associates

Testifying witness: Eric J. Walsh

Q 2.2: On page 17 of his testimony, Mr. Walsh acknowledges that the SRF has not agreed to the terms Petitioner uses to develop its proposed amortization schedule. Please answer the following questions related to Mr. Walsh's statement.

- A) When does Petitioner anticipate hearing from the SRF regarding its proposed terms?
- B) If the SRF does not agree to Petitioner's proposed terms, what are the terms that Petitioner anticipates will be available to Petitioner?
- C) Please provide a copy of the amortization schedules that would be used for Petitioner's anticipated debt issuance(s) if the SRF does not agree to Petitioner's proposed terms presented in this cause.

Fort Wayne's Responses to OUCG Data Request No. 2
Cause No. 45125 – August 10, 2018

Response:

A) In the spring of 2019, the SRF Program will begin having substantive conversations with funding applicants regarding the amount of subsidized funds that will be available to the individual applicants. By the summer of 2019, the SRF Program will publish its project priority list ("PPL") which will formally allocate a specific amount of subsidized funds to the individual applicants. At that time, the Petitioner will officially know the amount of subsidized SRF funds that will be available for its projects and the terms and conditions of any SRF pooling funds that might be available.

B) If the SRF Program does not agree to the proposed terms, Petitioner anticipates issuing bonds on the open market with interest rates ranging from 2% to 3.75%. Petitioner must caution, however, that we are in a rising interest rate environment. With this in mind, Fort Wayne cannot definitively state what the terms and conditions of an open market bond issue might be at the time the bonds are issued.

Depending on the market in 2019, Petitioner is also exploring the possibility of funding approximately \$9 million of the proposed project (i.e. meters) on the open market. Based on its preliminary analysis, Fort Wayne believes it could potentially avoid certain bidding costs (i.e. Davis-Bacon wages) by issuing bonds on the open market (and not utilize the SRF Program's subsidized or pooled funds). This opportunity will, however, depend on the interest rate environment at that time. If Petitioner can separate a portion of the project and save construction/installation costs, it will do so and reflect the savings in its true-up.

C) See the document titled "Exhibit 2.2(C)" attached to the email transmitting this Response.

Person(s) providing information: H.J. Umbaugh and Associates

Testifying witness: Eric J. Walsh

Q 2.3: Please provide a copy of 2014 report from Moody's referred to by Mr. Walsh on page 20 of his testimony.

Response: See the document titled "Exhibit 2.3" attached to the email transmitting this Response.

Person(s) providing information: H.J. Umbaugh and Associates

Testifying witness: Eric J. Walsh

AFFIRMATION

I affirm the representations I made in the foregoing testimony are true to the best of my knowledge, information, and belief.

Edward R. Kaufman

By: Edward R. Kaufman

Cause No. 45125

Indiana Office of

Utility Consumer Counselor

OCT. 30, 2018

Date: