BEFORE THE

WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION Complainant, v. NORTHWEST NATURAL GAS COMPANY, Respondent.	DOCKET UG-_____

NORTHWEST NATURAL GAS COMPANY

Direct Testimony of Brody J. Wilson

COST OF CAPITAL

Exh. BJW-1T

December 18, 2020

DIRECT TESTIMONY OF BRODY J. WILSON

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I. INTRODUCTION AND SUMMARY

Q. Please state your name, address and position at Northwest Natural Gas Company ("NW Natural" or "Company").

A. My name is Brody Wilson. My business address is 250 SW Taylor Street, Portland, Oregon 97204. My current position at NW Natural is Vice President, Controller, Treasurer and Chief Accounting Officer.

Q. Please summarize your educational background and business experience.

A. I received a Bachelor of Arts in accounting from George Fox University in 2001. From 2001 through 2012, I worked at PricewaterhouseCoopers, LLP, in the Power and Utilities Assurance practice. I joined NW Natural in 2012 as Accounting Director. In 2013, I was appointed as Controller and Chief Accounting Officer of NW Natural and its subsidiaries. In 2016, I was appointed Treasurer.

Q. Please summarize your testimony.

A. My testimony will discuss the Company's financing strategy and credit ratings, appropriate capital structure, overall rate of return, common equity, cost of long-term debt and the cost of short-term debt. More specifically, my testimony will:

- Explain NW Natural's financing strategy, now that NW Natural is under the holding company structure of Northwest Natural Holding Company ("NW Natural Holdings");
- Discuss the Company's current credit ratings and why it is important for the Company to maintain its current credit ratings;

- Present NW Natural's proposal to maintain its target capital structure of 49 percent common equity, 1 percent short-term debt and 50 percent long-term debt, with an overall rate of return ("ROR") on rate base of 6.913 percent;
- Describe NW Natural's plan to maintain its targeted ratios of equity and long-term debt at 50/50 with minimal reliance on short-term debt;
- Explain NW Natural's access to equity and plans to maintain target utility common equity ratio; and
- Explain the calculation used for the Test Year short and long-term cost of debt.

II. FINANCING STRATEGY AND CREDIT RATINGS

Q. What is the Company's financing strategy?

A. The Company's financing strategy is to maintain a capital structure to support our strong credit ratings, which provides us optimal access to capital markets. We work to manage interest rate risk and secure low-cost capital to fund utility growth and operations. To do this, we focus on maintaining a strong balance sheet, focused on financing short-term obligations with short-term debt including commercial paper, and to finance long-term assets (i.e. capital expenditures) of the Company through a balance of long-term debt and equity financings.

Q. What is the Company's strategy for funding these ongoing capital expenditures?

A. To fund ongoing capital expenditures, the Company seeks to maintain a strong capital structure and solid investment grade credit ratings. The Company targets a capital structure consisting of 50 percent common stock equity and 50 percent long-term debt with minimal reliance on short-term debt. The Company's short-term debt is not used to finance long-term assets but rather is used to fund seasonal working capital requirements. Achieving the target capital structure and maintaining sufficient liquidity are necessary to maintain attractive credit ratings and to have access to capital markets at reasonable rates.

Q. Has the formation of NW Natural Holdings changed NW Natural's financing strategy?

A. The overall financing strategy has not changed. As discussed above, NW Natural targets a 50 percent common stock equity and 50 percent long-term debt capital structure with little reliance on short-term debt, and when the Company needs equity to maintain that capital structure, it will request equity infusions from NW Natural Holdings. Further, Order 01 in docket UG-170094 (NW Natural's approval to reorganize to form a holding company) requires the Company to maintain a capital structure of no lower than 44 percent equity levels or face restrictions on its ability to issue dividends to NW Natural Holdings (among other conditions placed upon NW Natural). Additionally, NW Natural Holdings maintains similar credit metric goals as did NW Natural. To the extent needed, NW Natural Holdings uses the public equity markets to raise equity that is needed for NW Natural. NW Natural Holdings has no intention to increase leverage by borrowing to fund equity requirements of the Company.

Q. Do the equity markets view NW Natural Holdings different from NW Natural?

A. No. Equity markets realize that the Company earns nearly all of NW Natural Holdings' total annual earnings and that the Company is the primary driver of all critical financial and credit metrics of NW Natural Holdings. Investors' primary consideration is given to the growth and development of NW Natural and its overall contribution to NW Natural Holdings.

Q. What are NW Natural's current debt ratings?

A. The table below (Figure 1) shows the Company's current ratings for each type of debt security from Moody's Investor Service ("Moody's") and Standard and Poor's Ratings ("S&P").

	Moody's	S&P
Corporate	Baa1	A+
Secured	A2	AA-
Commercial Paper	P-2	A-1
Outlook	Stable	Stable

Figure 1

Q. How does NW Natural's "A2 / AA-" category debt ratings benefit customers?

A. The Company's interest expense, and to a large extent the Company's access to capital during turbulent market conditions, depends upon the debt ratings. If the Company's ratings were downgraded, the Company's access to fixed income investors could be impacted and likely result in higher interest rates that would result in increased interest expense. Additionally, lower credit ratings have a direct impact on financial terms the Company is able to negotiate from suppliers, and may cause increased costs associated with credit exposures with counterparties. In summary, credit ratings affect our cost of debt and subsequently our cost of capital and customer rates.

Q. Please explain the implications of the credit ratings in terms of NW Natural's ability to access capital markets.

A. Generally speaking, companies with higher credit ratings present less risk to investors and as a result require lower interest rate returns for those investors. Lower-rated companies may find it difficult to access capital, or potentially pay significantly more, especially in challenging capital market conditions. The capital market environment changes as macro business cycles move up and down, which creates tighter and looser access to capital. In order to ensure that the Company continues to have favorable pricing and continued access to capital markets during all market environments, it is imperative that the Company increases, or at least retains, its A2/AA- secured credit ratings.

Q. Has the COVID-19 public health emergency affected NW Natural's credit rating?

A. There has been no direct impact to NW Natural's credit ratings as of the date of this filing. In March 2020, the capital markets were extremely volatile, and as a result, NW Natural decided to secure cash on the balance sheet to support the operations of the Company during the pandemic. This resulted in additional debt on the Company's books for the majority of 2020. Throughout 2020 as capital markets recovered and volatility settled, the Company began to repay portions of the incremental borrowings it made. The expectation would be that debt levels would return to normal levels by the end of 2020 and into 2021, assuming the capital markets remain stable. This incremental debt has a negative impact on credit ratings. However, both Moody's and S&P acknowledged the benefits of taking these de-risking activities and have indicated they will not negatively impact the Company's ratings in the near-term.

An additional impact of COVID-19, and likely a more prolonged impact, has been a decrease in operating cash flows from higher bad debts, not charging late fees or disconnection fees, higher interest costs and incremental operating costs for safety of employees. The regulatory support to recover these costs greatly helps the long-term impacts; however, the lagged timing of recovery will have a near-term negative impact on cash flows.

Q. Are there other important factors that the rating agencies review in determining NW Natural's ratings?

A. Yes, Moody's and S&P rate the Company's debt based on their independent review of the Company's financial condition and credit metrics. Independent credit reviews consist of qualitative and quantitative metrics, such as the regulatory environment and cash flow metrics. Although each rating agency has a slightly different methodology for analyzing credit risk, many of the key financial ratios are the same, or at least comparable.

The tables below display Moody's and S&P's benchmarks and NW Natural's results over the Test Year (Oct/19 to Sep/20) results.

Ratio	Moody's "A" Benchmark	NW Natural's 2020 TY Results	Comment
Pre-tax Interest Coverage	4.5x or greater	4.7x	Within rating band
Debt Leverage	50% or less	54.7%	Slightly Unfavorable
FFO to Debt	Upgrade Sustain >17.5% Downgrade Sustain <14%	12.6%	Slightly Unfavorable
Retained Cash Flow	15% or greater	8.4%	Slightly Unfavorable

Ratio	S&P "A" Benchmark	NW Natural's 2020 TY Forecast	Comment
FFO/Debt	23% or less	15.3%	Within rating band
Debt/EBITDA (x)	3.0x or greater	5.2x	Within rating band
CFO/Debt	20% or greater	15.4%	Slightly Unfavorable

FFO = Funds From Operations
EBITDA = Earnings Before Interest, Taxes, Depreciation and Amortization
CFO = Cash Flow from Operations

Q. Have NW Natural's credit ratings changed since the Commission issued its order in the Company's 2018 rate case?

A. Yes, Moody's has made changes since the 2018 rate case, while S&P has made no changes. Moody's downgraded the Company's secured credit rating on May 17, 2019, from A1 to A2. The reason for the downgrade was due to financial performance more in line with Baa1 peers. Moody's current credit outlook for the Company is stable, an upgrade from negative. The latest credit rating reports for Moody's and S&P can be found in exhibits Exh. BJW-2 and Exh. BJW-3, respectively. Historical ratings for each rating agency can be found in Exh. BJW-4.

III. RECOMMENDED CAPITAL STRUCTURE AND RATE OF RETURN

Q. What is NW Natural's current Commission-authorized ratemaking capital structure and overall ROR?

A. In the Company's last general rate case (Order 06 in Docket UG-181053), the Commission adopted the following capital structure, capital costs and overall ROR:

NW NATURAL'S CAPITAL STRUCTURE AND RATE OF RETURN
ORDER 06, DOCKET UG-181053

Component	Ratio	Cost	Weighted Cost
Long-term Debt	50.0%	5.066%	2.533%
Short-term Debt	1.0%	2.186%	0.022%
Common Equity	49.0%	9.40%	4.606%
Total	**100%**		**7.161%**

Q. What is NW Natural's recommended capital structure and overall ROR for ratemaking purposes in this proceeding?

A. NW Natural is requesting to maintain the authorized capital structure of 49 percent equity, 1.0 percent short-term debt and 50 percent long-term debt, with an overall rate of return (ROR) on rate base of 6.913 percent, consistent with the capital structure embedded in rates from our last general rate case proceeding. The ROR is based upon a 0.756 percent and 4.597 percent embedded cost of debt for short-term and long-term debt, respectively, as well as a 9.4 percent cost of equity. The following table presents the proposed capital structure along with the calculation of the Company's ROR for the Test Year:

Component	Ratio	Cost	Weighted Cost
Long-term Debt	50.0%	4.597%	2.299%
Short-term Debt	1.0%	0.756%	0.008%
Common Equity	49.0%	9.40%	4.606%
Total	**100%**		**6.913%**

Q. What was NW Natural's capital structure in the Test Year?

A. Based on a 13-month average of monthly averages (AMA) for the year ended September 30, 2020, the Company's capital structure was 46.7 percent Equity, 49.93 percent Long-Term Debt, and 3.37 percent Short-Term Debt. The Company has removed the short-term debt issuances associated with liquidity needs in 2020 caused by the COVID-19 pandemic. By removing this anomalous short-term debt, our 13-month average balance for short-term debt is $59.9 million.

Q. Why has NW Natural proposed a target capital structure?

A. NW Natural's target capital structure has historically been, and continues to be, 50 percent equity and 50 percent long-term debt with limited short-term financing. A strong capital structure, with robust capitalization, is essential to a utility's financial health. While NW Natural seeks to maintain equity for the utility at 50 percent of its total long-term capitalization structure, there is a natural fluctuation in our capital structure on a temporary basis over time. The Company may experience temporary fluctuations that result from timing in equity and debt issuances, as well as the need to efficiently access public equity markets in one large offering to control issuance costs (as compared to like costs for multiple smaller offerings). Additionally, timing of cashflows impact our short-term debt issuances to support working capital requirements like the procurement of gas inventories for the winter heating season. These fluctuations do not, however, represent a meaningful departure from our targeted capital structure.

Q. How does NW Natural's proposed utility capital structure compare with the natural gas peer group?

A. The Company's proposed capital structure is similar to the equity-to-capital ratio of our peer group identified by Dr. Villadsen in the Company's Return on Equity Direct Testimony Exh. BV-1CT. The average equity-to-capital ratio of our full sample peer group is 49 percent (excluding short-term debt).

IV. COMMON EQUITY

Q. How does NW Natural now access the equity market after formation of NW Natural Holdings?

A. NW Natural (i.e., NW Natural Gas Company) no longer directly accesses equity markets. Therefore, all equity needs for the Company are provided from NW Natural Holdings, which has direct access to the public equity markets to raise equity as needed.

Q. Did NW Natural Holdings issue common equity shares through a public offering on June 7, 2019?

A. Yes. NW Natural Holdings issued 1,437,500 shares of common stock, with total net proceeds of $93.2 million. The entire amount of the offering was added to the general funds of NW Natural and used for corporate purposes, primarily to fund NW Natural's ongoing utility construction program and for general corporate purposes. The timing and amount issued were based on financial forecasts for the purpose of maintaining our capital structure within a target range.

Q. Does the Company have any preferred stock?

A. The Company retired its last remaining portion of preferred stock in 2005. The Company has no plans at this time to issue preferred stock.

Q. What is NW Natural's plan to maintain the target utility common equity ratio over the next few years?

A. The Company's plan includes taking a number of steps. In addition to the expected increase in common equity due to retained earnings growth each year, the Company intends to: (1) continue having NW Natural Holdings issue new shares of common stock to investors through its ongoing Dividend Reinvestment and Optional Cash Payment Plan; and (2) sell new common shares to investors through public offerings, as needed.

V. LONG-TERM DEBT AND SHORT-TERM DEBT

Q. How was the cost of long-term debt calculated for the Test Year?

A. Exh. BJW-5 presents the details of the Company's long-term debt outstanding ($924.7 million as of September 30, 2020) and the corresponding weighted average cost (4.597 percent) for the Test Year. The cost of long-term debt includes only existing debt at the end of the Test Year. The weighted average cost of long-term debt was calculated by multiplying the debt outstanding by the average cost for each debt issue.

Column (p) of Exh. BJW-5 shows the annualized expense of each individual issue in terms of an effective interest rate, which represents the total cost of issue, including coupon rate, premiums or discounts, underwriter's commissions, gains and losses on interest rate hedges, and other expenses related to the issue such as legal fees and unamortized debt discounts and early redemption premiums assigned to refunding issues. Unamortized debt discounts and early redemption premiums from previously outstanding debt issues are added to the new debt issuance because the Company was able to achieve a lower annualized cost of debt due to net present value savings from the early redemption.

Q. How was the cost of short-term debt calculated for the Test Year?

A. Short-term debt was calculated in a similar manner to long-term debt. Exh. BJW-6 presents the Company's short-term debt outstanding ($0.37 million[1]) and the corresponding cost (0.756 percent) as of September 30, 2020 for the Test Year. The cost of short-term debt was calculated by multiplying the short-term debt outstanding by its average cost for each debt issue.

Q. Does this conclude your testimony?

A. Yes.

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[1] Amount disclosed excludes COVID-19 related short-term debt. Total short-term debt at the end of the Test Year including COVID-19 related debt was $150,366,667.

VI. LIST OF EXHIBITS