Blue Water Utilities Case Study

Bob Smith is the owner of Blue Water Utilities, Inc. a privately owned, but public utility, that owns and operates a water treatment plant, water distribution, and metering facilities that provides water and sewer services to residential and commercial customers in a small community. As a public utility their rates are regulated by the state utility commission. New rates were approved when the current credit facilities were originated in anticipation of the upgrades and maintenance that was going to be required in this growing area.

Your Bank extended a $3,750,000 (Current balance of $3,1750,000) to Blue Water Utilities 7 years ago. The proceeds of the loan were used to consolidate $2,100,000 in existing debt on the water treatment plant, $1,050,000 for a new pipeline to serve new subdivisions in development, and $600,000 to pay off a construction lien. The note is amortizing over 15 years and will mature in two months. The loan is priced at Libor + 250 and was swapped at origination with a synthetic fixed rate of 6.50%. The 100% owner of the company, Bob Smith, also loaned the company $3,500,000 two years ago to replace some aging infrastructure that was servicing the industrial area of the community. The loan is on interest only and has fixed rate of 10%. The company has been making payments monthly on the loan to Mr. Smith.

The Bank loan is secured by a first deed of trust on all of the real estate plus a blanket lien on all other assets. The appraised value of the real estate and the water and sewer lines as of 12/31/21 was $7,500,000. The loan is personally guaranteed by Bob Smith. The loan to Mr. Smith is unsecured and has not been subordinated to the Bank.

Blue Water has made several infrastructure improvements over the past couple of years as well as the completion of a major expansion to service new subdivisions in a growing area of town. Some of these new additions have created some additional maintenance expense that was not capitalized and was not financed by any of the loan funds. The company expects this expense to drop to $150,000 and it should continue in that range for the foreseeable future. The recent increase in real estate development has caused growth to jump in 2021 and new customer additions are expected to continue to grow but at a more moderate pace.

Next week you have a meeting scheduled with the company to review their financial performance and address the fact that the loan is now in default. Your loan review group has recently downgraded the loan to substandard. You are confident that you can come to an arrangement with Mr. Smith as he has always been open and cooperative with the Bank. Their CFO, Sally Klein, will also join the meeting. Ms. Klein has always provided accurate numbers to the Bank and annual projections with reasonable assumptions.

What is your assessment of the situation with Blue Water Utilities?

What actions should the Bank take with Blue Water?

Should the loan be placed on non-accrual?

Do you anticipate a loss?

What actions should the Bank take internally?

What kind of workout proposal might you propose to the company?

Blue Water Utilities

	2020	2021	20200(P)
CCF (One hundred cubic feet or 748 Us gallons)	120000	150000	155000
Avg Combined Rate	$ 7.00	$ 7.00	$ 7.00
Revenues	$ 840,000	$ 1,050,000	$ 1,085,000
Expenses:			
Salaries & Administration	$ 400,000	$ 410,000	$ 425,000
Maintenance Expense	$ 100,000	$ 500,000	$ 150,000
Depreciation	$ 350,000	$ 350,000	$ 350,000
Interest Expense - Bank Note	$ 212,003	$ 206,375	$ 200,774
Interest Expense - Shareholder Note	$ 350,000	$ 350,000	$ 350,000
Total Expenses	$ 1,412,003	$ 1,816,375	$ 1,475,774
Net Income	$ (572,003)	$ (766,375)	$ (390,774)
EBITDA	$ 340,000	$ 140,000	$ 510,000
Balance Sheet			
Cash	$ 25,000	$ 10,000	
A/R	$ 70,000	$ 87,500	
Net Fixed Assets	$ 6,666,585	$ 6,577,500	
Liabilities			
Bank Note	$ 3,261,585	$ 3,175,000	$ 3,089,000
Shareholder Note	$ 3,500,000	$ 3,500,000	$ 3,500,000
Equity	$ (758,625)	$ (1,515,000)	$ (1,905,774)
Debt to Equity	-8.91	-4.41	-3.46
FCC (Covenant 1.20x)	0.53	0.22	0.79
Current SOFR 2.25%			