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MEMORANDUM

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TO: Docket Control

FROM: Deborah R. Scott  
Director  
Utilities Division

AZ CORP COMMISSION  
DOCUMENT CONTROL

DATE: February 26, 2001

RE: STAFF REPORT FOR NAVOPACHE ELECTRIC COOPERATIVE, INC.'S  
APPLICATION TO OBTAIN A LINE OF CREDIT (DOCKET NO. **E-01787A-**  
**00-0820**)

Attached is the Staff Report for Navopache Electric Cooperative, Inc.'s application to obtain a line of credit. Staff recommends approval without a hearing.

DRS:JMR:jbc

Originator: Joel M. Reiker

Arizona Corporation Commission  
**DOCKETED**

FEB 26 2001

DOCKETED BY

STAFF REPORT  
UTILITIES DIVISION  
ARIZONA CORPORATION COMMISSION

NAVOPACHE ELECTRIC COOPERATIVE, INC.  
DOCKET NO. E-1787A-00-0820

APPLICATION  
TO  
OBTAIN A LINE OF CREDIT

FEBRUARY 2001

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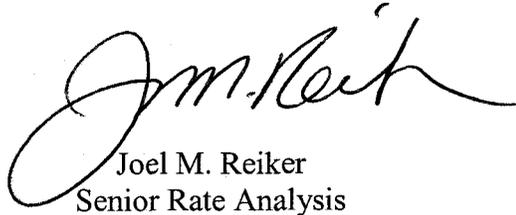
Capital Structure and Financial Ratios .....	Schedule 1
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## STAFF ACKNOWLEDGMENT

The Staff Report for Navopache Electric Cooperative, Inc., Docket No. E-1787A-00-0820, was the responsibility of the Staff members listed below. Joel M. Reiker was responsible for the review and analysis of the Company's application to obtain a line of credit in the amount of \$10,000,000. Asher Emerson was responsible for the engineering analysis of the proposed projects.



Joel M. Reiker  
Senior Rate Analysis



Asher Emerson  
Utilities Engineer

### **Introduction**

On October 16, 2000, Navopache Electric Cooperative, Inc., ("Navopache" or "Cooperative") filed an application for debt financing with the Arizona Corporation Commission ("Commission"). The Cooperative is seeking approval to issue an unsecured perpetual line of credit ("LOC") totaling \$10,000,000 from the National Rural Utilities Cooperative Finance Corporation ("CFC"). The proceeds of the LOC will be used to fund the first two years of its four-year construction work plan. Public notice of the Cooperative's application was published in the November 28, 2000, edition of the White Mountain Independent.

Navopache is a non-profit rural electric distribution cooperative supplying power to approximately 29,682 customers in Apache, Greenlee, Gila, and Navajo Counties in Arizona. Navopache also provides electric service to consumers in Catron County, New Mexico. Navopache's current rates were authorized in Decision No. 58041, dated October 9, 1992. On January 19, 2001, Navopache filed a rate application with the Commission.

### **Purpose of the Financing**

As part of its application, Navopache submitted a four-year work plan, prepared by SGS Witter, Inc., which detailed the projects to be completed and the accompanying costs. The work plan includes the construction of a new delivery point at the Springerville Power Plant with a 20 mile, 69 kilovolt line to the Round Valley Switching Station. These upgrades should dramatically improve voltage levels on Navopache's system, and would allow Navopache to continue servicing its eastern system in the event that the Coronado Transformer, which serves the area, fails.

Navopache will soon have insufficient internal funds to continue the four year work plan, and requires immediate financing in order to continue providing reliable service. The LOC is intended to be a "bridge loan", funding the first two years of the work plan until the proceeds from long-term financing with the Rural Utilities Service ("RUS") become available. Currently, there is a delay of up to two years from the time a borrower's application with RUS is filed until the time that the loan is consummated and funding is made available to the borrower. The Cooperative has stated that it is in the process of preparing an application for long-term debt with RUS, and will provide Staff with a copy when available. It is expected that the Cooperative's application for long-term financing will be consolidated with its rate application filed on January 19, 2001.

Staff Engineering has reviewed the Company's work plan and finds it to be reasonable and prudent (see Exhibit 1).

### **The Proposed Debt**

Navopache has in the past, borrowed money from the RUS and CFC to fund construction of its transmission and distribution system pursuant to orders of the Commission approving such borrowings. As of December 31, 1999, the balance of Navopache's loans from RUS and CFC was \$24,171,861 and \$8,019,304 respectively.

Navopache anticipates drawing down approximately \$4,109,025 in the first year of the LOC and \$3,476,225 in the second year. Navopache is not required to make any principal payments under the LOC. Under the terms of the LOC Agreement, each 12-month period Navopache will, for a period of at least five consecutive business days, reduce to zero all amounts outstanding. In addition, because the LOC is intended to be a "bridge loan", all amounts outstanding are due and payable when Navopache receives the proceeds from the long-term loan with RUS.

### **Financial Analysis**

Because the interest rate on the LOC is variable, it difficult to estimate the Cooperative's required annual debt service related to it. However, Navopache has provided Staff with a recent history of the CFC's interest rates. Schedule JMR-1 shows that the average variable interest rate charged by the CFC since March, of 2000 is approximately 7.96 percent. For purposes of this analysis, Staff conservatively assumed an average variable interest rate of 8.00 percent per annum for the LOC. According to Schedule JMR-1, the required annual debt service related to the LOC for the first year would be approximately \$328,722. According to Navopache's 1999 annual report filed with the Commission, the Cooperative had operating income of \$1,316,052.

As a measure of financial soundness, Staff examined the effects of the proposed debt on the Cooperative's Debt Service Coverage ("DSC") ratio. This ratio measures the number of times cash flow will cover principal and interest payments. There is no CFC covenant related to the LOC that requires a minimum DSC be maintained by Navopache. However, a benchmark of 1.25 is generally preferred by many financial institutions.

Column A of Schedule JMR-2 shows the actual 1999 DSC of 1.28. Column B depicts the estimated effect of the debt service related to the projected draw-downs on the LOC. Under the terms of the proposed financing mechanism and the projected principal draw-downs, the projected DSC ratio would be 1.18. Although this is below the preferred 1.25, it is above 1.00, indicating that that the Cooperative would still be able to service the proposed debt.

Navopache's 1999 year-end capital structure consisted of approximately 74.5 percent long-term debt and 25.5 percent membership equity. The addition of the full LOC will raise the percentage of total debt in the capital structure from 74.5 percent to 79.5. Cooperatives generally carry highly leveraged capital structures because they historically have received lower-than-market interest rates on debt, and therefore, are able assume more debt than investor-owned utilities. For example, Mohave Electric Cooperative, Sulphur Springs Valley Electric Cooperative, and Trico Electric Cooperative all have debt ratios in excess of 60 percent. Thus, because Staff expects the Cooperative to generate sufficient funds to support the LOC, and the addition of the LOC to the capital structure should not increase Navopache's cost of capital, Staff believes that the financing is compatible with sound financial practices.

**Conclusion and Recommendations**

Staff believes the proposed LOC is for purposes consistent with Navopache's proper performance as a public service corporation and will aid it in the continued provision of reliable services to its customers.

Staff believes the proposed transaction is for lawful purposes and compatible with sound financial practices.

Staff recommends that Navopache's request for approval of a line of credit in the amount of \$10,000,000 be granted.

**Recent CFC Interest Rates**

Sep-00	8.30%
Aug-00	8.25%
Jul-00	8.20%
Jun-00	8.15%
May-00	7.65%
Apr-00	7.65%
Mar-00	7.55%
<hr/>	
Average	7.96%

LOC Amount: \$ 10,000,000  
Assumed Interest Rate: 8.00%

	Expected Draw Down	Estimated Annual Interest Payments
Year 1:	\$ 4,109,025	\$ 328,722
Year 2:	3,476,225	278,098

**FINANCIAL ANALYSIS**

December 31, 1999 and Pro Forma Income Statement and Capital Structure

**INCOME STATEMENT**

	[A] <u>12/31/1999</u>	[B] <u>Pro Forma</u>
Revenue:	\$28,304,862	\$28,304,862
Expenses:		
Rent/Lease	\$23,364,629	\$23,364,629
Ad. & General	7,105	7,105
Maintenance	1,712,165	1,712,165
Depreciation/Amort. (d)	1,901,272	1,901,272
Property Taxes	0	0
Other taxes	<u>3,639</u>	<u>3,639</u>
Total Operating Expense	\$26,988,810	\$26,988,810
Operating Income	\$1,316,052	\$1,316,052
Other Income	\$244,511	\$244,511
Other Deductions	\$122,405	\$122,405
Interest Expense (a)	1,628,506	1,957,228
Net Income (b)	(\$190,348)	(\$396,665)
Principal repayment (c)	\$987,411	\$987,411
Reserve Deposit (per annum) (e)	\$0	\$0
<b>DSC</b>		
[(a) + (b) + (d)] ÷ [(a) + (c) + (e)]	1.28	1.18

**CAPITAL STRUCTURE**

Short-term Debt	\$ -	0.0%	\$ 10,000,000	19.6%
Long-term Debt	30,581,090	74.5%	30,581,090	59.9%
Total Debt	30,581,090	74.5%	40,581,090	79.5%
Common Equity	10,489,668	25.5%	10,489,668	20.5%
Total Capital	\$ 41,070,758	100%	\$ 51,070,758	100.0%

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**MEMORANDUM**

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**TO:** Joel Reiker, Senior Rate Analyst  
**FROM:** Asher Emerson, Utilities Engineer  
**THRU:** Del Smith, Utilities Engineer Supervisor  
**DATE:** February 20, 2001  
**RE:** NAVOPACHE FINANCING E-01787A-00-0820

Staff Engineering ("Staff") reviewed the above referenced application, which was submitted by the Navopache Electric Cooperative, Inc. ("Navopache"). AEPCO seeks approval for an unsecured Line of Credit of \$10,000,000 to fund the first two years of a four-year construction plan totaling \$18,434,894.

**Utility Overview**

Navopache purchases power from Plains Electric Generation and Transmission Cooperative, Inc. ("Plains G&T"), a wholesale generation and transmission cooperative. Navopache distributes energy to end users ("members") in its 10,000 square mile service area in the eastern and central part of Arizona. Navopache's growth rate in customer count is estimated to be 15% over the period of 2000 to 2003.

Navopache has maintained an average of 3.77 outage-hours per customer over the last 5 years, which is within the Rural Utility Service's guideline of 5 outage-hours per customer.

**Construction Work Plan**

The ACC Engineering Staff has reviewed the Navopache 2000-2003 Construction Work Plan. The proposed electric plant additions planned for 2000 through 2003 are judged to be proper and prudent given the growth being experienced by the utility and their technical study assessments.

The majority of the budget, for member extensions, is \$11,382,792, which is 62% of the \$18,434,894 budget. Another 24% of the budget, \$4,400,000, is to build a 2<sup>nd</sup> transmission feed into Navopache eastern system, which is presently served by a single 69kV line. The new 69kV line will improve reliability, improve voltage levels and dramatically reduce losses on the system. Electrical losses will be reduced from 845 kW to 183kW, which is a 78% reduction in losses.

**Recommendation**

Staff Engineering recommends approving Navopache's financing application, the majority of which will be used for member line extensions, improving reliability and reducing losses.

Nevertheless, Staff defers judgement of all aforementioned electric facilities as "used and useful" until such time that the utility applies for a rate adjustment. A more thorough review of facilities will be undertaken at that time.