

ORIGINAL



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MEMORANDUM

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TO: Docket Control

FROM: Ernest Johnson
EGJ
Director
Utilities Division

DATE: December 16, 2005

RE: STAFF REPORT FOR WATER UTILITY OF GREATER TONOPAH INC.'S,
APPLICATION FOR AUTHORITY TO ISSUE DEBT (DOCKET NO. W-
02450A-05-0607)

Attached is the Staff Report for Water Utility of Greater Tonopah, Inc.'s application for authority to issue debt. Staff recommends conditional approval.

EGJ:CSB:red

Originator: Crystal S. Brown

Attachment: Original and sixteen copies

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Service List for: Water Utility of Greater Tonopah, Inc.
Docket No. W-02450A-05-0607

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**STAFF REPORT
UTILITIES DIVISION
ARIZONA CORPORATION COMMISSION**

WATER UTILITY OF GREATER TONOPAH, INC.

DOCKET NO. W-02450A-05-0607

**APPLICATION
FOR AUTHORITY
TO ISSUE DEBT**

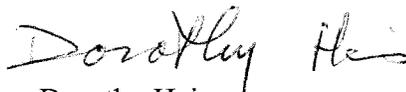
DECEMBER 16, 2005

STAFF ACKNOWLEDGMENT

The Staff Report for Water Utility of Greater Tonopah, Inc., Docket Number W-02450A-05-0607, was the responsibility of the Staff members listed below. Crystal S. Brown was responsible for the financial review and analysis. Dorothy Hains was responsible for the engineering and technical analysis.



Crystal S. Brown
Public Utilities Analyst V



Dorothy Hains
Utilities Engineer

EXECUTIVE SUMMARY
WATER UTILITY OF GREATER TONOPAH, INC.
DOCKET NO. W-02450A-05-0607

Water Utility of Greater Tonopah, Inc. requests authority to issue long-term debt to the Water Infrastructure Financing Authority ("WIFA") in an amount not to exceed \$500,000.

The purpose of the financing is to provide funds for an arsenic removal water treatment plant located in Arizona.

Staff recommends approval of the Company's application for authority to issue debt to WIFA in an amount not to exceed \$500,000 subject to the following conditions:

1. The Company is required to file with Docket Control, as a compliance item, for an increase in permanent rates in 2007 with a 2006 test year unless the Company can demonstrate to Staff's satisfaction that its times interest earned ("TIER") will increase to 1.0 or greater by December 31, 2006.
2. Tonopah is ordered to file with Docket Control, as a compliance item, a plan within 30 days of the date of a decision in this proceeding detailing how it will increase its equity to a minimum of 40 percent. Compliance with this condition shall be recognized only if Staff finds the plan acceptable.

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Engineering Memorandum
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Introduction and Background

On August 24, 2005, Water Utility of Greater Tonopah, Inc. ("Tonopah" or "Company") filed an application with the Arizona Corporation Commission ("Commission") requesting authorization to issue debt to the Water Infrastructure Financing Authority ("WIFA") in an amount not to exceed \$527,000. On October 12, 2005, Tonopah filed an amended application that reduced the original loan amount to \$500,000.

Tonopah is requesting the financing authorization in order to comply with the United States Environmental Protection Agency's ("EPA") revised drinking water standard for arsenic. The new standard that becomes effective January 23, 2006, reduces the maximum contaminant level from the current 50 parts per billion to 10 parts per billion.

Tonopah is an Arizona Corporation located west of the Hassayampa River, approximately 50 miles west of Phoenix, north and south of Interstate 10, near the Town of Tonopah. Tonopah charges rates approved in Decision No. 62092 dated November 19, 1999. As of December 31, 2004, Tonopah provided water service to approximately 214 customers.

Public Notice

On October 19, 2005, the Company filed an affidavit of publication verifying public notice of its financing application. The Company published notice of its financing application in the *West Valley View* newspaper of general circulation in Avondale, Buckeye, Goodyear, Litchfield Park and Tolleson, Maricopa County, Arizona on October 18, 2005. Attached is the affidavit of publication.

Purpose and Terms of the Proposed Financing

The purpose of the financing is to make improvements to Tonopah's water systems and to provide funds for arsenic removal water treatment plants located in Arizona. Staff examined the construction plans and estimated costs for Tonopah's water treatment project and found them to be reasonable and appropriate as discussed in the attached Engineering Memorandum. The proposed financing is a 20 year amortizing loan at a 4.55 percent annual interest rate.

Financial Analysis

Staff's analysis is based on Tonopah's adjusted financial statements dated December 31, 2004. The pro forma adjustments related solely to operating the arsenic treatment plant. The financial analysis shown on Schedule CSB-1 presents selected financial information from the financial statements and the pro forma effect of the \$500,000 loan. Schedule CSB-1 also shows the capital structure and ratios for debt service coverage ("DSC") and times interest earned ("TIER").

TIER and DSC

DSC represents the number of times internally generated cash (i.e., earnings before interest, income tax, depreciation and amortization expenses) covers required principle and interest payments on debt. A DSC greater than 1.0 means operating cash flow is sufficient to cover debt obligations.

TIER represents the number of times earnings before income tax expense covers interest expense on debt. A TIER greater than 1.0 means that operating income is greater than interest expense. A TIER less than 1.0 is not sustainable in the long term but does not necessarily mean that debt obligations cannot be met in the short term.

Tonopah's adjusted 2004 financial statements provide a negative 5.29 TIER and an 8.12 DSC. Drawing the entire \$500,000 proposed loan changes the TIER from negative 5.29 to negative 0.81. Negative TIER calculations can be deceptive and should be interpreted with caution. In this instance, the smaller negative TIER reflects a weaker position. Fully drawing the proposed \$500,000 reduces the pro forma DSC from 8.12 to 1.27. The pro forma DSC ratio shows that Tonopah has adequate cash flow to meet all obligations on the proposed loan. However, the negative TIER indicates that the Company's income is insufficient to support the proposed loan in the long-term.

Capital Structure

At December 31, 2004, Tonopah's capital structure consisted of 1.61 percent short-term debt, 39.61 percent long-term debt, and 58.78 percent equity. Tonopah drawing the entire proposed loan of \$500,000 would result in a pro forma capital structure comprised of 2.66 percent short-term debt, 79.04 percent long-term debt, and 18.30 percent equity as shown on Schedule CSB-1.

A financially sound utility company, on average, has at least 40 percent equity in its capital structure. This finding is based on Staff's analysis of publicly traded water companies followed by Value Line. This analysis found that the average water company capital structure is composed of 49.5 percent long-term debt and 50.5 percent equity. Additionally, Staff notes that NARUC training seminars recognize that a 60/40 debt to equity ratio is indicative of a sound capital structure.

Capital structure is an indicator of solvency. A capital structure with an atypical high level of leverage (i.e., debt) forewarns of potential financial distress. Increased leverage and the associated incremental financial risk have negative implications for owners, creditors and customers. Owners expect higher returns, creditors charge higher interest rates and apply stricter terms and customers have greater concerns regarding quality of service. A highly leveraged capital structure reduces a company's financial flexibility (i.e., its ability to take steps to counter unanticipated cash flow requirements) and reduces its appeal to potential equity investors.

Potential lenders may view a utility with a high percentage of debt in its capital structure as a high risk customer and consequently:

1. Deny loan requests needed for capital improvements and additions resulting in a deterioration of its water system (a lender cannot be expected to provide deference to a utility's need for funds to comply with an unfunded government mandate such as arsenic); and
2. Charge higher interest rates resulting in higher utility rates for its customers

Conclusions and Recommendations

Staff concludes that the project the Company proposes to construct is reasonable and appropriate.

Staff concludes that after the total \$500,000 loan is drawn, Tonopah's pro forma capital structure will be 2.66 percent short-term debt, 79.04 percent long-term debt, and 18.30 percent equity. The Company will need to increase its equity in order to obtain a financially sound capital structure. This can be accomplished by infusing capital, retaining profits, or both. Therefore, Tonopah should file a plan detailing how it will increase its equity to a minimum of 40 percent as a condition for authorization of the proposed debt.

Staff concludes that Tonopah would have adequate cash flow to meet all obligations on the recommended \$500,000 debt in the short-term; however, its income is insufficient to service the proposed debt in the long-term. Staff addresses this issue with its recommendations below.

Staff concludes that the proposed financing is for lawful purposes, within Tonopah's powers as a corporation and compatible with the public interest. The proposed financing would also be consistent with sound financial practices and not impair the Company's ability to provide public service provided the conditions recommended below are adopted.

Staff recommends approval of the Company's application for authority to issue debt to WIFA not to exceed \$500,000 subject to the following conditions:

1. The Company is required to file with Docket Control, as a compliance item, for an increase in permanent rates in 2007 with a 2006 test year unless the Company can demonstrate to Staff's satisfaction that its times interest earned ("TIER") will increase to 1.0 or greater by December 31, 2006.
2. Tonopah is ordered to file with Docket Control, as a compliance item, a plan within 30 days of the date of a decision in this proceeding detailing how it will increase its equity to a minimum of 40 percent. Compliance with this condition shall be recognized only if Staff finds the plan acceptable.

Staff further recommends approval of granting of liens in favor of the lender as required to secure the borrowings authorized.

Staff further recommends authorizing Tonopah to engage in any transaction and to execute any documents necessary to effectuate the authorizations granted.

Staff further recommends that Tonopah file with Docket Control, as a compliance item in this docket, within 90 days of the decision resulting from this proceeding, a copy of all executed documents associated with the financing herein.

FINANCIAL ANALYSIS

Selected Financial Information
Pro forma Includes Immediate Effects of the Proposed Long-term Debt

	[A] 12/31/2004 With ProForma Operating Expenses <u>Without Loan</u>		[B] 12/31/2004 With ProForma Operating Expenses and <u>Full Amount of Proposed Loan</u>	
1	Operating Income	\$ (21,547)		\$ (21,547)
2	Depreciation & Amortization Expense	\$ 79,126		\$ 79,126
3	Income Tax Expense	\$ -		\$ -
4	Interest Expense on Debt	\$ 4,076		\$ 26,501 (a)
5	Repayment of Principal	\$ 3,015		\$ 18,711
	TIER			
6	[1+3] ÷ [4]	(5.29)		(0.81)
	DSC			
7	[1+2+3] ÷ [4+5]	8.12		1.27
8	Short-term Debt	\$ 3,628 (b)	1.61%	\$ 19,324 (c) 2.66%
9	Long-term Debt	\$ 89,535	39.61%	\$ 573,839 79.04%
10	Equity	\$ 132,861	58.78%	\$ 132,861 18.30%
11	Total Capital	\$ 226,024	100.00%	\$ 726,024 100.00%

(a) The pro forma interest expense was annualized by multiplying the balances of existing debt (as of 12/31/04) by their stated interest rates and includes the first year interest on the entire proposed loan.

(b) Includes \$0 in short-term debt and \$3,628 in current maturities on long-term debt at 12/31/04.

(c) Includes \$0 in short-term debt and \$3,628 in current maturities on long-term debt at 12/31/04 and first year principal repayment on the full amount of the proposed loan.

MEMORANDUM

DATE: November 10, 2005
TO: Crystal Brown
FROM: Dorothy Hains DH
RE: **Financing Application for Water Utility of Greater Tonopah, Inc.
Docket No. W-02450A-05-0607**

I. Introduction

On October 12, 2005 Water Utility of Greater Tonopah (“WUGT” or “the Company”) sought Arizona Corporation Commission authorization to issue up to five hundred thousand dollars (\$500,000) in long-term indebtedness with the Water Infrastructure Financing Authority. This loan will be used to fund five projects which include: (1) installation of Point-of-Use (“POU”) arsenic treatment devices in five of the Company’s seven systems; (2) Drilling a new well to replace the existing well serving the Garden City/Big Horn system; (3) installation of 5,600 feet of water line to interconnect the well serving the West Phoenix Estates (“WPE”) #3 system with the well serving the WPE #6 system; (4) installation of 9,850 feet of water line to interconnect the well serving the Sunshine system with the well serving the Dixie system, and; (5) installation of centralized arsenic treatment equipment in the B&D/Buckeye Ranch system. Each of these projects will enable the Company to meet the new arsenic standard. In addition, projects 2, 3 and 4 will enable the Company to address existing and/or future capacity constraints in the effected systems.

II. Water System Analysis

The following table lists specific information about seven of the water systems WUGT operates.

System Name	B&D/Buckeye Ranch	Roseview	WPE #7/ Tuft	Garden City/Big Horn	Dixie	WPE #6	Sunshine
PWS ID#	07-618	07-082	07-617	07-037	07-030	07-733	07-071
# of wells	2	1	1	1	1	1	1
Total production (GPM)	145	30	20	30	40	20	130

# of storage tank	2	1	1	2	1	1	1
Total storage capacity (gallons)	155,000	10,000	5,000	45,000	10,000	7,500	100,000
Existing # of customers	65	14	6	15	21	21	72
Does system contain fire flow?	Yes	No	No	No	No	No	Yes
Is a storage and production capacity adequate to serve the Company's existing customer base?	Yes	Yes	Yes	Yes	Yes	Yes	No (see note 1 below)
ADWR # 55-xxxxxx	803811 & 802962	802143	802144 &	804131	639586	802145	802141
Arsenic (µg/l)	12 & 13	24	26	24	7	50	11

- 1) Project 4 as referenced in the introduction, which interconnects the Sunshine and Dixie systems, is intended to address the Company's existing capacity constraint in the Sunshine system. Staff has evaluated the Company's proposal and concludes that it will resolve the capacity constraint in this system.
- 2) WUGT systems WPE #1 and WPE #3 are not listed in the table above. WPE #1, which is currently serving one customer, is regulated by the Maricopa County Environmental Services Department ("MCESD") as a semi-public system. WPE #3, which is not serving customers at this time, is not regulated by MCESD.

III. MCESD Compliance

The WUGT systems are in compliance with MCESD, the systems are currently delivering water that meets the water quality standards required by Arizona Administrative Code, Title 18, Chapter 4. Staff received MCESD compliance

status reports for each system. A Summary of the reports received is listed in the following table.

System Name	B&D/ Buckeye Ranch	Roseview	WPE #7/ Tuft	Garden City/Big Horn	Dixie	WPE #6	Sunshine
PWS ID#	07-618	07-082	07-617	07-037	07-030	07-733	07-071
Status	Public system	Public system	Semi- public	Public system	Public system	Public system	Public system
Regulated by MCESD	Yes	Yes	No	Yes	Yes	Yes	Yes
Compliance status	Compliance	Compliant	-	Compliance	Compliant	Compliant	Compliant
Date received MCESD report	June 9, 2005	June 6, 2005		November 1, 2005	June 3, 2005	May 27, 2005	June 6, 2005

IV. Arizona Department of Water Resources (“ADWR”) Compliance

WUGT is located in Phoenix Active Management Area (“AMA”), as designated by ADWR. ADWR has indicated that WUGT is in compliance with the Phoenix AMA requirements.

V. Arizona Corporation Commission (“ACC”) Compliance

According to the Utilities Division Compliance Section, WUGT has no outstanding ACC compliance issues.

VI. Analysis & Detailed Costs

The Company has estimated its total construction cost to be \$628,000. The itemized costs are listed below:

	Project Description	Qty	Cost (\$)
Project 1	Install POU for arsenic removal¹		
	Numbers of devices ²	60 ³	41,958.00 ⁴
	Sub total		41,958
Project 2⁵	Drill and equip a new well to serve the Garden City System		
	Design, engineering & permit fee		15,000
	Drilling a 900' deep well equipped with 8-inch casing	1	77,015
	subtotal		92,015
Project 3⁵	Install interconnect between WPE #3 & WPE #6 wells		
	4" PVC	5,193 (feet)	88,281 ⁶
	4" DIP	407 (feet)	10,378
	4" valve	14	8,400
	2" air relief valve	4	5,400
	labor		59,150
	subtotal		176,609
Project 4⁵	Install interconnect between Dixie and Sunshine wells		
	8" PVC	9,850 (feet)	220,502
	subtotal		220,502
Project 5	Install centralized arsenic removal treatment equipment		
	McPhee Environmental Supply ("McPhee")		
	Design and permitting Fee		10,974
	Treatment Plant ⁶		74,632
	A 10' x 18' concrete slab		1,300
	Plumbing to connect treatment plant and existing system		1,200
	10% contingency		8,810
	subtotal		96,916
	Total Cost		628,000

1. WUGT has decided to use Watts Premier zero waste reverse osmosis (“RO”) devices. Staff supports this choice since the water to be treated contains high fluoride, arsenic and total dissolved solids. Staff believes an RO system will provide better performance under these conditions.
2. RO devices will be installed in the following systems: Roseview, Garden City/Big Horn, WPE #1, WPE #6 and WPE #7/ Tuftte.
3. WUGT will need a total of 60 units which include 14 units in the Roseview system, 6 units in the WPE #7/Tuftte system, 15 units in the Garden City/Big Horn system, 24 units in the WPE #6 system and 1 unit in WPE #1 system.
4. The average unit price including installation is \$699.30 per RO device.
5. These projects address capacity constraints in the effected systems and will help WUGT meet the new arsenic standard through the use of blending.
6. This treatment plant which is designed for a flow rate of 125 GPM includes two 3-foot diameter vessels and ArsenX media which is a new hybrid arsenic removal media that utilizes nano-particle technology to combine iron chemistry and plastic bead durability.

Staff concludes that the proposed projects are appropriate and the cost estimates presented herein are reasonable for purposes of this financing request. However, no “used and useful” determination of the proposed project item was made and no particular treatment should be inferred for rate making or rate base purpose in the future.

VII. Curtailment Tariff

The Company has had an approved Curtailment Tariff in effect since January 26, 2005.

VIII Summary

I. Conclusions

1. WUGT has no outstanding ACC compliance issues.
2. WUGT is in compliance with ADWR monitoring and reporting requirements.
3. The WUGT systems are in compliance with MCESD, the systems are currently delivering water that meets the water quality standards required by Arizona Administrative Code, Title 18, Chapter 4.
4. Staff concludes that the proposed projects are appropriate and the cost estimates presented herein are reasonable for purposes of this financing request.

However, no “used and useful” determination of the proposed project item was made and no particular treatment should be inferred for rate making or rate base purpose in the future.

Docket # W-02450A-05-0607

WEST VALLEY VIEW

200 W. Wigwam Blvd., Litchfield Park, Az. 85340-4636 ♦ (623) 535-VIEW (535-8439)

AFFIDAVIT OF PUBLICATION

State of Arizona

County of Maricopa

I, Elliott Freireich, publisher of West Valley View newspaper of general circulation in Avondale, Buckeye, Goodyear, Litchfield Park and Tolleson, Arizona, attest that the advertisements for

Water Utility of Greater Tonopah, Inc Ref.
Curtis, Goodwin, Sullivan, Udall + Schwab, PLC
Public Notice - Application for an Order Authorizing the issuance of Debt.

will be has been published on October 18, 2005.

Elliott Freireich
Elliott Freireich, Publisher

October 18, 2005.
Date

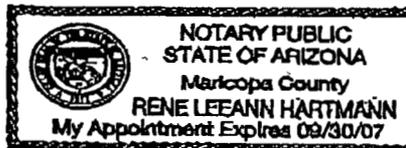
SUBSCRIBED AND SWORN TO BEFORE ME ON THE

18 DAY OF October (Month), 2005 (YEAR)

NOTARY SIGNATURE:

Rene Leeann Hartmann

COPY



Public Notice

**AN APPLICATION FOR AN
ORDER
AUTHORIZING THE ISSUANCE
OF DEBT**

**BY WATER UTILITY OF
GREATER TONOPAH, INC.**

Water Utility of Greater Tonopah, Inc. (Applicant) filed an Application with the Arizona Corporation Commission (Commission) for an order authorizing Applicant to issue \$500,000 in debt to make improvements to its water system to reduce the arsenic levels. The application is available for inspection during regular business hours at the office of the Commission in Phoenix, Arizona, and the Company's offices in

Phoenix and Buckeye, Arizona. Intervention in the Commission's proceedings on the application shall be permitted to any person entitled by law to intervene and having a direct substantial interest in this matter. Persons desiring to intervene must file a Motion to Intervene and thirteen copies with the Commission's Docket Control at 1200 West Washington, Phoenix, Arizona and serve a copy upon the Applicant c/o William Sullivan, Curtis, Goodwin, Sullivan, Udall & Schwab, P.L.C., 2712 North 7th Street, Phoenix, Arizona 85006. The Motion to Intervene at a minimum, shall contain the following information:

1. The name, address and telephone number of the proposed intervenor and of any person upon whom service of documents is to be made if different than the intervenor.
2. A short statement of the proposed intervenor's interest in the proceeding.
3. Whether the proposed intervenor desires a formal evidentiary hearing on the application and the reasons for such a hearing.
4. A statement certifying that a copy of the Motion to Intervene has been mailed to Applicant.

The granting of Motions to Intervene shall be governed by A.A.C. R14-3-105, except that all Motions to Intervene must be filed on, or before, the 15th day after the date this notice is published.

Published in the West Valley View, and the West Valley Business, on October 18, 2005.