

ORIGINAL



0000051719

RECEIVED

2001 NOV 28 A 10: 01

AZ CORP COMMISSION
DOCUMENT CONTROL

MEMORANDUM

TO: Docket Control

FROM: Ernest G. Johnson, Esq.
EGJ
Director
Utilities Division

DATE: November 26, 2001

RE: STAFF REPORT FOR PICACHO SEWER COMPANY'S APPLICATION FOR APPROVAL OF FINANCING (DOCKET NO. SW-03709A-01-0165)

Attached is the Staff Report for Picacho Sewer Company's application for approval of financing. Staff recommends partial approval without a hearing.

EGJ:JMR:rdp

Originator: Joel M. Reiker

Attachment: Original and ten copies

Arizona Corporation Commission
DOCKETED

NOV 28 2001

DOCKETED BY	<i>me</i>
-------------	-----------

Service List for: Picacho Sewer Company
Docket No. SW-03709A-01-0165

Mr. James Poulos
Picacho Sewer Company
9532 East Riggs Road
Sun Lakes, Arizona 85248

Mr. Scott Wakefield, Chief Counsel
RUCO
2828 North Central Avenue, Suite 1200
Phoenix, Arizona 85004

Mr. Christopher Kempley, Esq.
Chief, Legal Division
Arizona Corporation Commission
1200 West Washington Street
Phoenix, Arizona 85007

Mr. Ernest G. Johnson, Esq.
Director, Utilities Division
Arizona Corporation Commission
1200 West Washington Street
Phoenix, Arizona 85007

Ms. Lyn Farmer, Esq.
Chief, Hearing Division
Arizona Corporation Commission
1200 West Washington Street
Phoenix, Arizona 85007

STAFF REPORT
UTILITIES DIVISION
ARIZONA CORPORATION COMMISSION

PICACHO SEWER COMPANY
DOCKET NO. SW-03709A-01-0165

APPLICATION
FOR AUTHORIZATION OF FINANCING

NOVEMBER 2001

TABLE OF CONTENTS

	<u>PAGE</u>
Introduction.....	1
Background.....	1
Purpose of the Proposed Financing.....	1
Staff Analysis.....	2
Conclusions and Recommendations.....	3

Attachment

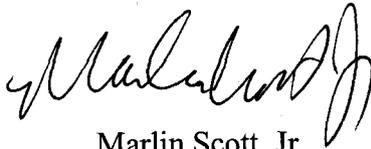
Engineering Report

STAFF ACKNOWLEDGMENT

The Staff Report for Picacho Sewer Company, Docket No. SW-03709A-01-0165, was the responsibility of the staff members listed below. Joel M. Reiker was responsible for the review and analysis of the Company's application for financing approval. Marlin Scott, Jr. was responsible for the engineering analysis of the proposed projects.



Joel M. Reiker
Senior Rate Analyst



Marlin Scott, Jr.
Utilities Engineer

Introduction

On February 26, 2001, Picacho Sewer Company ("PSC" or "Company"), filed an application requesting authorization to issue up to \$7,900,000 in stock equity to the shareholders of the Company. The proceeds of the proposed stock issuance are to be used to fund the Company's initial sewer infrastructure. Public notice of the proposed transaction was published on February 22, 2001.

Background

The Arizona Corporation Commission ("Commission") granted PSC a Certificate of Convenience and Necessity ("CC&N") to provide wastewater service in Decision No. 61994, dated October 8, 1999.

The Company's certificated area includes a proposed 3,000-acre age-restricted master planned community known as Sun Lakes – Casa Grande, located in Pinal County, near the town of Casa Grande. The Company presently does not serve any customers. However, it is anticipated that PSC will provide wastewater utility service to a community that will have approximately 8,000 homes at build-out.

Purpose of the Proposed Financing

Funds provided by the proposed \$7,900,000 stock issuance will be used to pay for the design and construction of the Company's initial sewer infrastructure. These projects include the following:

Table 1

<u>Capital Items</u>	<u>Amount</u>
First Phase of Wastewater Treatment Plant	\$4,221,500
Initial Collection System	1,500,000
Initial Lift Stations	300,000
Effluent lines	150,000
Land,	840,000
Generator, vehicle and other equipment	65,000
Engineering and Permitting for Items Above	707,650
Operating Losses	21,380

Subtotal	\$7,805,530
Total financing requested (rounded)	\$7,900,000

Staff Engineering has reviewed the capital items related to the \$7,900,000 financing and believes it would be more appropriate to itemize the capital requirements as follows:

Table 2

<u>Capital Items</u>	<u>Amount</u>
First Phase of Wastewater Treatment Plant	\$4,221,500
Initial collection system	1,500,000
Initial Lift Stations	300,000
Effluent Lines	150,000
Subtotal	6,171,500
Engineering and Permits	617,150
Subtotal	6,788,650
Land, 18.82 acres	752,800
Generator, vehicle and other equipment	65,000
Operating Losses	0

Subtotal	\$7,606,450
Total (rounded)	\$7,700,000

Staff Engineering adjusted Engineering and Permits to reflect 10 percent of plant related items, reduced Land to reflect \$40,000 per acre, and eliminated Operating Losses. (See attached Engineering Report.)

Staff Analysis

The Company proposes to fund the entire \$7,900,000 via the issuance of stock equity. Hence, the Company is proposing to finance 100 percent of its initial plant with equity. According to its application, PSC ultimately desires to maintain an overall balance in its capital structure. However, because the Company believes it will not have sufficient cash flow in its beginning years to service debt, it is proposing to finance its initial sewer infrastructure with equity. The Company will seek authority to introduce long-term debt into its capital structure as the development grows.

While Staff believes the Company's proposal is generally consistent with sound financial practices, it may expose PSC to additional risk related to the success and growth of the master planned community. Therefore, Staff is recommending that line extension items, specifically, the collection system, be financed with advances in aid of construction ("AIACs").

An AIAC is a payment made pursuant to a contract between a developer and a utility. An AIAC provides for the developer to finance the initial cost of a line extension. If the development is successful and the utility generates revenues from new customers on the line extension, then the utility refunds a percentage of those revenues to the developer over time. Thus, the developer retains the risk of the development being a success.

The Company's proposal to fund line extension items with equity may have a negative economic impact on ratepayers. This is because, unlike equity, AIACs are a zero-cost source of capital. Therefore, the Company's proposal to finance line extension items with equity increases the capital financing costs of the line extension. By financing line extensions with AIACs, the Company could reduce its own capital requirements, rate base, and cost of service. Further, the use of AIACs to finance main extension items can avoid the effect of existing ratepayers paying for both the capacity they use and the capacity that is reserved for future customers. This situation occurs when the capacity of a line extension is less than fully utilized, included in rate base, and financed by equity or debt.

Although Staff Engineering eliminated the \$21,380 related to operating losses, Staff acknowledges the Company's financial need for working capital. Therefore, Staff recommends that an additional \$25,000 be authorized to be used as working capital.

Conclusions and Recommendations

Staff recommends that the Commission authorize PSC to issue up to \$6,200,000 in stock equity. This amount represents Staff Engineering's recommended financing authorization of \$7,700,000, less \$1,500,000 related to the initial collection system (\$7,700,000 - \$1,500,000 = \$6,200,000). The Company should finance the initial collection system with AIACs, a zero-cost source of capital. Staff recommends that PSC be authorized to issue up to \$6,200,000 in stock equity for the purposes illustrated in the following table:

Table 3

<u>Capital Items</u>	<u>Amount</u>
First Phase of Wastewater Treatment Plant	\$4,221,500
Initial Lift Stations	300,000
Effluent Lines	150,000
Engineering and Permits	617,150
Land, 18.82 acres	752,800
Generator, vehicle and other equipment	65,000
Working Capital	25,000

Subtotal	\$6,131,450
Total (rounded)	\$6,200,000

Based on the information provided by PSC and the above analysis, the proposed financing, as adjusted by Staff, is for lawful purposes, within the corporate powers of the applicant, is compatible with the public interest, with sound financial practices, with the proper performance by the applicant of service as a public service corporation and will not impair its ability to perform that service.

Staff does not recommend a hearing in this matter.

**ENGINEERING REPORT
FOR
PICACHO SEWER COMPANY
DOCKET NO. SW-03709A-01-0165 (FINANCING)**

A. PURPOSE OF REPORT

This report was prepared in response to a financing application filed by Picacho Sewer Company (PSC) for approval to issue up to \$7,900,000 in common stock. This report will evaluate the proposed sewer system, its estimated costs, and provide information on its status with other regulatory agencies.

B. LOCATION OF PSC

PSC is located approximately six miles southeast of Casa Grande with a certificated area covering approximately five square miles in Pinal County.

C. DESCRIPTION OF PSC

Existing Sewer System

PSC does not have any plant facilities constructed and is not serving any customers at this time.

Proposed Sewer System

PSC is proposing to provide sewer service to the customers in the community of Sun Lakes-Casa Grande, which is a planned community that will have approximately 8,000 homes at build-out. PSC has obtained all of its operating and discharge permits and the design of the first phase of the Water Reclamation Plant (WRP) is nearly complete. The WRP will be built after construction permits are issued and will be placed into service in 2003. PSC is beginning to incur substantial costs for permitting, designing and construction of its facilities and is requesting authorization from the Commission for the financing that is necessary to pay the costs as they are incurred. Therefore, PSC is requesting approval to issue up to \$7,900,000 in common stock for the following capital requirements to serve customers in the first five years:

<u>Capital Items</u>	<u>Amount</u>
1. 1 st Phase of 250,000 GPD WRP and recharge basins (Cost adjusted for Oct. 2002 – per Carollo Engineering)	\$4,221,500

2.	Initial collection system (\$1,500/connection x 200 units x 5 years)	\$1,500,000
3.	Initial lift stations, 2 each	\$300,000
4.	Effluent lines	\$150,000
5.	Land, 18.82 acres	\$840,000
6.	Generator, vehicle and other equipment	\$65,000
7.	Engineering and Permits @ 10%	\$707,650
8.	Operating Losses	\$21,380

9.	Subtotal	\$7,805,530
10.	Total financing requested (rounded)	\$7,900,000

D. ARIZONA DEPARTMENT OF ENVIRONMENTAL QUALITY COMPLIANCE

PSC does not have any plant facilities in operation serving the public; therefore, ADEQ does not have any compliance status at this time.

E. ARIZONA CORPORATION COMMISSION COMPLIANCE

In Decision No. 61994, dated October 8, 1999, PSC was granted its CC&N provided that, within one year of the effective date of the Decision, PSC was to file a copy of the initial Certificate of Approval to Construct (Certificate) issued by the ADEQ. Subsequently, by Procedural Order, the Commission approved an extension until October 8, 2001, for PSC to file a copy of the Certificate and by another Procedural Order dated May 18, 2001, the Commission further approved the extension until December 31, 2002, for PSC to file this Certificate.

F. CONCLUSION AND RECOMMENDATION

Staff Engineering has reviewed the capital items related to the \$7,900,000 and believes it would be more appropriate to itemize the capital requirements as follows:

<u>Capital Items</u>	<u>Amount</u>
1. 1 st Phase of 250,000 GPD WRP and recharge basins (Cost adjusted for Oct. 2002 – per Carollo Engineering)	\$4,221,500
2. Initial collection system (\$1,500/connection x 200 units x 5 years)	\$1,500,000
3. Initial lift stations, 2 each	\$300,000

Picacho Sewer Company

July 5, 2001

Page 3

4.	Effluent lines	\$150,000
5.	Subtotal:	\$6,171,500
6.	Engineering and Permits @ 10%	\$617,150
7.	Subtotal:	\$6,788,650
8.	Land, 18.82 acres (\$40,000/acre per Co.'s quote from Gila Partners)	\$752,800
9.	Generator, vehicle and other equipment	\$65,000
10.	Operating Losses	\$0
11.	Total	\$7,606,450
12.	Total (rounded)	\$7,700,000

As itemized by Staff Engineering above, the cost for; 1) Engineering and Permits at 10% should be related and calculated only for the designing and preparation of engineering plans and permits for plant facilities for Items 1, 2, 3 and 4; 2) Land value evaluated by Gila Partners, per PSC request, was valued at \$35,000 to \$40,000 per acre, therefore the \$40,000 per acre was used by Staff; and 3) the Operating Losses at \$21,380 was omitted because operating expenses should not be allowed in any financing matter, but instead, should be covered in monthly rates.

Therefore, it is Staff Engineering's opinion that its revised capital requirement in the amount of \$7,700,000 is reasonable and appropriate for this financing request.