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MEMORANDUM

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TO: Docket Control

Arizona Corporation Commission

FROM: Ernest G. Johnson
Director
Utilities Division

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AZ CORP COMMISSION
DOCUMENT CONTROL

MAR 14 2007

DATE: March 14, 2007

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RE: IN THE MATTER OF THE APPLICATION OF PERKINS MOUNTAIN WATER COMPANY AND PERKINS MOUNTAIN UTILITY COMPANY FOR A CERTIFICATE OF CONVENIENCE AND NECESSITY (DOCKET NOS. W-20380A-05-0490 AND SW-20379A-05-0489)

On March 8, 2006, Perkins Mountain Water Company and Perkins Mountain Utility Company (together, "the Company") filed three exhibits in the docket and presented them at the evidentiary hearing. These late-filed exhibits included a Standard and Poors ("S&P") credit rating of the Rhodes Cos. LLC, a revised Schedule LAJ-1 and a draft update to a previously-filed Moody's Investor Service ("Moody's") bond rating. Administrative Law Judge Nodes requested that Staff respond to the late-filed exhibits by March 15, 2007.

The S&P document was dated October 24, 2005, and assigned the Rhodes Companies, LLC "and its affiliates/co-borrowers" a 'B+' rating for a \$450 million first lien term loan and a 'B-' rating to a \$150 million second lien secured term loan. According to S&P, the ratings reflected the company's smaller size, single market exposure and highly leveraged pro forma financial profile. The rating also reflected an "established, profitable track record and favorable land positions in one of the fastest growing housing markets in the country."

The Moody's draft opinion was undated. However, the draft commented on the Rhodes Companies, LLC's September 30, 2006 revenues, so it was likely written near the end of the next quarter. The draft continued Moody's stable outlook opinion which was previously expressed in its October 7, 2005 rating action. The October 7, 2005 rating was attached to the Addendum to the Staff Report filed December 15, 2006. The draft Moody's opinion lowered the rating for the \$450 million loan from Ba3 to B1 and the rating for the \$150 million loan from B1 to B3. However, according to the document, the changes in ratings "were not as a result of anything Rhodes did or failed to do. They were purely as a result of a change in the Moody's rating methodology."

The S&P rating, the October 7, 2005 rating by Moody's and the recent Moody's draft rating emphasize the strong link between the real estate/housing market and the financial well-being of the Rhodes Companies, LLC. They also point out the Rhodes Companies, LLC's "aggressive" debt leverage and its need to build cash.

The Company also filed a "Revised by applicant" Schedule LAJ-1 which updated Staff's ownership summary chart. This chart moved Desert Communities, Inc., identified as a development entity and land holding company, from its ownership by Sedora Holdings, LLC to the ownership of Sagebrush Enterprises, Inc. This places Desert Communities, Inc. on an organizational footing equal to that of the Rhodes Companies, LLC but does not change the position of Perkins Mountain Water or Perkins Utility Company in the Rhodes organization.

Staff has reviewed the three documents filed by the Company. The bond ratings from both bond rating agencies are still in the single "B" category which is a high-risk, speculative rating. The change in the organizational chart does not appear to affect the utility companies. Staff does not believe these documents affect Staff's recommendations in this case nor support modifying any of Staff's conditions for approval. Therefore, Staff continues to recommend approval of the Certificate of Convenience and Necessity and Order Preliminary with conditions as described at the hearing.

EGJ:LAJ:tdp

Originator: Linda Jaress