

ORIGINAL



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MEMORANDUM RECEIVED

TO: Docket Control

FROM: Ernest G. Johnson
EGJ
Director
Utilities Division

DATE: August 14, 2007

RE: STAFF REPORT FOR ARIZONA WATER COMPANY'S APPLICATION FOR AN ORDER AUTHORIZING EXECUTION OF A NEW LOAN AGREEMENT OR AMENDMENT TO AN EXISTING LOAN AGREEMENT (DOCKET NO. W-01445A-07-0238)

2007 AUG 14 P 1:16

AZ CORP COMMISSION
DOCKET CONTROL

Attached is the Staff Report for Arizona Water Company's application for approval to execute a new loan agreement or amend an existing loan agreement. Staff recommends approval.

Any party who wishes may file comments to the Staff Report with the Commission's Docket Control by 4:00 p.m. on or before August 24, 2007.

EGJ:GTM:red

Originator: Gary McMurry

Attachment: Original and thirteen copies

Arizona Corporation Commission
DOCKETED

AUG 14 2007

DOCKETED BY *nr*

Service List for: Arizona Water Company
Docket No. W-01445A-07-0238

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**STAFF REPORT
UTILITIES DIVISION
ARIZONA CORPORATION COMMISSION**

ARIZONA WATER COMPANY

DOCKET NO. W-01445A-07-0238

**APPLICATION FOR AN ORDER AUTHORIZING EXECUTION OF A NEW LOAN
AGREEMENT OR AMENDMENT TO AN EXISTING LOAN AGREEMENT**

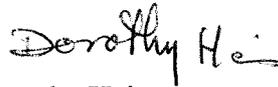
AUGUST 24, 2007

STAFF ACKNOWLEDGMENT

The Staff Report for Arizona Water Company, Docket No. W-01445A-07-0238, was the responsibility of the Staff members listed below. Gary McMurry was responsible for the review of the Company's application. John La Porta was responsible for the Consumer Services area. Dorothy Hains was responsible for the engineering review.



Gary McMurry
Public Utilities Analyst IV



Dorothy Hains
Utilities Engineer – Water/Wastewater



John La Porta
Public Utilities Consumer Analyst I

**EXECUTIVE SUMMARY
ARIZONA WATER COMPANY
DOCKET NO. W-01445A-07-0238**

Arizona Water Company (“AWC” or “Company”) filed an application with the Arizona Corporation Commission (“Commission”) on April 12, 2007, asking for authorization to increase its possible indebtedness under its line of credit from \$28,000,000 to \$32,000,000.

As of April 30, 2007, the outstanding line of credit balance was \$8,450,000. The rate on new advances will carry a maximum initial rate of 8.00 percent, and these advances will be taken after the Commission’s approval of the application through June 1, 2008. The Loan Agreement requires principal to be repaid by November 30 of any given year, but in practice, the principal is rolled over into the subsequent year’s borrowing against the line of credit. After the draw periods, the Company’s intention is to repay the amounts borrowed against the line of credit by issuing long term bonds.

AWC is an Arizona corporation that owns and operates a water utility business in various areas of the state. The purpose of AWC’s request is to finance future construction including: arsenic treatment facilities; expanded water facilities; maintenance of reliable water service to its customers; and reimbursement of monies actually expended from the Company’s treasury for these purposes.

Staff concludes that increasing the credit line as requested in the application is warranted so that AWC can perform the work outlined in its 2007 Construction Budget and replenish its working capital by recovering monies already spent on capital improvements.

Staff also concludes that increasing the credit line as requested in the application is lawful and within AWC’s corporate powers, is compatible with the public interest, would not impair its ability to provide services and is consistent with sound financial practices.

Staff recommends approval of AWC’s request for authorization to increase its potential borrowings under its line of credit instruments.

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ENGINEERING STAFF MEMO.....	EXHIBIT B

Introduction

On April 12, 2007, Arizona Water Company ("AWC" or "Company") filed an application with the Arizona Corporation Commission ("Commission") asking authorization to increase its authority to borrow under line of credit instruments from \$28,000,000 to \$32,000,000 and to extend the authorized borrowing period from May 31, 2007 to June 1, 2008.

Public Notice

Notice of a financing application was published in *The Tucson Citizen* on April 16, 2007, and in *The Arizona Business Gazette* on May 3, 2007. The affidavits of publication are attached to this report along with a copy of the Notice.

Background

AWC is a Class "A" Arizona public service corporation, organized under subchapter "C" of the Internal Revenue Code, that provides potable water service to customers located in Cochise, Coconino, Gila, Maricopa, Navajo, Pima, Pinal and Yavapai Counties in Arizona.

Prior Commission Approvals

On June 26, 2002, the Commission issued Decision No. 64996 which authorized AWC to enter into a Line of Credit agreement with Bank of America Arizona ("Bank of America" or "Bank") in an amount not to exceed \$11,500,000 and an expiration date of June 1, 2003. On July 25, 2003, Decision No. 66104, authorized an increase of the amount to \$15,000,000 and extended the expiration date to June 1, 2004. On October 5, 2004, Decision No. 67274, extended the expiration date to August 1, 2005 with no increase in the authorized amount. On September 9, 2005, Decision No. 68118, extended the expiration date to May 31, 2006, and increased the amount to \$21,000,000. On May 5, 2006, Decision No. 68694, authorized the issuance of \$25,000,000 of debt to repay existing advances under its Line of Credit, retire its existing Series I bonds in the amount of \$400,000 and to fund or reimburse monies already expended for various capital projects. On August 29, 2006, the Commission issued Decision No. 68918 which authorized AWC to enter into a loan agreement with Bank of America Arizona for a line of credit through June 1, 2007, not to exceed \$28,000,000 at an interest rate not to exceed the Bank's reference rate minus 0.25 percentage points.

Purpose and Description of Proposed Financing

AWC proposes to seek a loan modification or new loan agreement which will increase its authority to borrow under the line of credit from \$28,000,000 to \$32,000,000. More specifically, the purpose of AWC's request is to finance future construction including: arsenic treatment facilities and expansion of its water facilities in order to maintain and continue reliable water service to its customers and to obtain reimbursement of monies actually expended from the

Company's treasury for these purposes. AWC anticipates repaying the principal amounts owed through the issuance of long term debt and internally generated cash flows.

AWC seeks the Commission's authority to extend its existing line of credit with Bank of America to an amount not to exceed \$32.0 million and to extend the time period from June 1, 2007 (already expired) to June 1, 2008.

The unpaid principal balance of all advances made under the line of credit will bear interest during each calendar month under one of three rates depending on the timing and amount of the draws. AWC may choose between one of three options: (1) the Bank's Reference Rate minus 0.25 percentage points, (2) a fixed rate to be determined by the Bank, or (3) an interest rate computed using a formula¹ based on the London Interbank Offered Rate ("LIBOR"). As of June 6, 2007, the rates under the three options were as follows.

1. Option 1: Reference Rate less 0.25%: 8.00 %
2. Option 2: Fixed Rate on amounts not less than \$500,000 for periods of 30, 60, 90, 120, 150 and 180 days:
 - a. 30 days = 6.62%
 - b. 60 days = 6.34%
 - c. 90 days = 6.36%
 - d. 120 days = 6.37%
 - e. 150 days = 6.37%
 - f. 180 days = 6.38%
3. Option 3: LIBOR Rate: LIBOR on amounts not less than \$500,000 for periods of 30, 60, 90, 120, 150 and 180 days:
 - a. 30 days: $5.32000 + 1.0 = 6.32000\%$
 - b. 60 days: $5.34000 + 1.0 = 6.34000\%$
 - c. 90 days: $5.36000 + 1.0 = 6.36000\%$
 - d. 120 days: $5.37000 + 1.0 = 6.37000\%$
 - e. 150 days: $5.38000 + 1.0 = 6.38000\%$
 - f. 180 days: $5.38475 + 1.0 = 6.38475\%$

Engineering Analysis

The Staff Engineering Memorandum is attached. Staff reviewed the material cost estimates of AWC's construction budget for 2007. Staff concludes that AWC's cost estimates in the construction budget appear reasonable. Staff makes no "used and useful" determination in this proceeding. Treatment of the proposed plant improvements for rate-making purposes is deferred to a future rate proceeding.

¹ The formula is the LIBOR divided by the sum of 1.00 minus the Reserve Percentage. The components of the formula are defined and discussed in detail in the 2002 Loan Agreement.

Financial Analysis

Staff's analysis of this proposed transaction is based on audited financial statements at December 31, 2006. The newly requested debt authorization represents a total potential increase in borrowing of \$23,550,000. The Company expects to use \$18,000,000 of the increase for its 2007 Construction Budget as shown below.

Total requested LOC	\$32,000,000
Less:	
Amount outstanding at 4/30/07	<u>\$ 8,450,000</u>
Net Potential Increase	\$23,550,000
Less:	
2007 Construction Budget	<u>\$18,000,000</u>
Available for Working Capital	\$ 5,550,000

The attached Schedule GTM-1 shows selected actual and pro forma financial information including the capital structure and ratios for debt service coverage ("DSC") and times interest earned ("TIER").

Capital Structure

As of December 31, 2006, AWC's capital structure consisted of 6.5 percent short-term debt, 33.6 percent long-term debt, and 59.9 percent equity. A draw down of the entire proposed \$32 million credit line would result in a pro forma capital structure composed of 22.3 percent short-term debt, 27.9 percent long-term debt and 49.8 percent equity as shown on Schedule GTM-1.

Interest and Debt Service Coverage

Staff also examined the effects of the proposed financing on the TIER and DSC ratios. TIER represents the number of times earnings will cover interest expense on long term debt. The TIER greater than 1.0 means that operating income is greater than interest expense. DSC represents the number of times internally generated cash will cover required principal and interest payments on long term debt. A DSC greater than 1.0 indicates that operating cash flow is sufficient to cover debt obligations.

AWC had a TIER of 11.11 and a DSC of 17.31 as of December 31, 2006. The pro forma TIER and DSC resulting from fully drawing down the proposed \$32 million credit line are 1.94 and 3.03, respectively. The pro forma DSC shows that AWC would have adequate cash flow to meet all obligations.

Compliance

There are no outstanding compliance delinquencies for the Company.

Staff Conclusions and Recommendations

Staff concludes that authorizing the line of credit for the purposes stated in the Company's application is reasonable and appropriate.

Staff concludes that borrowing under the line of credit is for lawful purposes, is within AWC's powers as a corporation, is compatible with the public interest, is consistent with sound financial practices and will not impair its ability to provide public service.

Therefore, Staff recommends approval of the Company's application for authorization to enter into a loan agreement with Bank of America Arizona for a line of credit, through June 1, 2008, not to exceed \$32.0 million. Staff further recommends that the interest rate on the \$32.0 million line of credit not exceed the Bank's reference rate minus 0.25 percentage points.

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

Staff further recommends that one copy of executed loan documents be filed with Docket Control, as a compliance item in this case, within 90 days of the decision in this matter.

FINANCIAL ANALYSIS

Selected Financial Data

	<u>12/31/2006</u>		<u>Pro Forma</u>	(a)
1 Operating Income	\$ 7,097,860		\$ 7,097,860	
2 Depreciation & Amort.	5,726,476		5,726,476	
3 Income Tax Expense	3,156,731		3,156,731	
4 Interest Expense	923,272		4,780,908	(b)
5 Repayment of Principal	0		0	
6 TIER				
[1+3] ÷ [5]	11.11		2.14	
7 DSC				
[1+2+3] ÷ [5+6]	17.31		3.34	
8 Cash Coverage Ratio				
[1+2+3] ÷ [5]	17.31		3.34	
9 Short-term Debt	\$7,800,000	7%	\$32,000,000	22.3%
10 Long-term Debt	\$40,000,000	33.6%	\$40,000,000	27.9%
11 Common Equity	\$71,388,102	59.9%	\$71,388,102	49.8%
12 Total Capital	\$119,188,102	100%	\$143,388,102	100.0%

(a) This assumes that the entire \$32 million credit line is drawn down.

(b) Interest is imputed on the K and L series bonds at their coupon rates (8.04% and 6.3% respectively) and on the \$32 MM revolver for the entire year at the maximum possible rate (8%).

TUCSON'S NEWSPAPERS

Tucson, Arizona

STATE OF ARIZONA)
COUNTY OF PIMA)

Cezar Duron, being first duly sworn deposes and says:
that he is the Legal Advertising Representative of the
TUCSON'S NEWSPAPERS COMPANY, a corporation
organized and existing under the laws of the State of
Arizona, and that the said TUCSON'S
NEWSPAPERS PUBLISHING COMPANY prints and
publishes the Arizona Daily Star and Tucson Citizen,
daily newspapers printed and published in the City of
Tucson, Pima County, State of Arizona, and having a
general circulation in said City, County, State and
elsewhere, and that the attached

Legal Notice

was printed and published correctly in the entire issue
of the said Arizona Daily Star and Tucson Citizen on
each of the following dates, to-wit:

April 16, 2007

[Handwritten signature]

Subscribed and sworn to before me this 23 day of
2007

[Handwritten signature: Silvia H. Valdez]
Notary Public



SILVIA H. VALDEZ
Notary Public - Arizona
Pima County
Expires 12/15/09

My commission expires

TNI AD NO. 5539927

PUBLIC NOTICE OF AN
APPLICATION FOR AN ORDER
AUTHORIZING THE EXECU-
TION OF A LOAN AGREE-
MENT BY ARIZONA WATER
COMPANY
ARIZONA WATER COMPANY
('Applicant') has filed an Ap-
plication with the Arizona
Corporation Commission
(the 'Commission') for an or-
der authorizing Applicant to
execute a loan agreement es-
tablishing a line of credit not
to exceed \$32,000,000. The
Application is available for in-
spection during regular busi-
ness hours at the office of
the Commission in Phoenix,
Arizona, and Applicant's offi-
ces throughout Arizona.
Intervention in the Commis-
sion's proceedings on the Ap-
plication shall be permitted
to any person entitled by law
to intervene and having a di-
rect substantial interest in
this matter. Persons desiring
to intervene must file a Mo-
tion to Intervene with the
Commission which must be
served upon Applicant and
which, at a minimum, shall
contain the following
information:
1. The name, address, and tel-
ephone number of the pro-
posed intervenor and of any
person upon whom services
of documents is to be made
if different than the
intervenor.
2. A short statement of the
proposed intervenor's inter-
est in the proceeding.
3. Whether the proposed in-
tervenor 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 in-
tervene 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 this
Notice.
Publish April 16, 2007
The Arizona Daily Star
Tucson Citizen

Arizona Business Gazette

The business resource

PO BOX 194
Phoenix, Arizona 85001-0194
(602) 444-7315 FAX (602) 444-7364

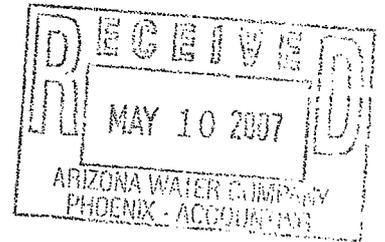
PUBLIC NOTICE OF AN APPLICATION FOR AN ORDER AUTHORIZING THE EXECUTION OF A LOAN AGREEMENT BY ARIZONA WATER COMPANY
ARIZONA WATER COMPANY ("Applicant") has filed with the Arizona Corporation Commission (the "Commission") for an order authorizing Applicant to execute a loan agreement establishing a line of credit not to exceed \$32,000,000. The Application is available for inspection during regular business hours at the office of the Commission in Phoenix, Arizona, and Applicant's offices throughout 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 with the Commission which must be served upon Applicant and which, 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 this Notice.
Published: May 3, 2007

STATE OF ARIZONA
COUNTY OF MARICOPA

} SS.

Ed Carlise, being first duly sworn, upon oath deposes and says: That of the Arizona Business Gazette, a newspaper of general circulation in the county of Maricopa, State of Arizona, published weekly at Phoenix, Arizona, and that the copy hereto attached is a true copy of the advertisement published in the said paper on the dates indicated.

5/3/2007



Sworn to before me this
3RD day of
MAY 2007

Notary Public

INTEROFFICE MEMORANDUM

TO: GARY MCMURRY
PUBLIC UTILITIES ANALYST IV

FROM: DOROTHY HAINS, P.E. DH
UTILITIES ENGINEER

SUBJECT: APPLICATION FOR AUTHORITY TO EXECUTE A NEW LOAN AGREEMENT OR AMENDMENT TO AN EXISTING LOAN AGREEMENT AND THE DELIVERY OF A PROMISSORY NOTE IN CONNECTION THEREWITH FROM ARIZONA WATER COMPANY DOCKET NO. W-01445A-07-0238)

DATE: JULY 19, 2007

Arizona Water Company ("Company") filed this financing application on April 12, 2007, to extend its line of credit not to exceed \$32,000,000 to be utilized, in part, for payment of the construction of improvements and additions to the Company's arsenic treatment facilities within the State of Arizona.

The Company's systems are in compliance with the water quality requirement of the Safe Drinking Water Act per Arizona Department of Environmental Quality's ("ADEQ") memo to Engineering. (See attachment.)

Staff has reviewed the Company's construction budgets for the year 2007 and its specific projects in order to evaluate the construction projects for this financing request. These projects and their budgets appear to be reasonable and appropriate. Staff recommends the acceptance of the Company's projections and analysis.

DEQ Compliance Status
By Arizona Water Company Division

System Name	PWS ID #	Compliance Status ¹	Drinking Water Meets MCL Standards ²
Ajo	10-003	No Major Deficiencies	Yes
Apache Junction	11-004	No Major Deficiencies	Yes
Arizona City ³	11-008	N/A	N/A
Bisbee	02-001	No Major Deficiencies	Yes
Casa Grande	11-009	No Major Deficiencies	Yes
Coolidge	11-014	No Major Deficiencies	Yes
Grasshopper ³	11-003	N/A	N/A
Lakeside	09-003	No Major Deficiencies	Yes
Miami	04-002	No Major Deficiencies	Yes
Oracle	11-019	No Major Deficiencies	Yes
Overgaard	09-004	No Major Deficiencies	Yes
Pinetop Lakes	09-018	No Major Deficiencies	Yes
Pinewood	03-002	No Major Deficiencies	Yes
Rancho Rojo	13-114	No Major Deficiencies	Yes
Rimrock	13-046	No Major Deficiencies	Yes
San Manuel	11-020	No Major Deficiencies	Yes
Stanfield	11-012	No Major Deficiencies	Yes
Sedona	03-003	No Major Deficiencies	Yes
Sierra Vista	02-004	No Major Deficiencies	Yes
Stanfield	11-012	No Major Deficiencies	Yes
Superior	11-021	No Major Deficiencies	Yes
Tierra Grande	11-076	No Major Deficiencies	Yes
White Tanks	07-128	No Major Deficiencies	Yes
Winkelman	04-003	No Major Deficiencies	Yes

Notes:

- (1) "No Major Deficiencies" means that the facility is in complete compliance with the Safe Drinking Water Act water quality requirements. "Major Deficiencies" means the facility poses a public health hazard, or which significantly impairs the operation and reliability of the water system.
- (2) "Yes" means that the water system is currently delivering water, which does not exceed any maximum contaminant levels ("MCL") and meets the water quality standards required by Arizona Administrative Code, Title 18, Chapter 4.
- (3) System is classified as an inactive non-public system, therefore, ADEQ is not regulating it.