

ORIGINAL



0000092432

MEMORANDUM

TO: Docket Control

FROM: Ernest G. Johnson  
Director  
Utilities Division

DATE: January 15, 2009

RE: STAFF REPORT FOR DELLS WATER COMPANY, INC.'s APPLICATION FOR APPROVAL TO BORROW FUNDS TO INCREASE THE WATER STORAGE CAPACITY OF THE UTILITY (DOCKET NO. W-01384A-08-0048)

Attached is the Staff Report for Dells Water Company, Inc.'s application for approval to borrow funds to increase the water storage capacity of the utility and to implement a surcharge to pay the associated debt service. Staff recommends approval to borrow funds and denial of the request to implement a surcharge.

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 January 26, 2009.

EGJ:GTM:tdp

Originator: Gary McMurry

Arizona Corporation Commission

DOCKETED

JAN 15 2009

DOCKETED BY *MM*

AZ CORP COMMISSION  
DOCKET CONTROL

2009 JAN 15 P 2:16

RECEIVED

Service List for: Dells Water Company, Inc.  
Docket No. W-01384A-08-0048

Mr. Jim West  
Authorized Representative  
Dells Water Company  
365 East Coronado Road, Suite 200  
Phoenix, Arizona 85004

Ms. Janice Alward  
Chief Legal Counsel, Legal Division  
Arizona Corporation Commission  
1200 West Washington Street  
Phoenix, Arizona 85007

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

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

**STAFF REPORT  
UTILITIES DIVISION  
ARIZONA CORPORATION COMMISSION**

**DELLS WATER COMPANY, INC.**

**DOCKET NO. W-01384A-08-0048**

**APPLICATION FOR APPROVAL TO BORROW FUNDS**

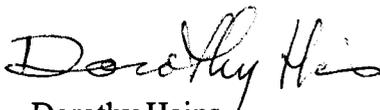
**JANUARY 15, 2009**

## STAFF ACKNOWLEDGMENT

The Staff Report for Dells Water Company, Inc., Docket No. W-01384A-08-0048 is the responsibility of the Staff members listed below. Gary McMurry is responsible for the review of the Company's application. Guadalupe Ortiz is responsible for reviewing the Commission's records on customer complaints filed with the Commission. Dorothy Hains is responsible for the engineering review.



Gary McMurry  
Public Utilities Analyst IV



Dorothy Hains  
Utilities Engineer – Water/Wastewater



Guadalupe Ortiz  
Public Utilities Consumer Analyst I

**EXECUTIVE SUMMARY  
DELLS WATER COMPANY, INC.  
DOCKET NO. W-01384A-08-0048**

Dells Water Company, Inc. ("Dells" or "Company") filed an application with the Arizona Corporation Commission ("Commission") on January 25, 2008, requesting authorization to borrow funds to finance new water storage capacity. The Company's application also states: "It is estimated that total new revenues needed to provide the Company with the same cash flow it would have had before the loan would be \$3,011 for loan payments. This would necessitate a surcharge of \$3.35 per customer, per month for the 75 customers of the system."

Dells is an investor-owned water utility providing water services to approximately 75 customers in Yavapai County in the City of Prescott. The purpose of Dells' request is to provide financing for two new 10,000 gallon storage tanks.

The Company has applied for Water Infrastructure Financing Authority ("WIFA") financing in an aggregate principal amount not to exceed \$30,000. The loan is projected to have a maturity not to exceed 20 years and carry an interest rate of 3.94 percent.<sup>1</sup>

The Commission authorized the Company's current rates in Decision No. 70102, dated December 21, 2007, with the expectation that those rates would generate \$4,174 of operating income. Using the operating results adopted in Decision No. 70102 provides a pro forma times interest earned ratio ("TIER") of 3.86 and a debt service coverage ratio ("DSC") of 2.67 with the issuance of a \$30,000, 20-year amortizing loan at 3.94 percent per annum. The pro forma DSC indicates that Dells would have sufficient cash flow to meet all obligations. However, issuance of a \$30,000, 20-year amortizing loan at 3.94 percent per annum results in an excessively leveraged capital structure composed of 2.5 percent short-term debt, 72.8 percent long-term debt and 24.6 percent equity. Staff considers a capital structure for an investor owned utility composed of less than 40 percent equity excessively leveraged, a state inconsistent with sound financial principals. Nevertheless, Dells needs the storage tanks to provide adequate service, and it has limited financial alternatives to borrowing to obtain funding. The debt service reserve provisions of the WIFA loan will assist the Company to build equity.

Staff concludes that construction of the water storage tanks is appropriate and that the estimated cost is reasonable.

Staff also concludes that the financing requested in the application is lawful and within Dell's corporate powers, is compatible with the public interest, would not impair its ability to provide services and, with the debt service reserve provisions of a WIFA loan, is consistent with sound financial practices.

---

<sup>1</sup> WIFA loans are generally priced at the prime rate (currently 3.25 percent) plus 2.00 percent. The Company qualifies for a 75 percent subsidy index resulting in an interest rate of 3.94 percent  $[(3.25+2.00) \times 0.75]$

Staff recommends:

- Authorization to obtain an 18- to 22-year WIFA loan in an amount not to exceed \$30,000 and at a rate not to exceed 6.75 percent per annum to purchase and install additional water storage.
- Requiring the Company to file the ADEQ Approval of Construction ("AOC") for the storage tank project with the Commission by December 31, 2009.
- No authorization to implement a surcharge to pay debt service on the authorized debt.
- Authorizing the Company to engage in any transaction and to execute any documents necessary to effectuate the authorizations granted.
- Requiring the Applicant to file with Docket Control, as a compliance item in this case, within 60 days of the execution of any transaction authorized herein, a copy of the loan agreement.
- That any authorization granted in this proceeding to incur long-term debt that remains unused at December 31, 2011, shall terminate on that date.

**TABLE OF CONTENTS**

	<b><u>PAGE</u></b>
INTRODUCTION .....	1
PUBLIC NOTICE .....	1
BACKGROUND .....	1
PRIOR COMMISSION APPROVALS .....	1
PURPOSE AND DESCRIPTION OF PROPOSED FINANCING .....	1
ENGINEERING ANALYSIS .....	2
FINANCIAL ANALYSIS.....	2
COMPLIANCE.....	3
CONSUMER SERVICES .....	3
STAFF CONCLUSIONS AND RECOMMENDATIONS .....	4

**SCHEDULES**

FINANCIAL ANALYSIS.....	SCHEDULE GTM-1
-------------------------	----------------

**ATTACHMENTS**

PUBLIC NOTICE / AFFIDAVITS OF PUBLICATION.....	EXHIBIT A
ENGINEERING STAFF MEMORANDUM.....	EXHIBIT B

## **Introduction**

On January 25, 2008, Dells Water Company, Inc. ("Dells" or "Company") filed an application with the Arizona Corporation Commission ("Commission") requesting authorization to borrow \$30,000 to finance the construction of new water storage capacity. The Company's application also states: "It is estimated that total new revenues needed to provide the Company with the same cash flow it would have had before the loan would be \$3,011 for loan payments. This would necessitate a surcharge of \$3.35 per customer, per month for the 75 customers of the system."

On February 8, 2008, Staff issued its first data request to the Company regarding this financing. Approximately four months later, the Company partially responded to Staff Data Request No. 1 on May 29, 2008, however, the Engineering data request information was not included in that response. On July 31, 2008, Staff issued their second Data Request. The Company responded to Staff Data Request No. 2 on August 20, 2008. On October 21, 2008, the Company responded to a portion of the remaining items from the February 2008 data request. On December 9, 2008, the final outstanding item of the data request, the Water Quality Report from the Arizona Department of Environmental Quality (ADEQ), was received.

## **Public Notice**

Notice of a financing application was published in *The Courier* on June 4, 2008. The affidavits of publication are attached to this report along with a copy of the Notice.

## **Background**

Dells is an Arizona public service corporation organized as a "C" corporation under the Internal Revenue Code located in Clarkdale, Arizona that provides potable water service to customers located in Yavapai County in Arizona.

## **Prior Commission Approvals**

On June 16, 1953, the Commission issued Decision No. 27705 granting the Company a Certificate of Convenience and Necessity ("CC&N"). The Commission authorized the Company's current rates in Decision No. 70102, dated December 21, 2007.

## **Purpose and Description of Proposed Financing**

The Company seeks the Commission's authority to obtain \$30,000 of debt financing and use the proceeds to purchase two 10,000 gallon water tanks. The Company has applied to the Water Infrastructure Financing Authority of Arizona ("WIFA") for a loan. The Company's application, as noted above, states that a \$3.35 monthly surcharge to each of its customers is

necessary to finance the annual \$3,011 debt service<sup>2</sup> on the proposed loan and maintain the same cash flow it had prior to issuance of the debt. The actual interest rate on WIFA loans is dependent on the prime rate at the time of issuance. The specific applicable interest rate is equal to the product of multiplying a subsidy index determined by WIFA times the sum of the prime interest rate (currently 3.25 percent) and 2.00 percent. Assuming the Company qualifies for a 75 percent subsidy index, the current rate is 3.94 percent.<sup>3</sup>

### **Engineering Analysis**

The Staff Engineering Memorandum is attached. Staff reviewed the Dells' cost estimates for construction of the storage tanks and concludes that those cost estimates are reasonable and appropriate. 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.

### **Financial Analysis**

The newly requested financing represents a total potential increase in borrowing of \$30,000. The Company's application states that it, "does not have sufficient reserves to construct the required storage tanks out of operating revenue." The basis for the Company's assertion is an unaudited income statement showing a \$3,732 net loss for the year ending December 31, 2007. However, the operating results from 2007 are stale since the Commission authorized new rates in Decision No. 70102, dated December 21, 2007, anticipating that those rates would generate \$4,174 of annual operating income.

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 Ratio ("TIER"), and it provides a basis for Staff's conclusions regarding the requested debt authorization and need for a surcharge to service additional debt. Column [A] reflects Dells' financial information for the year ended December 31, 2007. Column [B] presents pro forma financial information that modifies Column [A] to reflect the operating results authorized by Decision No. 70102; reclassification of unauthorized debt; and issuance of a \$30,000, 20-year amortizing loan at 3.94 percent per annum. Discussions pertaining to capital structure and debt service coverage are provided below.

### **Capital Structure**

According to unaudited financial statements, Dells capital structure consisted of 68.5 percent short-term debt, 20.4 percent long-term debt, and 11.1 percent equity as of December 31, 2007, as shown in Schedule GTM-1, Column [A]. The Company's financial statement balances

---

<sup>2</sup> Reflects a \$30,000, 20-year amortizing loan at 8.00 percent per annum.

<sup>3</sup>  $[(3.25+2.00) \times 0.75] = 3.94$  percent.

include \$6,721 of short-term and \$2,000 of unauthorized long-term debt. Neither claimed debt is evidenced by a loan document, a stated interest rate or a repayment schedule. Accordingly, Staff reclassified both the short-term and long-term debt as equity. A pro forma capital structure reflecting a draw down of the entire proposed \$30,000 loan is composed of 2.5 percent short-term debt, 72.8 percent long-term debt and 24.6 percent equity as shown on Schedule GTM-1, Column [B]. Staff considers a capital structure for an investor owned utility composed of less than 40 percent equity excessively leveraged, a state inconsistent with sound financial principals. Among other concerns, an excessively leveraged capital structure restricts a utility's ability to obtain additional debt financing, places upward pressure on rates and may result in less favorable terms for future financing. However, Dells has limited financial alternatives to borrowing to obtain funding for necessary capital improvements, and provision of adequate service should take priority over the anticipated leverage concerns in this instance. The debt service reserve provisions of a WIFA loan serve as an equity growth plan to mitigate the leverage concern.

#### 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.

TIER and DSC calculations based on Dells unaudited financial statements for the year ending December 31, 2007, are not meaningful since it had no authorized debt or repayment terms. Staff's pro forma TIER and DSC based on the Schedule GTM-1, Column [B] scenario discussed above are 3.86 and 2.67, respectively. The pro forma DSC and TIER shows that Dells would have adequate cash flow to meet all obligations.

Therefore, it is Staff's opinion that the Company has adequate operating cash flows to service a debt obligation sufficient to construct the needed storage capacity, and it does not need a surcharge to service the debt. Further, authorization of a surcharge should take place within the context of a rate case.

#### Compliance

The Company is out of compliance with ACC Decision No. 70102 which required the Company to docket a copy of the ADEQ AOC for its storage tank project by December 31, 2008. Commission approval of this financing will allow the Company to proceed with financing necessary to complete this project. The Company has provided evidence of satisfaction of the previously delinquent property taxes due to the Yavapai County Treasurer.

#### Consumer Services

A review of the Consumer Service database revealed from January 1, 2005 to current, there have been no complaints, inquires, or opinions filed for Dells.

The Company is in Good Standing with the Corporations Division as of December 30, 2008.

### **Staff Conclusions and Recommendations**

Staff concludes that the estimated costs of construction of the storage tank appear to be reasonable.

Staff further concludes that authorizing the debt financing of the storage tanks for the purposes stated in the Company's application is reasonable and appropriate.

Staff further concludes that issuance of a \$30,000 long-term amortizing loan of 18 to 22-years at a rate not to exceed 6.75 percent for the construction of storage facilities is appropriate, is within its corporate powers, is compatible with the public interest, would not impair its ability to provide services and, with the debt service reserve provisions of a WIFA loan, is consistent with sound financial practices.

Staff recommends:

- Authorization to obtain an 18- to 22-year WIFA loan in an amount not to exceed \$30,000 and at a rate not to exceed 6.75 percent per annum to purchase and install additional water storage.
- Requiring the Company to file the ADEQ Approval of Construction ("AOC") for the storage tank project with the Commission by December 31, 2009.
- No authorization to implement a surcharge to pay debt service on the authorized debt.
- Authorizing the Company to engage in any transaction and to execute any documents necessary to effectuate the authorizations granted.
- Requiring the Applicant to file with Docket Control, as a compliance item in this case, within 60 days of the execution of any transaction authorized herein, a copy of the loan agreement.
- That any authorization granted in this proceeding to incur long-term debt that remains unused at December 31, 2011, shall terminate on that date.

**FINANCIAL ANALYSIS**

Selected Financial Data

12 months ending

		<u>12/31/2007</u>		<u>Pro Forma</u>	
1	Operating Income/(Loss) <sup>1</sup>	\$ (3,732)		\$ 4,174	
2	Depreciation & Amort.	1,305		1,305	
3	Income Tax Expense	0		313	
4	Interest Expense	0 <sup>2</sup>		1,163 <sup>3</sup>	
5	Repayment of Principal	0		1,006	
6	<b>TIER</b>				
	[1+3] + [5]	NMF		3.86	
7	<b>DSC</b>				
	[1+2+3] + [5+6]	NMF		2.67	
8	Short-term Debt	\$6,721 <sup>2</sup>	68.5%	\$1,006	2.5%
9	Long-term Debt	\$2,000 <sup>2</sup>	20.4%	\$28,994	72.8%
10	Common Equity	\$1,085	11.1%	\$9,806	24.6%
11	Total Capital	\$9,806	100%	\$39,806	100.0%

1 The Company's operating income is based on an unaudited financial statement for the period ending 12/31/07. The Pro Forma operating income is based on the operating income authorized in Decision No. 70102, dated December 21, 2007.

2 The Company reported unauthorized ST (Wilhoit Water-\$6,721) and LT (Land Bankers-\$2,000) debt which Staff re-classified as equity.

3 Reflects issuance of a \$30,000, 20-year amortizing loan at 3.94 percent.

06-11-08P03:11 RCVD

RECEIVED

2008 JUN 11 P 12:02

**AFFIDAVIT OF PUBLICATION**

STATE OF ARIZONA )  
County of Yavapai ) ss.

I, Aileen Kemper, being first duly sworn on her oath says:  
That she is the Classified Coordinator of PRESCOTT NEWSPAPERS,  
INC., an Arizona corporation, which owns and publishes the COURIER,  
a Daily Newspaper published in the City of Prescott, County of Yavapai  
that the notice attached hereto, namely,

**PUBLIC NOTICE OF AN APPLICATION FOR AN ORDER AUTHORIZING  
THE ISSUANCE OF DEBT BY DELLS WATER CO. INC**

has, to the personal knowledge of affidavit, been published in the news  
paper aforesaid, according to law, on 4 day of JUNE, 2008 to 4 day of  
JUNE, 2008 both inclusive without change, interruption or omission,  
amounting in all 1 insertions, made on the following dates:  
JUNE 4, 2008

By: [Signature]  
Dated this 4 Day of JUNE, 2008

By: Malia L Miller  
Notary Public

My commission expires:



PUBLIC NOTICE OF AN APPLICATION FOR AN ORDER AUTHORIZING THE ISSUANCE OF DEBT BY DELLS WATER COMPANY, INC.  
Dells Water Company, Inc. (Company) filed an Application with the Arizona Corporation Commission (Commission) for an order authorizing Applicant to issue \$30,000.00 of debt. 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 Clarkdale, 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.  
1TC RUB June 4, 2008

**MEMORANDUM**

DATE: December 9, 2008

TO: Gary McMurry  
Public Utilities Analyst IV  
Utilities Division

FROM: Dorothy Hains, P. E. *DH*  
Utilities Engineer  
Utilities Division

RE: Dells Water Company, Inc.  
Docket No. W-01384A-08-0048 (Financing Application)

---

**Introduction**

In Decision No. 70102 issued on December 27, 2007, the Arizona Corporation Commission ("the Commission") ordered Dells Water Company ("Dells" or "Company") to resolve its existing inadequate storage capacity problem. On January 21, 2008, the Company submitted its financing application to seek a \$29,046 loan for installation of two 10,000 gallons storage tanks.

The Company is located northeast of the City of Prescott ("City") and west of HWY 89 near Willow Creek, in Yavapai County.

**Existing Water System**

The Company owns and operates a system that consists of two wells, one 6,000-gallon storage tank at same site. The system has a combined well production of 55 gallons per minute ("GPM"). The system does not have adequate storage capacity to serve its existing customers.

**Proposed Tank Addition Project**

The Company proposes to install two 10,000-gallon galvanized steel tanks on the existing well site. The proposed tanks will be manufactured by Brown Tank & Steel and installed by Prescott Pump Service, Inc. Based on 2007 water usage data, the Company should have adequate storage capacity after the new tanks are in service. Dells is requesting Commission approval to obtain the funds needed to complete the proposed project from the Water Infrastructure Finance Authority of Arizona ("WIFA"). The Company estimates the cost of this project to be \$29,046.

### Detailed Cost Analysis

A general description and breakdown of the funding required is as follows:

<b>Project Description</b>	<b>Estimated Cost (\$)</b>
Two 10,000-gallon galvanized steel tanks with ring and external painting	11,900
Pipelines, electric wiring, upgrading control panel	3,000
Subtotal	14,900
Sale tax (6.35%)	946.15
Engineering (site inspection, writing design report, drafting plan, disinfection unit installation, plan permitting)	3,500
Tank delivery & crane rental	1,700
Site preparation (including soil excavation)	5,500
Labor	2,500
<b>Total</b>	<b>29,046.15</b>

Staff concludes that the proposed project is 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.

### Arizona Department of Environmental Quality ("ADEQ") Compliance

#### Compliance

ADEQ has determined that the Dells water system (ADEQ Public Water System Identification No. 13-029) has no major deficiencies and is currently delivering water that meets water quality standards required by Arizona Administrative Code, Title 18, Chapter 4.<sup>1</sup>

#### Approval of Construction

Staff recommends that the Company submit the ADEQ Certificate of Approval of Construction for the plant related to the Company's development of a new storage system by December 31, 2009.

---

<sup>1</sup> ADEQ Drinking Water Compliance Status Report dated December 9, 2008.

### **Arizona Department Of Water Resources (“ADWR”) Compliance**

The Company is located in the Prescott Active Management Area (“AMA”). In a Compliance Status Report dated November 14, 2008, ADWR reported that the Company is not in compliance with department requirements governing water providers and/or community water systems and the Company has not submitted an updated system water plan to the ADWR. Staff recommends that the Company file with Docket Control, as a compliance item within 90 days from the effective date of an order in this proceeding, documentation from ADWR indicating that the Company has submitted a satisfactory water system plan and the Company is in full compliance with ADWR requirements.

### **Conclusions/Recommendations**

1. Staff recommends that the Company submit the ADEQ Certificate of Approval of Construction for the plant related to the Company’s development of a new storage system by December 31, 2009.
2. Staff recommends that the Company file with Docket Control, as a compliance item within 90 days from the effective date of an order in this proceeding, documentation from ADWR indicating that the Company has submitted a satisfactory water system plan and the Company is in full compliance with ADWR requirements.
3. The Dells water system does not have adequate storage capacity to serve its existing customers. Based on 2007 water usage data, the Company should have adequate storage capacity after the new tanks are in service.
4. Staff concludes that the proposed tank addition project is appropriate and the estimated costs appear to be reasonable. However, this does not imply any particular future treatment for rate base. 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.