



0000100973

ORIGINAL

MEMORANDUM

TO: Docket Control

FROM: Ernest G. Johnson
for Director
Utilities Division

DATE: July 24, 2009

RE: STAFF REPORT FOR ARIZONA WATER COMPANY'S APPLICATION FOR AN ORDER AUTHORIZING THE ISSUANCE OF SHORT-TERM DEBT AND THE DELIVERY OF A PROMISSORY NOTE IN CONNECTION THEREWITH (DOCKET NO. W-01445A-08-0607)

Attached is the Staff Report for Arizona Water Company's application for authority to issue additional general mortgage bonds. Staff recommends approval with conditions.

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 7, 2009.

EGJ:JCM:red

Originator: Juan C. Manrique

Attachment: Original and thirteen copies

Arizona Corporation Commission

DOCKETED

JUL 24 2009

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AZ CORP COMMISSION
DOCKET CONTROL

2009 JUL 24 A 8:36

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Service List for: Arizona Water Company
Docket No. W-01445A-08-0607

Mr. Robert W. Geake, Esq.
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Phoenix, Arizona 85007

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Arizona Corporation Commission
1200 West Washington Street
Phoenix, Arizona 85007

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Chief Administrative Law Judge, Hearing Division
Arizona Corporation Commission
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Phoenix, Arizona 85007

**STAFF REPORT
UTILITIES DIVISION
ARIZONA CORPORATION COMMISSION**

**ARIZONA WATER COMPANY
DOCKET NO. W-01445A-08-0607**

**APPLICATION FOR AN ORDER AUTHORIZING
A LINE OF CREDIT NOT TO EXCEED \$30,000,000**

JULY 24, 2009

The Staff Report for Arizona Water Company, Docket No. W-01445A-08-0607 is the responsibility of the Staff members listed below. Juan C. Manrique is responsible for the financial analysis. Katrin Stukov is responsible for the engineering review.



JUAN C. MANRIQUE
PUBLIC UTILITIES ANALYST I



KATRIN STUKOV
UTILITIES ENGINEER – WATER/WASTEWATER

**EXECUTIVE SUMMARY
ARIZONA WATER COMPANY
DOCKET NO. W-01445A-08-0607**

Arizona Water Company ("AWC" or "Company") filed an application with the Arizona Corporation Commission ("Commission") on December 19, 2008, asking for authorization to execute a loan agreement on a line of credit not to exceed \$30,000,000. According to the Company, various financial institutions are offering a rate of LIBOR plus one and a half percent. As of December 31, 2008, the Company had \$7,300,000 in outstanding short-term debt under a current Bank of America Line of Credit.

AWC is an Arizona corporation that owns and operates public water utilities in various parts of the state. The purpose of AWC's request for the Line of Credit is to pay for improvements and additions to the Company's utility plant as well as to pay off the outstanding Bank of America Line of Credit and for working capital requirements.

As of December 31, 2008, AWC's capital structure consisted of 4.8 percent short-term debt, 49.4 percent long-term debt, and 45.8 percent equity. Staff calculated a pro forma capital structure reflecting issuance of a \$30,000,000 1-year amortizing line of credit at 7.0 percent per annum, and it is composed of 17.2 percent short-term debt, 42.9 percent long-term debt and 39.9 percent equity. Staff also calculated pro forma times interest earned ("TIER") and debt service coverage ("DSC") ratios of 2.19 and 0.52, respectively. This also includes an additional \$1,034,356 in revenues from the Company's ACRM approved under Decision No. 70834 on March 17, 2009. The DSC results show that cash flow from operations would not be sufficient to cover all obligations.

Staff calculated the maximum amount of short-term debt the Company could incur with its current revenues including the aforementioned ACRM. Under this scenario, the Company can borrow up to \$14,200,000 in short-term debt and still maintain a DSC of 1.00.

Staff concludes that authorizing a line of credit not to exceed \$30,000,000 as requested in the application is lawful and within AWC's corporate powers, is compatible with the public interest, but would impair its ability to provide services and is not consistent with sound financial practices.

Staff concludes that authorizing the line of credit as requested in the application is not appropriate and should be denied. However, Staff recommends that the Company be authorized to incur a line of credit not to exceed \$14,200,000.

Staff further recommends that any unused authorizations to issue debt granted in this proceeding terminate within twelve months of a decision in this docket.

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

Staff recommends that the Company file as a compliance item in this docket no later than December 31, 2010, documentation issued by Arizona Department of Water Resources ("ADWR") indicating that the Company's Superior and Oracle systems Management Plans meet ADWR requirements.

Staff further recommends that a copy of executed loan documents be filed with Docket Control, as a compliance item in this case, within 60 days of the decision in this matter.

TABLE OF CONTENTS

	<u>PAGE</u>
INTRODUCTION	1
PUBLIC NOTICE	1
BACKGROUND	1
COMPLIANCE.....	1
PURPOSE AND DESCRIPTION OF THE REQUESTED APPROVAL	1
ENGINEERING ANALYSIS	2
FINANCIAL ANALYSIS.....	2
<i>DSC</i>	2
<i>CAPITAL STRUCTURE</i>	2
<i>CAPITAL STRUCTURE INCLUSIVE OF AIAC AND CIAC</i>	3
CONCLUSION AND RECOMMENDATIONS	3

SCHEDULES

FINANCIAL ANALYSIS	JCM-1
--------------------------	-------

ATTACHMENTS

ENGINEERING REPORT	A
AFFIDAVIT OF PUBLICATION	B

INTRODUCTION

On December 19, 2008, Arizona Water Company (“AWC” or “Applicant” or “Company”), filed an application with the Arizona Corporation Commission (“Commission”) requesting authorization to execute a loan agreement on a line of credit not to exceed \$30,000,000.

PUBLIC NOTICE

On January 16, 2009, the Applicant filed an affidavit of publication verifying public notice of its financing application. The Applicant published notice of its financing application in the *Arizona Republic* on January 8, 2009. The *Arizona Republic* is a daily newspaper of general circulation in the county of Maricopa, State of Arizona. The affidavit of publication is attached along with a copy of the Notice. The Applicant also published notice of its financing application in the *Arizona Daily Star* and *The Tucson Citizen* on January 9, 2009. The *Arizona Daily Star* and *The Tucson Citizen* are daily newspapers of general circulation in the county of Pima, State of Arizona.

BACKGROUND

AWC is a Class “A” Arizona corporation located in Phoenix, Arizona. AWC owns and operates public water utilities in Cochise, Coconino, Gila, Maricopa, Navajo, Pima, Pinal and Yavapai Counties in Arizona.

On September 27, 2007, Decision No. 69925 authorized an increase and extension of a previous loan agreement from \$28,000,000 to \$32,000,000. That authorization expired on June 1, 2008.

On March 17, 2009, Decision No. 70834 authorized ACRM surcharges in the amount of \$1,034,356 in additional revenues.

COMPLIANCE

Arizona Department of Water Resources (“ADWR”) has determined that Management Plans filed for Superior and Oracle systems are not in compliance with ADWR requirements with regard to potential Lost and Unaccounted for Water (“L & U”) violations.

PURPOSE AND DESCRIPTION OF THE REQUESTED APPROVAL

AWC has expended some of its own funds and borrowed on a short-term line of credit to improve its utility plant. According to A.R.S. 40-302(D) “a public service corporation may issue notes, not exceeding seven percent of total capitalization if operating revenues exceed two hundred fifty thousand dollars, for proper purposes and not in violation of law payable at periods of not more than twelve months after date of issuance, without consent of the Commission, but

no such note shall, wholly or in part, be refunded by any issue of stocks or stock certificates, bonds, notes or any other evidence of indebtedness without consent of the Commission.” The Company seeks Commission approval to borrow on the new line of credit to pay the existing line of credit as well as replenishing its own funds expended on capital improvements.

ENGINEERING ANALYSIS

The Staff Engineering Memorandum is attached. Staff reviewed the material cost estimates of the Company’s construction budget for 2009. Staff concludes that AWC’s cost estimates in the construction budget seem reasonable and appropriate. Staff makes no “used and useful” determination of the proposed improvements and no conclusions are made for rate base or ratemaking purposes.

FINANCIAL ANALYSIS

AWC does not currently have a short-term financing authorization. Therefore, the newly requested financing represents a net increase in borrowing of \$30,000,000. Staff’s analysis is illustrated on Schedule JCM-1. Column [A] reflects the Company’s historical financial information for the year ended December 31, 2008. Column [B] presents pro forma financial information that modifies Column [A] to reflect a 1-year, \$30,000,000 line of credit at 7.0 percent per annum and additional revenues of \$1,034,356 per year. Column [C] presents pro forma financial information that shows the level of short-term debt the Company can acquire and still meet a DSC of 1.00.

DSC

Debt service coverage ratio (“DSC”) represents the number of times internally generated cash will cover required principal and interest payments on short-term and long-term debt. A DSC greater than 1.0 indicates that cash flow from operations is sufficient to cover debt obligations. A DSC less than 1.0 means that debt service obligations cannot be met by cash generated from operations and that another source of funds is needed to avoid default.

Schedule JCM-1, Column [A] shows that for the year ended December 31, 2008, the Company’s DSC was 1.59. The pro forma DSC for the Company under the scenario described above for Column [B] is 0.52. The pro forma DSC for the Company under the scenario described above for Column [C] is 1.00.

Capital Structure

As of December 31, 2008, the Company’s capital structure consisted of 4.8 percent short-term debt, 49.4 percent long-term debt, and 45.8 percent equity (Schedule JCM-1, Column [A], lines 19-25). Issuance of the proposed \$30,000,000 line of credit would result in a capital structure composed of 17.2 percent short-term debt, 42.9 percent long-term debt and 39.9 percent equity (Schedule JCM-1, Column [B], lines 19-25). Issuance of a \$14,200,000 line of credit

would result in a capital structure composed of 8.9 percent short-term debt, 47.2 percent long-term debt and 43.9 percent equity (Schedule JCM-1, Column [C], lines 19-25).

Staff typically recommends capital structures with a minimum of 40 percent equity (where compared to debt) as appropriate to provide a balance of cost and financial risk for regulated utilities and ratepayers.

Capital Structure inclusive of AIAC and CIAC

As of December 31, 2008, the Company's capital structure, inclusive of Advances In Aid of Construction ("AIAC") and Net Contributions In Aid of Construction ("CIAC")¹, consisted of 2.6 percent short-term debt, 26.7 percent long-term debt, 24.8 percent equity, 30.7 percent AIAC and 15.2 percent CIAC (Schedule JCM-1, Column [A], lines 30-40).

When including AIAC and CIAC, Staff typically recommends capital structures with a minimum of 28 percent equity as appropriate to provide a balance of cost and financial risk for regulated utilities and ratepayer.

CONCLUSION AND RECOMMENDATIONS

Staff concludes that authorizing a line of credit not to exceed \$30,000,000 as requested in the application is lawful and within AWC's corporate powers, is compatible with the public interest, but would impair its ability to provide services and is not consistent with sound financial practices.

Staff concludes that authorizing the line of credit as requested in the application is not appropriate and should be denied. However, Staff recommends that the Company be authorized to incur a line of credit not to exceed \$14,200,000.

Staff further recommends that any unused authorizations to issue debt granted in this proceeding terminate within twelve months of a decision in this docket.

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

Staff recommends that the Company file as a compliance item in this docket no later than December 31, 2010, documentation issued by ADWR indicating that the Company's Superior and Oracle systems Management Plans meet ADWR requirements.

Staff further recommends that a copy of executed loan documents be filed with Docket Control, as a compliance item in this case, within 60 days of the decision in this matter.

¹ Contributions in Aid of Construction less Amortization of Contributions in Aid of Construction.

FINANCIAL ANALYSIS

Selected Financial Information

	[A] ¹ <u>12/31/2008</u>		[B] ² <u>Pro Forma</u>		[C] ³ <u>Pro Forma</u>	
1 Operating Income	\$6,769,547		\$7,803,903		\$7,803,903	
2 Depreciation & Amort.	\$8,095,538		\$8,095,538		\$8,095,538	
3 Income Tax Expense	\$2,188,428		\$2,188,428		\$2,188,428	
4						
5 Interest Expense	\$3,410,018		\$5,510,018		\$4,369,018	
6 Repayment of Principal	\$7,300,000		\$30,000,000		\$13,700,000	
7						
8						
9						
10						
11 DSC						
12 [1+2+3] ÷ [5+6]	1.59		0.51		1.00	
13						
14						
15						
16						
17 Capital Structure						
18						
19 Short-term Debt	\$7,300,000	4.8%	\$30,000,000	17.2%	\$13,700,000	8.7%
20						
21 Long-term Debt	\$75,000,000	49.4%	\$75,000,000	42.9%	\$75,000,000	47.4%
22						
23 Common Equity	\$69,671,689	45.8%	\$69,671,689	39.9%	\$69,671,689	44.0%
24						
25 Total Capital	\$151,971,689	100.0%	\$174,671,689	100.0%	\$158,371,689	100.0%
26						
27						
28 Capital Structure (Inclusive of AIAC and Net CIAC)						
29						
30 Short-term Debt	7,300,000	2.6%	30,000,000	9.9%	\$13,700,000	4.8%
31						
32 Long-term Debt	75,000,000	26.7%	75,000,000	24.7%	\$75,000,000	26.1%
33						
34 Common Equity	69,671,689	24.8%	69,671,689	22.9%	\$69,671,689	24.2%
35						
36 Advances in Aid of Construction ("AIAC")	86,302,513	30.7%	86,302,513	28.4%	\$86,302,513	30.0%
37						
38 Contributions in Aid of Construction ("CIAC") ⁴	42,667,784	15.2%	42,667,784	14.1%	\$42,667,784	14.8%
39						
40 Total Capital (Inclusive of AIAC and CIAC)	\$ 280,941,986	100.0%	\$ 303,641,986	100.0%	\$287,341,986	100.0%
41						
42						
43 AIAC and CIAC Funding Ratio ⁵	45.9%		42.5%		44.9%	
44 (36+38)/(40)						
45						
46						

47 ¹ Column [A] is based on audited 2008 financial information for the year ended December 31, 2008.
48 ² Column [B] reflects the issuance of \$30 Million Line of Credit at 7.0 percent and \$1,034,358 of additional operating income from the permanent portion of authorized ACRM surcharges.
49 ³ Column [C] reflects maximum short-term debt the Company can acquire and still cover its debt service payments.
50 ⁴ Net CIAC balance (i.e. less: accumulated amortization of contributions).
51 ⁵ Staff typically recommends that combined AIAC and Net CIAC funding not exceed 30 percent of total capital, inclusive of AIAC and Net CIAC,
52 for private and investor owned utilities.
53

MEMORANDUM

DATE: March 16, 2009

TO: Juan Manrique
Public Utilities Analyst I

FROM: Katrin Stukov
Utilities Engineer *KS*

RE: Arizona Water Company
Application for Authority to Issue Short-Term Debt
Docket No. W-01445A-08-0607

Introduction

Arizona Water Company ("AWC" or the "Company") has filed an application with the Arizona Corporation Commission ("ACC") requesting authorization to execute a new Loan Agreement for a line of credit in an amount not to exceed \$30.0 million. Out of \$30.0 million, \$6.2 million is for funding of construction during 2009. According to the Company, the upper limit of \$30.0 million was determined based on the projected amount of construction of improvements and additions to the Company's utility plant, plus an amount to cover contingencies and the estimated amount necessary to reimburse the Company's treasury for funds expended for this purpose.

Construction Projects and Budgets

AWC provided Staff with a copy of its construction budget for the year 2009 with cost estimates totaling \$6.2 million. This budget included "blanket funding" for mains, services, meters, hydrants, pumping equipment, office equipment and tools. In addition, specific projects were identified and budgeted for the repair, replacement and installation of SCADA¹ systems, arsenic plants, wells, well equipment, pumps, tanks, lines, etc. The levels of funding for the various categories of utility plant for each of the Company's three operating divisions appear reasonable. The specific projects and cost estimates identified in the Company's budget appear to be reasonable and appropriate. However, approval of this application does not imply any particular future treatment for rate base. No "used and useful" determination of the proposed plant was made, and no conclusions should be inferred for rate making or rate base purposes.

¹ Supervisory Control and Data Acquisition

Arizona Department of Environmental Quality (“ADEQ”) Compliance²

The ADEQ and the Maricopa County Environmental Services Department (“MCESD”) regulate the water systems operated by AWC. ADEQ and MCESD have determined that all AWC water systems have no deficiencies and these systems are currently delivering water that meets water quality standards required by Arizona Administrative Code, Title 18, Chapter 4.

Arizona Department of Water Resources (“ADWR”) Compliance³

ADWR has determined that, except for the Superior and Oracle systems, all other AWC water systems are in compliance with ADWR requirements governing community water systems.

ADWR has determined that Management Plans filed for Superior and Oracle systems are not in compliance with ADWR requirements with regard to potential Lost and Unaccounted for Water (“L&U”) violations.

Staff recommends that the Company file as a compliance item in this docket no later than December 31, 2010, documentation issued by ADWR indicating that the Company’s Superior and Oracle systems Management Plans meet ADWR requirements.

Curtailment Tariff

The Company currently has a curtailment tariff on file which covers all of its systems.

² Per ADEQ compliance status reports from January and February and June 2009

³ Per ADWR Compliance Reports dated December 2008 and May 2009

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COMMISSIONERS:

- Kristin K. Mayes - Chairman
- Gary Pierce
- Paul Newman
- Sandra Kennedy
- Bob Stump

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AZ CORP COMMISSION
DOCKET CONTROL

IN THE MATTER OF THE APPLICATION OF W-01445A-08-0607
 ARIZONA WATER COMPANY, AN ARIZONA CORPORATION, FOR AN ORDER AUTHORIZING CERTIFICATION OF PUBLICATION
 THE ISSUANCE OF SHORT-TERM DEBT AND
 THE DELIVERY OF A PROMISSORY NOTE IN
 CONNECTION THEREWITH.

Arizona Water Company, a public service corporation (the "Company"), respectfully
 Submits the following certification:

IT IS HEREBY CERTIFIED that the Company published notice of its application in this
 matter in the newspapers and counties on the dates set forth below. The newspapers are of
 general circulation in the counties shown.

- | | | | |
|----|--|-----------------|----------|
| 1. | Arizona Daily Star and
The Tucson Citizen | January 9, 2008 | Pima |
| 2. | The Arizona Republic | January 8, 2008 | Maricopa |

Affidavits of publication of the notice showing proof of publication are marked Exhibit A
 and attached hereto and by reference made a part of the original of this Certification.

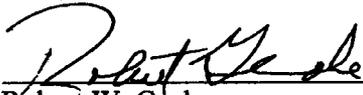
Arizona Corporation Commission
DOCKETED
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DATED this 16th day of January, 2009.

Respectfully submitted,

By: 
Robert W. Geake
Vice President and General Counsel
Post Office Box 29006
Phoenix, Arizona 85038-9006

Original and thirteen (13) copies delivered this 16th day of January 2009 to:

Arizona Corporation Commission
Docket Control Division
200 West Washington Street
Phoenix, Arizona 85007

A copy of the foregoing was hand-delivered this 16th day of January 2009 to:

Kevin O'Torrey
Attorney, Legal Division
Arizona Corporation Commission
Docket Control Division
200 West Washington Street
Phoenix, Arizona 85007

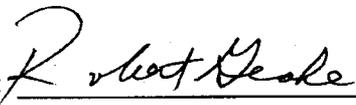
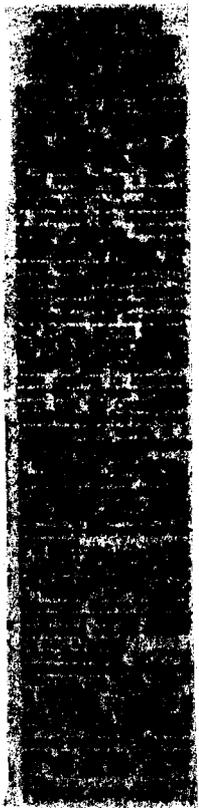
By: 

EXHIBIT A

AFFIDAVIT OF PUBLICATION

THE ARIZONA REPUBLIC

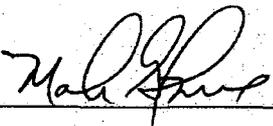
STATE OF ARIZONA }
COUNTY OF MARICOPA } SS.



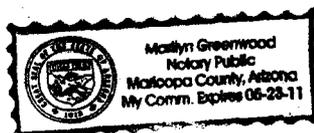
Mark Gilmore, being first duly sworn, upon oath deposes and says: That he is a legal advertising representative of the Arizona Business Gazette, a newspaper of general circulation in the county of Maricopa, State of Arizona, published at Phoenix, Arizona, by Phoenix Newspapers Inc., which also publishes The Arizona Republic, and that the copy hereto attached is a true copy of the advertisement published in the said paper on the dates as indicated.

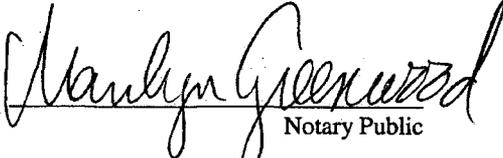
The Arizona Republic

January 8, 2009.



Sworn to before me this
8TH day of
January A.D. 2009





Notary Public

EXHIBIT A

TUCSON NEWSPAPERS

Tucson, Arizona

STATE OF ARIZONA)
COUNTY OF PIMA)

Debbie Capanear, being first duly sworn deposes and says: that she is the Legal Advertising Representative of **TNI PARTNERS, DBA TUCSON NEWSPAPERS**, a General Partnership organized and existing under the laws of the State of Arizona, and that it 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:

January 9, 2009

Debbie Capanear

Subscribed and sworn to before me this 14 day of Jan, 2009

Silvia H Valdez
Notary Public



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

My commission expires _____

TNI AD NO. 6583338

