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BEFORE THE ARIZONA CORPORATION COMMISSION

KRISTIN K. MAYES
Chairman
GARY PIERCE
Commissioner
PAUL NEWMAN
Commissioner
SANDRA D. KENNEDY
Commissioner
BOB STUMP
Commissioner

Arizona Corporation Commission
DOCKETED
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IN THE MATTER OF THE APPLICATION OF ARIZONA PUBLIC SERVICE COMPANY FOR APPROVAL OF ITS 2010 ENERGY EFFICIENCY IMPLEMENTATION PLAN-RESIDENTIAL REPAYMENT FINANCING PROGRAM

DOCKET NO. E-01345A-08-0172

DECISION NO. 71866

ORDER

Open Meeting
August 24 and 25, 2010
Phoenix, Arizona

BY THE COMMISSION:

FINDINGS OF FACT

1. Arizona Public Service Company ("APS" or "Company") is certificated to provide electric service as a public service corporation in the State of Arizona.

BACKGROUND

2. On February 26, 2010, APS filed an application with the Arizona Corporation Commission ("Commission") in compliance with Decision No. 71444. Decision No. 71444, dated December 23, 2009, ordered APS to "...file a residential repayment financing program, as a supplement to the 2010 [Energy Efficiency Implementation Plan]...by February 26, 2010, for Commission consideration." On January 26, 2010, in Decision No. 71460, the Commission granted APS approval of its Non-Residential Customer Repayment Financing option.

PROGRAM DESIGN PARAMETERS

3. APS states that offering a residential financing program could increase customer participation in its energy efficiency programs. In its application, APS states that because there are

various ways to implement an energy efficiency program, many different program design parameters must be considered when structuring a successful program. APS discusses the following design parameters it considered in developing its proposed Residential Energy Efficiency Financing ("REEF") Program.

Sources of Capital

4. In its application, APS describes three major sources of capital that have typically been used for other utility energy efficiency programs.

> ***Public Funding***-This includes funding from state treasury funds and federal grants as an initial source of capital. This source of capital is currently being used in similar energy efficiency financing programs such as the Pennsylvania Keystone Home Energy Loan Program ("Pennsylvania Keystone HELP").[1] APS states that given the economic climate in Arizona, it is unlikely that these funds would be available to fund APS energy efficiency programs. In addition, APS states that federal funds, specifically from the American Recovery and Reinvestment Act of 2009 ("ARRA"), are generally being used by local municipalities through Energy Efficiency and Conservation Block Grants or State Energy Program grants and are not directly available for utilities.

> ***Utility Funding***-This source of capital would be provided either in the form of demand-side management ("DSM") program funds or utility shareholder capital. APS states that although it may be necessary to pursue this form of funding in the future, there are numerous risks and concerns with this source of funding. For example, APS states that because lending/financing is outside of its core business expertise, customers and shareholders are exposed to additional business risks. In addition, APS states that there is risk of future regulations in consumer lending laws that would subject the Company to additional regulations. Further, APS states that because lending/financing would require expertise in lending laws and regulations that it does not currently possess, this would lead to increased costs to provide this source of funding.

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[1] The Pennsylvania Keystone Home Energy Loan Program is funded by the Pennsylvania Department of Environmental Protection, the Pennsylvania Treasury Department, and the Pennsylvania Housing Finance Agency.

Private Third Party Funding-This source of capital includes bank loans, consumer credit, and home equity lines of credit. According to APS, banks are unwilling to offer loans for non-traditional projects such as energy efficiency retrofits. However, APS states that this source of capital in conjunction with utility support such as an interest rate buy down or a loan loss reserve fund can help create a financing program that can be implemented in a cost-effective manner.

Interest Rates

5. In its application, APS states that it identified the following mechanisms to achieve a competitive range of interest rates similar to those offered in other energy efficiency financing programs.

Interest Rate Buy Down-According to APS, this mechanism allows customer rebates to be used to reduce the principal loan amount or to buy down the interest rate. However, APS states that using only customer rebate funds to buy down the interest rate would not provide adequate funding to achieve intended interest rate levels, resulting in additional DSM funds being needed to buy down the interest rate which would impact the cost of the program.

Guaranty Reserve Account-APS states that having a default reserve account leverages DSM dollars to create a fund used to cover the cost of loan defaults. This will help reduce the risk to private lenders and help drive down interest rates without significantly increasing program costs.

Loan Terms, Loan Types, and Amounts

6. Loan term refers to the length of time of the loan. APS states that although a longer loan term helps achieve a close to zero impact cash flow for the customer, it may be more difficult to finance and may increase the risk of loan defaults. Therefore, reaching a balance that is attractive to customers and acceptable to lenders but also minimizes program default costs is an important aspect in a loan program.

7. According to APS, offering a broad range of loan amounts and terms, including secured and unsecured loans, will allow the program to meet the financing needs of customers. To

encourage a variety of energy efficiency projects, APS states that the range of loan amounts should start as low as $1,000 to a maximum of $20,000.

Risk Management

8. In its application, APS states that when using a third party lender for financing, in order to limit the number of loan defaults, lending guidelines will generally be a combination of loan criteria used by the utility and the standard underwriting requirements of the lender. Utility criteria will usually consist of the length of time a customer has been a customer of the utility and the customer's payment history with the utility. Lender criteria will generally include bankruptcy history, credit scores, and employment history/stability.

Integration of Financing into the Overall Energy Efficiency Program

9. According to APS, all financing options that are pursued should be integrated into the DSM program marketing and delivery. In addition, APS states that the participating contractors should be fully trained to explain and offer financing options to customers. Further, participating contractors should be able to show customers the estimated savings and the payback likely to be seen by the customer.

Ease of Use

10. APS states that programs that allow a customer to be pre-approved over the phone are the most streamlined and easy programs to administer and use. In addition, financing options should be easy for participating contractors to explain to customers and easy for customers to understand.

Repayment Billing

11. In its application, APS states that there are many options and differing levels of integration into the utility bill of monthly repayment billing. In addition, APS states that each option can significantly affect the costs and implementation of the financing program. APS describes the four following options for repayment billing.

Option I: Direct Third Party Billing

With this option, a third party lender would administer the loan. The lender would be the party to bill the participating customers for monthly payments. This bill would be sent to customers in separate statement from the customer's APS bill. In addition, APS states that the implementation timeframe is relatively short. According to APS, this option has low initial program costs and ongoing bill administration costs because these costs are borne by the lender and do not impact the program costs. This option also includes an optional energy savings report insert provided by APS that would be included in the customer's financing bill or in a separate mailing. The energy savings report would allow customers to compare the energy savings to the cost of the energy efficiency measures installed at a relatively low program cost. This option would require a one-time modification to the lender's billing system. APS estimates that there would be ongoing mailing costs per quarter for the energy reports.

Option II: Parallel Billing

With this option, the lender would send monthly statements to APS. APS would then insert the statements into the participating customers' monthly APS bill. This approach has minimal initial program costs because this process does not require any significant billing system modifications. In addition, the implementation time frame is relatively short. APS states that based on the number of loans, there would be ongoing costs to implement this option due to the time it will take to manually identify and match each participating customer's APS bill and lender bill. APS states that manual handling of the bills could result in mismatched APS and lender bills for a customer and lender statements that are inadvertently missing from the customer's monthly bill.

Option III: Partially Integrated "On-Bill"

According to APS, this approach includes an informational message on the customer's APS bill that details the customer's monthly charges from the lender. With this option, the amount owed to the lender is automatically withdrawn and paid to the lender. A separate bill will still be required by the lender in order to comply with lending regulation requirements. This option allows for more integrated billing statements where energy savings and monthly charges appear on one statement. However, this option has a longer implementation time frame and a higher initial program cost due to the modifications required to both APS' and the lender's billing systems.

Option IV: Fully Integrated "On-Bill"

APS states that this option would allow customers' financing charges to be printed directly on the utility bill with both the APS bill and the lender charges paid directly to APS. This approach provides the greatest level of integration. However, this option also has significant initial program costs and the longest implementation time frame of over one year. APS states that there would be significant billing and payment system modifications for both the lender and APS.

APS' PROPOSED REEF PROGRAM

12. APS' application includes its proposed REEF Program based on the program design parameters described above. APS states that it could begin to implement its proposed REEF program in as little as 90 days after Commission approval. In addition, APS notes that the design parameters, time frames, and estimated program costs are preliminary estimates and may change in final negotiations with the participating lender.

Sources of Capital

13. APS states that it believes that the most feasible, timely, and cost-effective option for a source of capital is through private third-party funding. APS is proposing that National Bank of Arizona ("NBAZ") provide the third-party source of capital. Staff notes that NBAZ is the lender for APS' Non-Residential Customer Repayment Financing Program approved by the Commission in Decision No. 71460. Through this partnership with NBAZ, APS states that financing for eligible energy efficiency improvements will be available to APS' customers as part of its Home Performance Program. Capital provided by NBAZ would be available up to an aggregate limit of $1.5 million. APS has estimated that the average amount that would be financed is $5,000 which would allow the Program to finance approximately 300 consumer loans at any time. APS states that if the limit were reached, APS and NBAZ would negotiate allowing additional capital or APS could seek an additional lending partner.

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Interest Rates

14. According to APS, its proposed REEF Program would help buy down interest rates using customer rebate dollars. In order to reduce interest, APS states that any utility rebate that the customer would otherwise receive from installing energy efficiency measures, would be applied to the customer's loan to reduce the principal amount of the loan and buy down the interest rate. APS would invest in an interest bearing Guaranty Reserve Account in order to allow customers to obtain below market interest rates ranging from 6.5 percent to 7.99 percent. The Guaranty Reserve Account would be used as a collateral guaranty for the loans issued under this program. The funds would be used to create a reserve to offset any losses incurred by NBAZ. NBAZ would be able to collect a percentage of the unpaid balance of a loan in default through the Guaranty Reserve Account. Staff believes that the amount that can be collected by NBAZ through the Guaranty Reserve Account should not exceed fifty percent (50%) of the amount of the unpaid loan amount in default. This will help ensure that NBAZ takes all appropriate actions necessary to recover the loan amount directly from the customer before withdrawing funds from the Guaranty Reserve Account.

15. Based on the $1.5 million in capital that would be provided by NBAZ, APS states that it would deposit $450,000 (30 percent) to establish the Guaranty Reserve Account. APS states that the funds used to create the Guaranty Reserve Account would come from funds generated from the revenues of day-to-day operations at APS that would otherwise be allocated to other Company investments. Staff believes that the Guaranty Reserve Account established by APS should not exceed $250,000. This will ensure that any risk to ratepayers will be minimized. APS is proposing the cost (discussed below) of the REEF program be recovered through its Demand-Side Management Adjustment Charge ("DSMAC").

Loan Terms, Loan Types, and Loan Amounts

16. The proposed REEF program would offer secured loans ranging from $5,000 to $20,000 with payment terms from 60 to 120 months. The proposed REEF program would also offer unsecured loans ranging from $1,000 to $20,000 with payment terms from 12 months to 60 months. In its application, APS states that it estimated that the average amount financed for a loan

would be approximately $5,000 based on the $1.5 million in capital from NBAZ. Staff believes that the maximum loan amount offered (and the maximum outstanding pre-interest loan balance) should be $10,000 rather than $20,000 per home. In addition, Staff believes that only secured loans be offered to customers. A secured loan would provide customers the opportunity of monthly repayment amounts that would be lower over a longer time period.

Risk Management

17. In its application, APS states that it and NBAZ have developed the following minimum criteria that a customer must meet in order to qualify for a loan:

- Meet the eligibility requirements of APS' REEF program
- Be an APS customer for a minimum of six months
- Be a customer in good standing with APS
- Not have filed for bankruptcy
- Meet the following underwriting requirements of NBAZ:
    - Employment stability (minimum of two years)
    - Credit history including Fair Isaac Corporation scores (>700 for unsecured loans and >650 for secured loans)
    - Risk of bankruptcy scores (<450 for unsecured loans and <600 for secured loans)
    - Meet maximum debt-to-income thresholds
    - Meet maximum loan-to-value thresholds for secured loans

18. APS states that when a loan becomes 60 days past due, NBAZ will then provide APS with written notice that it intends to offset the outstanding balance of a loan against the Guaranty Reserve Account once the loan becomes 90 days past due. At 90 days past due, NBAZ may then charge the Guaranty Reserve Account the outstanding balance of the loan.

Integration of Financing into the Overall Energy Efficiency Program

19. APS states that it intends for the REEF program to be fully integrated into the Home Performance Program. Participating contractors would be trained on providing customers with information regarding the REEF program. Customers would be able to apply by telephone during the contractor visit.

Ease of Use

20. APS states that participating contractors would receive detailed training on the REEF program from the lender. This will allow the contractors to offer the benefits of the REEF program at the same time they perform an energy audit in conjunction with the Home Performance Program. Customers would be able to be pre-approved over the phone at the time of the energy audit and would have access to several NBAZ branches for finalizing the loan.

Repayment Billing

21. APS' proposed REEF program includes the direct third-party billing option. APS states that this option offers the shortest implementation time frame and is the most cost-effective option. In addition, this option includes the optional quarterly energy savings report which will illustrate to customers their energy savings compared to the cost of financing.

PROGRAM COSTS

22. In its application, APS is proposing to recover the cost of its proposed REEF program through its DSMAC. In Decision No. 71460, the Commission granted APS a DSMAC of $0.001646 per kWh. Based on the program costs in the tables below for each option, APS has estimated the incremental impact each of the options would have on its DSMAC. The tables below show the estimated program costs of each of the four options for repayment billing previously described:

Option I: Direct Third Party Billing (APS' proposed option)

Category	Amount
Marketing	$50,000
Training	$10,000
Program Implementation	$65,000
IT modification to NBAZ system*	$30,000
Customer Incentive Cost	$50,000
Total	**$205,000**
DSMAC Incremental Increase (per kWh)	$0.000007

*Represents a one-time cost

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Option II: Parallel Billing

Category	Amount
Marketing	$50,000
Training	$10,000
Program Implementation	$114,000
IT modification to APS system*	$25,000
Customer Incentive Cost	$50,000
Total	**$249,000**
DSMAC Incremental Increase (per kWh)	$0.000009

*Represents a one-time cost

Option III: Partially Integrated "On-Bill"

Category	Amount
Marketing	$50,000
Training	$10,000
Program Implementation	$119,000
IT modification to APS and NBAZ	$150,000
Customer Incentive Cost	$50,000
Total	**$379,000**
DSMAC Incremental Increase (per kWh)	$0.000013

*Represents a one-time cost

Option IV: Fully Integrated "On-Bill"

Category	Amount
Marketing	$50,000
Training	$10,000
Program Implementation	$174,000
IT modification to APS and NBAZ	$800,000
Customer Incentive Cost	$50,000
Total	**$1,084,000**
DSMAC Incremental Increase (per kWh)	$0.000038

*Represents a one-time cost

RECOMMENDATIONS

23. Based on its analysis, Staff believes that APS' proposed financing program would allow participation from customers who otherwise would be unable to participate in residential energy efficiency measures. Therefore, Staff has recommended approval of the program with the following modifications:

- APS offer only secured loans to customers;
- The maximum loan amount offered (and the maximum pre-interest outstanding loan balance allowed) be reduced to $10,000 per home;

- The maximum amount of the Guaranty Reserve Account funded with ratepayer funds not exceed $250,000; and

- The maximum percentage that can be recovered by NBAZ from the Guaranty Reserve Account not exceed fifty percent of the outstanding loan amount.

24. In addition, Staff has recommended that APS docket with the Commission a copy of the final agreement reached with NBAZ within 30 days of executing the agreement.

25. Staff has further recommended that APS report on the REEF program in its DSM semi-annual report filed with the Commission, or in any succeeding form of report ordered by the Commission. The information and data reported should include the number and size of the loans, the number and size of the loans in default, the total amount found to be uncollectible, and any other information necessary for the Commission to understand the progress and status of the program, including any ongoing problems and their proposed solutions.

26. Staff has further recommended that any default or group of defaults that would significantly affect the functioning of the REEF program be reported to the Commission within 30 days of APS being notified, or otherwise becoming aware, of the affecting default or defaults.

27. Staff has further recommended that APS work to modify the loan requirements if it becomes necessary to address unanticipated problems. APS should file an application with the Commission for approval of any modifications.

28. While the Commission recognizes the concerns raised by Staff, we believe the Company's proposal is crafted to minimize ratepayer impacts. Under the proposal, NBAZ remains incented to pursue outstanding loans. Funds received pursuant to NBAZ's collection efforts will be used to replenish the Guaranty Reserve Account. Further, the experience of similar programs in other jurisdictions reflects minimal loan default rates. Accordingly, we believe it is in the public interest to approve the Company's proposal as designed, except that we believe it is appropriate to limit the individual loan amounts to a maximum of $20,000 for those projects with solar hot water heating and $15,000 for all other loans.

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CONCLUSIONS OF LAW

1. APS is an Arizona public service corporation within the meaning of Article XV, Section 2, of the Arizona Constitution.

2. The Commission has jurisdiction over APS and over the subject matter of the Application.

3. The Commission, having reviewed the application and Staff's Memorandum dated August 11, 2010, concludes that it is in the public interest to approve the APS request for approval of its Residential Repayment financing Program.

ORDER

IT IS THEREFORE ORDERED that Arizona Public Service Company's request for approval of its Residential Repayment Financing Program be and hereby is granted, except that we believe it is appropriate to limit the individual loan amounts to a maximum of $20,000 for those projects with solar hot water heating and $15,000 for all other loans.

IT IS FURTHER ORDERED that Arizona Public Service Company file, with the Commission's Compliance Section, a copy of the final agreement reached with National Bank of Arizona within 30 days of executing the agreement.

IT IS FURTHER ORDERED that Arizona Public Service Company report on the REEF program in its DSM semi-annual report filed with the Commission, or in any succeeding form of report ordered by the Commission. The information and data reported shall include the number and size of the loans, the number and size of the loans in default, the total amount found to be uncollectible, and any other information necessary for the Commission to understand the progress and status of the program, including any ongoing problems and their proposed solutions.

IT IS FURTHER ORDERED that any default or group of defaults that would significantly affect the functioning of the REEF program be reported to the Commission within 30 days of Arizona Public Service Company being notified, or otherwise becoming aware, of the affecting default or defaults.

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IT IS FURTHER ORDERED that Arizona Public Service Company work to modify the loan requirements if it becomes necessary to address unanticipated problems and file an application with the Commission for any modifications.

IT IS FURTHER ORDERED that this Order shall become effective immediately.

BY THE ORDER OF THE ARIZONA CORPORATION COMMISSION

CHAIRMAN

COMMISSIONER

COMMISSIONER

COMMISSIONER

COMMISSIONER

IN WITNESS WHEREOF, I, ERNEST G. JOHNSON, Executive Director of the Arizona Corporation Commission, have hereunto, set my hand and caused the official seal of this Commission to be affixed at the Capitol, in the City of Phoenix, this 31st day of August, 2010.

ERNEST G. JOHNSON
EXECUTIVE DIRECTOR

DISSENT: ____________________

DISSENT: ____________________

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