

OPEN MEETING ITEM



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COMMISSIONERS  
GARY PIERCE - Chairman  
BOB STUMP  
SANDRA D. KENNEDY  
PAUL NEWMAN  
BRENDA BURNS

ORIGINAL



ARIZONA CORPORATION COMMISSION

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2012 MAR -8 A 11: 32

AZ CORP COMMISSION  
DOCKET CONTROL

DATE: MARCH 8, 2012

DOCKET NOS.: W-02199A-11-0403 and SW-02199A-11-0404

TO ALL PARTIES:

Enclosed please find the recommendation of Administrative Law Judge Sarah N. Harpring. The recommendation has been filed in the form of an Order on:

PIMA UTILITY COMPANY  
(FINANCE)

Pursuant to A.A.C. R14-3-110(B), you may file exceptions to the recommendation of the Administrative Law Judge by filing an original and thirteen (13) copies of the exceptions with the Commission's Docket Control at the address listed below by 4:00 p.m. on or before:

MARCH 19, 2012

The enclosed is NOT an order of the Commission, but a recommendation of the Administrative Law Judge to the Commissioners. Consideration of this matter has tentatively been scheduled for the Commission's Open Meeting to be held on:

MARCH 27, 2012 and MARCH 28, 2012

For more information, you may contact Docket Control at (602) 542-3477 or the Hearing Division at (602) 542-4250. For information about the Open Meeting, contact the Executive Director's Office at (602) 542-3931.

Arizona Corporation Commission

DOCKETED

MAR - 8 2012

DOCKETED BY

ERNEST G. JOHNSON  
EXECUTIVE DIRECTOR

1 **BEFORE THE ARIZONA CORPORATION COMMISSION**

2 COMMISSIONERS

3 GARY PIERCE - Chairman  
4 BOB STUMP  
5 SANDRA D. KENNEDY  
6 PAUL NEWMAN  
7 BRENDA BURNS

7 IN THE MATTER OF THE APPLICATION OF  
8 PIMA UTILITY COMPANY, AN ARIZONA  
9 CORPORATION, FOR AUTHORITY TO: (1)  
10 ISSUE EVIDENCE OF INDEBTEDNESS IN AN  
11 AMOUNT NOT TO EXCEED \$8,370,000 IN  
12 CONNECTION WITH (A) INFRASTRUCTURE  
13 IMPROVEMENTS TO THE UTILITY SYSTEM  
14 AND (B) THE PURCHASE OF EQUITY; AND (2)  
15 ENCUMBER REAL PROPERTY AND PLANT AS  
16 SECURITY FOR SUCH INDEBTEDNESS.

DOCKET NO. W-02199A-11-0403

12 IN THE MATTER OF THE APPLICATION OF  
13 PIMA UTILITY COMPANY, AN ARIZONA  
14 CORPORATION, FOR AUTHORITY TO: (1)  
15 ISSUE EVIDENCE OF INDEBTEDNESS IN AN  
16 AMOUNT NOT TO EXCEED \$8,370,000 IN  
17 CONNECTION WITH (A) INFRASTRUCTURE  
18 IMPROVEMENTS TO THE UTILITY SYSTEM  
19 AND (B) THE PURCHASE OF EQUITY; AND (2)  
20 ENCUMBER REAL PROPERTY AND PLANT AS  
21 SECURITY FOR SUCH INDEBTEDNESS.

DOCKET NO. SW-02199A-11-0404

ORDER

18 Open Meeting  
19 March 27 and 28, 2012  
20 Phoenix, Arizona

21 **BY THE COMMISSION:**

22 Having considered the entire record herein and being fully advised in the premises, the  
23 Arizona Corporation Commission ("Commission") finds, concludes, and orders that:

24 \* \* \* \* \*

25 FINDINGS OF FACT

26 Background and Procedural History

27 1. Pima Utility Company ("Pima") is an Arizona Subchapter "S" Corporation and a  
28 Class "B" Arizona public service corporation that provides water and wastewater utility services in  
portions of Maricopa County, Arizona, including the community of Sun Lakes, pursuant to authority

1 granted by the Commission. (Application; Decision No. 62184 (January 5, 2000) at 22.) As of  
2 December 31, 2010, Pima's water system served approximately 10,175 connections, and its  
3 wastewater system served approximately 10,050 connections. (Application.)

4 2. The current rates and charges for Pima's water and wastewater systems were  
5 established in Decision No. 58743 (August 11, 1994) and Decision No. 62184 (January 5, 2000),  
6 respectively. Pima currently has permanent rate applications for both systems pending before the  
7 Commission.<sup>1</sup>

8 3. On November 8, 2011, Pima filed with the Commission identical financing  
9 applications, in separate dockets for its water system and wastewater system, requesting (1) authority  
10 to issue evidence of indebtedness in an amount not to exceed \$8,370,000; and (2) authority to  
11 encumber all of its real property and utility plant, for both its water and wastewater systems, as  
12 security for such indebtedness. Pima stated that it intended to obtain a loan, probably from Wells  
13 Fargo Bank, National Association ("Wells Fargo"), with the proceeds to be used for three purposes:  
14 (1) to replace existing debt at a reduced interest rate, (2) to fund infrastructure improvements to its  
15 wastewater system,<sup>2</sup> and (3) to buy back equity to rebalance its capital structure to reflect a higher  
16 amount of debt.

17 4. On November 16, 2011, Pima filed a Motion to Consolidate in each docket.

18 5. On December 2, 2011, a Procedural Order was issued consolidating the two dockets.

19 6. On December 22, 2011, Pima filed an Affidavit of Publication showing that notice of  
20 its financing applications had been published in the *Arizona Business Gazette*, a newspaper of general  
21 circulation in Maricopa County, on November 24, 2011.

22 7. On January 6, 2012, Pima filed a Notice of Filing Amended Exhibit, including a new  
23 Term Sheet for the proposed loan from Wells Fargo, which was filed to replace the one in the  
24 application.

25 8. On January 19, 2012, Pima filed a Notice of Errata correcting a typographical error

26 <sup>1</sup> The rate applications were filed on August 29, 2011, in Docket Nos. W-02199A-11-0329 and SW-02199A-11-0330,  
27 which have since been consolidated.

28 <sup>2</sup> Pima's application stated that infrastructure improvements would be made to both its water and wastewater systems.  
Pima later filed a Notice of Errata indicating that the infrastructure improvements would be made only to its wastewater  
system.

1 appearing in each financing application.

2 9. On February 7, 2012, the Commission's Utilities Division ("Staff") issued a Staff  
3 Report recommending approval of Pima's financing applications.

4 10. On February 15, 2012, Pima filed a Response to Staff Report, indicating that it takes  
5 no exception to the Staff Report, that it does not object to any of Staff's recommendations, and that it  
6 has not received any comments or requests for intervention in response to its published notice and  
7 thus believes that no hearing is necessary in this matter.

8 **Financing Proposal**

9 11. Pima proposes to obtain a loan in an amount not to exceed \$8,370,000, with a 5-year  
10 maturity and 15-year amortization, at an interest rate not to exceed 5.50 percent. (Application; Term  
11 Sheet.) The Term Sheet from Wells Fargo shows a loan in the amount of \$8,370,000, with a 5-year  
12 maturity and 15-year amortization, at an interest rate of "L"<sup>3</sup> plus 2.00 percent or "P"<sup>4</sup> plus 0.00  
13 percent. The Term Sheet states that the borrower can use an Interest Rate Swap to synthetically fix  
14 the LIBOR portion of the interest rate, which would result in a 3.65 percent "all-in rate." The Term  
15 Sheet further states that the collateral for the loan would be all of Pima's allowable assets, including a  
16 revenue pledge, as well as a negative pledge on plant assets/infrastructure.

17 12. Pima proposes to use the proceeds from the loan for the following:

- 18 a. To fund force main replacement projects in the wastewater system and  
19 refurbish certain outdated wastewater facilities, at a cost of approximately  
20 \$1,500,000;
- 21 b. To refinance \$4,370,000 in existing Industrial Development Authority ("IDA")  
22 bonds at a lower interest rate;<sup>5</sup> and
- 23 c. To buy back \$2,500,000 of equity using debt capital, which would result in a  
24 more balanced capital structure that will lower the cost of capital to the benefit  
25 of ratepayers.

26  
27 <sup>3</sup> "L" is understood to mean LIBOR, which stands for London Interbank Offer Rate. (See Term Sheet; Staff Report.)

<sup>4</sup> Although its meaning is not stated on the Term Sheet, "P" is understood to signify the Prime Rate.

28 <sup>5</sup> Pima noted that there is no prepayment penalty related to the IDA bonds and that the debt was approved in Decision No. 59130 (June 27, 1995). (Application.)

1 **Wastewater Facilities; Engineering Analysis**

2 13. Staff performed an engineering analysis to determine whether Pima's proposed  
3 wastewater system improvement project, known as the Hunt Highway-Price Road Force Main  
4 Improvements ("Improvement Project"), is appropriate and whether its \$1,500,000 projected cost is  
5 reasonable. (Staff Engineering Report.)

6 14. Pima's wastewater system consists of a Water Reclamation Facility ("WRF"), a reuse  
7 system, and a collection system. (*Id.*) The WRF has a 2.4 million gallon per day sequential batch  
8 reactor treatment plant, a wastewater collection system with 15 collection lift stations, and  
9 approximately 99.6 miles of wastewater mains serving Pima's approximately 10,050 service  
10 connections. (*Id.*) The effluent from the WRF is directly delivered to the Oakwood Golf Course.  
11 (*Id.*) The effluent reuse system includes five recharge/recovery wells, which are used to deliver  
12 recovered effluent to the Oakwood Golf Course and to a Home Owners Association for landscape  
13 watering. (*Id.*)

14 15. The Arizona Department of Environmental Quality ("ADEQ") reported on December  
15 12, 2011, that Pima's WRF was in compliance with ADEQ regulations. (*Id.*) Staff's Compliance  
16 Section has also reported that Pima has no delinquent compliance issues. (*Id.*)

17 16. The Improvement Project would reroute flows from four existing lift stations to a new  
18 major lift station and force main system, for direct delivery to the WRF, which is expected to  
19 improve wastewater collection efficiency and to ease the burden on the remaining downstream lift  
20 stations and lines, some of which are operating beyond capacity. (*Id.*) The Improvement Project  
21 would also result in abandonment of an existing force main that has reached the end of its useful life.  
22 (*Id.*)

23 17. A breakdown of the components of the Improvement Project, with their projected  
24 costs, is attached hereto and incorporated herein as Exhibit 1. Exhibit 1 shows that the total projected  
25 cost for the Improvement Project is \$1,517,321.61, which breaks down into the following major  
26 categories and costs:

27 ...  
28 ...

Category	Projected Cost
Piping	\$865,258.61
Valves & Fittings	\$201,365.00
Lift Station Improvements	\$375,000.00
Pavement Replacement	\$25,698.00
Traffic Control	\$50,000.00
<b>Total</b>	<b>\$1,517,321.61</b>

18. Staff determined that the Improvement Project is appropriate and that the projected costs for the Improvement Project are reasonable. (Staff Engineering Report.) Staff did not make a “used and useful” determination regarding the proposed Improvement Project items, and no particular treatment for future ratemaking or rate base purposes should be inferred. (*Id.*)

#### **Financial Analysis**

19. 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. (Staff Report.) A DSC greater than 1.0 indicates that cash flow from operations is sufficient to cover debt obligations, while a DSC lower than 1.0 indicates that cash generated from operations is not sufficient to cover debt service obligations and that another source of funds is needed to avoid default. (*Id.*)

20. Staff’s analysis of the impact the proposed financing would have on Pima’s finances is set forth in Schedule JAC-1 to the Staff Report, which is attached hereto as Exhibit 2 and incorporated herein. Exhibit 2 shows that, for year ending December 31, 2010, Pima had a DSC of 2.68, indicating sufficient cash flow from operations to cover Pima’s debt obligations. Staff determined that with the addition of the proposed \$8,370,000 loan, at an interest rate of 5.50 percent and with a 5-year maturity and 15-year amortization, Pima would have a DSC of 3.04, also indicating sufficient cash flow from operations to cover debt obligations. Staff’s analysis then went further, with what Staff described as a “stringent test,” and determined that even if the \$8,370,000 loan were fully amortized over only 5 years, Pima would have a DSC of 1.30, still indicating a sufficient cash flow from operations to cover its debt obligations. Staff noted that Pima does not have any existing

1 unused authorizations to issue evidence of indebtedness and also factored into its analysis \$1.755  
2 million in 2011 IDA payments not to be financed by the proposed loan. (Staff Report.)

3 21. As of December 31, 2010, Pima's capital structure consisted of 2.0 percent short-term  
4 debt, 22.0 percent long-term debt, and 76.0 percent equity. (Staff Report.) When Advances in Aid of  
5 Construction ("AIAC") and Contributions in Aid of Construction ("CIAC") are considered, Pima's  
6 capital structure on that date consisted of 1.9 percent short-term debt, 21.2 percent long-term debt,  
7 73.4 percent equity, 2.5 percent AIAC, and 1.0 percent CIAC. (*Id.*) Staff calculated that the pro  
8 forma capital structure resulting from approval of the proposed loan (with the proposed 15-year  
9 amortization) would be 1.5 percent short-term debt, 31.6 percent long-term debt, and 66.9 percent  
10 equity and, if AIAC and CIAC are considered, 1.4 percent short-term debt, 30.5 percent long-term  
11 debt, 64.5 percent equity, 2.5 percent AIAC, and 1.0 percent CIAC.<sup>6</sup> (*Id.*) Staff determined that  
12 Pima's buying back \$2,500,000 in equity with loan proceeds would result in a capital structure that is  
13 still equity rich, although to a lesser degree than Pima's current capital structure and, further, that the  
14 proposed capital structure rebalancing is reasonable because of Pima's strong balance sheet,  
15 historically good operating results, continuing equity-rich capital structure, and professional financial  
16 management. (*Id.*)

17 22. Staff concluded that Pima's proposal to refinance \$4,370,000 of existing IDA bonds at  
18 a lower interest rate is appropriate and that its proposal to rebalance its capital structure by replacing  
19 \$2,500,000 of equity with debt is reasonable.

20 23. Staff further concluded that issuance of the proposed debt financing for the purposes  
21 stated in the application is within Pima's corporate powers, is compatible with the public interest, will  
22 not impair Pima's ability to provide services, and is consistent with sound financial practices.

### 23 Staff Recommendations

24 24. Staff recommends approval of Pima's requested financing under the following terms  
25 and conditions:

26 a. Pima should be authorized to incur a 15-year amortizing loan, in an amount not

27 <sup>6</sup> Staff noted that a private and investor-owned utility's combined AIAC and net CIAC funding generally should not  
28 exceed 30 percent of total capital, including AIAC and net CIAC, and calculated Pima's pro forma AIAC and CIAC  
funding ratio at 3.6 percent, well within this guideline. (*See Exhibit 2.*)

1 to exceed \$8,370,000, with a 5- to 7-year maturity date, at an interest rate not to  
2 exceed 5.5 percent per annum, for the purposes stated in the Company's  
3 application.

4 b. Pima should be authorized to pledge its assets in the State of Arizona pursuant  
5 to A.R.S. § 40-285 in connection with any indebtedness authorized in this  
6 proceeding.

7 c. Any unused authorization to incur debt granted to Pima in this proceeding  
8 should expire on December 31, 2013.

9 d. Pima should be authorized to engage in any transaction and to execute any  
10 documents necessary to effectuate the authorizations granted herein.

11 e. Pima should be required to file with Docket Control, as a compliance item in  
12 this docket, within 60 days after the execution of any financing transaction  
13 authorized herein, copies of the loan documents executed for the financing.

14 f. Pima should be required to file with Docket Control, as a compliance item in  
15 this docket, by June 30, 2013, a copy of the ADEQ/Maricopa County  
16 Certificate for Approval to Construct for the Improvement Project.

17 **Conclusion**

18 25. Staff's recommendations, as described herein, are reasonable and appropriate, and we  
19 will adopt them.

20 **CONCLUSIONS OF LAW**

21 1. Pima is a public service corporation within the meaning of Article XV of the Arizona  
22 Constitution and A.R.S. §§ 40-285, 40-301, 40-302, and 40-303.

23 2. The Commission has jurisdiction over Pima and the subject matter of the financing  
24 application.

25 3. Notice of the financing application was provided in accordance with the law.

26 4. The financing approved herein is for lawful purposes within Pima's corporate powers,  
27 is compatible with the public interest, with sound financial practices, and with the proper  
28 performance by Pima of service as a public service corporation and will not impair Pima's ability to

1 perform the service.

2 5. The financing approved herein is for the purposes stated in the application and is  
3 reasonably necessary for those purposes, and such purposes are not, wholly or in part, reasonably  
4 chargeable to operating expenses or to income.

5 6. Approval of the proposed financing is not intended to, and should not be interpreted  
6 to, guarantee or imply any specific treatment of any capital additions for rate base or ratemaking  
7 purposes.

8 7. Staff's recommendations, as described herein, are reasonable and appropriate and  
9 should be adopted.

10 **ORDER**

11 IT IS THEREFORE ORDERED that Pima Utility Company is hereby authorized to incur a  
12 15-year amortizing loan, in an amount not to exceed \$8,370,000, with a 5- to 7-year maturity date, at  
13 an interest rate not to exceed 5.5 percent per annum, for the purposes stated in Pima Utility  
14 Company's financing application.

15 IT IS FURTHER ORDERED that Pima Utility Company is hereby authorized to pledge,  
16 mortgage, lien and/or encumber its assets in the State of Arizona pursuant to A.R.S. § 40-285 in  
17 connection with the indebtedness authorized in this Decision.

18 IT IS FURTHER ORDERED that any unused authorization to incur debt granted in this  
19 proceeding shall expire on December 31, 2013.

20 IT IS FURTHER ORDERED that Pima Utility Company is authorized to engage in any  
21 transaction and to execute any documents necessary to effectuate the authorizations granted herein.

22 IT IS FURTHER ORDERED that Pima Utility Company's authority to incur the loan  
23 described in the first ordering paragraph herein, and to encumber its assets pursuant to the second  
24 ordering paragraph herein, is conditioned on Pima Utility Company's compliance with the  
25 requirements set forth in the following ordering paragraphs.

26 IT IS FURTHER ORDERED that Pima Utility Company shall file with Docket Control, as a  
27 compliance item in this docket, within 60 days after the execution of any financing transaction  
28 authorized herein, copies of all executed financing documents related to the authorizations granted

1 herein.

2 IT IS FURTHER ORDERED that Pima Utility Company, shall file with Docket Control, as a  
3 compliance item in this docket, by June 30, 2013, a copy of the Arizona Department of  
4 Environmental Quality/Maricopa County Certificate for Approval to Construct for the Hunt  
5 Highway-Price Road Sewer Force Main Improvement Project.

6 IT IS FURTHER ORDERED that approval of the financing set forth herein does not  
7 constitute or imply approval or disapproval by the Commission of any particular expenditure of the  
8 proceeds derived thereby for purposes of establishing just and reasonable rates.

9 IT IS FURTHER ORDERED that this Decision shall become effective immediately.

10 BY ORDER OF THE ARIZONA CORPORATION COMMISSION.

11  
12  
13 CHAIRMAN

COMMISSIONER

14  
15 COMMISSIONER

COMMISSIONER

COMMISSIONER

16  
17 IN WITNESS WHEREOF, I, ERNEST G. JOHNSON,  
18 Executive Director of the Arizona Corporation Commission,  
19 have hereunto set my hand and caused the official seal of the  
20 Commission to be affixed at the Capitol, in the City of Phoenix,  
21 this \_\_\_\_\_ day of \_\_\_\_\_, 2012.

22 \_\_\_\_\_  
ERNEST G. JOHNSON  
EXECUTIVE DIRECTOR

23 DISSENT \_\_\_\_\_

24  
25 DISSENT \_\_\_\_\_

1 SERVICE LIST FOR: PIMA UTILITY COMPANY  
2 DOCKET NOS.: W-02199A-11-0403 and SW-02199A-11-0404

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## EXHIBIT 2

Pima Utility Company  
Docket No. W-02199A-11-0403  
Docket No. SW-02199A-11-0404  
Application For Financing

Schedule JAC-1

## FINANCIAL ANALYSIS

## Selected Financial Information

	[A] <sup>1</sup> 12/31/2010		[B] <sup>2</sup> Pro Forma		[C] <sup>3</sup> Pro Forma	
1 Operating Income	\$ 1,314,000		\$ 1,314,000		\$ 1,314,000	
2 Depreciation & Amort.	1,180,000		1,180,000		1,180,000	
3 Income Tax Expense	0		0		0	
4						
5 Interest Expense	461,000		451,127		423,025	
6 Repayment of Principal	470,000		369,552		1,495,496	
7						
8						
9						
10						
11 <b>DSC</b>						
12 [1+2+3] + [5+6]	2.68		3.04		1.30	
13						
14						
15						
16						
17 <b>Capital Structure</b>						
18						
19 Short-term Debt	505,000	2.0%	369,552	1.5% <sup>4</sup>	1,495,496	5.9% <sup>4</sup>
20						
21 Long-term Debt	5,620,000	22.0%	8,000,448	31.6%	6,874,504	27.2%
22						
23 Common Equity	19,432,000	76.0%	16,932,000	66.9%	16,932,000	66.9%
24						
25 Total Capital	\$25,557,000	100.0%	\$25,302,000	100.0%	\$25,302,000	100.0%
26						
27						
28 <b>Capital Structure (inclusive of AIAC and Net CIAC)</b>						
29						
30 Short-term Debt	505,000	1.9%	369,552	1.4%	1,495,496	5.7%
31						
32 Long-term Debt	5,620,000	21.2%	8,000,448	30.5%	6,874,504	26.2%
33						
34 Common Equity	19,432,000	73.4%	16,932,000	64.5%	16,932,000	64.5%
35						
36 Advances in Aid of Construction ("AIAC")	660,000	2.5%	660,000	2.5%	660,000	2.5%
37						
38 Contributions in Aid of Construction ("CIAC") <sup>5</sup>	274,000	1.0%	274,000	1.0%	274,000	1.0%
39						
40 Total Capital (Inclusive of AIAC and CIAC)	\$26,491,000	100.0%	\$26,236,000	100.0%	\$26,236,000	100.0%
41						
42						
43 <b>AIAC and CIAC Funding Ratio<sup>6</sup></b>	3.5%		3.6%		3.6%	
44 (36+38)/(40)						

46 <sup>1</sup> Column [A] is based on financial information for the year ended December 31, 2010.

47 <sup>2</sup> Column [B] is Column [A] modified to reflect issuance of the proposed \$8,370,000 debt financing maturing in 5 years, and amortized for 15 years at 5.5 percent per annum.

48 <sup>3</sup> \$1.755 million IDA payments in 2011 not financed by the proposed loan, \$4.37 million in IDA Bond repayments and \$2.5 million in equity buy back.

49 <sup>4</sup> Column [C] is Column [B] modified to reflect full amortization of the proposed \$8,370,000 loan over its 5-year term versus a 15-year amortization.

50 <sup>5</sup> Pro Forma Short-term Debt represents the first year principal repayment on the proposed loan.

51 <sup>6</sup> Net CIAC balance (i.e. less: accumulated amortization of contributions).

52 <sup>7</sup> Staff typically recommends that combined AIAC and Net CIAC funding not exceed 30 percent of total capital, inclusive of AIAC and Net CIAC,  
53 for private and investor owned utilities.

DECISION NO. \_\_\_\_\_