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ORIGINAL

Arizona Corporation Commission
DOCKETED
MAY 20 2014
DOCKETED BY

TO: Docket Control

FROM: Steven M. Olea
Director
Utilities Division

DATE: May 20, 2014

RE: SUPPLEMENTAL STAFF REPORT FOR TRICO ELECTRIC COOPERATIVE, INC.'S APPLICATION FOR AUTHORIZATION TO BORROW UP TO $20 MILLION FROM THE NATIONAL RURAL UTILITIES COOPERATIVE FINANCE CORPORATION AND CoBANK, ACB
(DOCKET NO. E-01461A-14-0039)

Attached is the Supplemental Staff Report for Trico Electric Cooperative, Inc.'s application for authorization to obtain two committed revolving lines of credit in the combined amount of $20 million. Staff recommends approval of the requested authorization.

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 May 30, 2014.

SMO:CLP:tdp | BES

Originator: Christine Payne

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Docket No. E-01461A-14-0039

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SUPPLEMENTAL
STAFF REPORT
UTILITIES DIVISION
ARIZONA CORPORATION COMMISSION

TRICO ELECTRIC COOPERATIVE, INC.
DOCKET NO. E-01461A-14-0039

APPLICATION FOR AUTHORIZATION TO BORROW
UP TO $20 MILLION FROM THE NATIONAL RURAL
UTILITIES COOPERATIVE
FINANCE CORPORATION AND CoBANK, ACB
(DOCKET NO. E-01461A-14-0039)

MAY 20, 2014

STAFF ACKNOWLEDGMENT

The Supplemental Staff Report for Trico Electric Cooperative, Inc., Docket No. E-01461-A-14-0039 is the responsibility of the Staff members listed below. Christine Payne is responsible for the financial analysis. Ed Stoneburg is responsible for the engineering and technical analysis.

CHRISTINE PAYNE
PUBLIC UTILITIES ANALYST II

ED STONEBURG
UTILITIES ENGINEER

EXECUTIVE SUMMARY
TRICO ELECTRIC COOPERATIVE, INC.
DOCKET NO. E-01461A-14-0039

Trico Electric Cooperative, Inc., ("Trico" or "Cooperative") is a member-owned cooperative and a Class "A" public service corporation providing electric distribution service to approximately 41,000 metered customers in parts of Pima, Pinal and Santa Cruz Counties, Arizona. On February 7, 2014, Trico filed an application with the Arizona Corporation Commission ("Commission") requesting authorization to borrow up to $20,000,000 in the form of two revolving lines of credit ("RLOC") for $10,000,000 each from National Rural Utilities Cooperative Finance Corporation ("CFC") and CoBank, ACB ("CoBank").

The purpose of the RLOCs is to provide Trico with authority for interim financing of capital improvements similar to the authority granted in Decision No. 66779 (February 13, 2004) which expired February, 2014.

Staff recommends conditional approval of Trico's request to borrow an amount not to exceed $20,000,000 from CFC and CoBank in the form of two $10,000,000 RLOC agreements, each with a ten-year term.

Staff Conclusions and Recommendations:

- Staff concludes that it is in the public interest for Trico to have $20 million of new funding available to finance its 2013-2016 budgets for capital improvements. Staff also concludes that any borrowing authorizations granted to Trico in this proceeding should be subject to the condition that a pro forma Debt Service Coverage ("DSC") calculation using its most recent annual financial report reflecting the additional borrowing results in a minimum DSC of 1.35.

- Staff recommends that any unused debt issuance authorization granted in this proceeding terminates ten years from the date of the Commission decision in this financing approval application.

- Staff further recommends that Trico be ordered to file with Docket Control, as a compliance item in this docket, an annual report no later than April 15th of each year demonstrating compliance with the DSC debt issuance covenants stipulated above for any debt issued in the preceding calendar year. The first such report shall be due no later than April 15, 2015.

- Staff further recommends authorizing Trico to engage in any transaction and to execute any documents necessary to effectuate the authorization herein granted.

- Staff further recommends that Trico be ordered to provide the Utilities Division Director, within 60 days of closing of the loans, a copy of all executed loan documents and file a letter with Docket Control, as a compliance item in this docket, verifying that a copy of the loan documents was provided to the Director.

- Staff concludes that issuance of the two proposed RLOCs for the purposes stated in the application is within Trico's corporate powers, is compatible with the public interest, is consistent with sound financial practices and will not impair its ability to provide services.

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INTRODUCTION

On February 7, 2014, Trico Electric Cooperative, Inc., ("Trico" or "Cooperative") filed an application with the Arizona Corporation Commission ("Commission") requesting authorization to borrow up to $20,000,000 in the form of two revolving lines of credit for $10,000,000 each from National Rural Utilities Cooperative Finance Corporation ("CFC") and CoBank, ACB ("CoBank"). This new financing authority will replace the authority granted Trico in Decision No. 66779[1] which expired on February, 2014. Trico will use this financing authority to fund capital projects identified in Trico's 2013 – 2016 Construction Work Plan ("CWP") on an interim basis prior to obtaining long term financing from the Rural Utilities Services ("RUS").

PUBLIC NOTICE

On March 24, 2014, Trico filed an affidavit verifying that notice of its financing application was published. The Cooperative published notice in the *Daily Territorial* on March 6, 2014, March 13, 2014, and March 20, 2014. The *Daily Territorial* is a weekly newspaper of general circulation serving Pima County.

COMPLIANCE

As of March 13, 2014, a check of the Commission Compliance Database indicates that there currently are no delinquencies pending for Trico.

BACKGROUND

Trico is a non-profit member-owned cooperative and a Class "A" public service corporation. Trico provides electric distribution service to approximately 41,000 metered customers in parts of Pima, Pinal and Santa Cruz Counties in Arizona. Its principal place of business is located at 8600 W. Tangerine Road, Marana, Arizona, 85658.

Trico has no generating capacity of its own and contracts with the Arizona Electric Power Cooperative, Inc. ("AEPCO") for the majority of its electric power supply.

Trico's current rates were approved in Decision No. 71253[2] on September 2, 2009.

PURPOSE OF THE PROPOSED FINANCING

The Commission granted Trico authority to borrow an amount not to exceed $25 million from CFC in the form of a Revolving Line of Credit ("RLOC") in Decision No. 66779[3] (February 13, 2004). Trico is currently requesting authority from the Commission to borrow an amount not to

[1] Docket No. E-01461A-03-0607
[2] Docket No. E-01461A-08-0430
[3] Docket No. E-01461A-03-0607

exceed $20 million in the form of two RLOCs for $10 million each from CFC and CoBank. The minimum Debt Service Charge ("DSC") requirement for both CFC and CoBank is 1.35.

As stated in the financing application, the purpose of the proposed financing is to provide Trico short-term borrowing capacity for its Construction Work Plan ("CWP") for the period 2013 – 2016[4] (outlined on page 2 of the Engineering Report) until permanent long-term financing can be obtained for future capital projects. Trico will repay any outstanding balance to CFC and CoBank.

Trico's current CWP of $83.98 million includes estimates for continued growth in residential line extensions and accompanying system improvement construction projects. Trico states in its financing application that the economic recession that occurred from 2008 - 2012 and the 2009 Commission-approved modifications to Trico's Line Extension Policy ("LEP") have drastically reduced Trico's actual CWP spending.

FINANCIAL ANALYSIS

Debt Service Coverage

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 may be needed to avoid default under certain conditions.

Staff's financial analysis is summarized on Schedule CLP-1. The information presented under each of the four columns reflect the debt service requirements under four different loan draw down scenarios, as explained below. Column A of the schedule reflects Trico's actual, historic financial information for the year ended December 31, 2012. Column B presents the actual results from Column A plus the fully annualized loan funding requirements associated with the assumed draw down of all of the $39,400,000 existing, but not used, current loan authorization. Column C presents actual results from Column A plus the fully annualized loan funding requirements associated with the assumed draw down of the entire $20,000,000 in RLOC addressed in Trico's pending financing application. Column D reflects the fully annualized loan funding expenditures that would exist if Trico drew the entire $83,980,000 in long-term debt. Note that the $20,000,000 RLOC does not impact Column D results because the RLOC is effectively a bridge loan that would ultimately be retired through draws against the primary $83,980,000 RUS loan arrangement.

[4] Trico's financing application states the CWP was for the period 2013-2017. However, based upon Trico's responses to Staff data requests and as confirmed by Trico, the CWP for the purposes of this financing application should be for the period 2013-2016.

2012 Financial Results - Scenario A

The Cooperative's capital structure at December 31, 2012, consists of 1.68 percent short term debt, 60.83 percent long-term debt, and 37.50 percent equity. The DSC for 2012 was 1.95. Authorization of the proposed committed RLOCs will not affect Trico's capital structure until the Cooperative makes a draw upon the funds.

Issuance of Unused Debt - Scenario B

At December 31, 2012, Trico had approximately $39,400,000 of unused authorization to incur debt. A pro forma capital structure that modifies scenario A to reflect issuance of this unused authorization consists of 1.60 percent short-term debt, 66.73 percent long-term debt, and 31.67 percent equity. The pro forma DSC for Scenario B is 1.54. CFC[5] and CoBank[6] loan covenants both require a 1.35 DSC. The pro forma DSC results show Trico has sufficient margins and cash flow to meet its debt obligations and meet the minimum DSC loan covenants required by both CFC and CoBank in this scenario.

Issuance of the Proposed $20.00 Million Loan - Scenario C

Trico requests authorization to issue $20,000,000 to obtain interim financing to continue its CWP. Staff's capital structure in scenario C reflects issuance of the proposed $20,000,000 debt plus the existing debt of $44,580,000. Scenario C illustrates the pro forma results of 2.49 percent short-term debt, 66.53 percent long-term debt, and 30.98 percent equity with the $20,000,000 proposed financing and the existing debt of $44,580,000. The pro forma DSC for scenario C is 1.07. These results reflect a stress test since Trico anticipates drawing the funds over a five-year period beginning in 2014. Since the DSC requirements apply to two of the past three years, if the Cooperative falls short of these parameters in any one year, it has an opportunity to pursue corrective measures for compliance in subsequent years.

Issuance of the $83,980,000 Line of Credit - Scenario D

In Staff's capital structure in scenario D, Staff assumes complete draw down of the $83,980,000 line of credit. Scenario D illustrates the pro forma results of 2.18 percent short term debt, 74.28 percent long-term debt, and 23.54 percent equity. The pro forma DSC for scenario D is 0.82.

Trico's projections, which represent unknown assumptions about future results, show that it has the ability to meet debt service obligations including the proposed debt issuance. While Trico's projections may be reasonable, Staff concludes that these projections of financial performance are not sufficiently reliable to serve as a basis for unconditionally granting the requested debt issuance authorization with scenarios C and D illustrated on Staff's Financial Analysis (Schedule CLP-1).

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[5] RUS Loan Agreement, page 7, Article V Covenants, Section 5.01 (A) Financial Ratios: Design of Rates
[6] CoBank's Master Loan Agreement, page 8, Section 9 (B)

Since the DSC requirements apply to two of the past three years, if the Cooperative falls short of these parameters in any one year, it has an opportunity to pursue corrective measures for compliance in subsequent years.

As illustrated on Schedule CLP-1, Trico does not have enough cash flow to meet all of its debt obligations assuming that the unused authorization is entirely drawn down. For this reason, Staff recommends amounts drawn on the proposed and existing lines of credit granted in this proceeding are conditional as long as Trico meets the minimum 1.35 DSC requirements by both CFC and CoBank.

Staff further recommends that Trico be ordered to file with Docket Control, as a compliance item in this docket, an annual report no later than April 15th each year demonstrating compliance with the DSC debt issuance covenants for any debt issued in the preceding calendar year. The first such report shall be due no later than April 15, 2015.

Encumbrance

The terms of the anticipated loans provide for encumbrance of all Trico's assets and revenues. A.R.S. § 40-301 requires public service corporations to obtain Commission authorization to encumber certain utility assets. The statute serves to protect captive customers from a utility's act to dispose of any of its assets that are necessary for the provision of service; thus, it serves to preempt any service impairment due to disposal of assets essential for providing service. Pledging assets as security typically provides benefits to the borrower in the way of increased access to capital funds or preferable interest rates, and it is often an unavoidable condition for procurement of funds for small or financially stressed entities.

STAFF CONCLUSIONS AND RECOMMENDATIONS

- Staff concludes that it is in the public interest for Trico to have $20 million of new funding available to finance its 2013-2016 budgets for capital improvements. Staff also concludes that any borrowing authorizations granted to Trico in this proceeding should be subject to the condition that a pro forma DSC calculation using its most recent annual financial report reflecting the additional borrowing results in a minimum DSC of 1.35.

- Staff recommends that any unused debt issuance authorization granted in this proceeding terminates ten years from the date of the Commission decision in this financing approval application.

- Staff further recommends that Trico be ordered to file with Docket Control, as a compliance item in this docket, an annual report no later than April 15th each year demonstrating compliance with the DSC debt issuance covenants stipulated above for any debt issued in the preceding calendar year. The first such report shall be due no later than April 15, 2015.

- Staff further recommends authorizing Trico to engage in any transaction and to execute any documents necessary to effectuate the authorization herein granted.

- Staff further recommends that Trico be ordered to provide the Utilities Division Director, within 60 days of closing of the loans, a copy of all executed loan documents and file a letter with Docket Control, as a compliance item in this docket, verifying that a copy of the loan documents was provided to the Director.

- Staff concludes that issuance of the two proposed RLOCs for the purposes stated in the application is within Trico's corporate powers, is compatible with the public interest, is consistent with sound financial practices and will not impair its ability to provide services.

Schedule CLP -1

TRICO Electric Cooperative, Inc.
Docket No. E-01461A-14-0039
Application For Financing

FINANCIAL ANALYSIS

Selected Financial Information

Line		[A][1] 12/31/2012		[B][2] Pro Forma		[C][3] Pro Forma		[D][4] Pro Forma	
1	Operating Income	$ 11,044,983		$ 11,044,983		$ 11,044,983		$ 11,044,983	
2	Depreciation & Amort.	6,507,489		6,507,489		6,507,489		6,507,489	
3	Income Tax Expense	0		0		0		0	
5	Interest Expense	5,713,480		7,685,635		10,531,922		14,710,309	
6	Repayment of Principal	3,289,101		3,712,163		5,915,678		6,823,331	
8	**TIER**								
9	[1+3] ÷ [5]	1.93		1.45		1.05		0.75	
11	**DSC**								
12	[1+2+3] ÷ [5+6]	1.95		1.54		1.07		0.82	
14		11044983							
15	**Capital Structure**								
17	Short-term Debt	3,289,101	1.68%	3,712,163	1.60%	5,915,678	2.49%	6,823,331	2.18% (5)
19	Long-term Debt	119,439,132	60.83%	155,126,969	66.73%	158,103,454	66.53%	232,283,638	74.28%
21	Common Equity (6)	73,624,204	37.50%	73,624,204	31.67%	73,624,204	30.98%	73,624,204	23.54%
23	Total Capital	$ 196,352,437	100.00%	$232,463,336	100.00%	$237,643,336	100.00%	$ 312,731,173	100.00%

[1] Column [A] is based on Trico's actual historic financial information for the year ended December 31, 2012.
[2] Column [B] is Column [A] with the assumption of the $39,400,000 existing unused authorization draw down @ 5.03% interest rate for 35 years.
[3] Column [C] is Column [A] reflects fully annualized loan expenditures of the $20,000,000 proposed debt funding @ 3.2% interest rate for 10 years.
[4] Column [D] is a stress test that reflects a full draw down of the $83,980,000 at 5.03% interest rate for 35 years.
[5] Pro Forma short-term debt includes the first year principal of the pro forma loan.
[6] Staff typically recommends common equity to or greater than 30 percent of total capital for the Cooperative.

ATTACHMENT A

REVISED MEMORANDUM

TO: Christine Payne
Public Utilities Analyst II
Utilities Division

FROM: Edward Stoneburg EGS
Electric Utilities Engineer
Utilities Division

DATE: April 15, 2014

RE: **ENGINEERING REPORT – TRICO ELECTRIC COOPERATIVE, INC'S FINANCING APPLICATION DATED FEBRUARY 7, 2014 DOCKET NO. E-01461A-14-0039 - REVISED**

I. INTRODUCTION

Trico Electric Cooperative, Inc. ("Trico" or "Cooperative") submitted an application to the Arizona Corporation Commission ("Commission") for authorization to borrow up to $20,000,000 in the form of revolving lines of credit for $10,000,000 each from National Rural Utilities Cooperative Finance Corporation and CoBank, ACB. This new financing authority will replace the authority granted Trico in Decision No. 66779, which expired in February 2014. Trico will use this financing authority to fund capital projects identified in Trico's 2013 – 2016[1] Construction Work Plan ("CWP") on an interim basis prior to obtaining long term financing from the Rural Utilities Services ("RUS"). Trico stated in its Application that it intends to make application to the RUS and the Commission at some point in the future for a new long term CWP loan for the 2013 - 2016 time frame.

II. TRICO OVERVIEW

Trico is headquartered in Marana, Arizona, and provides electric service to approximately 41,000 members in an area around the City of Tucson. Trico is a partial-requirement member of Arizona Electric Power Cooperative ("AEPCO") and receives transmission service from Southwest Transmission Cooperative, Inc. ("SWTC"). The Cooperative's retail load peak was 195 MW in 2013.

As with most of Arizona, growth in Trico's service area was negatively impacted by the economic downturn over the past few years. This resulted in a number of projects in Trico's 2007 – 2010 CWP being deferred due to lower load growth, some of which are included in the 2013-2016 CWP. Trico stated in its Application that it expects to have unexpended funds of $30 million of the

[1] The Application stated the CWP was for 2013-2017. However, based upon Trico's responses to Staff data requests and as confirmed by Trico, the CWP is only for 2013-2016.

$83.98 million approved for its 2007 – 2010 CWP. Trico's financing authority for the $83.98 million expires July 31, 2014.

III. ENGINEERING REVIEW OF TRICO'S CONSTRUCTION WORK PLAN

Staff has reviewed Trico's 2013-2016 Construction Work Plan using the following criteria:

- Does the CWP adequately address the needs of the projected customer and load growth in Trico's service territory?
- Are the capital expenditures on transmission and distribution infrastructure upgrades and new additions appropriate and reasonable?
- Is the Cooperative operating and maintaining its electric system in a reliable manner?

Trico's 2013 – 2016 CWP is based upon a forecast of customer growth and related load growth prepared in 2012. The CWP notes that Trico has seen a strengthening of the economy in its service area with an increase in applications for new service during 2013 compared to previous years. In addition to line extensions to serve new customers, Trico anticipates needing other system improvements and upgrades to meet increased system loads and to maintain reliability. The CWP documents the engineering analysis completed for Trico by C.H. Guernsey & Company that examined the existing and forecast system capacity and operating conditions. Based upon that analysis, system improvements and additions were identified that Trico believes are necessary to provide adequate and dependable service to its members through 2016. The CWP budget for 2013-2016, totaling $30,589,542, is summarized in Table 1.

Table 1
SUMMARY OF TRICO CONSTRUCTION WORK PLAN COSTS 2013-2016
($000)

Category	2013	2014	2015	2016	Total
Member Extensions (Net of CIAC*)	$ 167	$ 203	$ 250	$ 276	$ 896
Tie Lines	181	2,015	1,045	370	3,611
Distribution Line Upgrades, Rebuilds (Net of CIAC**)	4,316	3,435	4,366	2,126	14,243
Substations	0	0	0	2,500	2,500
Misc. & Other Distribution Equipment	3,746	438	2,057	3,098	9,339
Total	**$8,410**	**$6,091**	**$7,718**	**$8,370**	**$30,589**

*Contribution in Aid of Construction totals $8.065 million for the four year period
**Contribution in Aid of Construction totals $2.993 million for the four year period

The CWP provides a description and estimated costs of facilities necessary to:

- Connect 3,593 new services to the system
- Install new transformers, service lines and meters to increase capacity for 226 existing customers
- Increase the capacity of 40.9 miles of existing overhead and underground distribution lines to serve projected increased system loads
- Construct 12.0 miles of new tie lines to provide backup capability and flexibility for distribution outages
- Increase the backup capability from other distribution substations for three radial transmission delivery points to provide increased flexibility for transmission system outages
- Increase the capacity of one substation to serve projected increased loads in the area
- Replace 820 deteriorated poles
- Replace 4.58 miles of aging underground conductor
- Install miscellaneous distribution equipment to improve system operations

Staff also reviewed Trico's customer outage metrics and system losses and found them to be well within the RUS guidelines.

IV. CONCLUSION

Based on Staff's engineering review of Trico's CWP, and other information provided by Trico in response to Staff's Data Requests, Staff believes that these projects are appropriate to meet the projected demand of the Cooperative's new and existing customers and will help ensure system reliability. Staff further concludes that the costs associated with these projects appear to be reasonable. Staff's conclusions do not, however, imply a specific treatment for rate base or rate making purposes.