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MEMORANDUM

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TO: Docket Control

FROM: Steven M. Olea  
Director  
Utilities Division

DATE: January 29, 2015

RE: STAFF REPORT FOR VERDE SANTA FE WASTEWATER COMPANY, INC.'S APPLICATION FOR AUTHORITY TO: (1) ISSUE LONG-TERM DEBT INSTRUMENTS IN AN AMOUNT NOT TO EXCEED \$137,500 IN CONNECTION WITH FINANCING THE ACQUISITION OF WASTEWATER UTILITY PLANT OF PIVOTAL UTILITY MANAGEMENT, L.L.C.; AND 2) ENCUMBER ITS REAL PROPERTY AND UTILITY PLANT AS SECURITY FOR SUCH INDEBTEDNESS. (DOCKET NO. SW-03437A-14-0377)

Attached is the Staff Report for Verde Santa Fe Wastewater Company, Inc.'s application for financing approval. Staff recommends approval of the requested financing.

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 February 9, 2015.

SMO:CSB:vsc

Originator: Crystal Brown

ORIGINAL

Arizona Corporation Commission

DOCKETED

JAN 29 2015

DOCKETED BY

Service List for: Verde Santa Fe Wastewater Company, Inc.  
Docket No. SW-03437A-14-0377

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**STAFF REPORT  
UTILITIES DIVISION  
ARIZONA CORPORATION COMMISSION**

**VERDE SANTA FE WASTEWATER COMPANY, INC.**

**DOCKET NO. SW-03437A-14-0377**

**APPLICATION FOR AUTHORITY TO: (1) ISSUE LONG-TERM DEBT INSTRUMENTS IN AN AMOUNT NOT TO EXCEED \$137,500 IN CONNECTION WITH FINANCING THE ACQUISITION OF WASTEWATER UTILITY PLANT OF PIVOTAL UTILITY MANAGEMENT, L.L.C.; AND 2) ENCUMBER ITS REAL PROPERTY AND UTILITY PLANT AS SECURITY FOR SUCH INDEBTEDNESS**

**JANUARY 29, 2015**

## STAFF ACKNOWLEDGMENT

The Staff Report for Verde Santa Fe Wastewater Company, Inc., Docket No. SW-03437A-14-0377, was the responsibility of the Staff members listed below. Crystal Brown was responsible for the financial review and analysis of the Company's application. Katrin Stukov was responsible for the engineering and technical analysis.



Crystal Brown  
Executive Consultant III



Katrin Stukov  
Utilities Engineer

**EXECUTIVE SUMMARY  
VERDE SANTA FE WASTEWATER CO., INC.  
DOCKET NO. SW-03437A-14-0377**

Verde Santa Fe Wastewater Company, Inc. (“Verde Santa Fe” or “Company”) is an Arizona Class C utility engaged in the business of providing wastewater service in portions of Yavapai County, Arizona. Verde Santa Fe serves approximately 950 customers.

The purpose of the application is to provide financing for Verde Santa Fe to purchase wastewater plant currently owned by Pivotal Utility Management L.L.C. The proposed financing is an 11-year amortizing loan at a 5.0 percent interest rate. Filing this application is a compliance item ordered in Decision No. 74608, dated July 30, 2014.

**STAFF’S RECOMMENDATIONS**

1. Staff recommends approval the Company’s application for authority to issue a note receivable in an amount not to exceed \$137,500 for a period of 11 years at an interest rate not to exceed 5.0 percent.
2. Staff further recommends that Verde Santa Fe be ordered to file a copy of all executed financing documents setting forth the terms of this financing with the Utilities Division Director (“Director”).
3. Staff further recommends that Verde Santa Fe be ordered to file a notice in Docket Control indicating the date that one copy of all executed financing documents was provided to the Director within 60 days of providing such documents to the Director.

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### **Introduction and Background**

Verde Santa Fe Wastewater Company, Inc. (“Verde Santa Fe” or “Company”) is an Arizona Class C utility engaged in the business of providing wastewater service in portions of Yavapai County, Arizona. Verde Santa Fe serves approximately 950 customers.

Decision No. 74608, dated July 30, 2014, ordered that:

Verde Santa Fe Wastewater Co., Inc. shall, within 90 days after the effective date of this Decision, as a compliance item in this docket, file a financing application designed to result in Verde Santa Fe Wastewater Co., Inc.’s obtaining ownership of the plant items, with an asserted original cost of \$250,000, that Verde Santa Fe Wastewater Co., Inc. has been leasing from Pivotal Utility Management.

On October 30, 2014, in compliance with Decision No. 74608, Verde Santa Fe filed an application to issue a note receivable in an amount not to exceed \$137,500. The \$137,500 represents the net book value of the underlying \$250,000 original plant cost.

### **Public Notice**

On November 26, 2014, the Company filed an affidavit of publication verifying public notice of its financing application. The Company published notice of its financing application in the *Sedona Red Rock News* newspaper of general circulation in Yavapai County, Arizona on November 7, 2014.

### **Compliance**

A check of the compliance database indicates that there are currently no delinquencies for Verde Santa Fe.

### **Purpose and Terms of the Proposed Financing Application**

The purpose of the application is to provide financing for Verde Santa Fe to purchase wastewater plant currently owned by Pivotal Utility Management L.L.C. The proposed financing is an 11-year amortizing loan at a 5.0 percent interest rate.

### Engineering Analysis

Staff reviewed the estimated cost for the plant and found it to be reasonable and appropriate. A complete discussion of Staff's findings and recommendations concerning the financing application can be found in the attached Engineering Memorandum.

### Financial Analysis

Staff's financial analysis is based on Verde Santa Fe's financial statements for the year ended December 31, 2013, as shown on Schedule CSB-1. Column A of the schedule presents selected financial information from the financial statements, and Column B presents the pro forma effect of the \$137,500 loan. Schedule CSB-1 also shows the debt service coverage ratio and capital structure.

#### Debt Service Coverage Ratio ("DSC")

The DSC represents the number of times cash flow from operations (i.e., operating income plus income tax, depreciation and amortization expenses) covers required principle and interest payments on debt. A DSC greater than 1.0 means 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.

Based on the 2013 financial statements, Verde Santa Fe's DSC is 61.82. The pro forma effect of fully drawing the \$137,500 loan decreases the DSC to 1.93. The pro forma DSC shows that Verde Santa Fe has adequate cash flow to meet all obligations on the proposed loan.

#### Capital Structure

At December 31, 2013, Verde Santa Fe's capital structure consisted of 100 percent equity as shown on Schedule CSB-1, Column A. The pro forma effect of Verde Santa Fe drawing the entire proposed loan of \$137,500 would result in a capital structure comprised of 2.1 percent short-term debt, 27.3 percent long-term debt, and 70.6 percent equity as shown on Schedule CSB-1, Column B.

#### Encumbrance

The terms of the anticipated loan provide for encumbrance of the Company's assets that will be financed with the loan. A.R.S. § 40-285 requires public service corporations to obtain Commission authorization to encumber certain utility assets. 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.

### Conclusions

Staff concludes that the cost of the plant that the Company proposes to finance is reasonable and that the plant is used and useful in the provision of service.

Staff concludes that the debt requested by Verde Santa Fe is for lawful purposes, within the corporate powers of the Company, compatible with the public interest, compatible with sound financial practices, compatible with its proper performance as a public service corporation and will not impair its ability to perform that service.

Staff further concludes that Verde Santa Fe would have adequate cash flow to meet all obligations on the debt.

**Staff's Recommendations**

1. Staff recommends approval of the Company's application for authority to issue a note receivable in an amount not to exceed \$137,500 for a period of 11 years at an interest rate not to exceed 5.0 percent.
2. Staff further recommends that Verde Santa Fe be ordered to file a copy of all executed financing documents setting forth the terms of this financing with the Utilities Division Director ("Director").
3. Staff further recommends that Verde Santa Fe be ordered to file a notice in Docket Control indicating the date that one copy of all executed financing documents was provided to the Director within 60 days of providing such documents to the Director.

**FINANCIAL ANALYSIS**

Selected Financial Information

	[A] <sup>1</sup> 12/31/2013 <u>Without Loan</u>		[B] <sup>2</sup> <i>Pro Forma</i> <u>With \$137,500 Loan</u>	
1 Operating Income	\$	1,853	\$	1,853
2 Depreciation & Amort.		29,350		29,350
3 Income Tax Expense		137		137
4				
5 Interest Expense		507		6,657
6 Repayment of Principal		0		9,620
7				
8				
9				
10				
11 <b>DSC</b>				
12 [1+2+3] + [5+6]		61.82		1.93
13				
14				
15				
16				
17 <b>Capital Structure</b>				
18				
19 Short-term Debt		0	0.0%	9,620
20				2.1% <sup>3</sup>
21 Long-term Debt		0	0.0%	127,880
22				27.3%
23 Common Equity		330,307	100.0%	330,307
24				70.6%
25 Total Capital	\$	330,307	100.0%	\$ 467,807
26				100.0%
27				
45				

46 <sup>1</sup> Column [A] is based on financial information for the year ended December 31, 2013.

49 <sup>2</sup> Column [B] is Column [A] modified to reflect full amortization of the proposed \$137,500 loan.

50 <sup>3</sup> Pro Forma Short-term Debt represents the first year principal repayment on the proposed loan.

**MEMORANDUM**

DATE: January 12, 2015

TO: Crystal Brown  
Public Utilities Analyst III

FROM: Katrin Stukov *KS*  
Utilities Engineer *for*

RE: Verde Santa Fe Wastewater Co., Inc. (Financing)  
Docket No. SW-03437A-14-0377

Pursuant to Decision No. 74608, on October 29, 2014, Verde Santa Fe Wastewater Co., Inc. ("VSF" or "Company") filed with the Arizona Corporation Commission ("Commission") an application for approval to incur indebtedness in an amount not to exceed \$137,500 to purchase a variety of equipment that VSF currently leases in order to operate its Verde Santa Fe wastewater treatment plant. A list of the leased equipment to be purchased and a breakdown of costs<sup>1</sup> is summarized below:

Equipment		
Quantity	Description	Cost
1	Horizontal cylindrical fiberglass sludge holding tank (12'x25'=20,092 gallons)	\$19,480.00
1	Vertical cylindrical chlorine contact tank (8'x13.5'=5,076 gallons)	\$12,377.00
1	Olympian D150PL 150kW standby generator with transfer switch	\$48,572.00
1	Inline Franklin Miller SS600 comminutor	\$25,815.00
2	Horizontal cylindrical fiberglass anoxic tanks (10'x18.5'=10,094 gallons each)	\$44,656.00
2	Horizontal cylindrical fiberglass aeration tanks (12'x47'9"=39,362 gallons each)	\$99,100.00
	Total	\$250,000.00

Staff concludes that described leased equipment to be purchased is in service<sup>2</sup> and the original cost totaling \$250,000.00 is reasonable.

<sup>1</sup> According to the Company's response to CSB 2.16 (Docket No.13-0292)

<sup>2</sup> Based on Staff site visit on November 20, 2013