

ORIGINAL



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MEMORANDUM

TO: Docket Control *for [Signature]*

FROM: Elijah Abinah *for [Signature]*
Acting Director
Utilities Division

DATE: January 23, 2017

RE: STAFF REPORT FOR NAVOPACHE ELECTRIC COOPERATIVE, INC.'S APPLICATION FOR AUTHORIZATION TO SECURE UP TO \$9,500,000 IN LONG-TERM FINANCING, TO PLEDGE, MORTGAGE, LIEN AND/OR ENCUMBER UTILITY ASSETS, AND FOR RELATED AUTHORIZATIONS (DOCKET NO. E-01787A-16-0480)

Attached is the Staff Report for Navopache Electric Cooperative, Inc.'s application for authorization to secure up to \$9,500,000 in long-term financing, to pledge, mortgage, lien and/or encumber utility assets, and for related authorizations. Staff recommends approval of \$9,142,781.

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 2, 2017.

EOA:PNT:nr/CH

Originator: Phan Tsan

Arizona Corporation Commission

DOCKETED

JAN 23 2017

DOCKETED BY *[Signature]*

JAN 23 P 3 12


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AZ CORP COMMISSION
DOCKET CONTROL

On this 23rd day of January, 2017, the foregoing document was filed with Docket Control as a Staff Report, and copies of the foregoing were mailed on behalf of the Utilities Division to the following who have not consented to email service. On this date or as soon as possible thereafter, the Commission's eDocket program will automatically email a link to the foregoing to the following who have consented to email service.

Mr. William Sullivan
Law Offices of William P. Sullivan, P.L.L.C.
501 East Thomas Road
Phoenix Arizona 85012

Mr. Timothy La Sota
Acting General Counsel and Acting Director, Legal Division
Arizona Corporation Commission
1200 West Washington Street
Phoenix, Arizona 85007
Legaldiv@azcc.gov
EAbinah@azcc.gov

Consented to service by email

By: 
Nanisha Ross
Administrative Support Specialist

**STAFF REPORT
UTILITIES DIVISION
ARIZONA CORPORATION COMMISSION**

**NAVOPACHE ELECTRIC COOPERATIVE, INC.
DOCKET NO. E-01787A-16-0480**

**APPLICATION FOR AUTHORIZATION TO SECURE UP TO \$9,500,000 IN LONG-
TERM FINANCING, TO PLEDGE, MORTGAGE, LIEN AND/OR ENCUMBER
UTILITY ASSETS, AND FOR RELATED AUTHORIZATIONS**

JANUARY 23, 2017

STAFF ACKNOWLEDGMENT

The Staff Report for Navopache Electric Cooperative, Inc., Docket No. F-01787A-16-0480, was the responsibility of the Staff members listed below. Phan Tsan is responsible for the financial review and analysis of the Cooperative's application.



Phan Tsan

Public Utilities Analyst

EXECUTIVE SUMMARY
NAVOPACHE ELECTRIC COOPERATIVE, INC.
DOCKET NO. E-01787A-16-0480

On December 23, 2016, Navopache Electric Cooperative, Inc. ("Navopache" or "Cooperative"), filed an application with the Arizona Corporation Commission ("Commission") requesting authorization to secure up to \$9,500,000 in long-term debt for the purpose of retiring and consolidating existing long-term debt previously authorized by the Commission in order to secure better interest rates. Navopache requested to expedite this process without need for a separate evidentiary hearing. The Hearing Division has not ruled on the request.

Navopache is a non-profit, member-owned Class "A" Arizona public service corporation operating out of Pinetop-Lakeside, Arizona, providing approximately 39,000 customers with electric distribution service. The Cooperative seeks authorization to incur up to \$9,500,000 in long-term debt from the National Rural Utilities Cooperative Financing Corporation ("CFC"). The CFC loans will generate only the level of funds needed to pay off or retire the United States Department of Agriculture Rural Development ("RUS") loans previously approved by the Commission. The CFC loans will be issued at interest rates at or below the current RUS loans interest rate which is 5 percent. The total outstanding principal under these loans, as of December 31, 2016, is approximately \$9,142,781.

Staff's pro forma times interest earned ratio ("TIER") and debt service coverage ("DSC") ratios are 1.04 and 1.26, respectively. These results suggest that projected operating results are sufficient to meet all obligations and covenants.

If the RUS loans are refinanced with the CFC loans at an effective interest rate of 3.90 percent, it's projected that Navopache will save approximately \$772,202 in interest expense over the next thirteen years. In addition to interest savings, the patronage capital from CFC would generate cash inflow of \$208,012.

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

Staff recommends:

- Granting Navopache authorization to incur long-term debt from the CFC for the purpose of paying off or retiring the existing RUS loans only, in an amount not to exceed \$9,142,781, at interest rates not more than 5 percent over varying terms but not to exceed the remaining terms of the RUS loans.
- Authorizing Navopache to engage in any transaction and to execute any documents necessary to effectuate the authorization herein granted.
- That Navopache provide to the Utilities Division Director, a copy of the loan documents executed pursuant to the authorizations granted herein, within 60 days of

the execution of the loan, and also file a letter in Docket Control verifying that such documents have been provided to the Utilities Division.

- Authorizing Navopache to pledge its assets in the State of Arizona pursuant to A.R.S §40-285 in connection with any indebtedness authorized in this proceeding.

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INTRODUCTION

On December 23, 2016, Navopache Electric Cooperative, Inc. ("Navopache" or "Cooperative"), filed an application with the Arizona Corporation Commission ("Commission") requesting authorization to secure up to \$9,500,000 in long-term debt for the purpose of retiring and consolidating existing long-term debt previously authorized by the Commission in order to secure better interest rates.

PUBLIC NOTICE

On January 23, 2017, the Applicant filed an affidavit of publication verifying public notice of its financing application. The Applicant published notice of its financing application in the *White Mountain Independent* on January 17, 2011. The *White Mountain Independent* is a semi-weekly newspaper of general circulation published at Show Low and St. Johns, County of Navajo, and St. Johns, Apache County, Arizona. The affidavit of publication is attached along with a copy of each Notice.

COMPLIANCE

As of January 12, 2017, a check of the Compliance Database indicates Navopache is currently in Compliance with the Compliance database.

BACKGROUND

Navopache is a non-profit, member-owned Class "A" Arizona public service corporation operating out of Pinetop-Lakeside, Arizona, providing approximately 39,000 customers with electric distribution service.

Navopache's current rates were approved in Decision No. 75833, dated December 5, 2016.

Navopache has twelve outstanding Commission approved long-term United States Department of Agriculture Rural Development ("RUS") guaranteed loans issued at an interest rate of 5.00 percent. These loans were approved in Decision Nos. 53416, 55444, 58213 and 59560. As of December 31, 2016, there is approximately \$9,142,781 in principal still outstanding on the various RUS loans.

PURPOSE AND DESCRIPTION OF THE REQUESTED FINANCING

The Cooperative seeks authorization to incur up to \$9,500,000 in long-term debt from the National Rural utilities Cooperative Financing Corporation ("CFC"). The CFC loans will generate only the funds needed to pay off or retire the RUS loans previously approved by the Commission. The CFC loans will be issued at interest rates at or below the current RUS loans interest rates which is 5.00 percent, in the length no longer than the remaining terms of RUS loans. The rates from CFC would vary from 2.9 percent to 4.4 percent per annum, with an average interest rate of 4.16 percent or average effective rate of 3.90 percent. In addition to better interest rates, refinancing under the

CFC program will allow Navopache to receive capital credit distributions from CFC. Such capital credit distribution represent an additional financial value to the Cooperative's members which are not generated from the existing RUS loan arrangement.

FINANCIAL ANALYSIS

Although Navopache requested \$9,500,000 in its application, Staff believes it is more appropriate to only recommend the authorization needed to cover the unpaid balances of the RUS loans which, as of the end of 2016, amounted to \$9,142,781.

If the RUS loans are refinanced with the CFC loans under an effective interest rate of 3.9 percent, it's projected by CFC that Navopache will save approximately \$772,202 in interest expense over the life of the loans. In addition to interest savings, the patronage capital from CFC would generate cash inflow of \$208,012.

Navopache intends to maintain the same payment amount as under current loans. However, with lower interest rates from CFC and shorter terms of the new loans, the new annual interest expenses will be lower and new annual repayments of principal will be higher, compared to current RUS loans.

Staff's analysis is illustrated on Schedule PNT-1. Column [A] reflects the Cooperative's unaudited financial information for the year ended October 31, 2016. Column [B] represents pro forma financial information that reflects the amount of \$9,142,781 debt refinanced at an effective interest rate of 3.90 percent.

Capital Structure

As of October 31, 2016, Navopache's capital structure consisted of 3.28 percent short-term debt, 73.54 percent long-term debt, and 23.17 percent equity. A pro forma structure reflecting refinancing of \$9,142,781 debt at an effective interest rate of 3.90 percent per annum is composed of 3.35 percent short-term debt, 73.48 percent long-term debt and 23.1 percent equity.

Debt Service Coverage ("DSC") 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 may be needed to avoid default under certain conditions.

Schedule PNT-1, column [A] shows that for the year ended October 31, 2016, Navopache's DSC was 1.26. The pro forma DSC for the Cooperative under the scenario described above for Column [B] is 1.26. The pro forma DSC results show Navopache has sufficient funds to meet all debt obligations.

Times Interest Earned Ratio ("TIER")

TIER represents the number of times operating income covers interest expense on short-term and long-term debt. A TIER greater than 1.0 means that operating income is greater than interest expense. A TIER less than 1.0 is not sustainable in the long-term but does not mean that debt obligations cannot be met in the short-term.

Schedule PNT-1, column [A] shows that for the year ended October 31, 2016, Navopache's TIER was 1.01. The pro forma TIER for the Cooperative under the scenario described above for Column [B] is 1.04. The pro forma TIER results show the Cooperative has sufficient funds to meet all debt obligations.

Encumbrance

A.R.S. § 40-285 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.

CONCLUSION AND RECOMMENDATIONS

Staff concludes that issuance of the debt contemplated in the application is within Navopache's corporate powers, is compatible with the public interest, is consistent with sound financial practices and will not impair its ability to provide services.

Staff recommends:

- Granting Navopache authorization to incur long-term debt from the CFC for the purpose of paying off or retiring the existing RUS loans only, in an amount not to exceed \$9,142,781, at interest rates not more than 5 percent over varying terms not to exceed the remaining terms of the RUS loans.
- Authorizing Navopache to engage in any transaction and to execute any documents necessary to effectuate the authorization herein granted.
- That Navopache provide to the Utilities Division Director, a copy of the loan documents executed pursuant to the authorizations granted herein, within 60 days of the execution of the loan, and also file a letter in Docket Control verifying that such documents have been provided to the Utilities Division.
- Authorizing Navopache to pledge its assets in the State of Arizona pursuant to A.R.S. §40-285 in connection with any indebtedness authorized in this proceeding.

FINANCIAL ANALYSIS

October 31, 2016 unaudited Income Statement and Capital Structure and Pro Forma
Including Immediate Effects of the Proposed Debt

	[A] ¹ <u>10/31/2016</u>		[B] ² <u>Pro Forma</u>		
1	Operating Margin	\$ 2,297,955		\$ 2,297,955	
2	Depreciation & Amort.	5,337,212		5,337,212	
3	Income Tax Expense	-		-	
4					
5	Interest Expense	2,282,325		2,208,228	
6	Repayment of Principal	3,766,641		3,844,588	
7					
8					
9	TIER				
10	[1+3] ÷ [5]	1.01		1.04	
11	DSC				
12	[1+2+3] ÷ [5+6]	1.26		1.26	
13					
14					
15					
16					
17					
18	Short-term Debt ³	\$3,930,399	3.28%	\$4,008,346	3.35%
19					
20	Long-term Debt	\$87,995,453	73.54%	\$87,917,506	73.48%
21					
22	Common Equity	\$27,727,186	23.17%	\$27,727,186	23.17%
23					
24	Total Capital	\$119,653,038	100.00%	\$119,653,038	100.00%
25					
26					

27 ¹ Column [A] is based on unaudited financial information of the year ended October 31, 2016.

28 ² Column [B] represents pro forma amounts to reflect the refinance of the \$9,142,781
29 at 4.16 percent annum.

30 ³ Short-term Debt inclusive of Accounts Payable, and Consumers Deposits.

State of Arizona)
) ss.
County of Apache)

Affidavit of Publication

White Mountain Independent

PUBLIC NOTICE
AN APPLICATION FOR AN ORDER
AUTHORIZING THE ISSUANCE OF LONG
TERM FINANCING BY NAVOPACHE
ELECTRIC COOPERATIVE, INC.
Docket No. E-017871A-16-0480
Navopache Electric Cooperative, Inc. ("Com-
pany") filed an Application with the Arizona
Corporation Commission ("Commission") for
an order authorizing Company to issue up to
\$9,500,000 (gross proceeds) of Long Term
Financing to retire and consolidate previously
approved long term financing. The application
is available for inspection during regular busi-
ness hours at the office of the Commission at
1200 W. Washington, Phoenix, Arizona 85007,
and the Company's offices at 1878 W. White
Mountain Boulevard, Lakeside, Arizona 85929.
Intervention in the Commission's proceed-
ings on the application shall be permitted to
any person entitled by law to intervene and
having a direct substantial interest in this mat-
ter. Persons desiring to intervene must file
a Motion to Intervene with the Commission
which must contain the following information:
1. The name, address and telephone num-
ber of the proposed intervenor and of any
person upon whom service of documents is
to be made if different than the intervenor.
2. A short statement of the proposed
intervenor's interest in the proceeding.
3. Whether the proposed intervenor desires
a formal evidentiary hearing on the applica-
tion and the reasons for such a hearing.
4. A statement certifying that a copy of the Motion
to Intervene has been mailed to Applicant.
The granting of Motions to Intervene
shall be governed by A.A.C. R14-3-105,
except that all Motions to Intervene must
be filed on, or before, February 1, 2017.

Published in the White Mountain Independent:
January 17, 2017am
WMI-0263, T, 1x, 1/17/17a

I, Sally Moreno being first duly sworn, depose and say: I am the agent of the White Mountain Publishing Company, publisher of the White Mountain Independent, a semi-weekly newspaper of general circulation published at St. Johns, County of Apache, Arizona and that the copy hereto attached is a true copy of the advertisement as published in the White Mountain Independent on the following date(s):

January 17, 2017

White Mountain Independent

Sally Moreno

Sworn to me this day of
January 17, 2017 A.D.

Jenna Troutt

Notary Public



State of Arizona)
)ss.
County of Navajo)

Affidavit of Publication

White Mountain Independent

I, Sally Moreno being first duly sworn, depose and say: I am the agent of the White Mountain Publishing Company, publisher of the White Mountain Independent, a semi-weekly newspaper of general circulation published at Show Low, County of Navajo, Arizona and that the copy hereto attached is a true copy of the advertisement as published in the White Mountain Independent on the following date(s):

January 17, 2017

PUBLIC NOTICE
AN APPLICATION FOR AN ORDER
AUTHORIZING THE ISSUANCE OF LONG
TERM FINANCING BY NAVOPACHE
ELECTRIC COOPERATIVE, INC.
Docket No. E-017871A-16-0480
Navopache Electric Cooperative, Inc. ("Company") filed an Application with the Arizona Corporation Commission ("Commission") for an order authorizing Company to issue up to \$9,500,000 (gross proceeds) of Long Term Financing to retire and consolidate previously approved long term financing. The application is available for inspection during regular business hours at the office of the Commission at 1200 W. Washington, Phoenix, Arizona 85007, and the Company's offices at 1878 W. White Mountain Boulevard, Lakeside, Arizona 85929. Intervention in the Commission's proceedings on the application shall be permitted to any person entitled by law to intervene and having a direct substantial interest in this matter. Persons desiring to intervene must file a Motion to intervene with the Commission which must contain the following information:
1. The name, address and telephone number of the proposed intervenor and of any person upon whom service of documents is to be made if different than the intervenor.
2. A short statement of the proposed intervenor's interest in the proceeding.
3. Whether the proposed intervenor desires a formal evidentiary hearing on the application and the reasons for such a hearing.
4. A statement certifying that a copy of the Motion to Intervene has been mailed to Applicant.
The granting of Motions to Intervene shall be governed by A.A.C. R14-3-105, except that all Motions to Intervene must be filed on or before February 1, 2017.
Published in the White Mountain Independent
January 17, 2017sm
WMI 0263, T. 1x, 1/17/17e

White Mountain Independent

Sally Moreno

Sworn to me this
January 17, 2017 A.D

Jennet Troutt

Notary Public

