

WATER/RSK/KOK/DLW/RHG

PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

**DIVISION OF WATER AND AUDITS
UTILITY AUDIT, FINANCE AND
COMPLIANCE BRANCH**

**RESOLUTION W-4778
JULY 30, 2009**

R E S O L U T I O N

RESOLUTION W-4778. NORTH GUALALA WATER COMPANY (NGWC). REQUEST FOR AUTHORITY TO BORROW AN ADDITIONAL \$400,000, UNDER THE SAFE DRINKING WATER STATE REVOLVING FUND LOAN PROGRAM (SRF), TO ENCUMBER UTILITY ASSETS IN CONNECTION WITH THE LOAN, AND TO INSTITUTE A SURCHARGE TO PAY OFF THE LOAN.

By Draft Advice Letter filed on May 18, 2009.

SUMMARY

This Resolution grants NGWC the authority requested in the filing.

NGWC requests authority, pursuant to §§ 816 and 851 of the Public Utilities Code, to secure an additional \$400,000, under the SRF, from the California Department of Public Health (CDPH) and the Department of Water Resources (DWR); to place in effect a surcharge on existing water rates to repay the loan principal and interest; and to encumber utility assets in connection with the loan.¹ The proceeds of the loan will be used for various studies and investigations to be conducted for the improvement and maintenance of NGWC's water system.

In Resolution (Res.) W-4678, dated March 13, 2008, the Commission authorized NGWC to secure a \$100,000 planning loan, under the SRF, to be repaid through a surcharge, over a 5-year term. To-date, NGWC has not drawn any amount from the \$100,000 SRF planning loan.

¹ All statutory references are to the Public Utilities Code unless otherwise indicated.

On July 17, 2008, NGWC was notified by CDPH that the utility was qualified for a planning loan totaling \$500,000, an additional \$400,000 over the \$100,000 originally authorized. NGWC complied with the application process and by letter dated, April 27, 2009, CDPH notified NGWC that the total \$500,000 planning loan had been reviewed and approved. CDPH requires this Commission's approval for the additional funding and the surcharge necessary to secure the repayment of the increased loan amount.

BACKGROUND

NGWC is a Class C water utility subject to the jurisdiction of this Commission. NGWC provides water service to approximately 1,038 metered customers in Gualala and vicinity, located approximately 15 miles south of Point Arena, Mendocino County.

In its Income Statement for the year ending December 31, 2008, NGWC reported that it generated total operating revenues of \$796,128 and net income of \$6,409.

NGWC's Balance Sheet, as of December 31, 2008, as reported, is summarized below:

| <u>Assets</u> | <u>Amount</u> |
|--|-------------------------------|
| Current and Accrued Assets | \$ 520,528 |
| Investments | 0 |
| Deferred Charges | 777,496 |
| Net Utility Plant | <u>4,272,856</u> |
| Total Assets and Deferred Charges | <u><u>\$5,570,880</u></u> |
| <u>Liabilities & Capital</u> | |
| Current and Accrued Liabilities | \$ 66,745 |
| Long-Term Debt | 3,658,382 |
| Deferred Credits | 0 |
| Advances for Construction | 0 |
| Net Contributions in Aid of Construction | 1,057,888 |
| Corporate Capital and Retained Earnings | <u>787,865</u> |

Total Liabilities & Capital \$5,570,880

The \$3,658,382 in long-term debt, shown above, is a 1996 Safe Drinking Water Bond Act (SDWBA) loan, authorized by Res. F-645 and Res. W-4108, with a term of 35 years, which is currently being paid through a surcharge. This loan was used to finance the replacement of existing water mains, construction of water storage facilities, including a pump station and emergency generators, and improvements to NGWC's surface water treatment plant.

NGWC estimates in its filing, that the planning study will cost a total of \$500,000. This planning study includes an investigation regarding alternative source capacity, including new wells, continued use of existing wells, and desalination of sea water. It also includes consideration of additional storage capacity, rehabilitation of existing tanks, replacing undersized water mains, constructing an off-site storage reservoir, and installing monitoring systems, backup power-generation equipment, and improvement of fire-flow conditions within the system.

NOTICE AND PROTESTS

On May 22, 2009, NGWC published a public notice of its filing in the Independent Coast Observer, a weekly newspaper printed, published, and circulated in the County of Mendocino.

By bill insert, dated May 27, 2009, NGWC notified its customers of the additional requested \$400,000 planning loan (for a total of \$500,000) and the corresponding surcharge to repay the loan. The notice also stated that based on the results of the planning study, NGWC may at a later date, submit a pre-application to undertake water system improvements with CDPH. If the project is fundable, an invitation to submit application from CDPH will be received by NGWC. At that time, a full application for construction loan will be submitted, subject to CDPH's and DWR's review and approval.

No customer concerns or protests have been received.

DISCUSSION

CDPH requires this Commission's approval for the additional planning loan amount and the surcharge to secure the repayment of the increased loan amount.

A. Description of Financing

According to CDPH's Policy and Procedures Manual, planning loans are generally appropriate where an applicant is unsure of the best means of solving a particular problem and cannot afford to pay the up-front costs of evaluating the problem and doing the necessary preliminary engineering to prepare a construction loan application. A planning loan may be used to conduct feasibility studies, evaluate problems and potential solutions, conduct environmental evaluations, conduct all preliminary engineering, and prepare a full application for a construction loan.

The below-market interest rate that will apply to the SRF planning loan will be the same as for a construction loan and will be determined at the time the planning loan contract is executed. Currently, CDPH estimates the annual interest rate will be 2.5017%.

Approval of NGWC's application will result in the preparation and execution of an immediate loan contract with CDPH. In connection with the loan, CDPH requires a security interest in the utility's real and personal properties.

Before CDPH can disburse funds under the planning loan, NGWC must provide the following:

- (a) Satisfactory documentation of the action taken by its Board of Directors authorizing it to borrow funds and to enter into a loan contract, and designating a representative to execute the contract and to sign a claim for disbursement of funds.
- (b) Satisfactory documentation showing that it has dedicated a source of revenue for repayment of the principal amount of the loan plus interest.
- (c) Security for the loan.

- (d) A separate bank account entitled "Safe Drinking Water State Revolving Fund Account" for deposit of loan proceeds.
- (e) A fiscal agent who will oversee surcharge deposits and loan payments.
- (f) An initial budget of eligible project costs approved by CDPH.

All recipients of planning loans are required to submit a draft planning report to the district office of CDPH, within 18 months from the date of the loan contract execution. The purpose of this is to assure that all work performed was eligible for reimbursement, the study addressed the problem adequately, and any technical, managerial and financial deficiencies required to be addressed as conditions of the loan were evaluated.

Pursuant to CDPH and DWR requirements, the repayment of a planning loan will commence within six months from the date the draft planning report is received and approved, and shall be fully repaid within five years from when the repayment begins. Should a construction loan be awarded, the planning loan and the construction loan may (at the option of the applicant) be combined into one loan with repayment beginning at the same time the repayment of the construction loan would normally commence.

B. Use of Proceeds & Cost Estimates

NGWC proposes to use the proceeds of the SRF loan to finance the cost of studies, planning, and preliminary engineering for improvements to NGWC's water system to enable the utility to maintain safe drinking water standards.

NGWC's estimated budget follows:

| | |
|--|-----------|
| Engineering study on potential sources of new water, evaluation of existing supply, identification of sites for | \$197,500 |
|--|-----------|

| | |
|--|------------------|
| off-stream water storage reservoir and preparation of a long-term plan on storage capacity and system requirements | |
| Geotechnical investigation to evaluate site, with subsurface exploration, geotechnical and geological evaluation of viable site, development of project feasibility and comprehensive plan | 125,000 |
| Predesign study to establish detailed cost estimates, design, project priorities, and construction schedules | 30,000 |
| Environmental documentation for categorically exempt and negative declaration projects, identification of specific studies and permits | 50,000 |
| Financial plan on financing requirements, rates, and surcharges | 60,000 |
| Application for Construction Funds preparation, incorporating reports and studies, using State guidelines | 25,000 |
| Real estate appraisal to establish value of property and easements | <u>12,500</u> |
| Total | <u>\$500,000</u> |

While the costs of studies, planning, and preliminary engineering are a proper use of loan funds based on § 817(b) of the Public Utilities Code, we do not make a finding as to the reasonableness of these costs in this Resolution.

For this SRF-funded debt, NGWC will only be allowed to expend funds based on CDPH's approved project components and CDPH will verify all work performed prior to reimbursing the utility.

C. Capital Ratios

NGWC's capital ratios are shown below as recorded and adjusted to give pro forma effect to the transactions listed:

| | <u>Recorded</u> | | <u>Adjustments</u> | <u>Proforma</u> | |
|----------------------|--------------------|----------------|-------------------------------|-----------------|----------------|
| Long-term debt | \$3,658,382 | 82.28% | \$500,000 ⁽¹⁾ | \$4,158,382 | |
| 84.65% | | | | | |
| Short-term debt | <u>-</u> | <u>-</u> | <u>-</u> | <u>-</u> | <u>-</u> |
| Subtotal | 3,658,382 | 82.28% | 500,000 | 4,158,382 | 84.65% |
| Common Equity | 500 | 0.01% | - | 500 | 0.01% |
| Paid In Capital | - | - | - | - | - |
| Retained Earnings | <u>787,365</u> | <u>17.71%</u> | <u>(34,000)⁽²⁾</u> | <u>753,365</u> | |
| <u>15.34%</u> | | | | | |
| Total Capitalization | <u>\$4,446,247</u> | <u>100.00%</u> | \$466,000 | \$4,912,247 | <u>100.00%</u> |

(1) Issuance of a total of \$500,000 debt consisting of \$100,000 authorized by Res. W-4678; and \$400,000 requested in this filing.

(2) Projected net loss of \$34,000 for the year ending 2009.

While NGWC's proposed debt does not appear to materially change NGWC's capital structure to the detriment of ratepayers, capital structure issues are normally subject to review in cost of capital or general rate case proceedings. We will not, therefore, make a finding in this Resolution of the reasonableness of the projected capital ratios for ratemaking purposes.

D. Loan Approval

Upon order of the Commission and for proper cause, § 817 allows the use of proceeds from the issue of debt security for purposes reasonably required for the improvement or maintenance of service of a utility.

Section 851 requires Commission authorization before a utility may "sell, lease, assign, mortgage, or otherwise dispose of or encumber the whole or

any part of its... plant, system, or other property necessary or useful in the performance of its duties to the public..."

SRF borrowings represent a much lower cost of capital than either equity or other forms of debt. In addition, there are conditions set by CDPH and this Resolution to ensure proper accounting and handling of the loan proceeds and surcharges collected.

As a public utility, NGWC has the responsibility to maintain its quality of service and provide necessary improvements to its present water system. NGWC's proposed financing transaction is in the public interest because it is intended to enable NGWC to perform a complete evaluation and determination of the best way to improve its water system and maintain safe drinking water standards.

To the extent that CDPH has approved the additional planning loan, it is our responsibility to provide the regulated utility the means to avail of this low-cost debt facility.

Therefore, it is reasonable to authorize NGWC to borrow the additional \$400,000; to execute a loan agreement on terms and conditions contemplated herein; and to encumber utility assets in connection with the loan.

Consistent with § 824, NGWC will need to maintain records to (i) identify the specific long-term debt issued pursuant to this Resolution, and (ii) demonstrate that the proceeds from such debt have been used only for the purposes authorized herein.

E. Proposed Surcharge

NGWC's present rate schedule for general metered service was authorized by the Commission's approval of Advice Letter No. 65, effective October 20, 2008, pursuant to Resolution W-4714, dated October 2, 2008, which granted a 44.3% increase in rates.

In Resolution W-4678 that authorized the \$100,000 planning loan, the Commission allowed NGWC to establish a monthly surcharge on

customer bills, for an equal charge of \$1.72 per customer, for a period of five years. This monthly surcharge of \$1.72 has not yet been imposed.

Pursuant to the amortization schedule provided by DWR dated June 16, 2009, NGWC will need \$58,854 semi-annually, or \$117,709 per year, to make principal, interest, and maintain a 10% reserve requirement throughout the 5-year loan term.²

To provide for the principal, interest and reserve requirement, NGWC proposes the following surcharges that will be in direct proportion to the capacity of each customer's meter or service connection:

| <u>Size of Meter</u> | <u>Proposed Surcharge Per Month³</u> |
|----------------------|---|
| 5/8 x 3/4-inch meter | \$ 8.97 |
| 3/4-inch meter | 13.45 |
| 1-inch meter | 22.42 |
| 1 1/2-inch meter | 44.83 |
| 2-inch meter | 71.73 |
| 3-inch meter | 134.49 |
| 4-inch meter | 224.16 |

The current monthly bill for a 5/8 x 3/4-inch metered customer using approximately 620 cubic feet of water would increase from \$73.23 to \$82.20, or 12.2%, for five years.⁴ Of NGWC's 1033 connections, 897, or 86.8%, are 5/8 x 3/4-inch metered, single-family residential users.

Since the interest rate that will apply to the SRF planning loan will be determined at the time the planning loan contract is executed, the proposed surcharges shown above are estimates and consequently may

² The total \$500,000 SRF planning loan is to be repaid over a 5-year term, with an estimated 2.5017% annual interest rate.

³ The proposed surcharge schedule is inclusive of the surcharge authorized by Res. W-4678.

⁴ The current monthly bill includes the monthly service charge of \$28.50, a quantity rate of \$4.25 per 100 cu.ft. for the first 300 cu.ft. and \$5.40 per 100 cu.ft. for over 300 cu.ft. of water and the SDWBA surcharge for 5/8 x 3/4-inch meter of \$14.70, authorized by Res. F-645 and Res. W-4108 (\$73.23 = \$28.50 + (3 x \$4.25) + (3.2 x \$5.40) + \$14.70).

change. Accordingly, the surcharges will be calculated using the same methodology used in calculating the surcharges above but will be adjusted to reflect the actual interest rate and any other changes to the assumptions underlying the above proposed surcharges. The advice letter shall be filed as a Tier 2 Advice Letter to allow for staff review and approval of the surcharge filing.

In order to ensure that the surcharges are appropriate throughout the loan repayment period, we will require NGWC, to review the balancing account at least once per year. If the balance immediately following a payment to CDPH is less than the CDPH required reserve, or exceeds the CDPH required reserve by more than thirty five percent of the next semi-annual payment, NGWC will be required to file an advice letter to adjust the surcharge.

We are aware that NGWC will not be able to obtain the SRF loan until it demonstrates that it has the source of funds to be used for repayment of the loan, and that such dedicated funds are documented in an order or resolution. To the extent that the source of funds requirement remains a condition in this low-cost funding, NGWC's financing request cannot be processed by CDPH and granted without a surcharge authorization.

The ratepayers ultimately pay for all water system requirements and improvements, regardless of the manner in which they are financed. If the utility were able to borrow the money to make the water system improvements entirely from regular commercial sources, it would be far more expensive for the ratepayers than the low-cost state-funded loan. Likewise, if the utility owners invested their own funds to pay for the water system improvements, they would be entitled to similar investor earnings on such funds, which would likely be higher than the SRF loan rate.

The surcharge method of recovery ensures that the loan will be repaid without financial stress to the water utility. The surcharge serves only to repay the loan and will not generate any profit to the utility owners.

Therefore, it is reasonable to authorize NGWC to impose a surcharge on its customers, as set forth herein.

F. Conditions

When Res. W-4678 authorized the \$100,000 planning loan in 2008, certain conditions were set forth, to which NGWC posed no objection. For purposes of this Resolution, the same conditions imposed by Res. W-4678 will continue to apply:

1. The loan repayment surcharge shall be separately identified on customers' bills.
2. NGWC shall use a balancing account to be credited with revenues collected through the surcharge and to be charged with payments of principal and interest on the loan.
3. NGWC shall deposit all surcharge revenues with a fiscal agent approved by DWR or CDPH. Such deposits shall be made within 30 days after the surcharges are collected from customers.
4. The surcharge rates to repay the loan shall last for approximately 60 months, until the loan is fully paid.
5. Any surplus accrued in the bank account shall be refunded or applied on behalf of the customers when ordered by the Commission.
6. Changes in future surcharge rates shall be accomplished by normal advice letter procedure subject to review and approval.
7. The cost of the studies financed through the surcharge shall be excluded from ratebase for ratemaking purposes.

G. Fees

Whenever the Commission authorizes a utility to issue debt, the Commission is required to charge and collect a fee in accordance with § 1904(b).

The fee for this financing authority as set forth by § 1904(b) is \$800.⁵

⁵ The amount subject to the fee is \$400,000. The fee is determined as follows:
 $\$2 \times (\$400,000/1,000) = \$800.$

COMMENTS

Section 311(g) (1) generally requires that draft resolutions be served on all parties and subject to at least 30 days public review and comment prior to a vote of the Commission.

NGWC, the only party in this filing, has informed the DWA that it has no objection to the conditions added to the relief requested in the draft advice letter, and that it is waiving its right to the 30-day public review and comment period. These added conditions are to: (1) separately identify the loan repayment surcharge in customer billing; (2) remit surcharge revenues to the fiscal agent, within 30 days of collection; (3) exclude from ratebase the cost of the studies financed through the surcharge; (4) use a balancing account; (5) refund or apply on behalf of the customers any surplus accrued in the bank account; (6) make changes in future surcharge rates by the advice letter procedure; and (7) impose the surcharge for 60 months, until the loan is fully paid.

Accordingly, pursuant to § 311(g) (2), the otherwise applicable 30-day period for public review and comment is being waived.

FINDINGS

1. NGWC, a California corporation, is a Class C water utility subject to the jurisdiction of this Commission.
2. NGWC is responsible for maintaining its quality of service and providing necessary improvements to its water system.
3. The studies, planning and preliminary engineering for NGWC's system are necessary to enable the utility to modify its system to maintain safe drinking water standards.
4. SRF borrowings represent a much lower cost of capital than either equity or other forms of debt.
5. CDPH and DWR require various conditions designed to ensure proper accounting and handling of the loan proceeds and surcharges.

6. The proposed borrowing is for proper purposes and in the public interest.
7. With a surcharge for cost recovery, the utility or its owners will not personally benefit from the loan.
8. CDPH requires a customer surcharge to repay the loan, which includes a 10% reserve requirement.
9. CDPH requires a security interest in the utility's properties.
10. The surcharge, as currently estimated, will generate approximately \$107,006 annually.
11. The reasonableness of any resulting interest rate and cost of money arising from debt capital are normally subject to review in cost of capital or general rate case proceedings.
12. CDPH requires a fiscal agent to ensure adequate accountability of loan proceeds, surcharge revenues, interest earned, loan amortization payments and fees paid to the fiscal agent.
13. No protests have been received.
14. NGWC, the only party to this filing, informed the DWA that it has no objection to the conditions added to the relief requested in the draft advice letter and that it is waiving its right to the 30-day public review and comment period.

CONCLUSIONS OF LAW

1. It is reasonable to require in this Resolution, the same conditions set forth in Res. W-4678.
2. NGWC's proposed debt should be authorized subject to the conditions specified in this Resolution.

3. NGWC should be authorized to execute loan agreements and encumber its property whenever such encumbrance serves to secure the debt authorized herein.
4. It is reasonable to authorize NGWC to implement a surcharge to recover the SRF principal and interest payments and any fiscal agent fees.
5. NGWC should be authorized to implement a surcharge.
6. Consistent with § 824, NGWC should maintain records to (i) identify the specific long-term debt issued pursuant to this Resolution, and (ii) demonstrate that the proceeds from such debt have been used only for the purposes authorized herein.
7. Pursuant to § 1904(b), NGWC should pay a fee of \$800.

THEREFORE, IT IS ORDERED that:

1. North Gualala Water Company is authorized to borrow an additional \$400,000, under the Safe Drinking Water State Revolving Fund (SRF), to encumber utility assets to secure the loan, and to use the proceeds to finance the cost of studies, planning, and preliminary engineering for improvements to North Gualala Water Company's water system to enable the utility to maintain safe drinking water standards, as permitted by the California Department of Public Health (CDPH).
2. North Gualala Water Company shall establish a separate bank account, for all surcharge collections and loan payment transactions, managed by a fiscal agent, as requested in the filing.
3. North Gualala Water Company shall establish a balancing account and record in it all surcharges, interest earned, and payments of trustee fees and principal and interest on the loan, as requested in the filing.
4. North Gualala Water Company shall file, in accordance with General Order No. 96-B, six months from the date the draft planning report is received and approved by the CDPH or one hundred eighty days prior to CDPH's first semi-annual billing, whichever comes first, an advice letter, which establishes a monthly surcharge on customer bills. The surcharges shall be calculated using the same methodology used in calculating the

proposed surcharges shown in Section E of this Resolution, and shall be adjusted to reflect the actual interest rate and any other changes to the assumptions underlying the proposed surcharges shown in Section E. The advice letter shall be filed as a Tier 2 Advice Letter.

5. The authority granted herein shall be subject to the following seven conditions:

- a. The loan repayment surcharge shall be separately identified on customers' bills.
- b. NGWC shall use a balancing account to be credited with revenues collected through the surcharge and to be charged with payments of principal and interest on the loan.
- c. NGWC shall deposit all surcharge revenues with a fiscal agent approved by DWR or CDPH. Such deposits shall be made within 30 days after the surcharges are collected from customers.
- d. The surcharge rates to repay the loan shall last for approximately 60 months, until the loan is fully paid.
- e. Any surplus accrued in the bank account shall be refunded or applied on behalf of the customers when ordered by the Commission.
- f. No less frequently than once per year, the utility shall review the balance in the balancing account immediately following a payment to CDPH, and if the balance is less than the CDPH required reserve or exceeds the CDPH required reserve by more than thirty five percent of the next semi-annual payment, North Gualala Water Company shall file an advice letter to adjust the surcharge. Changes in future surcharge rates shall be accomplished by normal advice letter procedure subject to review and approval.
- g. The cost of the studies financed through the surcharge shall be excluded from ratebase for ratemaking purposes.

6. North Gualala Water Company shall file with the Division of Water and Audits' Utility Audit, Finance and Compliance Branch a copy of the loan documents within 15 days of execution.

7. Pursuant to Pub. Util. Code § 824 and General Order 24-B, North Gualala Water Company shall maintain records to (i) identify the specific long-term debt issued pursuant to this Resolution, and (ii) demonstrate that the proceeds from such debt have been used only for the purposes authorized herein.

8. The authority granted by this order shall become effective when North Gualala Water Company pays \$800, the fee set forth by Public Utilities Code § 1904(b).

9. This Resolution is effective today.

I certify that the foregoing Resolution was duly introduced, passed, and adopted at a conference of the Public Utilities Commission of the State of California held on July 30, 2009. The following Commissioners approved it.

/s/ PAUL CLANON
PAUL CLANON
Executive Director

MICHAEL R. PEEVEY
President
DIAN M. GRUENEICH
JOHN A. BOHN
RACHELLE B. CHONG
TIMOTHY ALAN SIMON
Commissioners

Resolution W-4778

July 30, 2009

North Gualala Water Co./Draft AL/RSK/KOK/DLW/RHG