

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-4678
MARCH 13, 2008**

R E S O L U T I O N

RESOLUTION W-4678. NORTH GUALALA WATER COMPANY (NGWC). REQUEST FOR AUTHORITY TO BORROW \$100,000, UNDER THE SAFE DRINKING WATER STATE REVOLVING FUND LOAN PROGRAM (SRF); TO ENCUMBER ASSETS IN CONNECTION WITH THE LOAN; AND TO INSTITUTE A SURCHARGE TO PAY OFF THE LOAN.

By Draft Advice Letter filed on November 7, 2007.

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 borrow \$100,000, under the SRF, and to enter into a secured loan contract with the Department of Public Health (DPH) and the Department of Water Resources (DWR).¹ The proceeds of the loan will be used to finance a planning study to be conducted on NGWC's water system.

In addition, NGWC requests authority to establish a surcharge to make payments of principal and interest on the loan and to establish a separate bank account and balancing account for depositing surcharge collections and making payments on the loan. As required by the loan contract, NGWC proposes to appoint a fiscal agent or trustee to manage the funds.

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

On January 18, 2008, a public notice of the proposed debt and surcharge was published in a newspaper circulated in the County of Mendocino. Subsequently, on January 24, 2008, a bill insert of the proposed debt and surcharge was mailed to each customer. Two customers responded to the notice. One requested information about the purpose and handling of the loan, and one objected to the proposed loan and surcharge.

BACKGROUND

NGWC is a Class C water utility subject to the jurisdiction of this Commission. NGWC provides water service to approximately 1,033 metered customers in Gualala and vicinity, located approximately 15 miles south of Point Arena, Mendocino County.

Pursuant to its Income Statement as of December 31, 2006, NGWC reported that it generated total operating revenues of \$740,069 and net income of \$7,529.

The company's Balance Sheet as of December 31, 2006 is summarized below:

<u>Assets</u>	<u>Amount</u>
Current and Accrued Assets	\$ 592,089
Investments	0
Deferred Charges	682,983
Net Utility Plant	<u>4,596,950</u>
 Total Assets and Deferred Charges	 <u><u>\$5,872,022</u></u>
 <u>Liabilities & Capital</u>	
Current and Accrued Liabilities	\$ 70,863
Long-Term Debt	3,847,238
Deferred Credits	0
Advances for Construction	0
Contributions in Aid of Constructions	1,065,961
Corporate Capital and Retained Earnings	<u>887,960</u>
 Total Liabilities & Capital	 <u><u>\$5,872,022</u></u>

The \$3,847,238 long-term debt, shown above, is a 1996 Safe Drinking Water Bond Act (SDWBA) loan, authorized by Resolutions (Res.) F-645, and W-4108, with a term of 35 years, and being paid through a surcharge. The proceeds of the loan were used for 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. The outstanding balance as of December 31, 2007, is \$3,754,162.77, with a remaining term of 25 years.

Pending before the Commission, is NGWC's general rate case, filed on August 1, 2007, seeking an increase in rates of approximately \$233,258 or 30%, of present rates, and a request to impose a monthly surcharge of \$6.78 for sixty months, to recover extraordinary expenses totaling \$420,533.24, pursuant to Decision (D.) 02-11-004.

On October 30, 2007, NGWC filed an application with DPH for a planning loan, under the SRF, for an estimated amount of \$100,000. NGWC plans to conduct an investigation regarding alternative source capacity, including new wells, continued use of existing wells, and desalination of sea water. The planning study will also include consideration of additional storage capacity, rehabilitation of existing tanks, the replacement of undersized water mains, the installation of monitoring systems, backup power-generation equipment, and improvement of fire-flow conditions within the system.

NOTICE AND PROTESTS

On January 18, 2008, a public notice of the NGWC's filing was published in the Independent Coast Observer, a weekly newspaper printed, published, and circulated in the County of Mendocino.

By bill insert, dated January 24, 2008, NGWC notified its customers of the proposed planning loan and the 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 DPH. If the project is fundable, an invitation to submit application from DPH will be received by NGWC. At that time, a

full application for construction loan will be submitted, subject to DPH's and DWR's review and approval.

On January 29, 2008, a customer sent an e-mail to the Commission's Division of Water and Audits (DWA), asking for a copy of NGWC's filing. On January 30, 2008, DWA's Utility Audit, Finance and Compliance Branch (UAFCB) sent the customer a copy of NGWC's filing and a brief explanation of the loan and advice letter procedures. On the same day, staff requested NGWC to respond to the customer's concerns.

On January 30, 2008, another customer sent NGWC a letter questioning the loan and the surcharge.

By letters, dated February 5, 2008, NGWC provided the first customer with the components of the estimated cost of the planning study, and informed the other that the SRF loan facility carries a lower interest rate than commercial banks.

DISCUSSION

In connection with NGWC's application with DPH for a planning loan, and in order to comply with the requirements of § 818, NGWC filed the draft advice letter, to secure Commission authorization for the \$100,000 SRF loan, to encumber its property, and impose a surcharge, as required under the SRF loan program.

A. Description of Financing

According to DPH'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. Any project that is awarded as a planning loan will remain on DPH's priority list and will retain its ranking until such time that a construction loan is executed. However, the award of a planning loan does not guarantee that a subsequent construction loan will be offered or available.

In connection with the loan application, DPH assesses the utility's financial needs to meet water quality standards and its ability to meet the loan

obligations. DWR acts as the lending agency. Loan funds may be used only for eligible project costs approved by DPH.

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 interest rate that will apply to the planning loan will be the same as for a construction loan and will be determined at the time the planning loan contract is executed. DPH's approval of NGWC's application will result in the preparation and execution of an immediate loan contract with DWR. In connection with the loan, DWR requires a security interest in the utility's real and personal properties.

Before DWR can disburse funds under the planning loan, the borrower must provide the following:

- (a) Satisfactory documentation of the action taken by its governing body 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 DPH.

All recipients of planning loans are required to submit a draft planning report to the district office of DPH, 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.

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 repayments begin. 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 various projects, to enable the utility to meet safe drinking water standards.

NGWC’s cost estimates, as described in detail in its fax message to UAFCB, dated January 30, 2008, are summarized as follows:

Engineering study on potential sources of new water, evaluation of existing supply, identification of sites for off-stream water storage reservoir, and preparation of a long-term plan on storage capacity and system requirements	\$ 39,500
Geotechnical investigation to evaluate site, with subsurface exploration, geotechnical and geological evaluation of viable site, development of project feasibility and comprehensive plan	25,000

Pre-design study to establish detailed cost estimates, design, project priorities, and construction schedules	6,000
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Environmental documentation for categorically exempt and negative declaration projects, identification of specific studies and permits	10,000
Financial study on financing requirements, rates, and surcharges	12,000
Application for Construction Funds preparation, incorporating reports and studies, using State guidelines	5,000
Real estate appraisal to establish value of property and easements	<u>2,500</u>
Total	<u>\$100,000</u>

Normally, for plant expenditures that will be included in ratebase, the reasonableness of such expenditures is addressed during a general rate case. In this case, the plant expenditures will not be included in ratebase and we will not make a finding in this Resolution on the reasonableness of the proposed budget. However, for SRF-funded plant expenditures, the utility may only expend funds on DPH approved project components and DPH verifies all work performed prior to reimbursing the utility. Accordingly, we are assured that the payments made on SRF-funded loans, with ratepayer surcharges, are for proper purposes.

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	3,847,238	81.24%	100,000	3,947,238	80.63%
Short-term debt	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>
Subtotal	3,847,238	81.24%	100,000	3,947,238	80.63%
Common Equity	500	0.01%	-	500	0.01%
Paid In Capital	-	-	-	-	-
Retained Earnings	<u>887,960</u>	<u>18.75%</u>	<u>60,000</u>	<u>947,960</u>	<u>19.36%</u>
Total Capitalization	<u>4,735,698</u>	<u>100.00%</u>	<u>160,000</u>	<u>4,895,698</u>	<u>100.00%</u>

(1) Issuance of \$100,000 debt requested in this filing.

(2) Increase in retained earnings of approximately \$60,000 (based on Summary of Earnings, Test Year 2008, shown on Sheet VII-1of NGWC's general rate case filing of August 1, 2007). NGWC is requesting an increase in the rate case filing, of approximately \$233,258 or 30%.

While NGWC's proposed debt does not appear to materially change NGWC's capital structure to the detriment of ratepayers, capital structures 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

NGWC's proposed financing transaction is in the public interest and is intended to enable NGWC to evaluate and determine the best way to improve its water system. As a public utility, NGWC has the responsibility to maintain its quality of service and provide necessary improvement to its present water system.

We do not find anything in the customers' concerns that would require the Commission to reject NGWC's financing request. Public interest dictates that the utility should have the ability to conduct studies relating to water system improvements, specifically, if the DPH, the state agency responsible for water supply health and safety, is involved in the processing of the loan application, project evaluation, and reimbursement procedures.

Upon order of the Commission and for proper cause, § 818 allows the use of proceeds from the issue of debt security for purposes reasonably required in the operation 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 DPH and this Resolution to ensure proper accounting and handling of the loan proceeds.

We will authorize NGWC to borrow up to \$100,000; to execute a loan agreement on terms and conditions contemplated herein; and to encumber its assets in connection with the loan.

E. Proposed Surcharge

NGWC's present rate schedule for general metered service was authorized by the Commission's approval of Advice Letter No. 60, effective January 26, 2006, which granted a 3.3% increase in rates. In addition to their monthly bill, customers are responsible for a monthly surcharge to repay the 35-year SDWBA loan authorized by Res. F-656 and Res. W-4108.

NGWC estimates that it will need \$10,639 semi-annually, or \$21,278 per year, to make principal and interest payments throughout the 5-year loan

term.² NGWC estimates the surcharge for each customer will be \$1.72 per month.

The current monthly bill for a 5/8 x 3/4-inch metered customer using approximately 955 cubic feet of water (at a quantity rate of \$3.13 per 100 cu. ft.) would increase from \$66.39 to \$68.11, or 2.59%, for five years. Of NGWC's 1033 connections, 897, or 86.8%, are 5/8 x 3/4-inch metered, single-family residential users.

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 DPH 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 earnings on such funds.

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.

The following conditions apply:³

² The proposed \$100,000 SRF planning loan is to be repaid over a 5-year term, with an estimated 2.28% annual interest rate, and with the first payment due June 1, 2008.

³ On February 20, 2008, NGWC, by e-mail, informed DWA that it has no objection to the added conditions and is waiving its opportunity for formal comment.

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 DPH. 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.

F. 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 \$200.⁴

COMMENTS

While there were two customers concerned about the proposed loan and surcharge, there were no showings as to why the proposed project would

⁴ The amount subject to the fee is \$100,000. The fee is determined as follows: $(\$2 \times (\$100,000/1000)) = \$200$.

not lead to improvement of service or why the proposed surcharge could not be justified. DWA did not receive any formal protests after NGWC responded to the customer concerns.

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 its customer billing; (2) remit surcharge revenues to the fiscal agent, within 30 days of collection; and (3) exclude from ratebase, the cost of the studies financed through the surcharge.

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. The proposed borrowing is for proper purposes.
3. With a surcharge type of recovery, the utility or its owners do not personally benefit from the planning loan.
4. DWR requires a customer surcharge to repay the loan, and a security interest on the utility's properties.
5. The surcharge will generate approximately \$21,278 annually. Surcharge revenues will not be commingled with other utility charges.
6. The cost of the studies financed by the SRF loan is not to be included in ratebase.

7. 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.
8. NGWC should establish a separate balancing account to be credited with revenue collected through the surcharge and any interest earned on the account, and reduced by payments of principal and interest on the loan and trustee fees.
9. DWR requires a fiscal agent to ensure adequate accountability of surcharge revenues, interest earned, loan amortization payments and fees paid to the trust account.
10. NGWC should pay the fee determined in accordance with § 1904(b).

THEREFORE, IT IS ORDERED that:

1. North Gualala Water Company is authorized, pursuant to § 816 et seq. of the Public Utilities Code, to borrow \$100,000, under the Safe Drinking Water State Revolving Fund; to encumber its assets in connection with the loan; and to use the proceeds for the purposes described in the body of this order.
2. North Gualala Water Company shall establish a separate bank account, managed by a trustee or fiscal agent, as requested in the filing.
3. North Gualala Water Company shall establish a balancing account and record all billed surcharges, interest earned, and reduced by payment of trustee fee and principal and interest on the loan, as requested in the filing.
4. North Gualala Water Company is authorized to file in accordance with General Order No. 96-B, six months from the date the draft planning report is received and approved by the Department of Public Health or one hundred eighty days prior to the first semi-annual billing, an advice letter, which establishes a monthly surcharge on customer bills, with an equal charge of \$1.72 per customer, for a period of five years. The filing shall become effective on five days' notice.

5. The authority granted herein shall be subject to condition Numbers 1 through 7, enumerated on pages 10 and 11, of this order.
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 agreement and fiscal agreement within 15 days of execution.
7. The authority granted by this order shall become effective when North Gualala Water Company pays \$200, the fee set forth by Public Utilities Code § 1904(b).
8. 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 March 13, 2008. 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