

Decision No. 91498 APR 2 1980

ORIGINAL

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Application of LAGUNA HILLS)
 SANITATION, INC. for authoriza-)
 tion to incur an indebtedness of)
 \$1,400,000 and to service such)
 indebtedness through a surcharge)
 resulting in an increase in)
 Applicant's rates and charges for)
 sewer service.)

Application No. 59033
 (Filed July 30, 1979;
 amended November 16, 1979)

(Appearances are listed in Decision No. 91339.)

SUPPLEMENTAL OPINION

By Decision No. 91339 issued February 13, 1980, we authorized applicant Laguna Hills Sanitation, Inc. to:

"Enter into a contract with the California Pollution Control Financing Authority (Authority) to obtain financing through the Authority in the principal amount of \$1,870,000 for a term of twenty years at the applicable market interest rate and (to) issue such evidences of the indebtedness to be so incurred and encumber such property as is required by the Authority or the ultimate lender. This authority is granted subject to the condition that it shall not result in any way in a shortening of the term of Applicant's presently existing bonds or in an increase in the rate of interest thereon."
 (Ordering Paragraph 1.)

We also authorized applicant to service the debt authorized by Ordering Paragraph 1 by establishing a surcharge on applicant's existing rates. The revenues from the surcharge were to be placed in a Dedicated Fund Account (a balancing account)

and employed to service the debt created by the bond issuance. (See Findings 5 and 6, Decision No. 91339.)

Applicant was authorized to incur the subject indebtedness in order to provide funds for the upgrading of its sewage treatment plant so that that plant might meet federal and state effluent quality standards.

On March 17, 1980, applicant filed a Petition for Modification of Decision No. 91339. Generally, applicant seeks two modifications of that decision. Both are premised upon the dramatic recent increase in interest rates and the resultant impact on the bond market.

First, applicant seeks authority to obtain interim financing for the project until such time as the bond market becomes more favorable. Specifically, applicant seeks the Commission's authority to privately place the indebtedness authorized by Decision No. 91339 with a nonrelated entity through an interest-only note for a period not to exceed five years. Applicant hopes that during that five-year period the bond market will become more favorable and at that time the privately placed debt can be refinanced through the bond issuance authorized by Decision No. 91339. Applicant's Petition for Modification indicates that this is the course recommended by its bond underwriter, E. F. Hutton & Company. The petition alleges that the ratepayers will benefit by virtue of a lower interest rate at the time of the long-term debt issuance. Applicant states that this will be the case even though the principal amount shall have to be augmented to provide for the additional underwriting and legal fees (\$45,000) that applicant will incur by virtue of the interim financing.

Secondly, applicant seeks an increase in the principal amount of indebtedness authorized (whether or not interim financing is obtained) to reflect an additional amount allocated for debt service reserve. The debt service reserve is the amount of bond proceeds which represents one year's debt service (principal and interest). Lenders in Authority issuances generally require that this amount be held in reserve by the borrower and not expended on the project. When applicant amended Application No. 59033 in November 1979, it sought a debt service reserve of \$197,200. That debt service reserve was premised on a 9 percent interest rate on a principal amount of \$1,602,800 and a 20-year loan. With respect to the principal amount, the amendment which sought the debt service reserve also sought an allowance for inflation from November 1979 to a period some three or four months after the issuance of the order.

When we issued Decision No. 91339, we acceded to applicant's request for inflation allowance. We did not adjust the debt service reserve beyond the \$197,200 requested by the amendment to Application No. 59033 to reflect the inflation-adjusted principal amount of indebtedness because, at 9 percent, the amount of debt service reserve required was not appreciably greater than \$197,200.

However, applicant points out that the interest rates which are presently available in the market are considerably higher than the 9 percent which was considered as reasonable at the hearing and which formed the basis for the computation of a debt service reserve of \$197,200. Applicant states that an interest rate in the range of 11 percent to 13 percent is "not unrealistic in today's market". The debt service reserve required at an interest rate in the range of 11 percent to 13 percent is, even if the principal amount of indebtedness

remains the same as that authorized in Decision No. 91339, approximately \$240,000 to \$277,000. Applicant thus seeks the authority to augment the total amount of authorized indebtedness to account for this large increase in required debt service reserve. Attached to applicant's petition for modification is a table setting forth the total principal amount of indebtedness required computed at various interest rates. A separate set of data is provided which includes interim financing for legal and underwriting costs in the principal amount as well. The tables are attached as Appendices A and B to this decision.

Discussion

We are well aware of the dramatic increase in interest rates which has affected applicant's, and every other credit-seeking entity's, ability to obtain financing. Applicant's seeking to avoid long-term financing until a more favorable interest rate is available is prudent and, hopefully, will benefit applicant's ratepayers who will service the long-term debt through the Dedicated Fund Account established by Decision No. 91339. This alternative course is desirable even though applicant will incur additional underwriting and legal fees of \$45,000 if it obtains the interim financing.

The requested modification with respect to the debt service reserve has merit. As we noted earlier, had the applicable market interest rate remained at 9 percent, the fact that we did not increase the debt service reserve to reflect our allowance for inflation would have been insignificant. However, the recent dramatic escalation of interest rates has been considerably more than insignificant and we agree with applicant that some adjustment of the total amount of indebtedness to reflect the increased required debt service reserve is appropriate.

We note that the debt service reserve will be invested at interest and that interest will be credited to the Dedicated Fund Account. During the last year of the loan the invested funds service the debt completely. Therefore, the size of the debt service reserve will, except as discussed below, have no impact on the rate surcharge paid by applicant's ratepayers. We also note that whether or not we augment the authorized indebtedness to account for the increased debt service reserve, applicant will undoubtedly have to maintain a debt service reserve of the size required by the applicable market interest rate. If the amount we provide is inadequate, applicant will have to divert sums which we, the Authority, and all parties to the proceeding, intended to have allocated to the completion of the necessary pollution control facilities. We are well aware of the importance of not risking a shortfall of project funds and will grant the modification requested in a manner which should have no adverse impact on applicant's ratepayers.

There are some instances in which an increase in debt service reserve could have an impact on the ratepayer. If the applicant is able to obtain interim financing as described above, the applicant should be authorized to incur an indebtedness of a sufficient amount to reflect a debt service reserve calculated on the market interest rate at the time of the interim financing. This will ensure that at the time of the refinancing applicant will have at least enough bond proceeds to fund the debt service reserve required at that time. However, if, as both this Commission and applicant hope, refinancing after a period of interim financing is at a lower interest rate than the initial interim financing, then a lower debt service reserve will be required. Were applicant to only maintain this lower debt service reserve, the principal amount of indebtedness (exclusive

of debt service reserve) would be augmented beyond the level authorized by Decision No. 91339 and the ratepayers would be affected. To ensure that this does not occur, our order will require that, in the event applicant obtains interim financing and subsequently refinances on a long-term basis at a lower interest rate, applicant will be required to maintain a debt service reserve calculated on the basis of the higher (interim financing) interest rate. This will ensure that no matter what debt service reserve is employed for purposes of determining applicant's total authorized amount of indebtedness, the principal amount of indebtedness (exclusive of debt service reserve), the amount actually being serviced by the Dedicated Fund Account, will not exceed the amount authorized in Decision No. 91339.^{1/}

The staff of the Revenue Requirements Division of the Commission has reviewed the Petition for Modification and recommends that it be granted. The interested party to the proceeding was served with a copy of the Petition for Modification and has indicated its support in a letter to the Executive Director of this Commission.

Findings of Fact

1. On February 13, 1980, we issued Decision No. 91339 authorizing applicant to incur an indebtedness of \$1,870,000 for a term of 20 years at the applicable market interest rate.

2. At the time of hearings on Application No. 59033, it was reasonable to conclude that 9 percent would be the available market interest rate.

^{1/} That amount is approximately \$1,672,000 (\$1,870,000 less \$197,200 debt service reserve).

3. Since the hearings on Application No. 59033, the interest rates available for all forms of financing have increased dramatically.

4. Applicant may be able to obtain a more favorable long-term interest rate by waiting for a period of time before entering into long-term financing.

5. Applicant's ratepayers will benefit if applicant is able to obtain a lower long-term interest rate than that presently available in the market.

6. Applicant's proposal to obtain interim financing with tax-free interest through the Authority, on an interest-only basis for a period not to exceed five years, is reasonable and should be authorized by the Commission.

7. It is reasonable to further augment the total principal amount of authorized indebtedness by \$45,000 to reflect additional underwriting and legal expenses if applicant is able to obtain interim financing.

8. Decision No. 91339 allowed \$197,200 for a debt service reserve calculated on the basis of an interest rate of 9 percent and a loan life of 20 years.

9. Presently available market interest rates would require a debt service reserve considerably in excess of the \$197,200 authorized by Decision No. 91339.

10. To the extent applicant is required to maintain a debt service reserve in excess of \$197,200, applicant will be required, if Decision No. 91339 is not modified, to divert

funds from project costs to the maintenance of that debt service reserve, resulting in a project fund shortfall.

11. The size of debt service reserve maintained by applicant will have no adverse impact on its ratepayers so long as the principal amount of indebtedness (exclusive of debt service reserve) remains unchanged and the interest rate on the debt service reserve, as invested by the trustee of the Dedicated Fund Account, equals or exceeds, as expected, the interest rate on the financing.

12. Applicant's request to modify Decision No. 91339 to augment the total authorized amount of indebtedness to reflect an increased debt service reserve is reasonable and should be granted.

13. Any additional authority conferred by this order should be granted subject to the condition that it shall not result in any way in a shortening of the term of applicant's presently existing bonds or in an increase in the rate of interest thereon.

14. A public hearing on the petition for modification is not necessary. The urgent nature of the project requires that our order be made effective on the date of signature.

Conclusion of Law

The petition should be granted to the extent set forth in the following order.

SUPPLEMENTAL ORDER

IT IS ORDERED that:

Decision No. 91339 is modified by providing applicant with additional authority as follows:

1. Applicant Laguna Hills Sanitation, Inc. is authorized to obtain interim financing for a maximum of five years to finance the sewage treatment plant improvements described in Decision No. 91339. Such financing will be serviced on an interest-only

basis through the Dedicated Fund Account described in Finding 5 of Decision No. 91339. Applicant may incur a total period of indebtedness in excess of 20 years to the extent necessary to obtain the interim financing prior to long-term bond issuance (i.e., the duration of the short-term financing need not shorten the 20-year term previously authorized for the bonds).

2. In the event the authority described in paragraph 1 above is exercised, (a) applicant is authorized to file an advice letter transmitting its tariff schedules revised to incorporate the initial surcharges required by the Dedicated Fund Account as soon as applicant has entered into the anticipated interim financing contract with the California Pollution Control Financing Authority (Authority) and the interest rate with respect to that financing has been fixed, or not more than 30 days prior to the execution of a note through the Authority, whichever is later; (b) applicant is authorized to incur a total principal amount of indebtedness of \$1,717,800 plus an amount sufficient to fund a debt service reserve at the interest rate at which interim financing is obtained; and (c) applicant shall file, within ten days after it enters into the interim financing contract with the Authority, two copies of the executed contract with the Commission.

3. In the event the authority described in paragraph 1 above is not exercised, applicant is authorized to incur a principal amount of indebtedness in an amount equal to \$1,672,800 plus an amount sufficient to fund a debt service reserve at the interest rate at which the bonds are issued.

4. In the event the authority conferred in paragraph 1 above is exercised, applicant shall maintain, at the time of refinancing from interim to long-term financing, a level of debt service reserve at least at the level required by the

interest rate of the interim financing to ensure that the principal amount of indebtedness (exclusive of debt service reserve) is not augmented at the time of refinancing.

5. In the event of applicant's obtaining the interim financing, it shall, as the time approaches it deems propitious to replace that financing with the long-term bond issuance, notify the Commission and all parties of record in this proceeding of its schedule to carry out that replacement. The notice shall be given at least thirty days prior to such intended replacement and provide such terms and conditions of the long-term bond issuance as are then anticipated.

6. The authority conferred above is granted subject to the condition that it shall not result in any way in a shortening of the term of applicant's presently existing bonds or in an increase in the rate of interest thereon.

Within fifteen days after the filing of the revised tariff schedules described in Ordering Paragraph 2 herein (in the event of interim financing), or Ordering Paragraph 2 of Decision No. 91339 (if applicant does not obtain interim financing),

applicant shall remit to the Commission the amount by which, if any, the fee prescribed by Section 1904(b) of the Public Utilities Code exceeds the amount of \$2,870 already paid by the applicant to the Commission.

The effective date of this order is the date hereof.

Dated APR 2 1980, at San Francisco, California.

John E. Gaylor President
Thomas L. Sturgeon
Richard W. Kwolek
Ronald H. Dennis Commissioners

Commissioner Claire T. Dedrick, being necessarily absent, did not participate in the disposition of this proceeding.

PUBLIC UTILITIES COMMISSION
STATE OF CALIFORNIA
PAID
98312
FEB 19 1980
2,870.-
BY *[Signature]*

PUBLIC UTILITIES COMMISSION
STATE OF CALIFORNIA
PAID
101911
SEP 2 - 1980
45.-
BY *[Signature]*

APPENDIX A

<u>Interest Rate</u>	<u>Principal Amount Req. Exclusive Of Debt Service Reserve</u>	<u>Debt Service Reserve</u>	<u>Total</u>
9%	\$1,602,800*	\$197,188*	\$1,799,988
9%	1,672,800**	205,800	1,878,600
9&1/4%	"	209,923	1,882,723
9&1/2%	"	214,128	1,886,928
9&3/4%	"	218,352	1,891,152
10%	"	222,743	1,895,543
10&1/4%	"	226,964	1,899,764
10&1/2%	"	231,340	1,904,140
10&3/4%	"	235,761	1,908,561
11%	"	240,229	1,913,029
11&1/4%	"	244,744	1,917,544
11&1/2%	"	249,306	1,922,106
11&3/4%	"	253,914	1,926,714
12%	"	258,569	1,931,369
12&1/4%	"	263,270	1,936,070
12&1/2%	"	268,019	1,940,819
12&3/4%	"	272,813	1,945,613
13%	"	277,655	1,950,455

* Per November 16, 1979 Amendment to A.59033.

** \$1,870,000 less the \$197,200 debt service reserve employed in Decision No. 91339.

APPENDIX B

<u>Interest Rate</u>	<u>Principal Amount Required Exclusive Of Debt Service Reserve</u>	<u>Debt Service Reserve</u>	<u>Total</u>
9%	\$1,717,800 (1,672,800 + 45,000)	\$211,329	\$1,929,129
9&1/4%	"	215,581	1,933,381
9&1/2%	"	219,881	1,937,681
9&3/4%	"	224,230	1,942,630
10%	"	228,626	1,946,426
10&1/4%	"	233,071	1,950,871
10&1/2%	"	237,563	1,955,363
10&3/4%	"	242,103	1,959,903
11%	"	246,692	1,964,442
11&1/4%	"	251,328	1,969,128
11&1/2%	"	256,013	1,973,813
11&3/4%	"	260,745	1,978,545
12%	"	265,525	1,983,325
12&1/4%	"	270,353	1,988,153
12&1/2%	"	275,228	1,993,029
12&3/4%	"	280,152	1,997,952
13%	"	285,124	2,002,924