

Exhibit No.:
Issue:
Witness:
Sponsoring Party:
Type of Exhibit:
Case Nos.:

Financial Review
Randy Z. Wright
MoPSC Staff
Rebuttal Testimony
WA-95-164

MISSOURI PUBLIC SERVICE COMMISSION
UTILITY SERVICES DIVISION

REBUTTAL TESTIMONY
OF
RANDY Z. WRIGHT

FILED

MAR 24 1995

**MISSOURI
PUBLIC SERVICE COMMISSION**

FOUR SEASONS LAKESITES WATER & SEWER COMPANY

CASE NO. WA-95-164

Jefferson City, Missouri
March, 1995

13.

✓x

REBUTTAL TESTIMONY

OF

RANDY Z. WRIGHT

FOUR SEASONS LAKESITES WATER & SEWER COMPANY

CASE NO. WA-95-164

Q. Please state your name.

A. My name is Randy Z. Wright.

Q. Please state your business address.

A. My business address is 301 W. High Street, P.O. Box 360, Jefferson City, Missouri, 65102.

Q. What is your present occupation?

A. I am employed as a Financial Analyst by the Missouri Public Service Commission (Commission). I accepted this position in August 1994.

Q. Were you previously employed before you joined the Commission?

A. Yes. I was employed as the Chief of Information Systems for the Office of the State Treasurer, Jefferson City, Missouri. My tenure lasted from November 1988 through August 1994. I began as a Project Specialist in 1988 and was promoted to Chief of Information Systems in 1991.

Q. What is your educational background?

A. In May 1986 I earned a Bachelor of Science degree in Business Administration from the University of Missouri, Columbia, Missouri. I completed a major in Economics, with an added concentration in Finance.

**Rebuttal Testimony of
Randy Z. Wright**

1 Q. What is the purpose of your testimony in this case?

2 A. My testimony is presented to provide comments to the Commission
3 concerning the reasonableness of the financial plan and provide a rate of return to the Water
4 and Sewer Department for the purpose of computing rates in the water and sewer
5 Application of Four Seasons Lakesites Water & Sewer Company ("Four Seasons Water &
6 Sewer, Company").

7
8 **Financial Plan of Four Seasons Lakesites Water & Sewer Company**

9 Q. Please describe Four Seasons Lakesites Water & Sewer Company's financial
10 plan.

11 A. The Company's Feasibility Study (Appendix C to the original Application)
12 states:

13 "The Company will invest \$900 per lot for the sewer service and \$900 per
14 lot for water service, and will provide 30 percent of this capital cost through
15 equity in the water and sewer system; 70 percent will be financed. New
16 homeowners will be expected to pay for individual water meter installation
17 and for the pressure system at their home. Four Seasons Lakesites, Inc. will
18 pay for applicable federal and state taxes, and all construction costs in excess
19 of \$900 per lot for water and \$900 per lot for sewer service."

20
21 The Company has estimated in the Application that a commitment of \$900 per lot will result
22 in a capital requirement of \$360,000 for water and \$360,000 for sewer, for a total of
23 \$720,000 in additional capital needed. With a 30 percent equity and 70 percent debt
24 allocation, this will amount to \$216,000 in additional equity and \$504,000 in additional debt.

**Rebuttal Testimony of
Randy Z. Wright**

1 Q. Has the Staff been provided any written confirmation or commitment
2 agreements from outside parties concerning the Company's proposed permanent financing
3 arrangements?

4 A. Yes. Question four on Staff's Data Information Request No. 3801 asked for
5 the source and terms of the financing. The Company's response which is dated February 28,
6 1995, included a financing commitment letter from Four Seasons Water & Sewer's affiliate
7 company, Four Seasons Lakesites, Inc. The letter stated that Four Seasons Lakesites, Inc.
8 will offer financing to Four Seasons Water & Sewer of up to \$720,000, at a fixed interest
9 rate of 10 percent per annum, based on a 30 year amortization schedule. The Company has
10 the option for the first five years, to pay interest only, with forgone principal payments to
11 be added to regular monthly payments when principal reduction begins.

12 Q. Is the staff proposing that the Company incur a \$720,000 investment?

13 A. No. The Staff has proposed that the Company finance the construction of the
14 sewer treatment plant and water production plant, and then record the actual construction
15 cost for rate-making purposes. Please refer to testimony of Staff witness Greg Meyer for the
16 discussion concerning the recognition of investment on the Company's books. However,
17 it is my understanding from discussions within the Staff that the actual construction costs
18 of the Company are not expected to exceed \$720,000. Therefore the financial viability of
19 the Company should remain approximately the same as under the Company's proposal.

Rebuttal Testimony of
Randy Z. Wright

Capital Structure and Embedded Costs

Q. What would be Four Seasons Water & Sewer's new capital structure, after the addition of the proposed debt and equity?

A. If the Company were to issue the full \$720,000 of capital, their pro forma capital structure would consist of 49.80 percent equity and 50.20 percent long-term debt (see Schedule 1).

Q. Is this capital structure reasonable for a water and sewer utility such as Four Seasons Water & Sewer?

A. Yes. A capital structure of 49.80 percent equity is above average for a comparable water and sewer company. This is due, in part, to the financial backing of the parent corporation, Four Seasons Group, Inc., which is the sole owner of all of Four Seasons Water & Sewer's common stock. As a result of this ownership, the Company will have the financial resources available for the expected growth in the future.

Rate of Return for Four Seasons Water & Sewer

Q. Has the Company indicated a required return on equity (ROE)?

A. Yes. In response to Staff's Data Information Request No. 3801, the Company indicated a required return on equity of twelve (12.00) percent.

Q. Is 12.00 percent reasonable, given present economic conditions and compared to other water and sewer utilities?

**Rebuttal Testimony of
Randy Z. Wright**

1 A. Yes. In a recent case before the Commission, Capital City Water Company -
2 Case No. WR-94-297, an ROE of 11.75 percent was recommended and approved. Given
3 Four Seasons Water & Sewer's somewhat higher risks associated with its smaller size and
4 proposed construction program, an ROE of 12.00 percent would be reasonable.

5 Q. What is your recommendation as to an overall rate of return for the Four
6 Seasons Water & Sewer Company?

7 A. It is generally accepted in the field of public utility regulation that a fair and
8 reasonable rate of return for a utility company equates to that firm's weighted cost of capital.
9 Given a capital structure of 50.20 percent debt and 49.80 percent common equity, the
10 weighted cost of capital for Four Seasons Water & Sewer would be 11.36 percent (see
11 Schedule 2). This is based on an embedded cost of long-term debt of 10.73 percent (see
12 Schedule 3), and a common equity return of 12.00 percent.

13 Q. Did you perform an analysis on Four Seasons Water & Sewer's resulting pre-
14 tax interest coverage ratios?

15 A. Yes. A pro forma pre-tax interest coverage calculation was completed for
16 the Company and is presented in Schedule 4. It reveals that a return on equity of 12.00
17 percent would yield a pre-tax interest coverage ratio of 2.38 times. The pro forma pre-tax
18 interest coverage test show that there should be enough earnings potential for Four Seasons
19 Water & Sewer to meet its capital costs based upon the above referenced return on equity
20 for the Company. Furthermore, a ratio of 2.38 times should maintain the Company in the

**Rebuttal Testimony of
Randy Z. Wright**

1 "BBB" or "Investment grade" category according to Standard & Poor's Water Utility
2 Financial Ratio Benchmarks (See Schedule 4).
3

4 **Summary Of Position**

5 Q. Please summarize your comments.

6 A. In summary, if the Company is granted a water Certificate and an expanded
7 sewer Certificate, it should have no adverse financial effect on the Company's existing
8 capital structure or its operations. The terms and conditions proposed for the loan and the
9 resulting capital structure appear to be reasonable. With respect to the overall rate of return
10 of 11.36 percent, this return is also reasonable in my opinion. Therefore, from a financial
11 perspective, the Staff has no objections to the Company's financing proposal.

12 Q. Does this conclude your rebuttal testimony?

13 A. Yes, it does.

Four Seasons Water & Sewer Company
Case No. WA-95-164

Pro Forma Capitalization as of December 31, 1994
For Four Seasons Water & Sewer Company

Capital Component	Percentage of Capital	Capital Dollars	Pro Forma Adjustments (1)	Pro Forma Capital Dollars	Pro Forma Percentage of Capital
Common Equity	57.85%	\$1,024,327	\$216,000	\$1,240,327	49.80%
Long-Term Debt	42.15%	746,299	504,000	1,250,299	50.20%
Total	100.00%	\$1,770,626	\$720,000	\$2,490,626	100.00%

Financial Ratio Benchmarks
Total Debt / Total Capital - Including Preferred Stock

Standard & Poor's Corporation's
CreditWeek, June 20, 1994
Water Utility Business
(Average Business Position)

AA	A	BBB
48 %	52%	59%

Note:

(1) The Application indicates \$720,000 of improvements will be funded through new capital (non-contributed capital), in the form of \$216,000 in common equity and \$504,000 in debt from Four Seasons Lakesites, Inc.

Four Seasons Water & Sewer Company
Case No. WA-95-164

Weighted Cost of Capital
for Four Seasons Water & Sewer Company

Capital Component	Pro Forma	Embedded	Weighted Cost of Capital Using
	Percentage of Capital (1)	Cost (2)	Common Equity Return of: 12.00%
Common Equity	49.80%	-----	5.98%
Long-Term Debt	50.20%	10.73%	5.39%
Total	100.00%		11.35%

Four Seasons Water & Sewer Company
Case No. WA-95-164

Embedded Cost of Long-Term Debt as of December 31, 1994

	(1)	(2)	(3)
	Interest	Principal	Annualized
Long-Term Debt	Rate	Amount	Cost to
		Outstanding	Company
		(12/31/94)	(1 * 2)
Note Payable - Chase Resorts - purchase water plant	11.500%	\$140,155	\$16,118
Note Payable - FSL purchase sewer main & water	11.500%	119,667	13,762
Note Payable - FSL purchase treatment plant	11.500%	343,278	39,477
Note Payable - FSL purchase water service & assets	11.500%	125,199	14,398
Proposed Note Payable - new system	10.000%	504,000	50,400
Proposed new Bank Note Payable (1)	11.500%	18,000	2,070
Total		<u>\$1,250,299</u>	<u>\$134,154</u>

$$\text{Embedded Cost of Long-Term Debt} = \frac{\$134,154}{\$1,250,299}$$

10.73%

Note:

(1) Proposed working capital note for projected cash needs during the first year of operation.

Source: Four Seasons Water & Sewer Company's response to Staff's Data Information Request No. 3801.

**Pro Forma Pre-Tax Interest Coverage Ratios
for Four Seasons Water & Sewer Company**

		<u>12.00%</u>
1.	Common Equity (Schedule 1)	\$1,240,327
2.	Earnings Allowed (ROE * [1])	\$148,839
3.	Preferred Dividends	\$0
4.	Net Income Available ([2] + [3])	\$148,839
5.	Tax Multiplier (1 / { 1 - Tax Rate }) Tax Rate= 19.55%	1.2430
6.	Pre-Tax Earnings ([4] * [5])	\$185,008
7.	Annual Interest Costs (Schedule 3)	\$134,154
8.	Avail. for Coverage ([6] + [7])	\$319,163
9.	Pro Forma Pre-Tax Interest Coverage ([8] / [7])	2.38 x

Water Utility Financial Ratio Benchmarks - Pretax Interest Coverage (x)

Standard & Poor's Corporation's
CreditWeek, June 20, 1994
Water Utility Business
(Average Business Position)

AA
3.25 x

A
3.00 x

BBB
2.00 x

BEFORE THE PUBLIC SERVICE COMMISSION

OF THE STATE OF MISSOURI

In the matter of the application of Four Seasons Lakesites)
Water & Sewer Company for a certificate of convenience)
and necessity authorizing it to construct, install, own,)
operate, control, manage and maintain water and sewer)
utility properties for the public, located in an unincor-)
porated area in Camden County and Miller County,)
Missouri, generally comprising the eastern half of the)
area known as "Shawnee Bend".)

Case No. WA-95-164

FILED

MAR 24 1995

**MISSOURI
PUBLIC SERVICE COMMISSION**

AFFIDAVIT OF RANDY Z. WRIGHT

STATE OF MISSOURI)
)
COUNTY OF COLE) ss.

Randy Z. Wright, of lawful age, on his oath states: that he has participated in the preparation of the foregoing Rebuttal Testimony in question and answer form, consisting of 6 pages to be presented in the above case; that the answers in the foregoing Rebuttal Testimony were given by him; that he has knowledge of the matters set forth in such answers; and that such matters are true and correct to the best of his knowledge and belief.

Randy Z. Wright
RANDY Z. WRIGHT

Subscribed and sworn to before me this 23rd day of March, 1995.

Diana L. Jones
Notary Public

My Commission Expires: **DIANA L. JONES**
NOTARY PUBLIC STATE OF MISSOURI
COLE COUNTY
MY COMMISSION EXP. NOV. 17, 1997