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DATE: May 25, 2006

TO: Director, Division of the Commission Clerk & Administrative Services (Bayó)

FROM: Division of Economic Regulation (Brady, Rieger) *pb pd*
Office of the General Counsel (Fleming) *ket West JDJ 198*

RE: Docket No. 980876-WS – Application for certificates to operate a water and wastewater utility in Marion County by Ocala Springs Utilities Inc.

AGENDA: 06/06/06 – Regular Agenda – Proposed Agency Action for Issues 1 and 2 -- Interested Persons May Participate

CRITICAL DATES: None

SPECIAL INSTRUCTIONS: None

FILE NAME AND LOCATION: S:\PSC\ECR\WP\980876.RCM.DOC

Case Background

Ocala Springs Utilities Inc. (OSUI or utility) is a wholly-owned subsidiary of Avatar Utilities, Inc. (Avatar), which is a wholly-owned subsidiary of Avatar Holdings, Inc. OSUI was established by Avatar for the specific purpose of providing water and wastewater service to an undeveloped tract of land in excess of 4,000 acres in Marion County known as Ocala Springs. The entire tract of land is owned by another wholly-owned subsidiary of Avatar Holdings, Avatar Properties, Inc. The acreage is located in the St. Johns River Water Management District where certain water restrictions apply. Based on the anticipated number of connections, Ocala Springs will be a Class A water and wastewater utility at build-out.

On July 13, 1998, OSUI submitted an application for original certificates to operate a water and wastewater utility in Marion County along with a petition requesting a temporary variance from, or a temporary waiver of, Rules 25-30.033(1)(h), (j), (m), (o), (r), (t), (u), (v), (w), (2) and (3) and 25-30.433(10), Florida Administrative Code, regarding the filing requirements for establishing initial rates. On July 31, 1998, the utility filed an amended petition requesting an

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additional temporary variance from, or a temporary waiver, of Rules 25-30.033(1)(k) and (4), Florida Administrative Code, regarding the requirement to file a tariff and the filing requirements for AFUDC (Allowance for Funds Used During Construction).

By Order No. PSC-98-1374-PCO-WS, issued October 12, 1998, the Commission granted OSUI's petitions for temporary rule waivers. Pursuant to that order, the utility was required to submit a separate application in this docket for initial rates and charges within 24 months of a Commission order granting original certificates. By Order No. PSC-98-1644-FOF-WS, issued December 7, 1998, OSUI's application for original water and wastewater certificates was approved, Certificate Nos. 604-W and 520-S were issued to the utility, and it was reaffirmed that the utility was required to file an application to establish initial rates and charges within 24 months of the order, making the filing deadline December 7, 2000.

There have been three subsequent orders granting filing extensions for rates and charges: Order No. PSC-00-2387-FOF-WS, issued December 13, 2000, which granted an extension until February 7, 2002; Order No. PSC-02-0180-PCO-WS, issued February 11, 2002, which granted an extension until December 7, 2003; and Order No. PSC-04-0877-PCO-WS, issued September 8, 2004, which granted an extension until April 7, 2005. On April 7, 2005, the utility filed its application for initial rates and charges. The filing was found to be deficient. A restated application was filed on December 21, 2005, with clarifying and supplemental information filed on March 21st and April 26th 2006.

The purpose of this recommendation is to address the appropriate initial rates and charges for the utility. The Commission has jurisdiction to consider this matter pursuant to Section 367.045, Florida Statutes.

Discussion of Issues

Issue 1: What are the appropriate initial rates and charges and return on investment for Ocala Springs Utilities Inc.?

Recommendation: The rates and charges as discussed in staff's analysis should be approved. The utility should be required to charge its approved rates and charges until authorized to change them by this Commission in a subsequent proceeding. Pursuant to Rule 25-30.475(1), Florida Administrative Code, the effective date of the tariffs should be the stamped approval date. A return on equity of 11.78% plus or minus 100 basis points should also be approved. Within 180 days of the date of a Consummating Order, the utility should be required to provide an executed and recorded warranty deed in the name of the utility for the land upon which the utility facilities are intended to be constructed. (Brady, Rieger)

Staff Analysis: OSUI's planning concept for the service territory is based on 9,835 equivalent residential connections (ERCs) consisting of single and multi-family homes, general service customers, and a golf course over an area of approximately 4,469 acres. While the development is anticipated to be built in phases, the utility's proposed rates are based on its projected rate base, cost of capital, and expenses at 80% of total build out which is expected to occur within 7 years after the initiation of construction. At that time, it is estimated that the utility will have approximately 8,420 equivalent residential connections (ERCs) utilizing 175 gallons of water per day (gpd) per ERC. In reviewing the utility's proposed rates and charges, it appears that the calculations are reasonable and consistent with those normally used by the Commission in setting initial rates and charges for a utility. The analysis below describes how the utility derived its proposed rates and charges.

Projected Rate Base

OSUI's master plan provides for water treatment facilities which will consist of three wells and two ground storage tanks, a wastewater treatment facility with the capability of being retrofitted with reclaim facilities, and a reuse irrigation system. Irrigation for residential and general service customers (treated reuse) will consist of a blend of treated storm water runoff, reclaimed water, and groundwater. Irrigation for the golf course (golf course reuse) will consist of separate reuse lines which will use untreated storm water collected within the golf course area blended with groundwater and some reclaimed water from the utility's facilities. The golf course reuse lines and facilities will be donated and maintained by the golf course. Based on this master plan, the utility has proposed separate rate bases for potable water, wastewater, treated reuse, and golf course reuse.

As shown on Schedule No. 1, the utility's total proposed rate base at 80% of projected design capacity is \$22,028,501, which includes \$4,735,281 for potable water, \$10,680,261 for wastewater, \$6,605,403 for treated reuse, and \$7,556 for golf course reuse. The rate base schedule is for informational purposes to establish initial rates and is not intended to formally establish rate base. This is consistent with Commission practice for original certificate applications. Descriptions of the utility's proposed rate base elements are given below:

Utility Plant in Service (UPIS). The utility's total UPIS balance at 80% of design capacity of \$98,285,476 includes \$19,010,197 for potable water, \$42,128,700 for wastewater, \$36,123,042 for treated reuse, and \$1,023,537 for golf course reuse. Staff has reviewed the utility's proposed UPIS costs and believes the costs are consistent with the utility's proposed facilities and that the amounts appear reasonable. Therefore, staff recommends that the utility's proposed UPIS balance of \$98,285,476 be included in rate base.

Land. The utility's total proposed cost for land is \$100,000, which includes \$50,000 for water and \$50,000 for wastewater. There are no anticipated land costs for the reuse systems. The exact amount of land which will be necessary for the water and wastewater facilities will not be known until the utility's Planned Unit Development (PUD) proposal is approved by Marion County. However, staff believes the proposed total amount of \$100,000 for land is reasonable based on the intended facilities and the location of the utility. Therefore, staff recommends that \$100,000 for land be included in rate base. The utility has provided a proposed warranty deed which will represent the contract for the sale of the land from Avatar to OSUI pursuant to Rule 25-30.033(1)(j), Florida Administrative Code. Within 180 days from the date of the Consummating Order, the utility should be required to file an executed and recorded copy of the deed.

Accumulated Depreciation. The utility's total proposed accumulated depreciation balance of \$22,846,109 at 80% of design capacity was calculated using the guidelines for average service lives as set forth in Rule 25-30.140, Florida Administrative Code. Staff therefore recommends that the utility's proposed accumulated depreciation balances of \$3,090,574 for potable water, \$9,557,104 for wastewater, \$9,893,001 for treated reuse, and \$305,430 for golf course reuse are appropriate and should be included in rate base.

Contributions In Aid of Construction (CIAC) and Accumulated Amortization. The utility's total proposed CIAC balance of \$66,176,139 at 80% of design capacity includes \$13,636,120 for potable water, \$25,866,668 for wastewater, \$25,649,814 for treated reuse, and \$1,023,537 for golf course reuse. The utility's total proposed accumulated amortization balance of \$12,371,323 at 80% of design capacity includes \$2,319,056 for potable water, \$3,755,602 for wastewater, \$5,991,234 for treated reuse, and \$305,430 for golf course reuse. Accumulated amortization was calculated using the guidelines of average service lives as set forth in Rule 25-30.140, Florida Administrative Code. Staff recommends that the utility's proposed balances for CIAC and accumulated amortization of CIAC are reasonable and should be approved. The utility's proposed service availability policy and charges are discussed in Issue 2.

Working Capital. The utility's total proposed working capital allowance of \$293,950 includes \$82,722 for potable water, \$169,731 for wastewater, \$33,941 for treated reuse, and \$7,556 for golf course reuse. These balances are based on 1/8 of the respective operating and maintenance expenses for each service. Staff therefore recommends that the utility's proposed balances for working capital allowance are reasonable and should be included in rate base.

Summary of Projected Rate Base. Based on the above, staff recommends that, for purposes of setting initial rates and charges, the utility's proposed rate base of \$4,735,281 for potable water, \$10,680,261 for wastewater treatment, \$6,605,403 for treated reuse, and \$7,556 for golf course reuse should be used. Again, rate base is used for informational purposes to

establish initial rates and is not intended to formally establish rate base. The utility's calculation of rate base is shown on Schedule No. 1, which is attached.

Cost of Capital

The utility's proposed capital structure, which consists of 40% equity and 60% debt, is shown on the attached Schedule No. 2. Based on the Commission's current leverage formula,¹ the utility proposes that its cost of equity is 11.78%. The utility anticipates that its cost of debt will be 7.0% based on its estimate of the average interest rate throughout the period of construction. Therefore, the utility proposes that its weighted cost of capital is 8.91%. Staff recommends that the utility's proposed weighted cost of capital is reasonable and should be used for calculating the utility's revenue requirements. Staff further recommends that the Commission approve a return on equity of 11.78% with a range of plus or minus 100 basis points.

Return on Investment

The utility's total proposed return on investment at 80% of design capacity is \$1,963,180, which includes \$422,008 for potable water, \$951,825 for wastewater, \$588,674 for treated reuse, and \$673 for golf course reuse. These amounts are based on the utility's proposed rate base amounts and a return on investment of 8.91%. Staff recommends that the utility's proposed return on investment is reasonable and should be included in the utility's revenue requirement.

Revenue Requirement

The utility's total proposed revenue requirement at 80% of design capacity is \$6,579,489, which includes \$1,399,743 for potable water, \$3,694,729 for wastewater, \$1,420,867 for treated reuse, and \$64,150 for golf course reuse. The calculation of the revenue requirement is shown on Schedule No. 3, as attached. In addition to the utility's proposed return on investment, its proposed revenue requirement includes the following expenses:

Operating and Maintenance (O&M) Expenses. The utility's total proposed O&M expense of \$2,351,598 includes \$661,774 for potable water, \$1,357,849 for wastewater, \$271,532 for treated reuse, and \$60,444 for golf course reuse. Included in these expenses are salary and benefits, power, chemicals, materials and supplies, contractual services, transportation expense, and insurance at 6% of net plant. Staff recommends that the utility's proposed O&M expenses are reasonable and should be included in the revenue requirement.

Depreciation and CIAC Amortization Expenses. The utility's total proposed depreciation expense of \$3,656,658 includes \$550,223 for potable water, \$1,746,644 for wastewater, \$1,319,067 for treated reuse, and \$40,724 for golf course reuse. The utility's total proposed CIAC amortization expense of \$2,542,521 includes \$480,488 for potable water, \$942,546 for wastewater, \$1,078,764 for treated reuse, and \$40,724 for golf course reuse. The

¹ Order No. PSC-05-0680-PAA-WS, issued June 20, 2005, in Docket No. 050006-WS, In re: Water and wastewater industry annual reestablishment of authorized range of return on common equity for water and wastewater utilities pursuant to Section 367.081(4)(f), F.S.

utility's depreciation and CIAC amortization expenses were calculated at 80% of design capacity using composite rates based on the guideline depreciation rates in Rule 25-30.140, Florida Administrative Code. Staff recommends that the utility's proposed depreciation and CIAC amortization expenses are reasonable and should be included in the revenue requirement.

Taxes Other than Income. The utility's total proposed amount for taxes other than income of \$571,433 at 80% of design capacity includes \$122,179 for potable water, \$299,766 for wastewater, \$146,507 for treated reuse, and \$2,981 for golf course reuse. These amounts consist of regulatory assessments fees in the amount of 4.5% of gross revenues and property taxes. Staff recommends that the utility's proposed amounts for taxes other than income are reasonable and should be included in the revenue requirement.

Income Taxes. The utility's total provision for income tax at 80% of its design capacity of \$579,140 includes \$124,046 for potable water, \$281,191 for wastewater, \$173,852 for treated reuse, and \$51 for golf course reuse. These amounts are net balances based on the utility's income tax requirements less the parent debt tax adjustment pursuant to Rule 25-14.004, Florida Administrative Code. Staff recommends that the utility's proposed provision for income tax expense is reasonable and should be included in the revenue requirement.

Summary of Revenue Requirement. Based on the utility's proposed expenses at 80% of design capacity for O&M, depreciation, CIAC amortization, taxes other than income and income taxes, and its proposed return on investment, the utility has proposed revenue requirements of \$1,399,743 for potable water, \$3,694,729 for wastewater, \$1,420,867 for treated reuse, and \$64,150 for golf course reuse. These revenue requirements are shown on Schedule No. 3. Staff believes the utility's proposed revenue requirements are reasonable and should be used in setting initial rates for OSUI.

Rates

Water, Wastewater, and Reuse Services. The utility's proposed monthly residential and general service water, wastewater, and treated reuse rates are based on revenue requirements of \$1,399,743, \$3,694,729 and \$1,420,867, respectively, as well as the utility's anticipated customer base (8420 ERCs) and usage (175 gpd/ERC) at 80% of its design capacity. The costs are allocated 40% to the base facility charge and 60% to the gallonage charge, which is considered a conservation rate structure pursuant to the requirements of Rule 25-30.255(1), Florida Administrative Code. Since the golf course facilities are contributed, 100% of its revenue requirement of \$64,150 is assigned to the gallonage charge. Staff recommends that the utility's proposed monthly water, wastewater, and treated reuse rates for residential and general service customers and its reuse rates for the golf course are reasonable and should be approved. The rates are shown on Schedule No. 4.

Miscellaneous Service Charges. OSUI's application contains a request for miscellaneous service charges consistent with Rule 25-30.460, Florida Administrative Code, which defines four categories of miscellaneous service charges as shown on Schedule No. 4, as

well as a \$5.00 late payment charge which, consistent with recent Commission decisions,² represents the cost to process late payments. Also, consistent with Commission practice, customers which receive both water and wastewater service are only charged for one service. In addition, OSUI's application contains a request for customer deposits for water, wastewater, and treated reuse which are consistent with Rule 25-30.311, Florida Administrative Code. Staff recommends that the utility's proposed miscellaneous service charges and customer deposits are appropriate and should be approved.

Conclusion

Staff recommends that the rates and charges as discussed in its analysis be approved. OSUI should be required to charge these rates and charges until authorized to change them by this Commission in a subsequent proceeding. Pursuant to Rule 25-30.475(1), Florida Administrative Code, the effective date of the tariffs should be the stamped approval date. A return on equity of 11.78% plus or minus 100 basis points should also be approved. Within 180 days of the date of the Consummating Order, the utility should be required to file a copy of an executed and recorded warranty deed in the name of the utility for the land upon which the utility facilities are intended to be constructed.

² Order No. PSC-06-0331-PAA-WS, issued April 24, 2006, in Docket No. 050902-WS, In Re: Application to transfer assets and Certificate Nos. 590-W and 508-S in Polk County from Lake Haven Utility Associates, Ltd. d/b/a Lake Wales Utility Company to Gold Coast Utility Corp.

Issue 2: What are the appropriate service availability policy and charges for Ocala Springs Utilities Inc.?

Recommendation: The utility's proposed service availability policy and charges set forth within the staff analysis are reasonable and should be approved effective for connections made on or after the stamped approval date on the tariff sheets pursuant to Rule 25-30.475(2), Florida Administrative Code. (Brady, Rieger)

Staff Analysis: The utility has a detailed service availability policy which anticipates future extensions of service as well as donated facilities. The utility intends to construct the water, wastewater, and treated reuse facilities for which it is requesting meter installation, main extension, and plant capacity charges. The proposed main extension charges reflect the average cost per ERC to install the transmission, distribution, collection, and reuse lines. Consistent with its proposed service availability policy, the utility is requiring the golf course to construct and donate its reuse lines and facilities. As such, there are no proposed service availability charges for golf course reuse.

At 100% of its design capacity, the utility's proposed service availability policy and charges are designed to result in CIAC levels of 73.3% for potable water, 74.8% for wastewater, 90.0% for treated reuse, and 100% for golf course reuse. This results in total CIAC of 79.6% at design capacity. Also consistent with its proposed service availability policy, the utility has requested monthly guaranteed revenue charges equal to the monthly base facility charge for potable water, wastewater, and treated reuse. Pursuant to Rule 25-30.515(9), Florida Administrative Code, the guaranteed revenue charge is designed to help the utility recover a portion of its cost from the time capacity is reserved until a customer begins to pay monthly service charges. The charges are collected after payment of service availability charges and end when monthly service charges begin.³

Staff recommends that the utility's proposed service availability policy and charges are reasonable and consistent with the guidelines for CIAC in Rule 25-30.580, Florida Administrative Code, and should be approved. The utility's proposed service availability charges are shown on Schedule No. 4. These charges should be effective for connections made on or after the stamped approval date on the tariff sheets, pursuant to Rule 25-30.475(2), Florida Administrative Code.

³ Order No. PSC-99-0513-FOF-WS, issued March 12, 1999, in Docket No. 980214-WS, In Re: Application for rate increase in Duval, St. Johns and Nassau Counties by United Water Florida Inc.

Issue 3: Should this docket be closed?

Recommendation: No. If no timely protest is received to the proposed agency action on initial rates and charges, the Order will become final upon the issuance of a Consummating Order. However, the docket should remain open pending receipt of an executed and recorded warranty deed in the name of the utility. Upon receipt and confirmation of proof of ownership, the docket should be administratively closed. (Fleming)

Staff Analysis: If no timely protest is received to the proposed agency action on initial rates and charges, the Order will become final upon the issuance of a Consummating Order. However, the docket should remain open pending receipt of an executed and recorded warranty deed in the name of the utility. Upon receipt and confirmation of proof of ownership, the docket should be administratively closed.

OCALA SPRINGS UTILITIES INC.

RATE BASE

AT 80% DESIGN CAPACITY

Description	Water	Wastewater	Treated Reuse	Golf Course Reuse	Total
Utility Plant in Service	\$ 19,010,197	\$ 42,128,700	\$ 36,123,042	\$ 1,023,537	\$ 98,285,476
Land	\$ 50,000	\$ 50,000	\$ -0-	\$ -0-	\$ 100,000
Accumulated Depreciation	\$(3,090,574)	\$(9,557,104)	\$(9,893,001)	\$(305,430)	\$(22,846,109)
Contributions in Aid of Construction (CIAC)	\$(13,636,120)	\$(25,866,668)	\$(25,649,814)	\$(1,023,537)	\$(66,176,139)
Accumulated Amortization of CIAC	\$ 2,319,056	\$ 3,755,602	\$ 5,991,234	\$ 305,430	\$ 12,371,323
Working Capital Allowance	<u>\$ 82,722</u>	<u>\$ 169,731</u>	<u>\$ 33,941</u>	<u>\$ 7,556</u>	<u>\$ 293,950</u>
Total Rate Base	\$ 4,735,281	\$ 10,680,261	\$ 6,605,403	\$ 7,556	\$ 22,028,501

OCALA SPRINGS UTILITIES INC.

COST OF CAPITAL

Description	Balance Per Utility	Weigh	Cost Rate	Weighted Cost
Common Equity	\$ 8,811,400	40.00%	11.78%	4.71%
Debt	<u>\$13,217,100</u>	<u>60.00%</u>	7.00%	<u>4.20%</u>
Weighted Cost of Capital	\$22,028,501	100.00%		8.91%

OCALA SPRINGS UTILITIES INC.
REVENUE REQUIREMENT
AT 80% DESIGN CAPACITY

Description	Water	Wastewater	Treated Reuse	Golf Course Reuse	Total
Operating Revenues	\$ 1,399,743	\$ 3,694,729	\$ 1,420,867	\$ 64,150	\$ 6,579,489
Operation & Maintenance	\$ 661,774	\$ 1,357,849	\$ 271,532	\$ 60,444	\$ 2,351,598
Depreciation	\$ 550,223	\$ 1,746,644	\$ 1,319,067	\$ 40,724	\$ 3,656,658
CIAC Amortization	\$(480,488)	\$(942,546)	\$(1,078,764)	\$(40,724)	\$(2,542,521)
Taxes Other Than Income	\$ 122,179	\$ 299,766	\$ 146,507	\$ 2,981	\$ 571,433
Income Taxes	<u>\$ 124,046</u>	<u>\$ 281,191</u>	<u>\$ 173,852</u>	<u>\$ 51</u>	<u>\$ 579,140</u>
Operating Expense	\$ 977,735	\$ 2,742,904	\$ 832,193	\$ 63,476	\$ 4,616,308
Net Operating Income	<u>\$ 422,008</u>	<u>\$ 951,825</u>	<u>\$ 588,674</u>	<u>\$ 673</u>	<u>\$ 1,963,180</u>
Rate Base	\$ 4,735,281	\$ 10,680,261	\$ 6,605,403	\$ 7,556	\$ 22,028,501
Rate of Return	8.91%	8.91%	8.91%	8.91%	8.91%

OCALA SPRINGS UTILITIES INC.

RATES AND CHARGES

Monthly Service Rates

Residential & General Service

	Water	Wastewater	Treated Reuse	Golf Course Reuse
Base Facility Charge				
Meter Size:				
5/8" x 3/4"	\$ 5.54	\$ 14.63	\$ 5.63	
3/4"	8.31	21.95	8.45	
1"	13.85	36.58	14.08	
1 1/2"	27.70	73.15	28.15	
2"	44.32	117.04	45.04	
3"	88.64	234.08	90.08	
4"	138.50	365.75	140.75	
6"	277.00	731.50	281.50	
8"	443.20	1,170.40	450.40	
Charge per 1,000 gallons	\$ 1.58	\$ 4.16 *	\$ 0.90	\$ 0.23

*Maximum of 8,000 gallons for residential wastewater service.

Miscellaneous Service Charges

	Water	Wastewater
Initial Connection Fee	\$15.00	\$15.00
Normal Reconnection Fee	\$15.00	\$15.00
Violation Reconnection Fee	\$15.00	Actual Cost
Premises Visit Fee (in lieu of disconnection)	\$10.00	\$10.00
Late Payment Fee	\$ 5.00	\$ 5.00

Service Availability Charges

	Water	Wastewater	Treated Reuse
Meter Installation			
Water Meters – 5/8” x 3/4”	\$180.00		
Water Meters – All Other Sizes	Actual Cost		
Reuse Meters – All Sizes			\$ 180.00
Main Extension Charge per ERC	\$995.00	\$1,770.00	\$1,300.00
Plant Capacity Charge per ERC	\$400.00	\$1,200.00	\$1,500.00
Guaranteed Revenue (Monthly Charge)	\$ 5.54	\$ 14.63	\$ 5.63