

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

| | | |
|---------------------------------|---|------------|
| ELECTRONIC APPLICATION OF ADAIR |) | CASE NO. |
| COUNTY WATER DISTRICT FOR AN |) | 2021-00316 |
| ALTERNATIVE RATE ADJUSTMENT |) | |

NOTICE OF FILING OF COMMISSION STAFF REPORT

Notice is hereby given that, in accordance with the Commission's Order of September 23, 2021, the attached report containing the findings of Commission Staff regarding the Applicant's proposed rate adjustment has been filed in the record of the above-styled proceeding. Pursuant to the Commission's September 23, 2021 Order, Adair County Water District (Adair District) is required to file written comments regarding the findings of Commission Staff no later than 14 days from the date of this report. The Commission directs Adair District to the Commission's July 22, 2021 Order in Case No. 2020-00085¹ regarding filings with the Commission.



Linda C. Bridwell, PE
Executive Director
Public Service Commission
P.O. Box 615
Frankfort, KY 40602

DATED DEC 16 2021

cc: Parties of Record

¹ Case No. 2020-00085, *Electronic Emergency Docket Related to the Novel Coronavirus COVID-19* (Ky. PSC July 22, 2021), Order (in which the Commission ordered that for case filings made on and after March 16, 2020, filers are NOT required to file the original physical copies of the filings required by 807 KAR 5:001, Section 8).

STAFF REPORT
ON
ADAIR COUNTY WATER DISTRICT
CASE NO. 2021-00316

Adair County Water District (Adair District) is a water utility organized pursuant to KRS Chapter 74 that owns and operates a wastewater system through which it provides wastewater service to approximately 1,739 customers that reside in Adair County, Kentucky.¹ On September 2, 2021, Adair District filed an application with the Commission requesting to adjust its wastewater rates pursuant to 807 KAR 5:076. The application was filed pursuant to the Commission's Order in Case No. 2020-00308.² To ensure the orderly review of the application, the Commission established a procedural schedule by Order dated September 23, 2021. Staff issued its first round of formal discovery on October 6, 2021, and a second round of formal discovery on November 5, 2021.

To comply with the requirements of 807 KAR 5:076, Section 9,³ Adair District used the calendar year ended December 31, 2020, as the basis for its application. Using its pro forma test-year operations, Adair District determined that a revenue increase of \$151,607, or 17.09 percent, over test-year normalized revenues of \$1,038,860 was

¹ *Annual Report of Adair District to the Public Service Commission for the Calendar Year Ended December 31, 2020* (2020 Annual Report) at 36.

² Case No. 2020-00308, *Electronic Application of the Adair County Water District for a Certificate of Public Convenience and Necessity to Construct a System Improvements Project and an Order Approving a Change in Rates and Authorizing the Issuance of Securities Pursuant to KRS 278.023* (filed May 14, 2020) at 9, ordering paragraph 16.

³ The reasonableness of the proposed rates shall be determined using a 12-month historical test period, adjusted for known and measureable changes, that coincides with the reporting period of the applicant's annual report for the immediate past year.

warranted,⁴ as shown in the table below. The rates requested by Adair District would increase the residential monthly bill of a typical residential customer using 5,299 gallons per month⁵ by \$7.72 from \$45.15⁶ to \$52.87 or approximately 17.10 percent.⁷

| | <u>Adair County Water District</u> |
|---|--|
| Pro Forma Operating Expenses | \$ 813,250 |
| Plus: Avg. Annual Principal and Interest Payments | 188,008 |
| Debt Coverage Requirement | <u>37,602</u> |
| Overall Revenue Requirement | 1,038,860 |
| Less: Other Operating Revenue | - |
| Miscellaneous Service Revenue | - |
| Interest Income | <u>-</u> |
| Revenue Required From Water Sales | 1,038,860 |
| Revenue from Sales at Present Rates | <u>(887,253)</u> |
| Required Revenue Increase | <u>151,607</u> |
| Percentage Increase | <u>17.09%</u> |

To determine the reasonableness of the rates requested by Adair District, Staff performed a limited financial review of Adair District’s test-year operations. The scope of Staff’s review was limited to determining whether operations reported for the test year were representative of normal operations. Known and measurable⁸ changes to test-year

⁴ Application, Exhibit D, Revenue Requirements Calculation.

⁵ Application, Exhibit K.

⁶ *Id.*

⁷ $(45.15-52.87)/45.15 = 17.099$.

⁸ Commission regulation 807 KAR 5:076, Section 9, sets the standard for the determination of the reasonableness of proposed rates and states, in pertinent part, that the test period shall be “adjusted for known and measurable changes.” See also Case No. 2001-00211, *The Application of Hardin County Water District No. 1 for (1) Issuance of Certificate of Public Convenience and Necessity; (2) Authorization to Borrow Funds and to Issue its Evidence of Indebtedness therefor; (3) Authority to Adjust Rates; and (4) Approval to Revise and Adjust Tariff* (Ky. PSC Mar. 1, 2002); Case No. 2002-00105, *Application of Northern*

operations were identified and adjustments made when their effects were deemed material. Insignificant and immaterial discrepancies were not necessarily pursued or addressed.

Staff's findings are summarized in this report. William Foley reviewed the calculation of Adair District's Overall Revenue Requirement. Sam Reid reviewed Adair District's reported revenues and rate design.

SUMMARY OF FINDINGS

1. Overall Revenue Requirement and Required Revenue Increase. By applying the Debt Service Coverage (DSC) method, as generally accepted by the Commission, Staff found that Adair District's required revenue from wastewater rates is \$1,349,527 to meet the Overall Revenue Requirement of \$1,349,597 and that a \$462,274 revenue increase, or 52.10 percent, to pro forma present rate revenues is necessary to generate the Overall Revenue Requirement.

2. Monthly Water Service Rates. Based upon the percentage increase in revenue requirement, Adair District proposed to increase its monthly wastewater service rates evenly across the board. Adair District did not perform a cost of service study (COSS). In response to Commission Staff's First Request for Information, Adair District stated that it did not complete a COSS at this time, as there has not been any material change in the wastewater system to warrant a COSS.⁹

Kentucky Water District for (A) an Adjustment of Rates; (B) a Certificate of Public Convenience and Necessity for Improvements to Water Facilities if Necessary; and (C) Issuance of Bonds (Ky. PSC June 25, 2003); Case No. 2017-00417, Electronic Proposed Adjustment of the Wholesale Water Service Rates of Lebanon Water Works (Ky. PSC July 12, 2018).

⁹ Adair District's Response to Commission Staff's First Request for Information (filed Oct. 20, 2021) (Response to Staff's First Request), Item 7.

The Commission has previously found that the allocation of a revenue adjustment evenly across the board to a utility's rate design is appropriate when there has been no evidence entered into the record demonstrating that this method is unreasonable and in the absence of a COSS. Finding no such evidence in this case, Staff followed the method proposed by Adair District and allocated the \$462,274 revenue increase across the board to Adair District's monthly wastewater service rates.

The rates set forth in the Appendix to this report are based upon the revenue requirement, as calculated by Staff, and will produce sufficient revenues from water sales to recover the \$1,349,527 Revenue Required from wastewater Sales, an approximate 52.10 percent increase. These rates will increase a typical customer's monthly wastewater bill from \$45.15 to \$68.73, an increase of \$23.58 or approximately 52.23 percent.¹⁰

PRO FORMA OPERATING STATEMENT

Adair District's Pro Forma Operating Statement for the test year ended December 31, 2020, as determined by Staff, appears below.

¹⁰ Application, Exhibit K, typical wastewater customer uses approximately 5,299 gallons per month.

| | Test Year | Adjustment | (Ref.) | Pro Forma |
|--|--------------------|-------------------|--------|--------------------|
| Operating Revenues | | | | |
| Sewage Service Revenues | | | | |
| Flat Rate Revenues | | | | |
| Measured Revenues | \$ 677,785 | \$ 209,468 | (A) | \$ 887,253 |
| Revenues from Public Authorities | | | | |
| Revenue from Other Systems | | | | |
| Miscellaneous Sewage Revenues | | | | |
| Total Operating Revenues | <u>\$ 677,785</u> | <u>209,468</u> | | <u>\$ 887,253</u> |
| Operaton Expenses | | | | |
| Salaries and Wages- Employees ¹¹ | 153,019 | (7,535) | (B) | |
| | | 1,200 | (C) | 146,684 |
| Rents | 255 | | | 255 |
| Fuel and Power Purchased for Pumping and Treatment | 111,649 | | | 111,649 |
| Chemicals | 58,501 | | | 58,501 |
| Miscellaneous Supplies and Expenses | | | | |
| Pumping System | 30,369 | 2,800 | (C) | 33,169 |
| Maintenance Expenses | | | | |
| Maintenance of Pumping System | 2,828 | | | 2,828 |
| Maintenance of Other Plant Facilities | 64,946 | | | 64,946 |
| Customer Accounts Expenses | | | | |
| Uncollectable Accounts | 11,653 | | | 11,653 |
| Administrative and General Expenses | | | | |
| Administrative and General Salaries | 39,831 | (11,114) | (D) | 28,717 |
| Office Supplies and Other Expenses | 11,647 | | | 11,647 |
| Outside Services Employed | 26,212 | | | 26,212 |
| Insurance Expenses | 23,451 | | | 23,451 |
| Employee Pensions and Benefits | 139,876 | (41,246) | (E) | |
| | | (15,347) | (F) | 83,284 |
| Regulatory Commission Expense | 1,329 | | | 1,329 |
| Transportation Expenses | 7,710 | | | 7,710 |
| Miscellaneous General Expenses | 31,687 | | | 31,687 |
| Maintenance of General Plant | 3,698 | | | 3,698 |
| Total Operation and Maintenance Expenses | 718,661 | (71,241) | | 647,420 |
| Depreciation | 518,989 | (56,727) | (G) | |
| | | 94 | (H) | 462,356 |
| Taxes Other Than Income | 14,821 | (1,403) | (I) | 13,418 |
| Utility Operating Expenses | <u>1,252,471</u> | <u>(129,278)</u> | | <u>1,123,193</u> |
| Utility Operating Income | (574,686) | 338,746 | | (235,940) |
| Interest and Dividend Income | | 70 | (J) | 70 |
| Income Available to Service Debt | <u>\$(574,686)</u> | <u>\$ 338,816</u> | | <u>\$(235,870)</u> |

(A) Billing Analysis. In its application, Adair District proposed an adjustment to increase test year revenues by \$209,468.¹² The adjustment is to normalize sales due to an increase in rates approved in Case No. 2020-00308.¹³ Staff finds that Adair District's proposed adjustment is appropriate and accepts the adjustment.

(B) Salaries and Wages - Employees. In its application, Adair District proposed an adjustment to increase Salaries and Wages - Employees Expense by \$5,183.¹⁴ The adjustment was proposed to account for merit increases in the Employee Salaries, and the change in the number of full-time employees subsequent to the test year.¹⁵

Adair District has a total staff of 24 hourly and 7 salaried employees between the water and sewer divisions. Adair District has 16 hourly employees who perform tasks exclusive to the water division, 4 who perform tasks exclusively for the sewer division, and 2 (Office Manager and a Customer Service Representative) who perform tasks for both water and sewer divisions. Discussions with Adair District revealed they currently allocate the 2 hourly employees' wages based on a time-allocation study performed when Adair District merged with the existing utility. The study looked at the tasks the two employees performed and determined which percentage of tasks were for the water division and which were for the sewer division.

¹¹ Salaries and Wages - Employees include Labor and Expenses – Collection System, Pumping System, as well as Treatment System- Labor, Materials, and Expense Accounts.

¹² Application, Exhibit C, Schedule of Adjusted Operations- Sewer Utility, Adjustment A

¹³ Case No. 2020-00308, *Electronic Application of the Adair County Water District for a Certificate of Public Convenience and Necessity to Construct a System Improvements Project and an Order Approving a Change in Rates and Authorizing the Issuance of Securities Pursuant to KRS 278.023* (filed May 14, 2020), at 9, ordering paragraph 16.

¹⁴ Application, Sewer Operations and Maintenance Expenses, Adjustment A.

¹⁵ Id., Exhibit C.1.

Adair District was unable to provide the time allocation study and reported it has gone missing. Staff recommends the Commission accept the allocation methodology for hourly employees. Staff also recommends that the Commission order Adair District to complete an updated time allocation study and supply it with the next rate case.

Staff used the information to calculate Salaries and Wages - Employees expense as \$145,484. Therefore, Staff made a net decrease to Salaries and Wages - Employees of \$7,535 as shown below.

| Employee Position | Test Year Total Hours | Test Year Salary Hours | Current Wages Rate | Test Year Normal Wages | Test Year Overtime Hours | Test Year Overtime/ Bonus Rate | Test Year Overtime Wages | Total Pro Forma Wages | Percent Sewer Allocation | Sewer Pro Forma Wages |
|---------------------------------|-----------------------------|------------------------------|--------------------------|------------------------------|--------------------------------|--------------------------------------|--------------------------------|-----------------------------|--------------------------------|-----------------------------|
| Chief SP Operator | 2,204 | 2,080 | \$ 21.00 | \$ 43,680 | \$123.50 | \$ 31.50 | \$ 3,890 | \$ 47,570 | 100% | \$ 47,570 |
| Office Manager | 2,080 | 2,080 | 25.75 | 53,560 | 0.29 | 38.63 | 11 | 53,571 | 19% | 10,178 |
| Collection Operator in Training | 2,224 | 2,080 | 11.25 | 23,400 | 143.50 | 16.88 | 2,422 | 25,822 | 100% | 25,822 |
| WW Operator Class II | 2,261 | 2,080 | 14.25 | 29,640 | 180.50 | 21.38 | 3,858 | 33,498 | 100% | 33,498 |
| WW Operator in Training | 2,141 | 2,080 | 11.25 | 23,400 | 60.50 | 16.88 | 1,021 | 24,421 | 100% | 24,421 |
| Customer Service Representative | 2,080 | 2,080 | 16.00 | 33,280 | 0.30 | 24.00 | 7 | 33,287 | 12% | 3,994 |
| Total Pro Forma Wages | | | | | | | | | | 145,484 |
| Less: Test Year Wages | | | | | | | | | | <u>(153,019)</u> |
| Pro Forma Adjustment | | | | | | | | | | <u>\$ (7,535)</u> |

(C) Expenses Related to Meter Installations. During the test year, Adair District installed five new sewer connections.¹⁶ Adair District reported \$4,000 for the installation of new water tap fees.¹⁷ Adair District included the labor and materials used for setting meters in the salaries and expenses, and did not separate the costs between labor and materials. The Uniform System of Accounts for Class A/B Water Systems (USoA) requires that these costs be capitalized as Utility Plant in Service and depreciated over their estimated useful lives. Therefore, Staff calculated that Labor and Expenses - Pumping System and Materials and Miscellaneous Supplies and Expenses - Pumping

¹⁶ Response to Staff's First Request, Item 5.

¹⁷ Id., Item 1b.

System should be increased by \$1,200 and \$2,800 respectively as shown below. In addition, Staff has capitalized the costs and made a corresponding adjustment to test-year depreciation as shown in adjustment (G).

| | |
|---------------------------------------|----------|
| Total amount collected for Water Taps | \$ 4,000 |
| Times: 30% labor | 1,200 |
| Times: 70% Materials | 2,800 |

(D) Salaries and Wages - Officers. During the test year, Adair District paid each of its commissioners \$1,800 per year.¹⁸ Adair District included its Attorney’s Salary of \$22,200, General Manager’s Salary of \$125,000, and \$601 Sewer Bonus in Salaries and Wages - Officers. Adair District has four departments: County Water, City Water, Sewer, and Water Plant. County Water, City Water, and Water Plant are merged and classified as part of the water division, while Sewer is classified as part of the sewer division. Adair District currently allocates 25 percent of commissioner wages, general manager salary, attorney salary, and bonuses to each department. Therefore, Adair District allocates 75 percent of Officer’s Salaries to water and 25 percent to sewer. Staff disagrees with this methodology and proposes using the number of customer allocation factor.¹⁹

¹⁸ Application, Wages_Calculations-PSC_Filings.xlsx, (filed Sept. 2, 2021)

¹⁹

| | <u>Number of Customers</u> | <u>Percent Allocation</u> |
|-----------------|--------------------------------|-------------------------------|
| Water Customers | 7,966 | 82% |
| Sewer Customers | <u>1,739</u> | <u>18%</u> |
| Total Customers | 9,705 | 100% |

Staff calculated test year Employee Salaries and Wages - Officers for the sewer division to be \$28,717. Therefore, Staff decreased Salaries and Wages – Officers by \$11,114 as shown below.

| <u>Commissioners</u> | <u>Test Year Salaries</u> | <u>Percent Allocation</u> | <u>Allocation To Sewer</u> |
|-------------------------|---------------------------|---------------------------|----------------------------|
| General Manager | \$ 125,000 | 18% | \$ 22,500 |
| General Manager's Bonus | 601 | 100% | 601 |
| Attorney | 22,200 | 18% | 3,996 |
| William Harris | 1,800 | 18% | 324 |
| David Jones | 1,800 | 18% | 324 |
| Richard Grant | 1,800 | 18% | 324 |
| Junior Brown | 1,800 | 18% | 324 |
| Joseph Pyles | 1,800 | 18% | 324 |
| | <u>Total</u> | | <u>28,717</u> |
| | Less: Test Year Salaries | | <u>(39,831)</u> |
| | Adjustment | | <u><u>\$(11,114)</u></u> |

(E) Employee Pensions and Benefits - Retirement. In its application, Adair District proposed an increase to its Employee Pensions and Benefits by \$7,058 for Retirement Contributions.²⁰ The adjustment reflects Adair District increasing the Employer’s contribution to employee’s retirement plan from 24.06 percent to 26.95 percent.²¹

Staff calculated the retirement contributions amount by combining the Pro Forma Salaries and Wages Expense with the General Manager’s and Accountant’s salaries then multiplying by the new contribution rate of 26.95 percent. As shown below, Staff

²⁰ Application, Sewer Operations and Maintenance Expenses, Adjustment B

²¹ *Id.*, Exhibit C.3.

calculated a Pro Forma Retirement contribution of \$46,672. Therefore, Staff made an adjustment reducing Employee Pensions and Benefits by \$41,246.

| | |
|--|------------------------|
| Total Pro Forma Wages | \$ 173,180 |
| Times: Contribution percentage | <u>26.95%</u> |
| Pro Forma Retirement Contribution | 46,672 |
| Less: Test Year Retirement Expense | <u>(87,918)</u> |
| Employee Pension contribution adjustment | <u><u>(41,246)</u></u> |

(F) Employee Pensions and Benefits - Insurance. In its application, Adair District proposed a decrease to its Employee Pensions and Benefits by \$10,485 for Health insurance premiums and \$923.56 for dental insurance premiums.²² The adjustment reflects Adair District’s limit for employer’s contribution to employee health insurance expenses adjustment to the insurance, as well as subsequent to the test year, Adair District is paying a portion of the new full time employee’s health, life, and disability insurance. Adair District currently pays employees 100 percent of a single Health insurance plan of \$871 per month.

The Commission continues to place greater emphasis on evaluating employees’ total compensation packages, including both salary and benefits programs, for market and geographic competitiveness to ensure the development of a fair, just and reasonable rate. The Commission has found that, in most cases, 100 percent of employer-funded health care does not meet those criteria.²³

²² *Id.*

²³ Case No. 2020-00167, *Electronic Application of Ohio County Water District for an Alternative Rate Adjustment* (Ky. PSC Dec. 3, 2020). Case No. 2020-00296, *Electronic Application of Allen County Water District for an Alternative Rate Adjustment* (Ky. PSC Feb. 3, 2021).

Staff agrees with Adair District’s methodology. However, Staff disagrees with Adair District’s proposed adjustment. Consistent with precedent in which the Commission has reduced benefit expenses for utilities that pay 100 percent of an employee’s health insurance coverage, Staff reduced Adair District’s single health insurance premiums by 22 percent,²⁴ and dental insurance premiums by 40 percent²⁵ as shown in the calculation below. Accordingly, Staff decreased Employee Pensions and Benefits by a net of \$15,347.

| Type of Premium | Employer Contributions | Average Employee Contribution Rate | Monthly Premium Adjustment | Pro Forma Monthly Premium |
|---------------------------------------|------------------------|------------------------------------|----------------------------|---------------------------|
| Single Health Insurance ²⁶ | \$ 3,911 | 22% | \$ (860) | \$ 3,051 |
| Dental Insurance ²⁷ | 126 | 40% | (50) | 76 |
| Total Pro Forma Monthly Premium | | | | 3,051 |
| Times: 12 Months | | | | <u>12</u> |
| Total Annual Pro Forma Premium | | | | 36,612 |
| Less: Test Year | | | | <u>(51,959)</u> |
| Adjustment | | | | <u><u>\$ (15,347)</u></u> |

(G) Depreciation. In its application, Adair District proposed an adjustment decreasing depreciation expense by \$440,056.²⁸ The adjustment is to reflect the

²⁴ Bureau of Labor Statistics, Healthcare Benefits, March 2020, Table 3, private industry workers. (<https://www.bls.gov/news.release/pdf/ebs2.pdf>).

²⁵ Case No. 2019-00268, *Application of Knott County Water and Sewer District for an Alternative Rate Adjustment* (Ky. PSC Mar. 24, 2020). Case No. 2020-00167, *Electronic Application of Ohio County Water District for an Alternative Rate Adjustment* (Ky. PSC Mar. 5, 2021). Case No. 2020-00296, *Electronic Application of Allen County Water District for an Alternative Rate Adjustment* (Ky. PSC Feb. 3, 2021).

²⁶ 4x Employees at \$871 each + General Manager (871 * 18%) + Office Manager (\$871 * 19%) + CSR (\$871 * 12%) = \$3,911.

²⁷ 4x Employees at \$28 each + General Manager (28 * 18%) + Office Manager (\$28 * 19%) + CSR (\$28 * 12%) = \$126.

²⁸ Application, Schedule of Adjusted Operations - Sewer Utility, Adjustment C.

adjustment service lifetimes to match the recommendations in the Operation and Maintenance (O&M) Guide for the support of Rural Water - Waste Water Systems and Rural Development (RD) Project additions. The adjustment would reduce Depreciation expense by \$45,392 to \$473,597. Adair District proposed to phase in the depreciation expense over six years and requested to include one sixth of the annual depreciation expense of \$78,933 in the revenue requirement.²⁹ Adair District requested this adjustment due to economic characteristics of the Adair County population and is requesting a gradual phase in of depreciation expense to allow customers time to adjust to each increase. All the sewer customers are also water customers of Adair District and will be facing an increase on their water bill in addition to the sewer increase.

Staff agrees with Adair District’s initial adjustment methodology for depreciation, in the use of the O&M Guide for the support of Rural Water - Waste Water Systems; however, Staff disagrees with Adair District’s calculation. Staff recalculated the totals when applying the useful lives from the O&M Study. Staff’s adjustment reduced test-year depreciation to \$462,262, a reduction of \$56,727 as shown in the table below. Staff also disagrees with the one-sixth phasing in of Depreciation Expense as proposed by Adair District. Limiting Depreciation Expense to one-sixth would not allow adequate working capital to fund current operations and future plant replacements. Therefore, Staff is including the full amount in depreciation expense into the revenue requirement.

| | |
|---|---------------------------|
| Pro Forma Adjusted Depreciation Expense | \$ 462,262 |
| Less: Test year Depreciation | <u>(518,989)</u> |
| Depreciation Expense adjustment | <u><u>\$ (56,727)</u></u> |

²⁹ \$473,597 / 6 years = \$78,933.

(H) Capitalization of Test-Year Water Taps. As explained in Adjustment (C) above, the expenses related to the installation of new water connections are capital expenditures that should be capitalized as Utility Plant in Service and depreciated over their estimated useful lives. Therefore, Staff calculated the annual depreciation amount for the test year and increased depreciation expense by \$94 as shown below

| | |
|--|---------------------|
| Labor Expense Associated with Tap Ons | \$ 1,200 |
| Materials and Supplies Expense Associated with Tap Ons | <u>2,800</u> |
| Test Year Tap On Expenses | 4,000 |
| Divided by: Useful Life of 42.5 Years | <u>42.50</u> |
| Pro Forma Depreciation Adjustment | <u><u>\$ 94</u></u> |

(I) Taxes other Than Income. In its application, Adair District reported \$14,821 in Taxes other Than Income Expense.³⁰ Staff utilized the Salaries and Wages - Employee expense from adjustments (B) and (C) above; and included the Officer's allocated Salaries from Salaries and Wages - Officers and calculated the FICA tax expense of \$13,418 as shown below. Therefore, Staff calculated a decrease to Taxes Other Than Income of \$1,403

| <u>Taxes other than Income- FICA</u> | |
|---|-----------------------|
| Pro Forma Salaries and Wages- Employees | \$ 146,684 |
| Pro Forma Salaries and Wages- Officers | <u>28,717</u> |
| Total Pro Forma Salaries and Wages | 175,401 |
| Times: 7.65 Percent FICA Rate | <u>7.65%</u> |
| FICA Taxes | 13,418 |
| Test Year Taxes other than Income | <u>(14,821)</u> |
| Taxes Other than Income Adjustment | <u><u>(1,403)</u></u> |

³⁰ Application, Statement of Adjusted Operations.

OVERALL REVENUE REQUIREMENT AND REQUIRED REVENUE INCREASE

The Commission has historically applied a DSC method to calculate the Overall Revenue Requirement of water districts and water associations. This method allows for recovery of (1) cash-related pro forma operating expenses; (2) recovery of depreciation expense, a non-cash item, to provide working capital;³¹ (3) the average annual principal and interest payments on all long-term debts; and (4) working capital that is in addition to depreciation expense.

| | <u>Adair County Water District</u> | <u>Staff</u> | |
|---|--|---------------------|-----|
| Pro Forma Operating Expenses | \$ 813,250 | \$ 1,123,193 | |
| Plus: Avg. Annual Principal and Interest Payments | 188,008 | 188,670 | (1) |
| Debt Coverage Requirement | <u>37,602</u> | <u>37,734</u> | (2) |
| Overall Revenue Requirement | 1,038,860 | 1,349,597 | |
| Less: Interest and Dividend Income | <u>-</u> | <u>(70)</u> | (3) |
| Revenue Required From Wastewater rates | 1,038,860 | 1,349,527 | |
| Revenue from Sales at Present Rates | <u>(887,253)</u> | <u>\$ (887,253)</u> | |
| Required Revenue Increase | <u>151,607</u> | <u>462,274</u> | |
| Percentage Increase | 17.09% | 52.10% | |

1. Average Annual Principal and Interest Payments. At the time of Staff's review, Adair District had one outstanding loan from the Kentucky Infrastructure Authority (KIA), two bonds with RD, and two loans with Kentucky Rural Water Finance Corporation

³¹ The Kentucky Supreme Court has held that the Commission must permit a water district to recover its depreciation expense through its rates for service to provide internal funds for renewing and replacing assets. See *Public Serv. Comm'n of Kentucky v. Dewitt Water Dist.*, 720 S.W.2d 725, 728 (Ky. 1986). Although a water district's lenders require that a small portion of the depreciation funds be deposited annually into a debt reserve/depreciation fund until the account's balance accumulates to a required threshold, neither the Commission nor the Court requires that revenues collected for depreciation be accounted for separately from the water district's general funds or that depreciation funds be used only for asset renewal and replacement. The Commission has recognized that the working capital provided through recovery of depreciation expense may be used for purposes other than renewal and replacement of assets. See Case No. 2012-00309, *Application of Southern Water and Sewer District for an Adjustment in Rates Pursuant to the Alternative Rate Filing Procedure for Small Utilities* (Ky. PSC Dec. 21, 2012).

(KRWFC). In its application, Adair District requested recovery of the average annual principal and interest on its indebtedness based on a five-year average of the annual principal, and interest and fee payments for the years 2022 through 2026.³² Staff agrees with the methodology Adair District proposes, but calculated a different amount. As shown below, Staff calculated an Average Principal and Interest.

| Year | Annual Principal and Interest Payment | | | | | | | | | | Total | |
|------|---------------------------------------|----------|---------------------|----------|-----------------------|----------|----------------------------|----------|----------------------------|----------|---------------------------------|---------|
| | 93-51 ³⁴ | | 93-42 ³⁵ | | F20-016 ³⁶ | | KRWFC 2013 D ³⁷ | | KRWFC 2020 G ³⁸ | | | |
| | Principal | Interest | Principal | Interest | Principal | Interest | Principal | Interest | Principal | Interest | | |
| 2022 | 4,810 | 3,477 | 14,000 | 11,653 | - | - | 70,950 | 27,510 | 3,200 | 2,807 | \$ 138,406 | |
| 2023 | 4,875 | 3,411 | 14,000 | 11,391 | 65,201 | 10,443 | 69,300 | 24,459 | 3,200 | 2,735 | 209,013 | |
| 2024 | 4,940 | 3,343 | 14,500 | 11,123 | 65,527 | 10,117 | 70,950 | 21,479 | 3,300 | 2,663 | 207,942 | |
| 2025 | 5,005 | 3,275 | 14,500 | 10,852 | 65,855 | 9,789 | 74,250 | 18,428 | 3,300 | 2,588 | 207,842 | |
| 2026 | 5,070 | 3,207 | 15,000 | 10,575 | 66,185 | 9,459 | 49,500 | 15,236 | 3,400 | 2,514 | 180,145 | |
| | | | | | | | | | | | 943,349 | |
| | | | | | | | | | | | Divide by: 5 years | 5 |
| | | | | | | | | | | | Average Annual Interest Payment | 188,670 |

³² Application, Exhibit D.1, and Debt_Details.xlsx.

³³ Case No. 2020-00308, *Electronic Application of the Adair County Water District for a Certificate of Public Convenience and Necessity to Construct a System Improvements Project and an Order Approving a Change in Rates and Authorizing the Issuance of Securities Pursuant to KRS 278.023* (Ky. PSC Oct. 21, 2020).

³⁴ Case No. 2014-00218, *Application of the Adair County Water District for a Certificate of Public Convenience and Necessity to Construct, Finance, and Increase Rates Pursuant To KRS 278.023* (Ky. PSC July 23, 2014).

³⁵ Case No. 2021-00156, *Electronic Application Of Adair County Water District for the Issuance of a Certificate of Public Convenience and Necessity to Construct a Sewer System Improvements Project and an Order Authorizing the Issuance of Securities Pursuant to the Provisions of KRS 278.020, KRS 278.300, and 807 KAR 5:001* (Ky. PSC June 11, 2021).

³⁶ Case No. 2013-00169, *Application of Adair County Water District to Issue Securities in the Approximate Principal Amount of \$4,025,000 for the Purpose of Refunding Certain Outstanding Revenue Bonds of the District Pursuant to the Provisions of KRS 278.300 and 807 KAR 5:001* (Ky. PSC June 3, 2013).

³⁷ Case No. 2020-00148, *Electronic Application of the Adair County Water District to Issue Securities in the Approximate Principal Amount of \$5,405,000 for the Purpose of Refunding Certain*

2. Additional Working Capital. The DSC method, as historically applied by the Commission, includes an allowance for additional working capital that is equal to the minimum net revenues required by a district's lenders that are above its average annual debt payments. In its application, Adair District requested recovery of an allowance for working capital that is equal to 120 percent of its average annual debt payments for its loan payable to KIA at the time of its application.

USDA/RD requires that Adair District charge rates that produce net revenues that are at least 120 percent of its average annual debt payments. Following the Commission's historic practice, Staff agrees with Adair District's revised methodology. Therefore, \$37,734 is included it in the revenue requirement.

| | | |
|---|----|----------------------|
| Average Annual Principal and Interest | \$ | 188,670 |
| Times: DSC Coverage Ratio | | <u>120%</u> |
| Total Net Revenues Required | | 226,404 |
| Less: Average Annual Principal and Interest | | <u>(188,670)</u> |
| Additional Working Capital | \$ | <u><u>37,734</u></u> |

3. Interest and Dividend Income. In the Application, Adair District did not include Interest and Dividend Income in the Revenue Requirement Calculation.³⁸ Adair District's Annual Report includes Interest and Dividend Income of \$70.³⁹ Calculations for Revenue Requirement include the removal of Interest and Dividend Income; therefore, Staff removed \$70 from the Revenue Requirement.

Outstanding Obligations of the District Pursuant to the Provisions of KRS 278.300 and 807 KAR 5:001 (Ky. PSC Sept. 4, 2020).

³⁸ Application, Exhibit E, Revenue Requirement Calculation - Debt Service Method.

³⁹ Annual Report at 26.

Signatures

_____/s/ William Foley_____
Prepared by: William Foley
Revenue Requirement Branch
Division of Financial Analysis

_____/s/ Sam Reid_____
Prepared by: Sam Reid
Rate Design Branch
Division of Financial Analysis

APPENDIX

APPENDIX TO A STAFF REPORT OF THE KENTUCKY PUBLIC SERVICE
COMMISSION IN CASE NO. 2021-00316 DATED DEC 16 2021

The following rates and charges are prescribed for the customers in the area served by Adair County Water District. All other rates and charges not specifically mentioned herein shall remain the same as those in effect under the authority of the Commission prior to the effective date of this Order.

Monthly Wastewater Rates

| | | |
|---|------------|--------------|
| <u>Minimum Bill</u> | \$ 10.65 | Per Customer |
| <u>All Usage (based on water usage)</u> | \$ 0.01096 | Per Gallon |

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