



# CITY OF BULLHEAD CITY

COUNCIL COMMUNICATION

MEETING DATE: July 16, 2019

SUBJECT: Resolution authorizing ballot initiative related to EPCOR Water Acquisition

DEPT OF ORIGIN: Office of the City Manager

DATE SUBMITTED: July 10, 2019

SUBMITTED BY: Toby Cotter, City Manager

*SUMMARY:*

This item is presented to the Bullhead City Council for discussion and possible action to adopt a resolution ordering and calling for an all-mail ballot election to be held on November 5, 2019, to submit to City voters the question of authorizing the acquisition of EPCOR Water, and as practical, any other privately owned water utility, in and around Bullhead City, and the authorization to have bonds issued in an amount necessary to complete the acquisition.

This requested action is the culmination of more than a year of extensive involvement in EPCOR's planned rate increases and proposed consolidation efforts with Phoenix area water systems. Earlier this year an administrative law judge sided with the City in not recommending that Bullhead City's rates be consolidated with EPCOR's other Arizona districts, many of which are in more affluent areas and which would have the effect of Bullhead's customers subsidizing more expensive systems. However, the Arizona Corporation Commission took an action that left many puzzled on its legal grounds and ordered the immediate implementation of interim rates that significantly increased Bullhead City residential and business water rates. The Corporation Commission then also directed EPCOR to submit another rate case by May of 2020, which could further raise rates. Rate-making in Phoenix with a corporation commission that appears to be focused on allowing increasing rates and rate consolidation of diverse water systems are all reasons this action has progressed to this point.

During the past 90 days the Raftelis team has been working diligently to place a value on EPCOR's water system within the City. After extensive research, the Raftelis team presented a range of values that assess different qualitative concerns, and has opined that the systems within Bullhead City would carry a market value of approximately \$55 million. What this value represents is a mixture of Arizona Corporation Commission rate base determinations, comparative sales and income stream analysis.

The authorizing resolution seeks authorization to: 1) purchase or acquire EPCOR, and if practical, any other water utility in and around Bullhead City; and 2) acquire bonding in the amount of \$130 million for the acquisition.

If the system is only worth \$55 million why would up to \$130 million in bonding authority be sought? Since the potential for acquiring EPCOR has been of public discussion, EPCOR has been alleging that its Bullhead City systems are worth \$130 million. City management and the professional valuation team believe the \$130 million is highly over-stated, but that is nonetheless, a value asserted by EPCOR. However, if EPCOR actually operated the Bullhead systems under the assumption that it is worth \$130 million, it should necessarily be operating, charging commensurate rates and taking revenue return based upon that number, which it is obviously not doing. If the voters approve the acquisition of EPCOR or another water utility as proposed, the actual prudence of any specific bonding amount would be submitted as a separate question to the City Council for further discussion and debate at a later date.



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EPCOR continues to tell the City that it is not for sale. Therefore, a court (jury) would establish the final purchase price based on a condemnation proceeding. The City is using EPCOR's stated price of \$130 million in the resolution, but will fight fiercely to obtain the system for a price much closer to the City's professional valuation of \$55 million as determined by professional consultants, engineers, and appraiser. If approved tonight, the City hired consultant will start its second phase to determine potential water rates, staffing and operational issues to supply to the City Council and voters as further information to be considered as part of the ballot initiative.

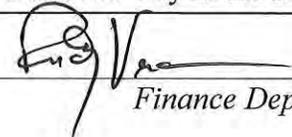
The proposal being considered by Council in this action contains the following (in summary):

1. Placing ballot language before voters through an all-mail ballot on November 5, 2019;
2. Authorization to acquire EPCOR and, if practical any other water utility in an around the City; and
3. Authorization to borrow funds necessary to complete the acquisition.

If adopted by the City Council, the measure would be presented to the voters through an all-mail ballot culminating on November 5, 2019. If approved by the voters, the City Council would then be authorized to commence the acquisition of EPCOR and/or other water utilities in an around Bullhead City in the future.

*FISCAL IMPACT:*

REVIEWED BY: \_\_\_\_\_

  
Finance Department

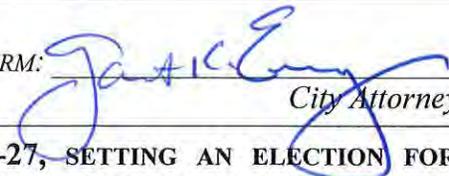
Initial Project Costs: Bond amount up to \$130 million  
 Future Ongoing Costs: Enterprise funding of water system  
 Physical Impact (on people/space): To be determined  
 Residual or Support/Overhead/Fringe Costs: Utility system operation

*ATTACHMENTS:*

1. Raftelis Summary Technical Memo
2. Resolution No. 2019R-27

*LEGAL REVIEW:*

APPROVED AS TO FORM: \_\_\_\_\_

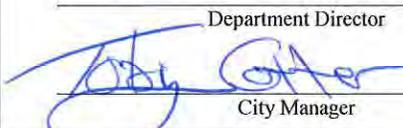
  
City Attorney

**RECOMMENDATION: MOVE TO ADOPT RESOLUTION NO. 2019R-27, SETTING AN ELECTION FOR THE QUESTION OF APPROVING OR NOT THE POTENTIAL ACQUISITION OF EPCOR OR ANY OTHER WATER UTILITY IN OR AROUND BULLHEAD CITY AND IF APPROVED, SEEKING BONDING AUTHORITY FOR THE ACQUISITION IN AN AMOUNT NOT TO EXCEED \$130 MILLION.**

APPROVED FOR SUBMITTAL BY:

CITY CLERK'S USE ONLY  
COUNCIL ACTION TAKEN

Department Director

  
City Manager

Resolution No. \_\_\_\_\_  
 Ordinance No. \_\_\_\_\_  
 Approved \_\_\_\_\_  
 Other \_\_\_\_\_

Continued To: \_\_\_\_\_  
 Referred To: \_\_\_\_\_  
 Denied \_\_\_\_\_  
 File No. \_\_\_\_\_

# MEMO

**To:** Toby Cotter, City Manager  
Bullhead City, Arizona

**From:** Rick Giardina, Executive Vice President, Raftelis

**Date:** July 10, 2019

**Re:** Summary Technical Memo - EPCOR Mohave and North Mohave Water System Phase I Valuation

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## 1. Executive Summary – Estimated Valuation

Raftelis utilized accepted valuation approaches that include the: Rate Base, Income, and Sales or Market Transactions approaches to estimate the market value of the Mohave and North Mohave water systems. The results are shown in Table 1.

**Table 1: Valuation Results**

| Valuation Approach | Amount       |
|--------------------|--------------|
| Rate Base          | \$42,165,000 |
| Income             | \$70,700,000 |
| Sales              | \$52,291,000 |
| Valuation Estimate | \$55,000,000 |

Reconciling the value estimate derived from the above noted approaches, Raftelis would estimate the market value of the Mohave and North Mohave water systems (collectively, Combined Mohave System) at \$55 million.

This estimate is a direct reflection of the Table 1 results relying primarily on the rate base and income approaches, with consideration of the market approach in weighing and reconciling the estimates. Rate base is given substantial weight because it is the approach used by the Arizona Corporation Commission (ACC) to set the value of the Combined Mohave System for rate regulation purposes. The income approach is also given strong consideration as buyer and sellers of income producing properties generally consider the income stream, rate of return and present value of the asset's ability to generate income over time in arriving at a negotiated price. Market transactions are relevant in that a willing buyer would not pay more, and a willing seller would not accept less, for a property of equal utility. In the context of the sales of regulated utilities, market

transactions are indicative of the reasonableness of the assumptions (such as rate of return and estimated income) and weighting to be given the rate base and income approaches in arriving at an estimate of market value, since they reflect what is actually paid for such assets in the market. It is often said that the best indicator of market value is a market sale of the subject property adjusted for intervening factors, such as market conditions over time.

Raftelis considered the cost approach which is a recognized method of valuation. This approach can be considered when other valuation methods are unavailable due to a lack of meaningful data and other considerations. In this case there was more than sufficient data to support a reliable valuation estimate based on the other approaches, and therefore the cost approach was given no weight.

EPCOR has stated that the systems serving Bullhead City are not for sale and that it is not a willing seller. However, the legal determination of value will be made as if EPCOR were a willing seller.

It is important to acknowledge that a willing seller would be reluctant to sell at the rate base value, the current value upon which their rate of return is applied; their income is set and the sale would not advantage them over keeping the asset. Likewise, a willing buyer would be reluctant to buy the system at the income valuation. Under this scenario the buyer “gains” nothing but is simply paying today what he would recover by operating the asset into perpetuity. One reflects the floor and the other the ceiling, while the reconciliation recognizes that a willing buyer and willing seller would compromise at a price that is not solely advantageous to either.

Hence, the recommended valuation of \$55 million is a negotiated value reflecting “the most probable cash price a willing buyer would pay a willing seller on the open market where the seller has a reasonable time to find a buyer and the buyer knows everything about the property.”<sup>1</sup>

## 2. Introduction

The City of Bullhead City, Arizona (the City) is considering acquiring, through negotiation and/or condemnation, the portions of the water assets of the investor-owned utility, EPCOR, in and around the City. Through acquisition of EPCOR assets, the City would take over full responsibility for water service to customers. The acquisition of a utility is a considerable undertaking that requires a comprehensive assessment of the value of the properties/assets that will be acquired and the development of a management and transition plan that assures customers and other stakeholders, such as regulatory agencies, that the City has the management, operational and financial capability to run the water system efficiently and effectively.

The City is investigating a November 2019 bond election where voters will be asked to authorize funding for the acquisition of the Combined Mohave System. In support of the election and the subsequent acquisition process, the City retained Raftelis to provide the needed valuation, management, and engagement assistance services. To this end, and in advance of the bond election, Raftelis, under a two-phase statement of work (SOW), was retained to provide a preliminary

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<sup>1</sup> State Bar of Arizona, RAJI, Civil (6<sup>th</sup>), Eminent Domain 3A.

estimate of the value of the Combined Mohave System utility assets to be acquired, a multi-year financial and rate plan, and a preliminary management and transition plan that includes stakeholder engagement activities. Part of the plan included preparation and execution of a stakeholder engagement strategy.

All elements of the two-phased SOW will be completed in advance of the prospective bond election.

If the City moves forward with the bond election, the preliminary valuation estimate from Phase I will be updated and refined in Phase II as necessary to support negotiations and condemnation proceedings, should they become necessary.

This Technical Memorandum (Tech Memo) documents the results of our Phase I valuation efforts. It includes information regarding EPCOR and the water systems included in the valuation: the Combined Mohave System. In this Tech Memo we also discuss the valuation approaches considered and the resulting preliminary valuation estimate.

### **3. EPCOR Background Information**

EPCOR USA is an indirect wholly-owned subsidiary of EPCOR Utilities Inc. (EPCOR). EPCOR is a municipally-owned Canadian corporation and holding company headquartered in Edmonton, Alberta, Canada. EPCOR is governed by a Board of Directors, appointed by the company's sole shareholder, the City of Edmonton, Alberta, Canada.

EPCOR USA is a Delaware corporation and holding company. EPCOR USA was formed to own water and wastewater treatment facilities in the United States, is headquartered in Phoenix, Arizona.

EPCOR USA purchased the Combined Mohave System as part of a 2011 acquisition of the Arizona-American Water Company and the New Mexico-American Water Company from American Water Works Company, Inc. for a reported \$470 million. As part of this acquisition, EPCOR USA purchased water and wastewater assets and facilities serving 124,000 water and 51,000 wastewater service connections throughout Arizona and New Mexico. Per the EPCOR USA application with the ACC, 107,000 water and 51,000 wastewater service connections were within Arizona, leaving 17,000 water and no wastewater service connections within New Mexico. Arizona water utilities, therefore, represented 86% of the total water service connections acquired, 100% of the total wastewater service connections acquired and 90% of the combined number of water and wastewater service connections acquired.

EPCOR USA purchased the North Mohave Water System from the North Mohave Valley Corporation in 2013 for approximately \$2.1 million. As part of this acquisition, EPCOR USA purchased water assets and facilities serving approximately 2,000 water service connections. EPCOR Water Arizona, Inc., was formed to hold and manage EPCOR USA's water assets in Arizona.

## 4. The Mohave Combined Water System

The following is a brief description of the two water systems involved, including the storage, booster pumps, wells, water mains and water service connections. The water rights are owned by the United States but allocated exclusively for the City’s use by contract with the Bureau of Reclamation. Water is then provided to the Combined Mohave System for distribution. EPCOR pays the City an administrative fee to use the City’s water allocations, but does not otherwise pay for the water.

### WATER STORAGE

The Mohave Water System and North Mohave Water System include multiple separate water storage facilities and tanks distributed throughout the respective water systems and often co-located with wells. Table 2 summarizes the individual assets, the combined capacity in terms of millions of gallons (MGD) per day of capacity.<sup>2</sup>

**Table 2: Water Storage Facilities and Tanks**

| System          | Assets | Capacity | Units |
|-----------------|--------|----------|-------|
| Mohave          | 23     | 8.405    | MGD   |
| North Mohave    | 7      | 2.500    | MGD   |
| Combined Mohave | 30     | 10.905   | MGD   |

### BOOSTER PUMPS

The Mohave Water System and North Mohave Water System include booster pumps throughout the respective water systems. Table 3 summarizes the individual assets, the combined capacity in terms of horse power.<sup>3</sup>

**Table 3Error! No text of specified style in document.: Booster Pumps**

| System          | Assets | Capacity | Units       |
|-----------------|--------|----------|-------------|
| Mohave          | 4      | 1,468    | Horse power |
| North Mohave    | 1      | 320      | Horse power |
| Combined Mohave | 5      | 1,788    | Horse power |

<sup>2</sup> Per Woodard & Curran (W&C), an engineering firm, as part of the Raftelis team, review of Mohave Water System comprised of historical Mohave, Camp Mohave, Lake Mohave, and Desert Foothills and North Mohave Water System facilities.

<sup>3</sup> Per W&C review of Mohave Water System comprised of historical Mohave, Camp Mohave, Lake Mohave, and Desert Foothills and North Mohave Water System facilities.

## WELLS

The Mohave Water System and North Mohave Water System include multiple separate wells distributed throughout the respective water systems and often co-located with water storage facilities. Table 4 summarizes the individual assets, the combined capacity in terms of gallon per minute (GPM) of capacity.<sup>4</sup>

**Table 4: Water Storage Facilities and Tanks**

| System          | Assets | Capacity | Units |
|-----------------|--------|----------|-------|
| Mohave          | 15     | 10,773   | GPM   |
| North Mohave    | 5      | 1,286    | GPM   |
| Combined Mohave | 20     | 12,059   | GPM   |

## WATER MAINS

Water is conveyed from the network of treated storage tank facilities to customers located throughout the respective water systems through a series of water distribution mains to customer service connections. A summary of the sizes and lengths of transmission main is provided in Table 5.<sup>5</sup>

**Table 5: Transmission Main Sizes and Lengths**

| Line Size (inches) | Mohave Length (LF) | North Mohave Length (LF) | Combined Mohave Length (LF) |
|--------------------|--------------------|--------------------------|-----------------------------|
| 4-inch and less    | 314,750            | 39,100                   | 353,850                     |
| 6-inch             | 443,700            | 165,000                  | 608,700                     |
| 8-inch             | 321,900            | 63,500                   | 385,400                     |
| 10-inch            | 24,000             | 0                        | 24,000                      |
| 12-inch            | 106,100            | 69,200                   | 175,300                     |
| 16-inch            | 3,000              | 0                        | 3,000                       |
| 18-inch            | 1,200              | 0                        | 1,200                       |
| 24-inch            | 100                | 0                        | 100                         |
| <b>Total</b>       | <b>1,214,750</b>   | <b>336,800</b>           | <b>1,551,550</b>            |

<sup>4</sup> Per W&C review of Mohave Water System comprised of historical Mohave, Camp Mohave, Lake Mohave, and Desert Foothills and North Mohave Water System facilities.

<sup>5</sup> Per W&C review of Mohave Water System comprised of historical Mohave, Camp Mohave, Lake Mohave, and Desert Foothills and North Mohave Water System facilities.

## WATER SERVICE CONNECTIONS

The total of water service connections by meter size for the respective water systems is provided in Table 6.<sup>6</sup>

**Table 6: Transmission Main Sizes and Lengths**

| Water Meter Size (inches) | Mohave (Service Connections) | North Mohave (Service Connections) | Combined Mohave (Service Connections) |
|---------------------------|------------------------------|------------------------------------|---------------------------------------|
| 5/8 x 3/4-inch            | 15,312                       | 1,912                              | 17,224                                |
| 3/4-inch                  | 10                           | 0                                  | 10                                    |
| 1-inch                    | 383                          | 56                                 | 439                                   |
| 1 1/2-inch                | 5                            | 37                                 | 42                                    |
| 2-inch                    | 532                          | 77                                 | 509                                   |
| 3-inch                    | 22                           | 1                                  | 23                                    |
| 4-inch                    | 5                            | 1                                  | 6                                     |
| 6-inch                    | 3                            | 0                                  | 3                                     |
| <b>Total</b>              | <b>16,172</b>                | <b>2,084</b>                       | <b>18,256</b>                         |

## 5. Completed and Planned Capital Improvements

Under ACC regulatory oversight, an Investor Owned Utility (IOU) may receive a return on completed and used and useful capital improvements. Annual depreciation, the annual decline in expected value, is also included as an operating expense and is based on the cost of the capital improvement divided by the expected useful life of the facility, which is also overseen and approved by the ACC.

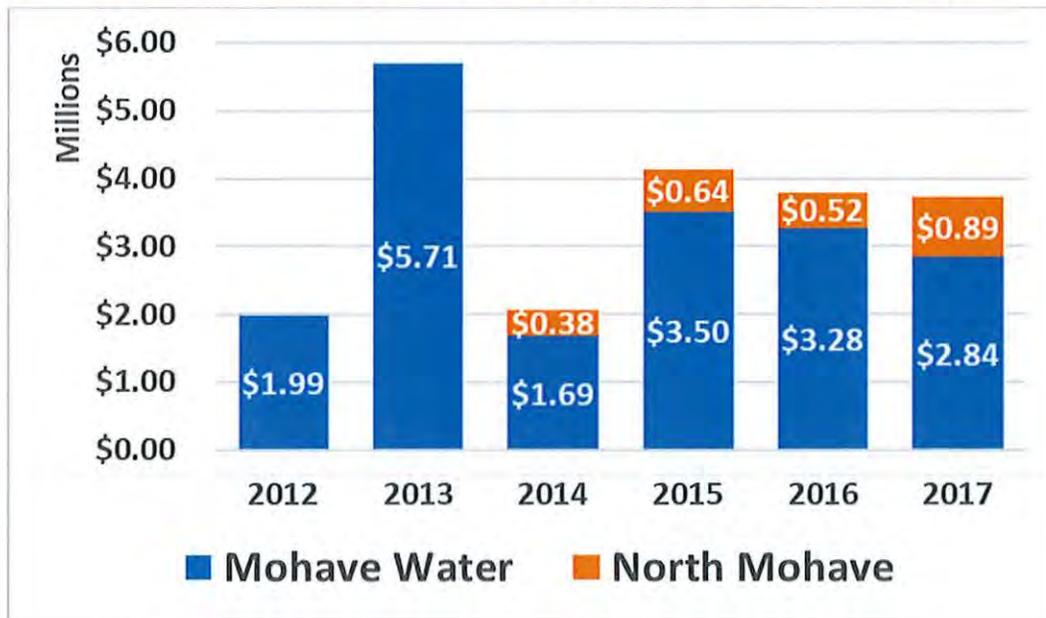
### COMPLETED CAPITAL IMPROVEMENTS

Over the six-year period of 2012 through 2017, EPCOR Water Arizona, Inc. has reportedly completed \$19 million in capital facility improvements to the Mohave Water System, which is an average of \$3.17 million per year. Over the four-year period of 2014 through 2017, EPCOR Water Arizona, Inc. has completed \$2.43 million in capital facility improvements to the North Mohave Water System, which is an average of \$0.61 million per year.

<sup>6</sup> Per EPCOR provided water system filed with the ACC as of 12/31/2017 per annual reports filed in May of 2018.

Figure 1 summarizes the annual capital spending amounts for each respective water system.

**Figure 1: Combined Mohave System - EPCOR Historic Capital Spending (\$ millions)**

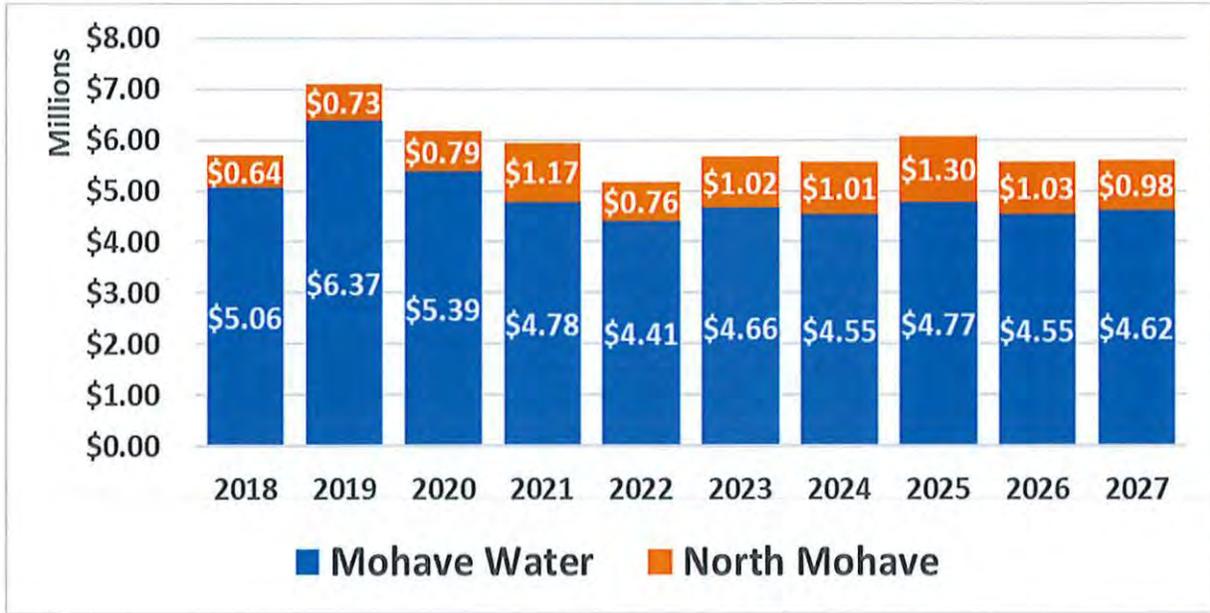


## PLANNED CAPITAL IMPROVEMENTS

As part of the rate case initiated in 2017, EPCOR Water Arizona, Inc. submitted testimony and projections regarding planned capital improvements over the ten-years including 2018 through 2027 for both the Mohave Water System and North Mohave Water System. EPCOR Water Arizona, Inc. plans to invest, before inflation, \$49.16 million in the Mohave Water System and \$9.41 million in the North Mohave Water System over the ten-years of 2018 through 2027.<sup>7</sup> This represents a combined 2018 through 2027 total of \$58.57 million and an average of \$5.86 million per year for the Combined Mohave System – see Figure 2.

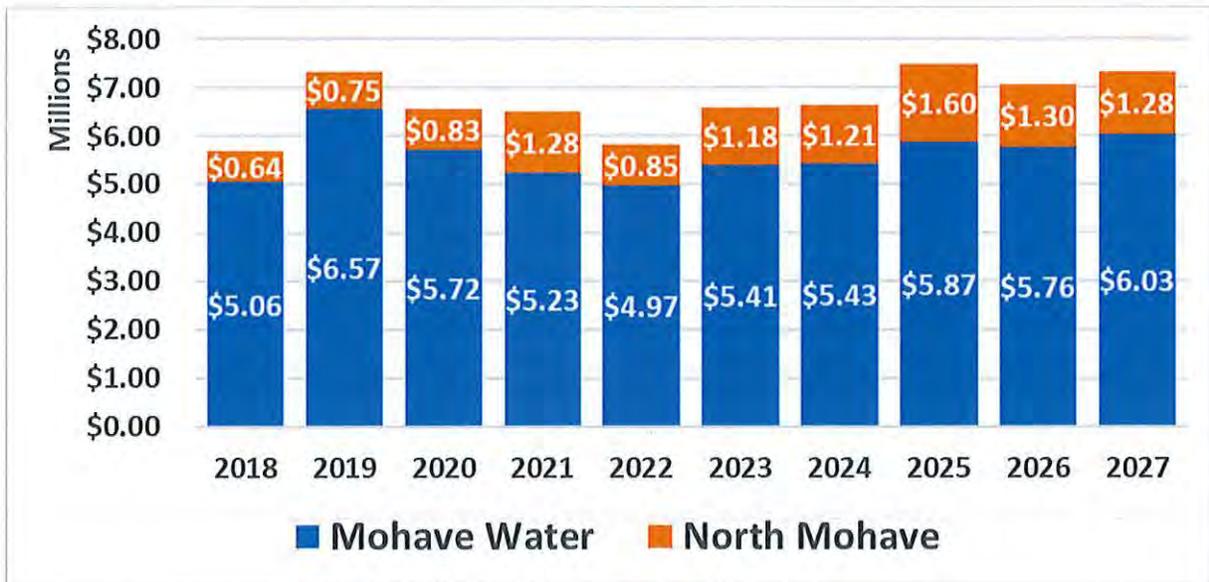
<sup>7</sup> Per EPCOR Water Arizona, Inc. staff testimony before the ACC on May 2018.

**Figure 2: Combined Mohave System - EPCOR Projected Capital Spending**  
 (\$ millions – current)



The same amounts adjusting for 3.0% annual inflation starting in 2019 results in the inflation-adjusted total of \$56.05 million in the Mohave Water System and \$10.92 million in the North Mohave Water System over the ten-years of 2018 through 2027 as summarized in Figure 3. This represents a combined 2018 through 2027 total of \$66.97 million and an average of \$6.70 million per year for the Combined Mohave System.

**Figure 3: Combined Mohave System - EPCOR Projected Capital Spending (\$ millions – inflated)**



## 6. Valuation Approaches – General Discussion

There are three generally recognized approaches to the determination of value that were utilized in this analysis: the rate base approach, the income approach, and the sales comparison approach.

### RATE BASE APPROACH

The rate base approach is the valuation applied by the regulatory body, in this case the ACC. For the Combined Mohave System, the rate base valuation is the average of the original cost less depreciation (book value) and the reconstructed new cost less depreciation. A rate base valuation is reliable because it reflects the return on which the utility’s rates are calculated.

Under the rate base approach, the value of the assets is estimated by subtracting the amount of depreciation from the original and reconstructed cost, respectively, of the assets as determined by the ACC. Depreciation in this context represents the loss in value caused by physical deterioration, functional obsolescence, and economic obsolescence.

The rate base approach considers the general practice by regulated public utilities of using original cost less depreciation (OCLD) value which is averaged with the reconstructed cost less depreciation (RCLD) within Arizona to arrive at the fair value rate based (FVRB). The rate base is that value upon which the IOU may recover its investment and earn a rate of return on the unrecouped asset value or rate base. Under most regulated ratemaking settings, rate base reflects the original cost of assets, which means the cost of an asset when first devoted to public service, rather than a purchase cost or acquisition cost in a sale or asset transfer.<sup>8</sup> In general, in an acquisition, any excess in

<sup>8</sup> Principles of Public Utility Rates. Public Utilities Reports, Inc., Second Edition. 1988, p.237.

acquisition cost over OCLD is excluded from rate base eliminating the opportunity for the buying entity to directly recoup its investment of this excess unless the IOU may demonstrate that the excess acquisition cost over the approved rate base results in long-term cost efficiencies for rate payers. For example, in 2019 EPCOR purchased the Rio Verde system for a price more than the rate base. EPCOR has asked the ACC to consider allowing it to set rates based on the full purchase price instead of only the rate base. The ACC denied this request.

This rate regulation by public utility commissions (PUCs) prevent utilities from artificially inflating plant and equipment prices to increase returns, earn monopolistic profits and making customers, in essence, pay again for the same assets.<sup>9</sup> It also would lower the amount that a buyer would be willing to offer for the water system assets. Therefore, due to the rate regulation in a PUC regulatory environment, fair value is the product of the rate-making process, whereby the rules associated with rate regulation impact the value of the property which is being regulated.<sup>10</sup> Furthermore, since the OCLD value of the assets is averaged with the RCLD of the assets within Arizona, the rate base approach should consider the value the assets at their OCLD and the RCLD.

Rate regulation also has a “used and useful” concept, which is a rule that the cost of property must be removed from rate base whenever the property ceases to be of public service. Under the used and useful rule, the cost is thereby ignored, even if it has not been recouped by previous charges for service, because the property has ceased to have any value for its intended use. This is applicable for so called “stranded assets” such as a treatment plant that has a certain capacity which it cannot utilize due to limitations on influent flow rates or transmission/distribution limitations. Other adjustments to rate base generally involve the inclusion of a working capital allowance and construction work in progress in rate base for rate-making purposes.

## INCOME APPROACH

The income approach is used primarily in valuing income producing assets. It is based on the premise that the value of a property is the present value of the future economic benefits of owning the property. The underlying principle in this approach is that buyers invest in assets with the expectation of receiving the anticipated future net income. This approach is relevant when that property being valued generates or is anticipated to generate net income, profits, or free cash flow to the owner. There are generally two methods of estimating value under the income approach. These are (1) the direct capitalization method, or single-period model, and (2) the discounted cash flow method. The direct capitalization method measures value by capitalizing a projected net income or cash flow stream in perpetuity by a capitalization rate. It assumes there will be no variation in the capitalization rate and no termination of the income stream. The discounted cash flow method measures value by projecting future expected (debt-free) net cash flows and discounted to present value using a discount rate.<sup>11</sup>

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<sup>9</sup> Ibid. p.239-240.

<sup>10</sup> Ibid. p.216-217.

<sup>11</sup> American Society of Appraisers, Business Valuation Standards, 2009, p.27.

Raftelis completed the income approach valuation for the Combined Mohave System using the discounted cash flow method.

Under the discounted cash flow method, the debt-free net cash flows, or “free cash flows” represent the total after-tax cash flow generated by the going concern and available to the providers of the subject’s invested capital: stockholders (equity) and creditors (debt). Debt-free net cash flow is defined as follows:

Net income  
Plus: depreciation and amortization  
Plus: interest expense  
Less: working capital additions  
Less: capital expenditures  
Equals: Free Cash Flow

These cash flows are discounted to present value at a discount rate that reflects the risks inherent in the investment and the returns reflective of current market conditions. If the cash flow stream is expected to continue beyond the projection period, a terminal value is estimated. The sum of the discounted cash flows and the discounted terminal value provides an indication of the value of the business.

## **SALES OR MARKET APPROACH**

The sales approach is based on the principle of substitution. That is, a person will not pay more, or accept less, for a property than for a functionally equivalent property, all else being equal. This method compares the subject to similar businesses that have been sold. There are two methods of estimating value of a business under the sales approach. These are (1) the Guideline Public Company Method, and (2) the Guideline Transactions Method. The Guideline Public Company Method is a method whereby market multiples are derived from market prices of stocks of companies that are engaged in the same or similar lines of business, and that are actively traded on a free and open market.<sup>12</sup> The Guideline Transactions Method is a method whereby pricing multiples are derived from transactions involving companies engaged in the same or similar lines of business.<sup>13</sup> If the sales comparisons are not exactly like the properties being valued, then the selling prices are adjusted to equate them to the characteristics of the properties being valued. Certain factors, such as the location, date of sale, physical characteristics, and technical and economic factors relating to the transaction are analyzed for their comparable uniqueness. This approach is most reliable and applicable when there is an active market providing a sufficient number of sales of comparable properties that can be independently verified through reliable sources. Raftelis completed the sales approach valuation for the Combined Mohave System using the Guideline Transaction Method and the adjusted sales price per water and wastewater service connection.

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<sup>12</sup> Ibid, p.28.

<sup>13</sup> Ibid, p.30.

It is axiomatic that the sale of the subject property is often the best indicator of its value, because many factors, such as location, need no adjustment. In this case the Combined Mohave System was sold as part of an aggregate transaction involving several individual systems. Therefore, a method of allocation was needed. Raftelis uses the price per connection as the unit of value to derive an allocation of the purchase price to the Combined Mohave System. Price per connection is also the unit of comparison with sales of other systems. Raftelis recognizes, as would a willing buyer and seller of the Combined Mohave System, that using price per connection as the unit of allocation and comparison may result in a higher value for those systems because of the inclusion of assets in the transaction, such as treatment plants, that would only be allocable to other systems purchased as part of the same transaction.

## **COST APPROACH**

The cost approach is the cost to reproduce the existing facility, less observed depreciation to arrive at the expected remaining life of the assets being valued. Given the rate base, regulated environment, and income generated by the Combined Mohave System, and looking at market transactions, including the sale of the Combined Mohave System as part of a larger transaction, buyers and sellers would not consider the cost approach. The cost approach was therefore considered, but given no weight or relevance in this analysis.

## **7. Combined Mohave System Valuation Estimate**

The following summarizes the valuation estimate resulting from the rate base approach, income approach and sales approach completed by Raftelis. Also included is a summary of the process, when applicable, in arriving at the preliminary asset valuation estimate under the respective valuation approaches.

### **RATE BASE APPROACH**

Raftelis prepared the rate base approach valuation incorporating the Arizona Corporation Commission Fair Value Rate Base which represents the average of the OCLD and RCND rate base amounts as of December 31, 2019. We used the following steps to estimate the rate base amounts using EPCOR provided data from the 2017 filing and for estimated capital spending in 2018 and 2019.

1. Incorporate original cost and accumulated depreciation as of December 31, 2017 per adjustments during the ACC rate process.
2. Include planned 2018 and 2019 capital projects increasing the original cost of system assets.
3. Adjust for anticipated depreciation for 2017 and 2018 assets constructed.
4. Adjust for continued amortization of Contributions in Aid of Construction and Advances in Aid of Construction since these facilities are included in the original cost of system assets but removed per ACC requirements prior to finalization of the rate base.
5. Adjust for increases to working capital and materials and supplies reserves.

Table 7 summarizes the estimated rate base under the OCLD and RCND methods as of December 31, 2019 for the respective water systems. The FVRB is the average of the OCLD and RCND values and is also summarized in Table 7.

**Table 7: Rate Base Approach Valuation**

| System          | OCLD         | RCND         | FVRB         |
|-----------------|--------------|--------------|--------------|
| Mohave          | \$33,192,200 | \$43,255,800 | \$38,224,000 |
| North Mohave    | 3,650,700    | 4,231,100    | 3,940,900    |
| Combined Mohave | \$36,842,900 | \$47,486,900 | \$42,164,900 |

## INCOME APPROACH

Raftelis completed an income approach valuation incorporating the discounted cash flow method using projected 2020 through 2039 annual financial results plus the terminal value represented by the capitalization of the stabilized income stream, starting in 2040, discounted to present value.

The discount rate was incorporated using the EPCOR Water Arizona, Inc. approved Weighted Average Cost of Capital (WACC), following adjustments for the fair value increment, of 5.98% per the filings ACC associated with the interim rate surcharge.

Table 8 summarizes the income approach derived valuation as of December 31, 2019 for the respective water systems.

**Table 8: Income Approach Valuation**

| System          | Value        |
|-----------------|--------------|
| Mohave          | \$58,600,000 |
| North Mohave    | 12,100,000   |
| Combined Mohave | \$70,700,00  |

## SALES APPROACH

Raftelis completed a market or sales comparison approach valuation incorporating the sales price per water and wastewater service connection of nine completed and/or pending water system acquisitions within Arizona over the ten-year period of 2009 through May 2019. It should be noted that EPCOR Water Arizona, Inc. / EPCOR USA / EPCOR was the buyer of the utility system in five of the nine acquisitions. Since the transactions occurred over a ten-year period and the acquisitions included a variety of water and/or wastewater systems, it was necessary to complete the following steps to have a price per service connection in 2019 equivalent costs:

1. Document sales price for each transaction

2. Calculate the Engineering New Record-Construction Cost Index (ENR-CCI) adjustment from the year of the sale to 2019. This is needed to acknowledge the passage of time since the sale occurred; essentially to bring the value to today's dollars.
3. Adjust sales price for resulted in the ENR-CCI adjusted sales price
4. Use the total number of water and wastewater service connections in the year of the sales
5. Calculate the adjusted sales price per connection

Table 9 summarizes the key components of the review of the nine recent acquisitions within Arizona.

The average of the 2019 Adjusted Sales Price per service connection for the nine recent Arizona acquisitions is \$3,164 with both the minimum (\$481) and the maximum (\$5,410) resulting from two 2019 pending acquisitions with EPCOR as the system buyer.

**Table 9: Adjusted Sales Price per Service Connection**

| Seller   | Sales Date | Buyer  | Sales Price (\$M) | ENR-CCI Adj. | 2019 Adjusted Sales Price (\$M) | Service Connections | Price Per Service Connection |
|--|------------|--|-------------------|--------------|---------------------------------|---------------------|------------------------------|
| Rio Verde Utilities                                | 3/1/19     | EPCOR  | \$22.977          | 1.00         | \$22.977                        | 4,247               | \$5,410                      |
| Brooke Water LLC                                   | 5/3/19     | EPCOR  | 1.007             | 1.00         | 1.007                           | 2,094               | 481                          |
| Arizona American Water / New Mexico American Water | 1/31/12    | EPCOR  | 470.000           | 1.22         | 573.400                         | 175,000             | 3,277                        |
| North Mohave Valley Corporation                    | 4/19/13    | EPCOR  | 2.137             | 1.19         | 2.543                           | 2,000               | 1,272                        |
| Chaparral City Water Company                       | 6/7/10     | EPCOR  | 34.600            | 1.29         | 44.634                          | 13,000              | 3,433                        |
| Red Rock Utilities, Inc                            | 1/1/18     | Global Water Resources, Inc.                     | 6.100             | 1.03         | 6.283                           | 1,654               | 3,799                        |
| New River Utility Company                          | 10/22/15   | City of Peoria                                   | 10.000            | 1.14         | 11.400                          | 2,882               | 3,956                        |
| H2O, Inc.  | 11/1/13    | Town of Queen Creek                              | 34.000            | 1.19         | 40.460                          | 9,831               | 4,116                        |
| Diablo Village Water Company / Thim Utility Co.    | 10/7/09    | Metropolitan Domestic Water Improvement District | 2.750             | 1.33         | 3.658                           | 1,339               | 2,732                        |

Table 10 summarizes the sales approach estimated valuation of \$52.3 million which is the product of multiplying the average \$3,164 per service connection by the 14,515 Mohave Water System and 2,012 North Mohave Water System service connections.

**Table 10: Sales Approach Valuation**

| System                 | Value               |
|------------------------|---------------------|
| Mohave                 | \$45,925,460        |
| North Mohave           | 6,365,968           |
| <b>Combined Mohave</b> | <b>\$52,291,428</b> |

## 8. Summary Valuation Results

Raftelis utilized accepted valuation approaches that include the: rate base, income, and sales or comparable transactions approaches. The valuation results are shown in Table 11.

**Table 11: Valuation Results**

| Valuation Approach        | Amount              |
|---------------------------|---------------------|
| Rate Base                 | \$42,165,000        |
| Income                    | \$70,700,000        |
| Sales                     | \$52,291,000        |
| <b>Valuation Estimate</b> | <b>\$55,000,000</b> |

Based on the resulting values from the above noted approaches, Raftelis would estimate the fair market value of the Combined Mohave System at \$55 million.

Figure 4: Valuation Results



This estimate is a direct reflection of the Table 1 (and Table 11) results relying primarily on the rate base and income approaches, with consideration of the market approach in weighing and reconciling the estimates. Rate base is given the greatest weight as it is the approach used by the Arizona Corporation Commission (ACC) to set the value of the Combined Mohave System for rate regulation purposes. The income approach is also given strong consideration as buyer and sellers of income producing properties generally consider the income stream, rate of return and present value of the asset’s ability to generate income over time in arriving at a negotiated price. Market transactions are relevant in that a willing buyer would not pay more, and a willing seller would not accept less, for a property of equal utility. In the context of the sales of regulated utilities, market transactions are indicative of the reasonableness of the assumptions (such as rate of return and estimated income) and weightings to be given the rate base and income approaches in arriving at an estimate of market value, since they reflect what is actually paid for such assets in the market. It is often said that the best indicator of market value is a market sale of the subject property adjusted for intervening factors, such as market conditions over time.

That said, it is important to acknowledge that a willing seller would be reluctant to sell at the rate base value, the current value upon which their rate of return is applied; their income is set and the sale would not advantage them over keeping the asset. Likewise, a willing buyer would be reluctant to buy the system at the income valuation because under this scenario the buyer “gains” nothing, and is simply paying today exactly what she would recover by operating the asset into perpetuity. The former reflects the floor and the latter the ceiling, while the reconciliation recognizes that a willing

buyer and willing seller would compromise at a price that is not solely advantageous to either, as is reflected in the actual market transactions analyzed above. Hence, the recommended valuation of \$55 million is a negotiated value reflecting “the most probable cash price a willing buyer would pay a willing seller on the open market where the seller has a reasonable time to find a buyer and the buyer knows everything about the property.”<sup>14</sup>

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<sup>14</sup> State Bar of Arizona, RAJI, Civil (6<sup>th</sup>), Eminent Domain 3A.

**RESOLUTION NO. 2019R-27**

**A RESOLUTION OF THE MAYOR AND COUNCIL OF THE CITY OF BULLHEAD CITY, ARIZONA, ORDERING AND CALLING AN ALL-MAIL BALLOT ELECTION TO BE HELD ON NOVEMBER 5, 2019, IN CONNECTION WITH THE GENERAL ELECTION FOR THE CITY OF BULLHEAD CITY, ARIZONA, TO SUBMIT TO THE QUALIFIED ELECTORS THEREOF THE QUESTION OF AUTHORIZING THE CITY'S ACQUISITION, BY PURCHASE, BY THE EXERCISE OF THE RIGHT OF EMINENT DOMAIN OR BY ANY OTHER LEGAL MEANS, OF ANY AND ALL OF THE PLANT OR PROPERTY OR PORTION OF PLANT OR PROPERTY OF EPCOR WATER ARIZONA, INC., AND AS PRACTICAL, ANY OTHER PRIVATELY OWNED WATER UTILITY, IN AND AROUND THE CITY OF BULLHEAD CITY, ARIZONA CORPORATE LIMITS, AND THE ISSUANCE AND SALE OF NOT TO EXCEED \$130,000,000 PRINCIPAL AMOUNT OF BONDS OF THE CITY OF BULLHEAD CITY, ARIZONA FOR SUCH PURPOSES AND RELATED MATTERS.**

WHEREAS, the Mayor and Council of the City of Bullhead City, Arizona (hereinafter referred to as the "City"), determine that the City's acquisition, by purchase, by the exercise of the right of eminent domain or by any other legal means, of any and all of the plant or property or portion of plant or property of EPCOR Water Arizona, Inc., and as practical, any other privately owned water utility, in and around City corporate limits devoted to the business of or services and enterprises rendered by such public utility should continue to be studied and undertaken if the City's best interests are ultimately served thereby (hereinafter referred to as the "Property"); and

WHEREAS, the City also determines that if the City's best interests are ultimately served by the acquisition, the needs and best interests of the City will be served by the issuance and sale of bonds to acquire the Property; and

WHEREAS, for such purposes an all-mail ballot election shall be duly called and held (hereinafter referred to as the "Election");

NOW, THEREFORE, BE IT RESOLVED BY THE MAYOR AND COUNCIL OF THE CITY OF BULLHEAD CITY, ARIZONA:

Section 1. That an all-mail ballot Election, in and for the City, be and the same is hereby ordered and called to be held on November 5, 2019.

Section 2. That the official ballot for the Election (hereinafter referred to as the "Official Ballot") shall be in substantially the form attached as Exhibit A hereto.

Section 3. That notice of the Election may be given by the Clerk of the City by mailing an informational pamphlet and publishing and posting this Resolution (such pamphlet,

postings and publications hereinafter referred to as the “Notices”) under the circumstances and in the form the Clerk deems necessary and appropriate.

Section 4. That in order to comply with the Voting Rights Act of 1965, as amended, the following materials pertaining to the Election shall be translated into Spanish and mailed or distributed in each instance where mailing or distributing of such materials is required, to-wit: Official Ballot, Notices, Absentee/Early Voting Materials and Voting Instructions.

Section 5. (A) That the Election shall be held, conducted and canvassed in conformity with the provisions of the general and special election laws of the State of Arizona, except as otherwise provided by law, and only such persons shall be permitted to vote at the Election who are qualified electors of the City.

(B) That the City Clerk of the City is authorized and directed to take all actions, including entering into a contract with the County Recorder of Mohave County, Arizona (the “County”), to enter into an agreement with the Elections Department of the County to conduct the Election for the City.

(C) That all expenditures as may be necessary to order, notice, hold and administer the Election are hereby authorized.

(D) That the Clerk of the City is hereby authorized to take all necessary action to facilitate the Election.

Section 6. That the official returns from the Election shall be made to the Mayor and Council of the City and the Election shall be canvassed and the results thereof certified by the Mayor and Council of the City, as provided by law.

PASSED, ADOPTED AND APPROVED by the Mayor and Council of the City of Bullhead City, Arizona, on this 16<sup>th</sup> day of July, 2019.

\_\_\_\_\_  
Tom Brady, Mayor

Date: \_\_\_\_\_

ATTEST:

\_\_\_\_\_  
Susan Stein, City Clerk

APPROVED AS TO FORM:

\_\_\_\_\_  
Garnet K. Emery, City Attorney

## CERTIFICATION

I hereby certify that the foregoing Resolution No. 2019R-27 was duly passed and adopted by the Mayor and Council of the City of Bullhead City, Arizona, at a regular meeting held on July 16, 2019, that the vote thereon was .... ayes, .... nays, and that the Mayor and .... Council members were present thereat.

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Susan Stein, City Clerk

**EXHIBIT A**

**FORM OF OFFICIAL BALLOT**

**PROPOSITION 415**

**ACQUISITION OF ANY OR ALL PLANT OR PROPERTY  
OF EPCOR WATER ARIZONA, INC., AND AS PRACTICAL, ANY OTHER PRIVATELY  
OWNED WATER UTILITY, IN AND AROUND BULLHEAD CITY, INCLUDING BOND  
AUTHORIZATION**

Shall the City of Bullhead City, Arizona (the "City"), be authorized to acquire, by purchase, by the exercise of the right of eminent domain or by any other legal means, any plant or property or portion of plant or property of EPCOR Water Arizona, Inc., (or any legal successor) and as practical, any other privately owned water utility, in and around City corporate limits devoted to the business of and services and enterprises rendered by a public utility, which authority shall include for such purposes, and to pay all expenses incidental to any of the foregoing and to the issuance and sale of bonds, the issuance and sale of bonds payable from rates charged for service to the public from such business, services and enterprises (not from a property tax); such bonds to be in the principal amount of not to exceed \$130,000,000 and such bonds or any series thereof to mature not more than 30 years from their date and to bear interest at a rate or rates not to exceed 8% per annum, payable at the times determined by the Council of the City?

FOR THE ACQUISITION AND BONDS

A "For" vote will authorize the city's acquisition of EPCOR Water Arizona, Inc., and as practical, any other privately owned water utility, in and around Bullhead City, and the issuance and sale of bonds for the acquisition.

AGAINST THE ACQUISITION AND BONDS

An "Against" vote will not authorize the city's acquisition of EPCOR Water Arizona, Inc., or any other privately owned water utility, nor the issuance and sale of bonds for that purpose.