

36 TEP's former free footage allowance. This paper focuses specifically on problems that have
37 arisen for master-planned community and subdivision developers and homebuilders as well as
38 related businesses and professions,⁴ and offers remedies that address the concerns and needs of
39 all stakeholders in southern Arizona.⁵

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41 A substantial portion of southern Arizona's current economic structure and employment
42 base is oriented towards the real estate development and homebuilding industries, and SAHBA
43 believes the recovery of southern Arizona's economy and job market is inextricably linked to a
44 timely recovery of those industries. In that regard, the lack of development and construction
45 activity negatively impacts various state and local tax revenues, and the current budget crises
46 (and associated job losses) are in part the result of reduced construction activity. Whether or not
47 southern Arizona's economic health ultimately "should be" heavily dependent on growth-related
48 industries has been a subject of active discussion during the current recession. However, for the
49 foreseeable future, that is the reality of southern Arizona's economy.

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51 As will be shown, the sum of the recently adopted changes to TEP line extension policies
52 create insurmountable challenges to initiating new real estate development and subdivision
53 projects, and thus stimulating near-term economic activity in southern Arizona. SAHBA believes
54 a failure to modify the current line extension policies is likely to prolong the economic recovery
55 of the region, and, therefore, requests that the Commission authorize TEP to work with the
56 development and homebuilding industries and Commission Staff to immediately modify TEP's
57 current line extension policies upon conclusion of the workshops.

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59 **II.**
60 **PROBLEMS TO BE ADDRESSED, PROPOSED MODIFICATION**
61 **IN LINE EXTENSION POLICY APPROACH, AND**
62 **BALANCING OF STAKEHOLDER INTERESTS TO BE ACHIEVED**

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64 **A. Problems Intended to Be Addressed.**

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66 The changes in electric utility line extension policies recently adopted by the Commission
67 occasioned several substantially adverse and direct financial consequences for the real estate
68 development and homebuilding industries in southern Arizona, as well as related businesses and
69 professions. Illustrative of this are the problems that SAHBA's members have experienced since
70 the Commission's Decision No. 70628 (December 1, 2008) in TEP's last rate case, in which the
71 Commission approved significant changes to TEP's previous line extension policies. SAHBA
72 notes that these policy changes were not included among TEP's original application in Docket
73 No. E-01933A-07-0402. Rather, they evolved from settlement negotiations and subsequent
74 testimony in support of the Settlement Agreement, which ultimately resulted from those
75 negotiations. Because the changes to TEP's line extension policies submitted on June 11, 2008
76 and approved in Decision No. 70628 were not included in TEP's original rate filing, neither

⁴ SAHBA will defer to others to discuss the impact of recent line extension policy changes on electric utility line extensions to individual lots or real estate parcels.

⁵ These stakeholders include the following: (i) affected electric utilities, and their investors; (ii) current and future ratepayers of affected utilities; (iii) the real estate development and homebuilder industries; and (iv) the related businesses and professions.

77 SAHBA nor any of its individual members intervened in TEP's 2007-2008 rate case. As a
78 consequence the Commission was unfortunately denied the opportunity to receive and consider
79 input from representatives of the real estate development and homebuilder industry, as well as
80 the related businesses and professions, at the time the Commission authorized the changes in
81 TEP's line extension policies.

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83 To date, much of the statewide debate on recently approved electric line extension policy
84 has focused on elimination of free footage allowances. However, SAHBA believes that the most
85 significant and costly changes to TEP's line extension policy were not associated with
86 elimination of the free footage allowance; and, in that regard, SAHBA does not seek to restore
87 TEP's free footage allowance. Rather, SAHBA's analysis and recommended modifications focus
88 on other, more significant changes made to the line extension policy approved in Decision No.
89 70628.

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91 Following the issuance of Decision No. 70628, TEP provided SAHBA with a comparison
92 of the costs associated with a 220-lot residential subdivision under the line extension tariff in
93 effect during the 2000-2008 time period vis-à-vis the new tariff (Table 1).⁶ The cost comparison
94 included three (3) electric distribution facilities situations: (i) 600amp Underground Feeder, (ii)
95 200amp Three-Phase Underground, and (iii) 200amp Single-Phase Underground. Each example
96 showed a dramatic increase in the costs of construction. In that regard, these construction cost
97 increases appear to be based on costs incurred during a period of unusually high demand for
98 materials and labor, rather than current actual costs. The new tariff also included charges for
99 facilities and equipment previously provided by TEP at no cost.⁷ Similarly, facilities for which
100 applicants previously paid either a refundable deposit (Option 1), or for which they were able to
101 defer payment of the deposit for several years by providing the utility with a bond or letter of
102 credit (Option 2), were now required to be funded by non-refundable cash deposits at the time
103 the line extension agreement was executed. In addition, because applicants would now be
104 providing payment as a non-refundable Contribution in Aid of Construction (CIAC), which TEP
105 had to account for as income, a new "gross-up" charge (effectively 65%) was added to line
106 extensions exceeding \$500,000. Finally, in addition to line extension related costs, the new tariff
107 included a significantly higher per lot charge for single-phase and three-phase Secondary
108 Service, increasing from \$12.50 to \$640 per unit or by more than 5000%.

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110 Cost increases of this magnitude would be impossible to pass through to homebuyers
111 under normal economic conditions, let alone under the current recessionary condition of southern
112 Arizona's real estate market. Southern Arizona has experienced a dramatic decline in property
113 values over the last several years. Market declines alone have rendered many projects financially
114 infeasible for the foreseeable future, resulting in lengthy and costly hold periods for investors, or
115 often, recapitalization with new investor groups, or worse, foreclosure. Other planned
116 development projects remain marginally feasible if development costs are tightly controlled. In

⁶ SAHBA and its members have since performed similar cost analyses for a variety of development projects and have found the magnitude of additional costs to be equal to or greater than the example provided by TEP. Exhibit 1 (attached) is an example provided by a SAHBA member, detailing the cost differential for a large lot subdivision under the old policy versus the new policy. As indicated in Exhibit 1, the additional per lot cost is estimated to be more than \$37,000.

⁷ In the previous tariff, TEP provided the 200amp three-phase portion of the job at no cost to the customer.

117 those instances, current market conditions warrant near-term construction if the costs of
 118 development are equal to or less than previously assumed. However, the unforeseen additional
 119 development costs associated with the TEP line extension policies are likely to delay project
 120 construction indefinitely. Under these conditions, investors and/or lenders are highly unlikely to
 121 commit the capital needed to begin construction and stimulate economic activity.
 122

123 Against that background, Table 1 provides a summary of the cost differential under
 124 TEP’s old and new line extension policies to construct the electrical facilities associated with a
 125 220-lot subdivision. ***The new policies create nearly \$8,000 per residential lot of additional costs
 126 for the real estate developer or homebuilder; or, \$1,760,000 for the illustrative subdivision.
 127 This represents an increase of nearly 750% in non-refundable costs.***
 128

129 **TABLE 1 - 220-Lot Subdivision Cost Comparison TEP Line Extension Policies (old vs. new)**

	Linear Feet	\$/ft.	Other Costs	Total Cost	Total + 65% Gross-Up	\$ Per Lot w/Gross Up	Deferrable	Refundable
600amp Underground Feeder								
• Old Tariff	10,319	\$14.62	\$80,000 (PME)	\$230,864	\$230,864	\$1,049	YES	NO
• New Tariff	10,319	\$51.00	\$82,000 (PME)	\$608,269	\$1,003,644	\$4,562	NO	NO
• Cost Difference		\$36.38	\$2,000	\$377,405	\$772,780	\$3,513		
200amp Three-Phase Underground								
• Old Tariff	2,690	\$0	NA	\$0	NA	\$0	NA	NA
• New Tariff	2,690	\$64.50	NA	\$173,505	NA	\$789	NO	NO
• Cost Difference		\$64.50	NA	\$173,505	NA	\$789		
200amp Single-Phase Underground								
• Old Tariff	28,156	NA	NA	\$247,713 (Refundable)	\$247,713 (Refundable)	\$1,126 (Refundable)	YES	YES
• New Tariff	28,156	\$18.00	NA	\$506,808	\$836,233	\$3,801	NO	NO
• Cost Difference				\$506,808	\$836,233	\$3,801		
TOTAL Line Ext.								
• Old Tariff				\$230,864	\$230,864	\$1,049		
• New Tariff				\$1,288,582	\$1,839,877	\$8,363		
• Cost Difference				\$1,057,718	\$1,609,013	\$7,314		
Establish Service (Secondary Service)								
• Old Tariff				\$2,750	\$2,750	\$12.50	NA	NA
• New Tariff				\$140,800	\$140,800	\$640	NA	NA
• Cost Diff				\$138,050	\$138,050	\$627.50		
GRAND TOTAL (Additional Costs)				\$1,198,518 500% Increase	\$1,747,063 750% Increase	\$7,941 750% Increase		

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 131 In addition to the magnitude of the cost increases, there are equally significant challenges
 132 associated with (i) requiring payment when the line extension agreement is executed instead of at
 133 the time of actual construction of the facilities being financed, which could be more than a year
 134 between contract execution and actual construction; and, (ii) requiring that in all situations the
 135 applicant pay in cash, as opposed to the bond or letter of credit options previously allowed, with
 136 no portion of the cash payment being refundable.

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Taken in combination, the above-discussed changes create impossible barriers to initiating near-term construction of development projects in TEP’s service area. At present, capital for real estate development is limited and expensive. Accessing the additional capital needed to build infrastructure—electric, water, roads, etc—is even more challenging. Even if a real estate developer or homebuilder theoretically could pass-through these additional line extension costs to homebuyers, a highly dubious assumption, it is nearly impossible to find the capital to finance the infrastructure necessary to begin the project. Thus, if unaddressed, southern Arizona will struggle to spark construction activity and will fail to provide relief to thousands of unemployed and underemployed workers at every level across multiple sectors of the labor market. Moreover, a prolonged lack of construction activity would further erode various local and state tax revenues used to support a variety of critical services and programs as well as public sector employment.

In making the above observations, SAHBA does not mean to suggest that the Commission, the Commission’s Staff, or TEP foresaw these outcomes. Few would have predicted the length and magnitude of the current recession, the degree to which property values have declined, or how depressed valuations combined with the aforementioned cost increases would render projects financially infeasible. To the contrary, SAHBA believes that which has occurred would readily qualify as a classic example of “unintended consequences.” SAHBA recognizes that TEP’s current policies might be appropriate during periods of extraordinary growth in order to address related financial difficulties such as those recently experienced by some electric utilities. During such periods, additional costs might be at least partly absorbed by the market. However, SAHBA believes the recent period of growth was in fact “extraordinary”, that future extraordinary growth periods (if any) will be limited, and that such periods are likely to be brief and followed by immediate contraction.

In addition, SAHBA believes that application of such policies in the future should consider the specific financial condition of a given electric utility, as well as the plausible impacts given broader economic conditions within its service territory. Assuming a financially healthy electric utility, SAHBA believes that the proposed modifications detailed in the following section offer a balanced approach to financing electric infrastructure and are appropriate during normal or stable economic conditions as well as current recessionary conditions. Conversely, when a particular electric utility is experiencing financial adversity attributable to unusual growth within its service area, the Commission continues to possess the authority to make such revisions in line extension policies as may be appropriate for that particular utility at that particular point in time.

B. Description of Proposed Modification In Line Extension Policy Approach.

The above mentioned consequences need not be immutable. As previously indicated, SAHBA believes that the current situation can and should be addressed by authorizing TEP to work with the development and homebuilding industries and Commission Staff to immediately modify line extension policies to the benefit of all stakeholders, which include: (i) TEP and its investors; (ii) current and future ratepayers of TEP; (iii) the real estate development and

183 homebuilder industries, and related businesses and professions, and (iv) the homebuyer.
184 Accordingly, SAHBA proposes line extension policies that include the following features and
185 concepts:

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187 1. Modifications to TEP's current line extension policies as herein proposed shall not
188 materially alter TEP's ability to endeavor to realize the revenue requirement recognized
189 by the Commission in Decision No. 70628.
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191 2. Data to be used for estimating the cost of infrastructure shall be updated immediately by
192 TEP to reflect current prevailing material and labor costs. Subsequent reviews of costs
193 should be performed no less than one (1) time each year thereafter.
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195 3. Funds to be provided by an applicant for service shall be provided at or near the time of
196 actual construction of the infrastructure, and not as of the date the underlying line
197 extension agreement is executed.
- 198
199 4. Master-planned community and subdivision applicants for service shall be allowed the
200 option of funding the construction of electric infrastructure facilities with (a) a refundable
201 cash payment, or (b) deferring cash payment by providing an acceptable security such as
202 a bond or letter of credit.
203
 - 204 a. Refundable Cash Payment. An applicant for service may fund infrastructure with
205 a refundable cash payment. Refund payments to be made by TEP semi-annually,
206 beginning two (2) years after installation, and to be calculated based on the
207 percentage of lots occupied by permanent customers. Semi-annual review will
208 continue until the project is 75% owner-occupied units, or a ten (10) year period
209 from installation elapses. In the event that 75% of the project is complete, a full
210 refund shall be due to the applicant (less applicable Cost of Ownership Charges).
211 In the event that 75% of the project is not complete after two (2) years, a Cost of
212 Ownership Charge is to be deducted semi-annually from the applicant's
213 remaining refundable cash deposit. Cost of Ownership Charges are to be
214 calculated and applied to that percentage of the project that is unoccupied and
215 therefore not producing revenue.
 - 216
217 b. Payment Deferral. An applicant for service may defer payment for up to four (4)
218 years by providing a bond or letter of credit. In the event the project is more than
219 75% complete within two (2) years from installation, the contract is satisfied and
220 no actual payment is required. In the event the project is not 75% complete after
221 two (2) years, the applicant shall pay a Deferral Charge and Cost of Ownership
222 Charge semi-annually. Both the Deferral Charge and Cost of Ownership Charge
223 are to be calculated and applied to that percentage of the project that is
224 unoccupied and therefore not producing revenue. Applicant is to continue paying
225 both charges semi-annually until up to four (4) years after installation (or until
226 75% of project is occupied). At the end of the four (4) year period, the applicant
227 shall submit a refundable cash payment based on that percentage of the project
228 that is unoccupied. Thereafter, Cost of Ownership Charges are to be deducted

229 from the cash payment as outlined above in 4(a) above, but Deferral Charges no
230 longer apply.

231
232 5. Eliminate (or mitigate) costs associated with the “gross-up” charge. This could be
233 accomplished by allowing applicants to use bonds or letters of credit. This effectively
234 reduces (or eliminates) the size of the cash payment to TEP that would need to be
235 accounted for as taxable income. This would likely reduce line extension cash payments
236 to the utility below the \$500,000 gross-up threshold.

237
238 **C. Balancing of Stakeholder Interests to Be Achieved.**

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240 Set forth below is a summary of the reasons why SAHBA believes the modified line
241 extension policy approach discussed above balances interests of the respective stakeholders.

242
243 **Real estate development and homebuilding industries—not TEP or ratepayers—bear the**
244 **risk of development for projected new customer growth that does not materialize.**

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 - TEP is compensated for its costs of ownership and maintenance and repair of that portion
247 of the new distribution infrastructure that is “unused” during the line extension agreement
248 period.
 - TEP is compensated for that portion of the new distribution infrastructure that remains
249 “unused” at the end of the line extension agreement period. TEP will acquire (as CIAC)
250 at the end of the 10-year contract period, and at no cost to it, that portion of new
251 distribution infrastructure for which new customer additions do not occur; and, the utility
252 will have been reimbursed its costs of ownership and operation and maintenance during
253 the contract.

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257 **TEP is able to include in future rate base that portion of new distribution infrastructure**
258 **funded with bonds or letters of credit to the extent “refund” credits are made to the**
259 **developer or homebuilder as a result of new customer additions.**

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 - TEP thus avoids erosion in rate base, and the associated erosion in earnings that occurs
262 when a disproportionate amount of plant in service is represented by CIAC. CIAC funded
263 plant receives no recognition in rate base and receives no return on or of the investment
264 in the cost of service or rates. As a result of TEP’s current policies, the utility’s earnings
265 and cash flows could diminish over time as rate base effectively shrinks. Further, CIAC
266 funded plant will eventually need to be replaced and the utility will need to fund
267 replacement plant with its own capital.

268
269 **During periods of normal customer growth and relatively stable construction costs, the**
270 **proposed policies are more likely to result in a reasonable balance of capitalization of the**
271 **utility (AIAC, CIAC, equity, debt) over time. With a balanced capitalization, rates are kept**
272 **in check and subsidization is minimized.**

273

- 274 • The division of responsibility between the real estate developer or homebuilder and TEP
275 for the total cost of distribution infrastructure for the development or subdivision in
276 question is established at the time of execution of the line extension agreement; and, the
277 costs are allocated under a formula designed to achieve an average rate base investment
278 per customer which is equivalent for existing and new customers of the affected electric
279 utility.
280
- 281 • Proper structuring and utilization of the refund formula may require periodic review of (i)
282 the affected utility’s average rate base investment per customer, and (ii) the cost of
283 materials and labor associated with construction of electric distribution infrastructure.
284

285 **Real estate developers and homebuilders are financially responsible for a balanced**
286 **allocation of the costs for electric distribution infrastructure associated with a given new**
287 **development or subdivision.**
288

- 289 • Deferral of cash payment by providing a bond or letter of credit would be accompanied
290 by semi-annual payments to TEP of its costs of ownership and maintenance and repair for
291 that portion of the infrastructure that is not connected to revenue producing load during
292 the deferral period.
293
- 294 • The allocation is intended to avoid a situation where it could be said that “new growth is
295 not paying for itself,” in terms of its impact upon TEP’s cost of service and return on its
296 investment.
297

298 **Real estate developers and homebuilders would have the flexibility to optimize their use of**
299 **available project financing through access to the option(s) of a bond, a letter of credit,**
300 **and/or refundable cash payment.**
301

- 302 • Reduction of “front-end” costs required under current line extension policies will enable
303 real estate developers and homebuilders to move forward with projects that otherwise
304 would be impossible to undertake at this time or in the foreseeable future. In turn, such
305 activity will create economic opportunities for related businesses and professions that
306 otherwise would not exist, as well as improve local and state tax revenues.
307

308 **III.**
309 **CONCLUSION**
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311 SAHBA believes that the modifications to TEP’s line extension policy described above
312 represents a constructive and balanced means for addressing and resolving the problems of the
313 real estate development and homebuilding industries in southern Arizona, as well as related
314 businesses and professions. More specifically, the recommended modifications achieve an
315 equitable balance of costs and benefits among all stakeholders, whereby (i) existing customers do
316 not subsidize new customer growth, and, conversely, new customers do not subsidize existing
317 customers; (ii) the risks of development are placed on developers and homebuilders, while those
318 risks are minimized or eliminated for TEP and its ratepayers; (iii) TEP is compensated for the
319 investment it makes to serve customers either by the developer or homebuilder during the period

320 of development or by the additional revenues from each new customer added to the system; (iv)
321 TEP rates to customers are kept in check due to a balanced capitalization of plant; and (v)
322 upfront development costs are reduced to promote near-term construction activity and thus
323 economic recovery in southern Arizona.

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325 SAHBA looks forward to presenting the proposed concepts and modifications in the
326 forthcoming general workshop on line extension policies for electric utilities. In that regard,
327 upon completion of the workshop, SAHBA respectfully requests that the Commission authorize
328 TEP to work directly with the development and homebuilding industries and Commission Staff
329 to immediately modify TEP’s current line extension policies consistent with recommendations
330 outlined in this paper or in another manner that is suitable for both the home building industry
331 and TEP. SAHBA maintains that a “one-size fits all” approach to electric line extension policy is
332 not required, nor is it appropriate, given the diverse and specific conditions of each electric
333 utility and service territory.

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EXHIBIT 1

Table 2 - 46-Large Lot Subdivision Cost Comparison TEP Line Extension Policies (old vs. new)

	Linear Feet	\$/ft.	Other Costs	Total Cost	Total + 65% Gross-Up	\$ Per Lot w/Gross Up	Deferrable	Refundable
600amp Underground Feeder								
• Old Tariff	11,439	\$14.62	\$60,000 (PME)	\$227,238	\$227,238	\$4,940	YES	NO
• New Tariff	11,439	\$51.00	\$61,500 (PME)	\$583,389	\$1,064,066	\$23,131	NO	NO
• Cost Difference		\$36.38	\$1,500	\$356,151	\$836,828	\$18,191		
200amp Three-Phase Underground								
• Old Tariff								
• New Tariff								
• Cost Difference								
200amp Single-Phase Underground								
• Old Tariff		NA ³	NA	\$266,923 (Refundable)	\$266,923 (Refundable)	\$5,803 (Refundable)	YES	YES
• New Tariff	32,252	\$18.00	NA	\$580,536	\$957,884	\$20,823	NO	NO
• Cost Difference				\$580,536	\$957,884	\$20,823		
TOTAL Line Ext.								
• Old Tariff				\$227,238	\$227,238	\$4,940		
• New Tariff				\$1,163,925	\$1,920,476	\$41,749		
• Cost Difference				\$936,687	\$1,693,238	\$36,809		
Establish Service (Secondary Service)								
• Old Tariff				\$575	\$575	\$12.50	-	NO
• New Tariff				\$29,440	\$29,440	\$640	-	NO
• Cost Diff				\$28865	\$28,865	\$627.50		
GRAND TOTAL (Additional Costs)				\$965,552 400% Increase	\$1,722,103 750% Increase	\$37,437 750% Increase		

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