

PUBLIC UTILITIES COMMISSION

505 VAN NESS AVENUE

SAN FRANCISCO, CA 94102-3298



March 3, 2021

RE: Rates of Return and Rates of Margin for Class C, Class D Water and Sewer Utilities

TO: COMMISSION

By this memorandum, the Water Division (WD) updates its recommended Rates of Return (ROR) and Rates of Margin (ROM) for Class C, Class D Water and Sewer Utilities. These updates have been calculated in accordance with Resolution W-4524, which revised the Standard Practice that addresses how the ROR and ROM are calculated for Class C and D water utilities. WD considered several factors in determining the ROR. WD assessed the movement in actual and forecasted interest rates, operational risks faced by the small investor-owned water and sewer utilities, and the constant level of authorized ROR for Class A water utilities averaging 7.77%.

In determining the ROM for Class C, Class D water and sewer utilities, WD also considered the Class B water utilities' most recent authorized rates of return with an average rate of 9.54% and an equivalent ROM average of 21.41%.

We note that the actual annual interest rates from 2015 to 2020 are inconstant. For example, the market yield on U.S. Treasury securities at 30-year constant maturity, quoted on investment basis was 1.56% as of December 31, 2020, compared to 2.58% on December 31, 2019.

For 2021, WD recommends that the following ROR and ROM be used in the water utilities' informal general rate cases (supporting documentation is attached):

Utility Type	Rate of Return (ROR)	Rate of Margin (ROM)
Class C	9.00% to 10.00%	21.33%
Class D	9.40% to 10.40%	22.23%

If you have any questions regarding the ROR and ROM recommendations, please contact Ramon Go of the WD at (415) 703-1350, or rhg@cpuc.ca.gov

Sincerely,

/s/BRUCE DEBERRY

Bruce DeBerry, Program Manager
Water Division

**CALCULATION OF CLASS C, CLASS D WATER AND SEWER UTILITIES¹
RATES OF RETURN (ROR) & RATES OF MARGIN (ROM)²**

- Rates are calculated using both ROR and ROM Methods.
- The Method that produces the higher result is used.
- ROR is set at a level within the recommended ranges.
- Where little or no rate base exists, the ROM is used.
- The ROM is applied to operating expenses to determine the estimated dollar return, which is then compared with the average dollar ROR on rate base.
- Calculations are based on assumption that there is a comparable relationship between authorized Class B ROR and ROM and Class C and D ROR and ROM.
- Class C and D water operations, finances, and risks are more like those of the Class B water utilities than with Class A water utilities.

Data Used in Determining the Rate of Return and Rate of Margin for Class C and Class D Water and Sewer Utilities						
Recommended ROR Range			Actual Interest Rates from the Federal Reserve			
Year	Class C Water	Class D Water	U.S. Treasuries			
			90-Day	1-Year	5-Year	30-Year
2014	10.20% - 11.20%	10.80% - 11.80%	0.03%	0.12%	1.64%	3.34%
2015	10.20% - 11.20%	10.80% - 11.80%	0.05%	0.32%	1.53%	2.84%
2016	9.60% - 10.60%	10.20% - 11.20%	0.32%	0.61%	1.33%	2.59%
2017	10.00% - 11.00%	10.50% - 11.50%	0.95%	1.20%	1.91%	2.89%
2018	10.06% - 11.06%	10.56% - 11.56%	1.97%	2.33%	2.75%	3.11%
2019	9.90% - 10.90%	10.40% - 11.40%	2.11%	2.05%	1.95%	2.58%
2020	9.90% - 10.90%	10.40% - 11.40%	0.36%	0.37%	0.53%	1.56%
2021	9.00% - 10.00%	9.40% - 10.40%	0.08%	0.10%	0.45%	1.82%
			<i>Forecast Interest Rates from IHS Global Insight</i>			
<i>Forecast for 2022 (as of 02/2021)</i>			0.08%	0.09%	0.87%	2.42%
			ROM			
Calculation of Rate of Margin ("ROM")			Inputs		Class C	Class D
Average Class B Rate of Margin ("ROM")			21.41%			
Average Class B Rate of Return ("ROR")			9.54%			
Average Class C ROR			9.50%			
Average Class D ROR			9.90%			
Average Class C ROM = Average Class B ROM * (Average Class C ROR/Average Class B ROR)					21.33%	
Average Class D ROM = Average Class B ROM * (Average Class D ROR/Average Class B ROR)						22.23%

¹ Class C water utilities have 501 to 2,000 customers; Class D water utilities have 500 or less customers.

² Pursuant to Decision 92-03-093, Ordering Paragraph No. 8 and Resolution W-4524.