STATE OF CALIFORNIA GAVIN NEWSOM, *Governor*

PUBLIC UTILITIES COMMISSION
505 VAN NESS AVENUE
SAN FRANCISCO, CA 94102-3298

February 25, 2019

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

TO: COMMISSION

By this memorandum, the Water Division (WD) updates its recommended Rates of Return and Rates of Margin for Class C and 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 rate of return and rate of margin are calculated for Class C and D water utilities.

WD considered several factors in determining the Rates of Return. WD assessed the movement in actual and forecasted interest rates, operational risks faced by Class C and Class D water utilities, and the constant level of authorized Rates of Return for Class A water utilities averaging 7.77%.

In determining the Rates of Margin for Class C and D water utilities, WD considered the Class B water utilities' most recent authorized average rates of return of 10.07%, their most recent authorized equivalent average Rate of Margin of 21.86%, and the recommended rates of return for Class C and D water utilities, as calculated.

For 2019, WD recommends that the following rates of return and rates of margin be used for Class C and Class D water uttilities' informal general rate cases (supporting documentation is attached):

Utility Type	Rate of Return (ROR)	Rate of Margin (ROM)
Class C	9.90% to 10.90%	22.57%
Class D	10.40% to 11.40%	23.65%

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

Sincerely,

Rami Kahlon, Director
Water Division

Bruce DeBerry, Manager
Water Division

Attachment

CALCULATION OF CLASS C & D WATER COMPANY[1] RATES OF RETURN (ROR) & Rates of Margin (ROM)[2]

- Rates are calculated using both return-on-rate base and rate of margin methods.
- The method that produces the higher result is used
- ROR is set at a level above or below the recommended ranges, if warranted.
- 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 the 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 similar to 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 Utilities

			Actual Interest Rates from the Federal Reserve			
	Recommended ROR Range		U.S. Treasuries			
Year	Class C Water	Class D Water	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 (As of 02.2019)	9.90% -10.90%	10.40% - 11.40%	2.42%	2.58%	2.54%	3.04%
			Forecast Interest Rates from IHS Global Insight			
Forecast for 2020 (As of 02/2019)			2.76%	3.07%	3.08%	3.54%

		ROM	
Calculation of Rate of Margin ("ROM")	Inputs	Class C	Class D
Average Class B Rate of Margin ("ROM")	21.86%		
Average Class B Rate of Return ("ROR")	10.07%		
Average Class C ROR	10.40%		
Average Class D ROR	10.90%		
Average Class C ROM = Average Class B ROM * (Average Class C ROR/Average Class B ROR)		22.57%	
Average Class D ROM = Average Class B ROM * (Average Class D ROR/Average Class B ROR)			23.65%

[1] Class C water utilities have 501 to 2,000 customers; Class D water utilities have 500 or less customers.
[2] Pursuant to D.92-03-093, Ordering Paragraph 8 and Resolution W-4524.