

PUBLIC UTILITIES COMMISSION

505 VAN NESS AVENUE
SAN FRANCISCO, CA 94102-3298



March 08, 2024

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

TO: Class C, Class D Water and Sewer Utilities

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 7.80%.

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 9.33% and an equivalent ROM average of 22.83%.

We note that the actual annual interest rates from 2018 to 2023 are inconstant. For example, the market yield on U.S. Treasury securities at 30-year constant maturity, quoted on investment basis was 4.09% as of December 31, 2023, compared to 3.11% on December 31, 2022.

For 2024, 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	10.70% to 11.90%	27.65%
Class D	11.00% to 12.30%	28.51%

If you have any questions regarding the ROR and ROM recommendations, please contact Kevin Truong at vt4@cpuc.ca.gov or (628) 217-1909.

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 Utilities**

Year	Recommended ROR Range		Actual Interest Rates from the Federal Reserve			
			U.S. Treasuries			
	Class C Water	Class D Water	90-Day	1-Year	5-Year	30-Year
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%	0.04%	0.10%	0.86%	2.06%
2022	9.00% - 10.00%	9.30% - 10.30%	2.09%	2.80%	3.00%	3.11%
2023	9.60% - 10.70%	9.90% - 11.00%	5.28%	5.08%	4.06%	4.09%
2024	10.70% - 11.90%	11.00% - 12.30%	5.45%	4.79%	3.98%	4.26%
			Forecast Interest Rates from IHS Global Insight			
Forecast for 2025 (as of 02/2024)			3.38%	3.27%	3.13%	3.78%

Calculation of Rate of Margin ("ROM")	Inputs	ROM	
		Class C	Class D
Average Class B Rate of Margin ("ROM")	22.83%		
Average Class B Rate of Return ("ROR")	9.33%		
Average Class C ROR	11.30%		
Average Class D ROR	11.65%		
Average Class C ROM = Average Class B ROM * (Average Class C ROR/Average Class B ROR)		27.65%	
Average Class D ROM = Average Class B ROM * (Average Class D ROR/Average Class B ROR)			28.51%

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.