

## PUBLIC UTILITIES COMMISSION

505 VAN NESS AVENUE  
SAN FRANCISCO, CA 94102-3298



March 17, 2023

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 7.77%.

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 9.33% and an equivalent ROM average of 22.83%.

We note that the actual annual interest rates from 2017 to 2022 vary significantly. For example, the market yield on U.S. Treasury securities at 30-year constant maturity, quoted on investment basis was 3.11% as of December 31, 2022, compared to 2.06% on December 31, 2021. Interest rates have increased significantly in 2022 compared to 2021 (please see actual interest rates from the Federal Reserve in the table on page 2).

For 2023, 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)
<b>Class C</b>	<b>9.60% to 10.70%</b>	<b>24.84%</b>
<b>Class D</b>	<b>9.90% to 11.00%</b>	<b>25.57%</b>

If you have any questions regarding the ROR and ROM recommendations, please contact Josefina Montero of the WD at (415) 703-1654, or [josefina.montero@cpuc.ca.gov](mailto:josefina.montero@cpuc.ca.gov)

Sincerely,

Bruce DeBerry, Program Manager  
Water Division

**CALCULATION OF CLASS C, CLASS D WATER AND SEWER UTILITIES<sup>1</sup>  
RATES OF RETURN (ROR) & RATES OF MARGIN (ROM)<sup>2</sup>**

- 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 a reasonable 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 those of Class A water utilities.

<b>Data Used in Determining the Rate of Return and Rate of Margin for Class C and Class D Water Utilities</b>						
Year	Recommended ROR Range		Actual Interest Rates from the Federal Reserve			
	Class C Water	Class D Water	U.S. Treasuries			
			90-Day	1-Year	5-Year	30-Year
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%	0.04%	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%	4.69%	4.69%	3.64%	3.66%
			Forecast Interest Rates from IHS Global Insight			
Forecast for 2024 (as of 02/2023)			4.14%	3.88%	3.21%	3.69%
<b>Calculation of Rate of Margin ("ROM")</b>				Inputs	ROM	
Average Class B Rate of Margin ("ROM")				22.83%	Class C	Class D
Average Class B Rate of Return ("ROR")				9.33%		
Average Class C ROR				10.15%		
Average Class D ROR				10.45%		
Average Class C ROM = Average Class B ROM * (Average Class C ROR/Average Class B ROR)					24.84%	
Average Class D ROM = Average Class B ROM * (Average Class D ROR/Average Class B ROR)						25.57%

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

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