



2018 General Rate Case Application Overview



- I. About San Jose Water
- II. General Information About Rates
- III. Summary of San Jose Water's 2018 General Rate Case Application
- IV. Frequently Asked Questions

I. About San Jose Water

Founded in 1866, San Jose Water (SJW) has been delivering safe drinking water to Bay Area families and communities for more than 150 years.

San Jose Water is committed to supporting the economic vitality, safety, and health of all of the communities we serve through our commitment to delivering the safest, highest quality drinking water available.

SJW by the numbers:

- 151 years of service to the region
- More than 225,000 customers
- 368 employees
- Service area includes:
 - 80% of San Jose
 - 50% of Cupertino
 - Saratoga, Los Gatos, Monte Sereno, and Campbell
 - Unincorporated parts of Santa Clara County
- 85 million gallons minimum - daily demand for drinking water
- 120 million gallons - average daily demand for drinking water
- 165 million gallons - maximum daily demand for drinking water
- 2,400 miles of water pipes (mains)
- 108 active wells
- 6,500-acre watershed in Santa Cruz Mountains
- 96 distribution reservoirs
- 24 miles of mains replaced each year
- Two surface water treatment plants
- More than 640 water quality tests performed each month
- About a penny per gallon of drinking water to your tap provided 24 hours a day, 365 days a year

II. General Information About Rates

SJW's rates are set by an independent state regulatory agency, the California Public Utilities Commission (CPUC). The CPUC's mission includes regulating services and utilities, protecting consumers, safeguarding the environment, and assuring Californians' access to safe and reliable utility infrastructure and services.

The CPUC follows a robust and transparent process, during which time staff and members of the Office of Ratepayer's Advocates (ORA) evaluate applications submitted by utilities and offer the public an opportunity to review that information and provide feedback.

The role of the CPUC is to oversee the investment, rates, service, quality, and operations of SJW as it balances the needs of customers with the financial and operational requirements of the water utility.

Regulated water rates are determined strictly on the “cost of service” needed to operate, maintain and replace the water system in compliance with state and federal guidelines and to deliver safe, high quality, and reliable water service.

What is considered as part of the rate-setting process?

Recurring expenses: These are the expenses of the utility that occur every year. In a home, these expenses would include things like electricity, cable, insurance, gas, etc. In a regulated water utility, recurring expenses are the costs to operate and maintain the water system, including cost of employees, taxes, chemicals, maintenance, and electricity. Under the “cost of service” principle such expenses are strictly reimbursed to the utility on a dollar for dollar basis.

Capital expenditures (sometimes called CAPEX): These expenditures relate to the investments to replace and improve water system components such as pipes, pumps, tanks and wells. SJW has made more than \$1 billion dollars in infrastructure investments throughout the region. All of the massive infrastructure, which includes thousands of miles of pipes, dozens of tanks and hundreds of wells must be replaced at intervals of 50 or 100 years. For SJW that means that the system is in a constant state of upgrade and evolution as older infrastructure ages out. But the challenge is further complicated by the increase in cost SJW absorbs as new material replaces aging infrastructure. Pipelines installed 100 years ago for roughly \$1 per foot now cost from \$150 – 200 dollars per foot today.

Capital expenses are funded through a combination of debt and shareholder equity. Each dollar invested by SJW is made up of approximately 50% debt, and 50% cash (or equity) provided by the utility’s shareholders. As part of the total expenses of the utility, the CPUC authorizes a return to bond holders as well as a return to shareholders. These returns are paid to bondholders in the form of interest and to shareholders in the form of a dividend. They are similar to the interest paid to you on your savings account or the interest you would pay the lender on a home or car loan.

In simple terms, when you take these items – the annually recurring costs to operate and maintain the system, and the cost of capital needed to fund infrastructure investments – and divide it by the number of gallons sold, you will determine the cost of a gallon of water. In SJW’s service area, the cost of high quality drinking water today is about a penny a gallon.

To establish rates for the next three years, SJW works with the CPUC to estimate the number of gallons we are likely to sell each year. That number is then divided by the items outlined above and any projected increases in costs or capital investments to establish the proposed rate structure for the next three years.

SJW’s Rate History

Over the last ten years, SJW’s average annual increase authorized by the CPUC through the General Rate Case process has been about 5%. The table shows how actual rates authorized by the CPUC have changed over the years.

	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
SJWC	3.0%	2.2%	9.2%	3.4%	4.9%	9.8%	5.2%	2.8%	8.6%	3.83%
SCVWD	9.5%	0.0%	0.0%	9.4%	9.3%	9.3%	9.9%	19.7%	19.9%	9.6%

Rate changes outside of the General Rate Case process may also occur and mostly relate to changes in water supply costs paid directly by SJW to the Santa Clara Valley Water District (District). The District’s increase is anticipated to be approximately 10% annually for the next 3-5 years. These increases are “pass-through” and charged at cost. A 10% increase in water supply costs from the District results in a nearly 4% increase in water rates for SJW customers. For example SCVWD increased the rate for treated potable water by \$103 per acre foot for a total cost of \$1,275. This increase, which is passed through without mark-up translates into an increase per average customer of about \$7 per bi-monthly bill or \$3.50 per month.

SJW and SCVWD partner closely to ensure customers have access to this valuable resource and both have significant infrastructure costs that can affect rates. This information is intended to provide insight into the various factors that affect customer rates and not shift responsibility.

What do rates actually pay for at SJW?

At SJW, our goal is to deliver high-quality water service and an exceptional customer experience at the lowest possible cost. We work hard to provide the best water service in the industry and have an excellent track record of efficient operations.

Safe and reliable water service is essential to protect public health, deliver fire service, and support our economy, all things that contribute to the high quality of life that we enjoy. Water touches everything our customer’s love and value and that is a responsibility we take to heart as we invest in our system to continue to provide excellent water service for generations to come. To do that, SJW must increase investments in all water system components, such as pipelines, wells, pumps, and tanks when they reach the end of their useful lives.

Water rates provide for the following:

- Operations, maintenance and replacement of the system of pipes, boosters, and pumps that deliver water from its source directly to your tap;
- Chemicals and technology to treat raw water to meet or surpass increasingly stringent federal and state water quality standards as well as frequent testing to ensure compliance with all water quality requirements;
- Electricity to move water through a large and complex system of transmission mains up and down mountainous terrain and boost or elevate the water to large

tanks or facilities, so the water is available to meet the highest demand in the system at any time;

- Water supply costs charged by the Santa Clara Valley Water District for treated water as well as for groundwater extraction;
- Pipes to deliver water from storage facilities to homes and businesses when it is needed and in the amount that is needed for personal or business use or for fire protection;
- Exceptional customer service provided by employees who ensure reliable water service is available 24 hours a day, 365 days of the year;
- Employee expenses, including the wages of our employees;
- Payment of federal, state and local taxes which support our schools and public services; and
- All debts and obligations of the water utility.

III. Summary of SJW's 2018 General Rate Case Application

On January 4, 2018, SJW submitted a General Rate Case (GRC) application to the CPUC for new water rates. The application proposes rate increases of 9.76% in 2019, 3.70% in 2020, and 5.17% in 2021.

Major drivers for the proposed rate increases include continued investments to replace water system components, increased taxes and operating costs, and increased costs to expand recycled water usage.

Counter to other industries, declining water sales can also be a factor in rate increases. The majority of a water utility's costs are fixed in the maintenance and replacement of the substantial infrastructure that is used to provide water service and in the expertise and operations needed to ensure the delivery of high-quality, safe, and reliable water. Even as customers seek to conserve by reducing their water usage, the infrastructure and operating costs remain the same. As a result, the cost of water per unit may increase to cover the utility's fixed costs.

Over the next 12 months, the application will undergo a comprehensive review by the CPUC and the independent Office of Ratepayer Advocates. The public is also invited to comment on the application through the Public Participation Hearing put on by the CPUC. This hearing is anticipated to take place in the second quarter of 2018 and customers will be notified via bill insert.

IV. Frequently Asked Questions

Q: Why is SJW filing for new water rates?

A: We are required by law to file for new rates once every three years for the following three year period. The rates reflect a combination of factors including projected capital costs of approximately \$400 million, increased operating costs, and declining water sales.. SJW filed an application with the CPUC on January 4, 2018, for new rates effective 2019, 2020, and 2021.

Q: SJW recently raised water rates. Why is it seeking another rate increase so soon?

A: The recent rate increases correspond to our 2015 GRC application establishing rates in 2016, 2017, and 2018. The CPUC did not issue a decision on that application until June 9, 2016. As a result of that delay we were authorized to retroactively collect rates that would have gone into effect on January 1, 2016, had the decision been issued at that time.

Q: How can SJW help customers manage their water bills?

A: We offer a comprehensive water conservation program to help customers use water more efficiently. We have informational brochures and offer free water check-ups to all customers. If you choose, a conservation inspector will visit your home and check for leaks, evaluate indoor and outdoor usage, and make recommendations on ways to use water more efficiently.

Additionally, we offer a Water Rate Assistance Program (WRAP) for qualified low income customers. The WRAP provides a 15% discount on the total water bill to customers who qualify. The program is funded by a \$1.45 per month surcharge on the water usage of all other customers (non-WRAP customers). For more information, visit www.sjwater.com.

Q: How will customers be notified of the application and how they can provide input?

A: All customers will be notified via a bill insert. A notice will be also be published in the newspaper and posted on sjwater.com. The application will also be posted on SJW's and the CPUC's websites.

Q: Why are these increases necessary?

A: SJW has been providing water service since 1866. Much of the water system was constructed more than 50 years ago and has reached the end of its useful life. In order to protect public health and safety and to deliver safe and reliable water service, we must continue to replace water system components to ensure continued safe and reliable water service.

The new rates reflect escalating operating costs and significant investments in the water system for mains, tanks, and wells. Key projects include:

- Replacing approximately 72 miles of water mains to maintain reliable service
- Upgrading important tank and water storage facilities to meet the latest seismic, safety and water quality requirements
- Replacing and upgrading pump stations and pressure systems to ensure water reliability

Q: Can't SJW reduce costs instead of raising rates?

A: We work hard to provide the highest quality water service, while conserving water, identifying efficiencies and controlling costs wherever possible. Water utility costs are

escalating rapidly due to accelerated investments needed to replace mains, tanks, wells, and pumps to comply with more stringent water quality regulations, to provide adequate fire protection, and to pay for higher water supply costs. Increasing costs for water supply and an aging water system are challenges facing all water utilities across the country.

Q: How have costs increased compared to past years?

A: Water system replacement costs have more than doubled in the past ten years. Staffing costs to deal with regulatory requirements have risen almost 50% in the past five years.

Q: What has SJW done to keep rates low?

A: We have an excellent track record of operating an efficient utility. Over the last five years, our operating costs (including operations, maintenance, purchased power, and administrative expenses) have remained stable. As one of the state's largest electricity consumers, we've taken steps to reduce our consumption by pumping most of the water through our system during off-peak hours. The number of customers served per employee has also remained relatively stable over the last 10 years. Our non-revenue water loss (volume lost through leaks, theft, firefighting, and water quality activities) is one of the industries' lowest at about 7 percent.

Q: Where does my dollar go?

A: About half of every dollar received from customers goes to cover costs that are beyond our control. These include water supply costs from the Santa Clara Valley Water District (38 cents) and payments of federal, state, and local taxes (11 cents). The remaining funding goes towards system improvements (21 cents), operating costs (22 cents), and cost of capital necessary to make system improvements (8 cents).

Q: Why do I have to pay more for using less water?

A: It's a good question and the explanation requires an understanding of fixed and variable costs. Fixed costs include water mains or pipes, wells, pumps, valves, tanks, and fire hydrants among many other items. These costs do not change based on water use and account for 70% of SJWC's total cost. In your household, the rent or mortgage you pay is a fixed cost because it does not change based on the number of people living in the home.

Variable costs include electricity, chemicals, equipment, and labor and can change based on actual water use. These costs make up the remaining 30%. Similarly, your household costs for groceries and utilities can vary depending on the number of people living in the home.

Let's apply the fixed and variable cost concepts to a very simple example. Suppose a water utility projects it will sell 10 units of water in the coming year. The total cost to produce the 10 units is \$10 so the utility must ultimately bill \$10 to cover the total cost of service.

From the utility's standpoint, their fixed and variable costs are broken down as follows. When we bill for service, the fixed and variable costs components are reversed due to regulatory requirements as shown below.

Utility (cost of service)	
- Fixed	7.00
- Variable	3.00
Total cost to SJWC	\$10.00

Customer (water bill)	
- Service (meter) charge	3.00
- Volumetric charge (\$0.7/unit)	7.00
Total bill	\$10.00

If the customer uses 10 units of water as shown above, then the utility's cost of service is equal to the amount billed even though the proportions of fixed and variable costs differ.

Now let us consider the same example when the customer conserves 20% and now only uses 8 units. The water utility's fixed cost remains the same at \$7.00 to pay for the costs of delivering water to the tap regardless of how much or how little is consumed. The variable cost is reduced 20% from \$3.00 to \$2.40. However, the customer is only billed \$8.60 as shown below.

Utility (cost of service)	
- Fixed	7.00
- Variable	2.40
Total cost to SJWC	\$9.60

Customer (water bill)	
- Service (meter) charge	3.00
- Volumetric charge (\$0.7/unit)	5.60
Total bill	\$8.60

Because the total bill is now less than the cost of service, the unit rate or variable charge for water must be increased to recover the difference. Depending on your actual water usage, this may not necessarily result in a higher total water bill.

Q: How affordable is your water service?

A: A widely used benchmark for affordability is published by the U.S. Environmental Protection Agency (EPA). EPA studies show that annual water bills less than 2.5% of median household incomes are considered affordable. SJW's current typical bill is approximately \$100 per month. This is approximately 1.5% of the median household income in San Jose.

We deliver high quality and reliable water service to your tap 24 hours a day, every day of the year for about a penny per gallon. Compared with other products we use every day, tap water is clearly one of the best deals around.