

# Attachment F: Operating expenditure in the current pricing period

This attachment further describes our operating expenditure performance in the current pricing period for 2020-2024, and explains our forecast planned expenditure for 2024-25.

## Our operating expenditure by product

Table 1 shows our actual expenditure over the current pricing period, by product.

**Table 1: Actual operating expenditure by product (\$2024-25, \$millions)**

Product	2020-21	2021-22	2022-23	2023-24	Total	Determination
Water	56.4	54.5	54.0	58.2	223.1	233.5
Wastewater	67.5	63.0	63.2	62.1	255.8	274.6
Stormwater	1.0	0.9	1.4	1.8	5.1	5.8
Corporate	64.0	63.9	66.5	73.2	267.5	258.2
<b>Total</b>	<b>188.9</b>	<b>182.3</b>	<b>185.0</b>	<b>195.3</b>	<b>751.5</b>	<b>772.1</b>

Source: 'Determination' (rows 47, 50, 51, 46) escalated by 'SIR CPI' (row 24)

While total operating expenditure was broadly in line with the current determination, there were offsetting variances across each of the four product categories.

- **Water** operating expenditure was 5 per cent lower than the four-year determination, driven by lower water treatment volumes than average. Customer demand was lower (particularly outdoor water usage) due to wetter than average conditions across the period. Section 5.3 of our proposal highlights the low water treatment volumes compared to the last 10 years and the assumed volumes in the current determination period.
- **Wastewater** operating expenditure was 7 per cent lower despite higher treatment volumes (as shown in section 5.3 of our proposal).

The effect of rising inflation over the period, described earlier, particularly impacted the treatment operations contract over the period. The contract includes a retrospective composite inflation measure to escalate costs each year made up of CPI and wage inflation – the two-fold impact included the temporary lagging effect of using retrospective inflation indices, and a wage inflation index lower than headline CPI.

We also incurred lower costs for long-cycle preventative maintenance activities than assumed in the current determination and delivered some capital upgrades to treatment plants later than anticipated, delaying higher operating costs to run the upgraded facilities.

- **Stormwater** operating expenditure was broadly in line with the determination – with underspends in the first two years offset by an overspend in 2023-24 due to a retendered contract price increase for stormwater maintenance services.
- **Corporate** support costs exceeded the determination allowance by 5 per cent over the four-year period for the reasons described in section 5.3 of our proposal.

## Our operating expenditure by cost category

Table 2 shows our actual expenditure over the current pricing period.

**Table 2: Actual operating expenditure by cost category (\$2024-25, \$millions)**

Cost Category	2020-21	2021-22	2022-23	2023-24	Total	Determination
Labour	65.0	63.8	65.4	70.9	265.2	256.0
Maintenance	24.8	22.1	22.1	24.1	93.1	104.8
Operations	50.7	47.8	49.9	48.9	197.4	217.5
Regulatory	7.5	6.3	6.0	6.3	26.1	31.9
Corporate	40.4	41.6	40.8	44.2	167.0	157.7
Revenue Offset - Expenses	0.6	0.7	0.7	0.8	2.8	4.2
Cost of Sales – Offset	(0.1)	(0.0)	0.1	0.0	0.0	-
<b>Total</b>	<b>188.9</b>	<b>182.3</b>	<b>185.0</b>	<b>195.3</b>	<b>751.5</b>	<b>772.1</b>

Sources: Total Actuals = 'Opex by item' (rows 81, 105, 122) escalated by 'SIR CPI' (row 24); Determination = 'Determination' (row 33), less the drought allowance of \$8.75 million, escalated by 'SIR CPI' (cell D23); Cost categories = Hunter Water analysis

- **Labour** expenditure for the first three years of the current pricing period was broadly in line with the determination with underspends from carrying vacant positions, offset by increasing digital resourcing classified as operating expenditure. Note: this was an example of capex to opex substitution, rather than additional expenditure.

The increased labour in 2023-24 was due to:

- Filling operational role vacancies after the tight labour market conditions following the COVID-19 pandemic began to ease.
- Higher wage inflation in response to the war-for-talent and changes to NSW Government wages policy. This included a 4 per cent general wage increase for most employees from 1 July 2023 (better reflecting the cost-of-living as measured by the CPI in recent years) and recruiting and/or regrading some positions to match labour market expectations to retain key talent, compared to 2.5 per cent in each of the earlier years.
- Additional resources to address increasing stakeholder and regulatory expectations and reporting regarding climate change adaptation and sustainability, as well as to manage dam safety and cyber security risks.
- Increased investment in non-recurrent external labour project resourcing for major digital projects such as the replacement of our end-of-life field service management (FSM) and related geographic information system (GIS). The cost of this temporary project resourcing has been removed as part of the 'base adjustments' to ensure these costs are not carried forward into the upcoming pricing period as part of this proposal. Note: digital projects such as these and others including our data insights capabilities and cyber security, have also experienced a shift from capital to operating expenditure (opex-capex substitution).
- **Maintenance** was \$12 million (11 per cent) lower than the four-year determination impacted by:
  - Favourable long-running contract terms, acting as a temporary 'inflation-shield' that delayed the impact of rising input prices. Several of these maintenance contracts have been

retendered in 2023-24 with significant price increases as reflected in the real price input trend projections described in Chapter 5 of our proposal.

- Job counts over the price period were 33 per cent lower than the determination assumption, with wet weather limiting our ability to perform preventative planned routine network and treatment plant maintenance as well as a lower number of corrective breakdown and planned breakdown jobs.
- Property repairs and maintenance costs were lower than expected with lower cleaning and maintenance due to changes in the working environment with COVID-19, especially working from home arrangements which are largely ongoing.
- Ongoing continuous improvement to manage spoil more efficiently, partially offsetting the impacts of continued customer and network growth.
- **Operations** was \$20 million (9 per cent) lower than the four-year determination due to:
  - Wet weather delays in treatment contract long-cycle works including preventative maintenance and cleaning of sludge lagoons and maturation ponds. The wet weather also delayed delivery of major capital upgrades at the Farley, Dungog and Tanilba Bay treatment facilities which deferred anticipated higher operating costs to run the upgraded treatment plants.
  - Laboratory testing expenditure was 30 per cent favourable to the determination, with a significant contract renewal occurring in the pricing period with favourable, competitive market pricing and no transition costs incurred.
  - Electricity costs were approximately 2 per cent favourable over the pricing period as a result of utilising progressive purchasing agreements, additional investment in solar renewables, and continued use and optimisation of smart-integrated-pump-scheduling to take advantage of time-of-use pricing.
  - The current determination included funding for an operating expenditure weir pool project in 2020-21 (approximately \$1.6 million), which was initially delayed (by various stakeholders) and the scope of the project changed resulting in the expenditure being mainly capital.
  - These favourable variances were partially offset by 9 per cent higher wastewater treatment flows over the pricing period (as shown in section 5.3) and higher chemical and fuel costs.
- **Regulatory** costs across the pricing period were \$6.0 million lower than expected, driven primarily by audit plan rescheduling during the COVID-19 pandemic, lower Council rates for land holdings because land valuations increased at a lower rate than anticipated, and lower expenditure incurred with the (former) Department of Industry (DOI) for the development of the Lower Hunter Water Security Plan.
- **Corporate** expenditure is made up of:
  - digital services such as computer software licencing and support services, cloud subscriptions, internet and mobile communications costs
  - non-recurrent consulting services for projects, strategy studies and specialised legal advice
  - customer billing costs including meter reading, printing and postage
  - property and fleet related costs such as insurance premiums, rent and security services
  - employee-related costs such as training, recruitment, employee assistance program, and other work, health, safety and wellbeing programs.

Like labour, corporate expenditure was broadly in line with the determination for the first three years of current pricing period, with an increase experienced in 2023-24. We explained the primary reasons for this in section 5.3 and 5.4.2 (Base Adjustments) of our proposal.

## Operating expenditure in 2024-25

In November 2021, IPART approved the extension of the 2020-24 pricing period by one year, to 2024-25. This section describes our approach to estimating our operating expenditure for 2024-25 and provides a comparison to 2023-24 actual operating costs.

### Our approach

The projected operating costs for 2024-25 included in this proposal are based on our Board-approved 2024-25 operating budget and Statement of Corporate Intent (and Business Plan) as provided to NSW Treasury in July 2024.

We prepared the operating budget in early calendar year 2024, using our usual bottom-up budgeting methodology – not the base-trend-step forecasting methodology used for the upcoming pricing period. We have subsequently retrofitted this bottom-up build to the base-trend-step methodology to complete the Special Information Return (SIR) that accompanies our proposal.

### 2024-25 operating expenditure is in line with 2023-24

Table 3 shows that our projected operating expenditure for 2024-25 of \$196 million is in line with our actual expenditure in 2023-24.

**Table 3: Comparison of 2023-24 actual to 2024-25 budget operating expenditure (\$2024-25, \$millions)**

Cost Category	2023-24	2024-25
Labour	70.9	71.2
Maintenance	24.1	24.5
Operations	48.9	46.9
Regulatory	6.3	6.7
Corporate	44.2	45.8
Revenue Offset – Expenses	0.8	0.8
Cost of Sales – Offset	0.0	0.0
<b>Total</b>	<b>195.3</b>	<b>195.9</b>

Source: 2023-24 = 'Opex by item' (rows 81, 105, 122) escalated by 'SIR CPI' (row 24); 2024-25 = 'SIR Opex 2 bts' (cell U567)

Several of the operating cost drivers (described in section 5.3 of our proposal) will continue into 2024-25:

- Non-recurrent expenditure on major digital transformation projects, FSM and GIS, supporting the replacement of end-of-life systems (such as AOMS).
- Increasing digital services costs incurred as operating expenditure, due to the increasing market prevalence of cloud-hosted, software-as-a-service style digital solutions, rather than traditional on-premises solutions.

- Non-recurrent project expenditure for the procurement of a new market-tendered treatment operations contract.
- Additional resources to meet increasing stakeholder expectations and reporting requirements related to climate-change adaptation and sustainability.

Additionally, real cost increases are projected in 2024-25 for:

- Growth – 1.3 per cent connections growth consistent with section 5.5 of our proposal.
- Wage inflation of 4.0 per cent – as described in section 5.5 of our proposal.
- Motor vehicle lease costs – as described in section 5.5 of our proposal.
- Cyber security – increased investment in cyber security. This is across consultancy, cloud-computing subscriptions for new and improved software and two new cyber security specialist roles. It also includes network threat detection, staff awareness and training, email security enhancements and third-party risk assessments.
- Digital transformation – to progress our digital strategy. This includes short-term contract roles and consultancy to deliver workstreams and projects such as 'empower our people', 'smart systems', and 'data insights' aimed at driving efficiencies and better service outcomes, and to modernise our data centre. This investment is expected to increase productivity and generate long-term cost efficiencies in both operating and capital expenditure.

These cost increases are offset by:

- A \$2.5 million cost efficiency target (as shown in Table 5.4) as part of the 1.0 per cent per year average (compounding) cost-efficiency target which we commenced on 1 July 2024, and the expected return (via lower energy costs) of recent investment in behind-the-meter solar at our sites.
- An assumed return to normal (average) climate and water demand conditions, impacting water and wastewater treatment costs, and associated energy consumption.