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Jane Doolan
Commissioner
Productivity Commission
By Website: pc.gov.au

Dear Commissioner,

Submission to Draft Report *National Water Reform 2020*

Thank you for the opportunity to provide a submission to the National Water Reform 2020 Draft Report. We support the review of the National Water Initiative to ensure it remains relevant over time, and generally support the direction of the draft recommendations in the report.

1 IPART regulates water businesses in NSW

IPART is the independent pricing regulator for water, public transport, and local government in NSW, and undertakes various other special reviews. We aim to make the people of NSW better off through independent decisions and advice. For water, we make price Determinations for 4 urban and 3 rural utilities, which comprise of State-Owned Corporations, a Government agency, one local water utility and one privately owned entity. We make recommendations on, and administer the licence conditions for 2 urban and one rural utility, as well as private water utilities under the Water Industry Competition Act (NSW). Apart from the Central Coast Council, we do not have a role in regulating the water and sewerage services for local water utilities.

We are reviewing how we regulate water utilities

We are currently undertaking a comprehensive review of the way we regulate water utilities, with a view to encourage the businesses to:

- ▼ put their customers' needs and preferences at the core of their business planning, through enhanced customer engagement
- ▼ drive improvements in business management, with performance incentives for innovation and efficiencies.

This review is also looking to streamline our regulatory approach to setting prices and may result in a different approach to regulation that is more tailored to the risk profiles and capacity of the businesses. This review is due to be completed in January 2022 and implemented over the following years. More information is available on our webpage [here](#).

2 We have found issues with integrated planning, stakeholder consultation, and Government funding of projects

Our pricing reviews have highlighted the need to improve planning, communications and transparency on Government funding of projects.

Water resource planning

We agree with the Commission's recommendations on integrated water resource planning, including having all options on the table. We consider that long-term integrated planning should be an ongoing program of work, so that the community is better prepared for the unpredictable major events of nature and the impacts of climate change. We have highlighted the importance of long term integrated planning in our recent pricing reviews for Sydney Water Corporation, Water NSW Greater Sydney and Hunter Water Corporation.¹ Further, in our current review of the Water Administration Ministerial Corporation prices, we have made a draft decision to no longer exclude recycled water and desalination planning costs from prices for the Corporation's monopoly services. This was a change to a decision made in 2016, to better allow consideration of all options for water resource planning.²

Stakeholder consultation

We consider that all planning should be supported by effective stakeholder consultation, and that this could be improved across the sector. Effective consultation and community engagement contributes to making the right decisions and enhances public confidence in those decisions. As mentioned, we are also developing ways to encourage our regulated utilities to improve their customer engagement and reflect customer preference in their outputs and prices. We understand there is strong support for a more customer-centric focus from the utilities, based on recent consultation that we have undertaken.³

We also noted a general lack of community consultation and planning for implementing the Murray-Darling Basin trading scheme changes, and made a submission to the ACCC inquiry to this effect.⁴

Government funding of infrastructure projects

We particularly support your recommendations for greater transparency and consistency in Government infrastructure project selection and assessment. In our recent WaterNSW rural bulk water pricing review, we considered how the funding of Government directed projects impacts prices for customers. In our Draft Report we have found that under a building block model, all of a utility's efficient capital expenditure should be included in its regulatory asset base to be recovered by customers, including if Government funding is expected. Any Government contributions should

¹ See IPART, *Review of price for Sydney Water from 1 July 2020*, June 2020, pp 6-7; IPART, *Review of prices for WaterNSW Greater Sydney from 1 July 2020*, June 2020, pp 12-13; and IPART, *Review of price for Hunter Water Corporation from 1 July 2020*, June 2020, pp 24-25.

² See IPART, *Review of prices for the Water Administration Ministerial Corporation from 1 July 2021 to 30 June 2025, Draft Report*, March 2021, p 23.

³ See IPART, *Water Pricing and Licensing Regulating Water Businesses, Review Update*, November 2020, pp 27-30.

⁴ IPART, *Submission to the ACCC inquiry into water markets in the Murray-Darling Basin Issues Paper*, 30 October 2020.

be deducted as a cash contribution as they occur.⁵ This provides some transparency to the impact of Government directed projects.

3 Pricing principles

We aim for our economic regulation to broadly align with the best-practice pricing principles outlined in Chapter 11 of the Draft Report. However, we consider that care should be taken in making pricing decisions based on actual dividend payments to shareholders. We agree that a regulator should set prices which ensure the financial viability of an efficient utility. However, we disagree that actual borrowing and dividend decisions made by Government shareholders should influence how prices are set under normal circumstances. In general, the actual capital structure and dividend payments of a utility are a matter for its board and shareholder/s. For major utilities, prices should be set to ensure an efficiently operated and structured firm is financially viable. We consider that any borrowing or dividend decisions taken by the shareholder/s that place the utility in a financially unsustainable position should, in the first instance, be referred back to the utility and shareholder/s to address. We apply a financeability test to ensure that our pricing decisions do not place an efficiently operated, geared and financed business in a financially unsustainable position.

In setting prices, we are committed to cost-reflective pricing. To reflect efficient cost of funds, we set a weighted average cost of capital based on our assessment of the efficient benchmark cost of capital rather than reflect the actual cost of borrowing. This means that customers are not exposed to any inefficient costs and that the business has an incentive to look for opportunities to meet (and potentially beat) the benchmark.

We also agree that jurisdictions should ensure that developer charges are cost reflective. In NSW, developer charges for water supplied by Sydney Water Corporation and Hunter Water Corporation are currently set to zero, contradicting the impactor pays principle (i.e. those that create the need for the cost to be incurred should pay for the cost) and adding cost burden to the existing customer base. The NSW Government has recently agreed to phase-in non-zero charges for developments completed on or after 1 July 2026⁶, and we support setting these charges at a cost-reflective rate. We also note the recommendation for a reporting metric for income that excludes developer charges and contributed assets. This may provide a smoother income measure, but a separate metric should clearly set out the annual amount of developer charges received by utilities.

Regarding water trading tariffs, we support the Commission's view that the outcome of any water trading scheme should be tariffs that promote the efficient allocation of water resources.

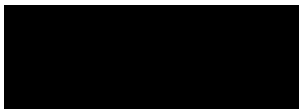
⁵ See IPART, *Review of Water NSW's rural bulk water prices from 1 July 2021 to 30 June 2025, Draft Report*, March 2021, p 72.

⁶ NSW Government, *NSW Productivity Commission's Review of Infrastructure Contributions in NSW*, March 2021, p 5.

IPART's contact officer for this matter is Matthew Mansell, A/ Executive Director Water Pricing and Local Government, contactable on (02) 9113 7770.

Yours sincerely

24/03/2021



Signed by: Liz Livingstone

Liz Livingstone
Chief Executive Officer