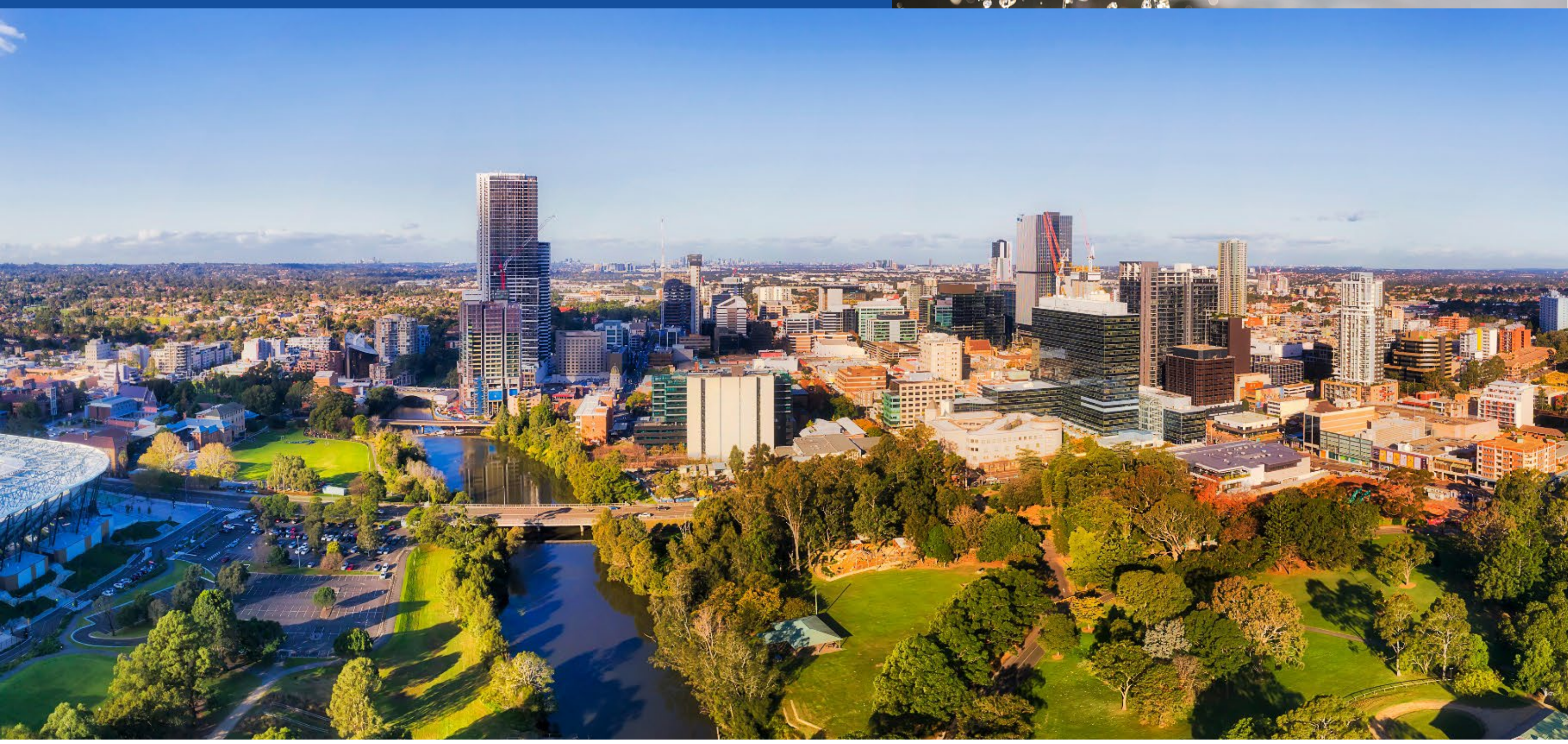
WATER SERVICES
ASSOCIATION OF AUSTRALIA

INVEST TO AVOID A WATER CRISIS

WSAA submission to IPART on NSW price determinations



Invest to avoid a water crisis in Australia

Preface

When water utilities consult their customers about their investment plans a consistent theme emerges: don't leave the problems of the day to the generation of tomorrow. Or more colloquially "don't kick the can down the road".

The Australian water sector needs to significantly increase investment to meet the challenges of population growth, ageing assets and climate change. This will require customers to pay more.

Governments and regulators have two choices.

They can allow utilities to work with their customers to manage the investment path, price increases and assistance programs.

Or they can defer investment and price rises in the short term. However, we know from overseas experience this will induce a water crisis where housing targets are not met, service standards decline, rivers and beaches are degraded and we are not prepared for the next drought. It would then require even larger price rises to fix the crisis.

As a country we cannot afford the second choice. We cannot afford to kick the can down the road.



1.0 Summary

The Water Services Association of Australia (WSAA) is the peak body representing the water sector. Our members provide water and wastewater services to over 24 million customers in Australia and New Zealand and many of Australia's largest industrial and commercial enterprises. In New South Wales, WSAA represents 37 local councils, WaterNSW, Hunter Water and Sydney Water, who service around eight million customers across the state.

We welcome the opportunity to provide a submission to the price reviews of WaterNSW, Hunter Water and Sydney Water. There are a number of national and international trends which we consider relevant to IPART's deliberations and which support the utility submissions proposals for significantly increased investment.

We want to emphasis three points:

1. **Investment is increasing significantly across the water sector**

   It represents a step change, rather than a once off peak. The proposals from the NSW water utilities are typical of what we expect to see across the sector at this time.

2. **There are risks if investment is not made**

   The UK provides lessons in the risks of not matching investment to the needs of customers.

3. **Cost of living is a significant issue, but we should not kick the investment tin down the road**

   There are several ways of handling a cost-of-living crisis. Deferring investment carries significant risks.

2.0 Investment is increasing significantly across the water sector

Sydney Water, Hunter Water and WaterNSW have lodged their five-year pricing proposals with the Independent Pricing and Regulatory Tribunal (IPART).

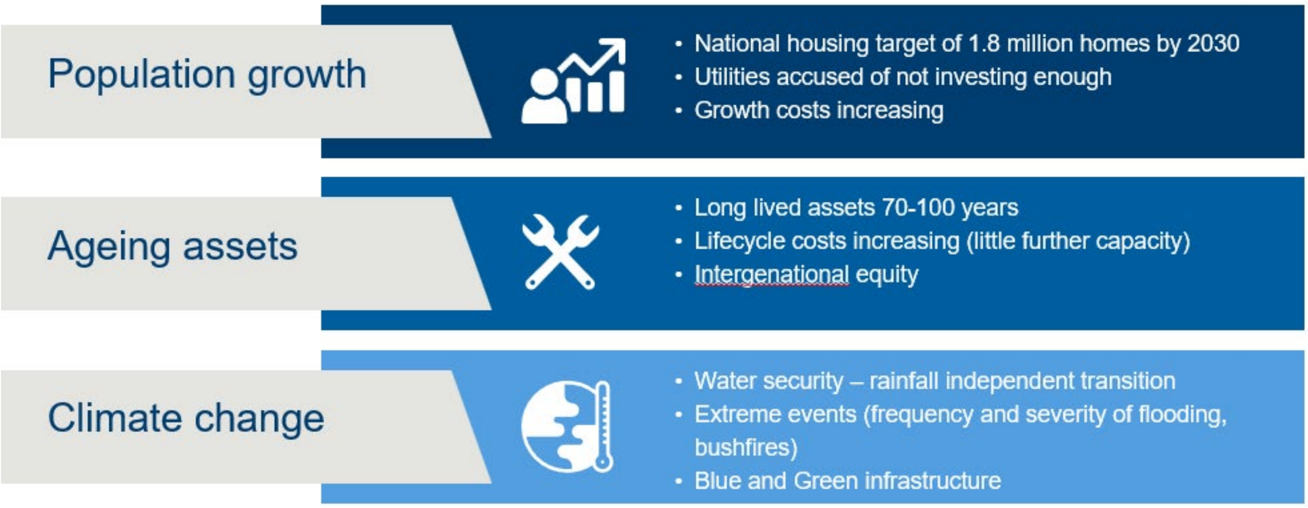
Each of the utilities proposes significant increases in investment, and price increases above inflation to fund this investment. For example, Hunter Water proposes price increase on average around six per cent above the Consumer Price Index (CPI) for each year of the five year determination. Sydney Water is proposing price increases of 18 per cent above CPI in the first year and seven per cent a year after for the remainder of the five year determination. WaterNSW is also proposing investment increases which feed into Sydney Water's prices.

These proposals reflect investment trends that have been underway in the sector for some time. For example, the 2023 price determinations in Victoria approved a 50 per cent increase in capital expenditure (although without significant price increases). In South Australia in 2024 the government approved price increases 3.5 per cent above CPI to fund a large increase in growth capital expenditure.

However, it is also true that the scale of investment in the NSW price determinations points to a new phase for the water sector in Australia. A phase that governments, regulators and the community are yet to fully understand.

The drivers of greater capital expenditure in Sydney Water, Hunter Water and WaterNSW are typical of the national trends. Across Australia all utilities are facing the challenges of ageing assets, population growth and climate change in different combinations. NSW is not an outlier, and these utilities are not alone. See Figure 1 Drivers of increased investment on next page.

Figure 1 Drivers of increased investment



2.1 Current and future investment in Australia

Nationally, water bills across Australia have been flat for the last 10 years (Figure 2 below). This has conditioned the expectations of customers, governments and regulators. It has created the perception that water is a sector in a steady with long term stable prices.

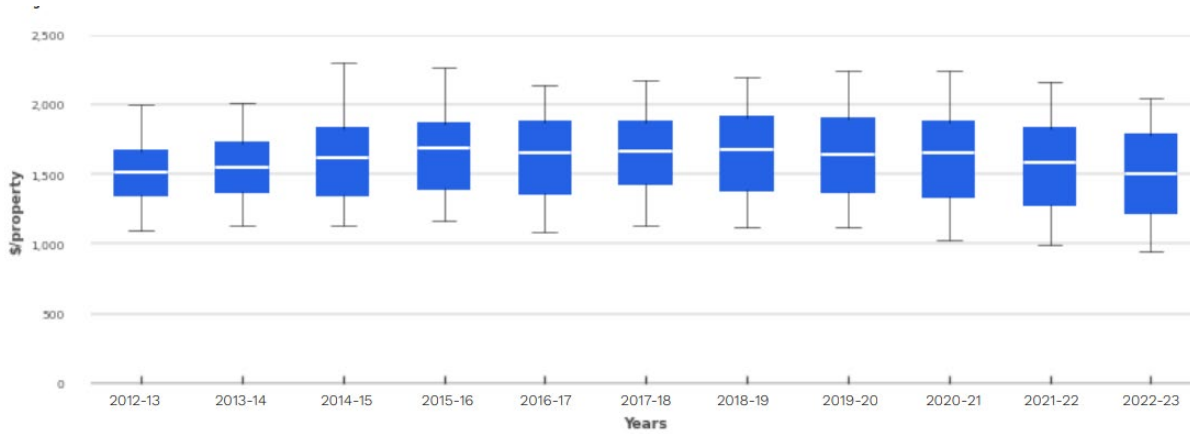
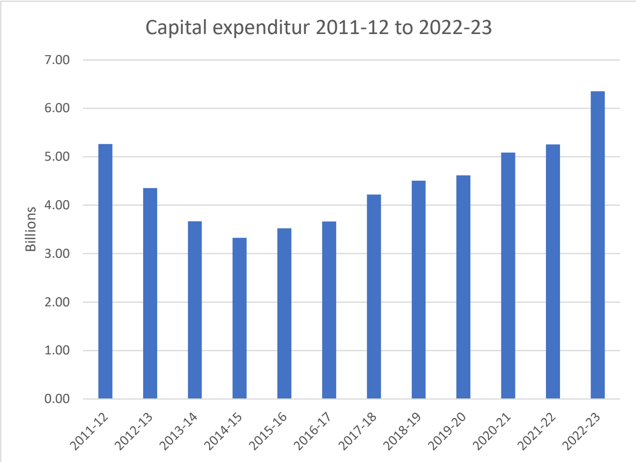


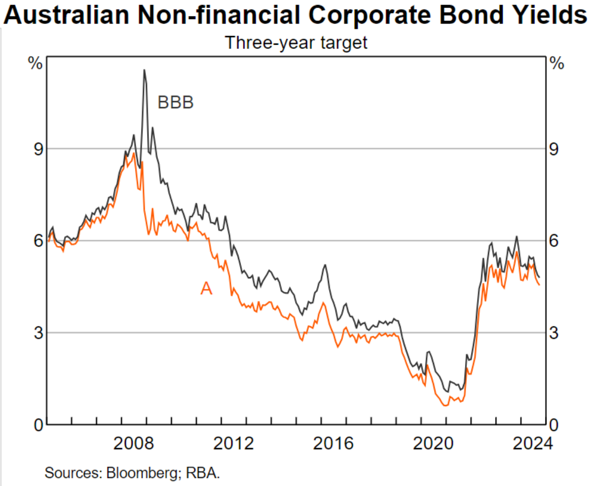
Figure 2: Typical residential water supply and wastewater ($), 2012-13 to 2022-23

However, this has never been the full story. In response to the millennium drought from 2006 to 2009 utilities invested around $30 billion in water security (desalination and recycling) which was completed by 2013-14. Since then, the water sector has been investing in a prudent and efficient way for current and future generations.

The observed outcomes of flat to declining water prices reflect two offsetting factors; higher investment in services offset by a falling cost of capital (Chart 1 and 2).

Chart 1 and 2 Higher investment offset by falling interest rates

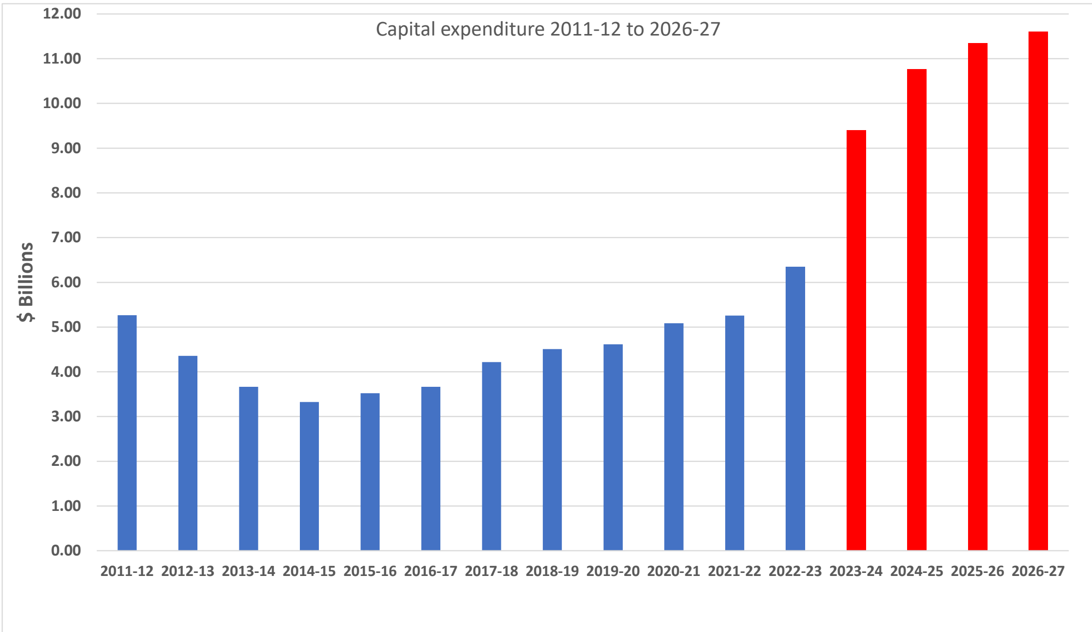




Between 2014-15 and 2022-23, 20 of the largest utilities surveyed by WSAA doubled their capital expenditure from just over $3 billion a year to $6 billion.[1] All the while, prices were able to remain flat owing to a falling weighted average cost of capital (WACC). In other words, lower interest rates reduced utilities payment on debt allowing utilities maintain stable or falling real prices.

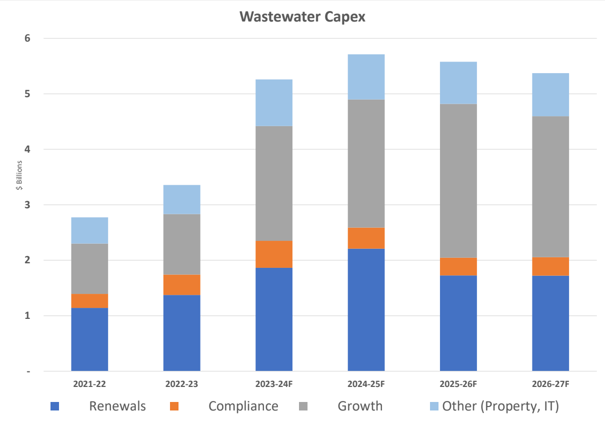
However, what we are seeing nationally now is a projected doubling of capital expenditure to nearly $12 billion a year by 2026-27. Expenditure is relatively evenly spread across water and wastewater. Growth is the single largest element. However, renewing ageing assets and complying with environmental and water quality regulations are also significant. We are beginning to see the next phase of water security expenditure, but this is not fully reflected in the numbers. We are also expecting significant dam safety expenditure to be necessary after 2026-27.

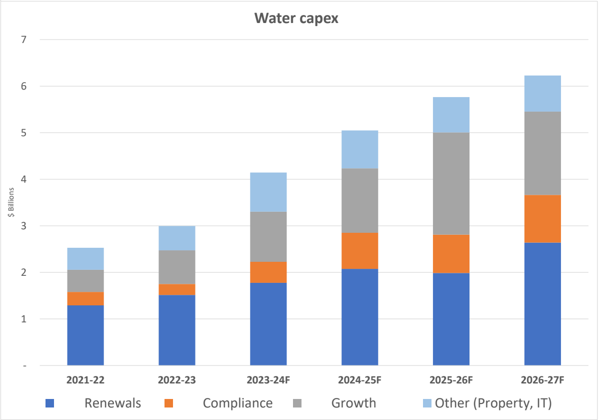
Chart 3 Capital expenditure to 2026-27



[1] Capital expenditure data in this submission is based on a WSAA survey of the 20 or so largest utilities in Australia. This is used as it contains the forward projection to 2026-27 on a consistent basis. However, the same historical trends is observable in the publicly available NPR data. In the NPR total capital expenditure increased from $4.3billion to $7.2billion.

Chart 4 Wastewater and Water Capital expenditure to 2026-27





Therefore, WSAA considers the sector is undergoing a step change in the investment required that will continue beyond 2026-27.

As previously stated by WSAA, higher capital expenditure, higher operating costs and a rising cost of capital can only result in a significant real price increase for customers.

The trends in NSW are reflective of the national trends. This is a critical decade for the water sector, and there are considerable risks if we don't get the investment right.

3.0 Australia cannot afford the risks of underinvestment

Throughout the water sector there has been a rebalancing of risk. In response to cost of living and affordability issues, utilities, working their customers, have prioritised capital expenditure to balance investment with affordability.

This is described in detail in the submissions of the NSW water utilities. This assessment will be further scrutinised by IPART's efficiency reviewers.

Against this background, there are significant risks if the forecast investment in water and wastewater infrastructure does not take place.

- Water and wastewater infrastructure is a vital to meeting all governments housing targets. The capital expenditure planned for growth is not to meet theoretical future development. Many utilities are already under pressure from governments and the community to accelerate their growth programs for existing development. Any disruption to the ability to fund this investment will put government housing targets at risk.
- Many water industry assets are reaching capacity. Renewal costs are increasing. For example. As Sydney Water says, "going forward, trying to maintain the historic level of renewal investment is no longer sustainable:
    - For example, almost 50% of our water and wastewater network infrastructure is more than 50-years old. Without appropriate intervention, this will continue to grow and place an even greater risk of asset failure and non-compliance with regulatory requirements and customer service expectations over the coming years ….
    - Delay will result in a greater backlog of maintenance and renewals work, requiring an even greater step change in future costs as assets continue to age.." (Sydney Water submission, p. 147).

- Most jurisdictions are planning the next phase of investment to provide water security for a growing population subject to a changing climate. Deferral of this expenditure would leave us exposed to severe restrictions during the next drought.

Unfortunately, we know what will happen if we do not get investment in water right. We have well known examples overseas.

3.1 The UK water crisis

The UK is the most prominent example. Bills have been declining in real terms since 2010 (Chart 5) However, unlike Australia it is now clear that this has been accompanied by a lack of necessary investment. As Water UK says:

> *"That means customers have paid lower bills than they otherwise could have. But with the benefit of hindsight, this arguably shows a missed opportunity for more investment. Additional money could have enabled the water sector to go much faster in reducing water leaks, eliminating sewage spills and building resilience to drought and extreme weather."*
>
> [The real (terms) story of historic water bills | Water UK]

Australia does not need the benefit of hindsight to learn the lessons from the UK.

Lack of investment in their combined wastewater and stormwater systems has resulted in high levels of pollution of beaches, lakes and streams from sewer overflows. These levels of pollution are out of step with customer expectations and the trust in the UK water sector has collapsed. This has occurred rapidly since the price determination in 2019. The water system also lacks resilience. The UK has not invested in a new water reservoir for 30 years. Investment is also necessary to provide for an additional five billion litres of drinking water per day by 2050.

Chart 5 Difference between average water and wastewater bills in the UK, and if bills had kept place with inflation since 2009-10 (pounds 2023-24 prices)

Source: Water UK analysis of average water and wastewater bills.

The UK crisis has triggered the biggest review of the entire framework since privatisation, including the regulatory framework. Box 1 below sets out the details of the review. While the review will promote measures to hold utilities to account, the key aim of the review is to attract greater investment to fix broken water infrastructure. Thus, it would be a mistake to attribute the crisis in the UK to privatisation. The root cause is a lack of necessary investment which can only be addressed by greater investment. As the head of the review said:

> *"I am looking forward to working with experts from across the water sector, from environment and customer groups and investors, to help deliver a water sector that works successfully for both customers, investors and our natural environment."*

The UK regulator Ofwat will release its final determinations for water utilities in December. It is expected that it will approve investment of well over £90 billion over the next 5 years. In a measure of the rapidly evolving situation, between the draft and final determinations Ofwat reports that Ofwat's "sister organisations" (its fellow regulators) had requested an additional £7 billion of investment since the drafts were published. This is expected to result in further bill pressure. Water and sewerage companies in the UK are seeking an average increase of 40 per cent ranging up to 84 per cent for one utility.

The lesson for Australia from the UK is that kicking the investment can down the road is a failed strategy. It will lead to a decline in service levels, and to an even greater level of investment and pricing increases to fix broken systems.

Box 1 The largest review of the UK water sector since privatisation

In announcing the review the government said:

"An Independent Commission into the water sector and its regulation will be launched by the government tomorrow (Wednesday 23 October), in what is expected to form the largest review of the industry since privatisation.

The Commission forms the next stage in the Government's long-term approach to ensuring we have a sufficiently robust and stable regulatory framework to attract the investment needed to clean up our waterways, speed up infrastructure delivery and restore public confidence in the sector.

It follows the Government's inaugural International Investment Summit last week at which the Prime Minister spoke of the need for regulation and regulators to support growth and investment in the UK.

Launched by the UK and Welsh governments, the Commission will report back next year with recommendations to the Government on how to tackle inherited systemic issues in the water sector to restore our rivers, lakes and seas to good health, meet the challenges of the future and drive economic growth.

These recommendations will form the basis of further legislation to attract long-term investment and clean up our waters for good – injecting billions of pounds into the economy, speeding up delivery on infrastructure to support house building and addressing water scarcity, given the country needs to source an additional 5 billion litres of water a day by 2050. "

Source: Governments launch largest review of sector since privatisation - GOV.UK

3.2 New Zealand also faces deep seated problems

The second example comes closer to home, in New Zealand. New Zealand has yet to fully land a reform process to deliver the necessary investment to the industry. In the meantime, water quality, system performance and environmental performance is poor. It is estimated there is a back log of investment estimated to be up to $185 billion.

While utilities such as Watercare are well placed to meet the needs of the future, much of the country is not financial sustainable and the price increases to fund necessary investment may be beyond the capacity of the community to pay.

While New Zealand has a capable industry, no amount of capability can overcome a deficit of investment over many years.

4.0 Responding to cost of living issues

Managing affordability and the cost-of-living crisis is front of mind for water utilities. The water sector has well developed programs to assist those who are not able to pay. In addition, NSW water utilities have worked directly with customers to understand what further assistance may be necessary during the current cost of living crisis.

These concerns also a high priority for governments.

In the case of the NSW determinations, the NSW Premier wrote to IPART requiring it to have regard to certain matters (Box 2).

Box 2 Excerpt from NSW Premier's letter to IPART

The Government understands that Sydney Water and Hunter Water will lodge their submissions shortly, which may propose increases to their customers' bills. NSW households are currently experiencing increasing cost of living pressures, including rising housing and utility expenses. These cumulative price increases may disproportionately impact vulnerable communities.

To help address these pressures, pursuant to section 13(1)(c) of the *Independent Pricing and Regulatory Tribunal Act 1992* (**IPART Act**), I require IPART to consider the following matters:

- the cost-of-living impacts of the price determinations
- the effectiveness of existing rebates to manage the social impacts of the price determinations, including if the program will adequately support customers who may be disproportionately impacted by any price increase
- opportunities to adjust project timelines within the price determination period and over the next ten years to minimise price impacts and, if necessary, to reduce the proposed capital programs in line with least cost planning principles, and
- deliverability of the proposed capital plans based on capability and market conditions.

These directions will maintain IPART's independence, while ensuring that the NSW Government is afforded the information required to consider the impacts of IPART's draft determination.

WSAA considers that IPART's existing powers and processes make it well placed to consider matters such as the cost of living impact, the effectiveness of existing rebate programs or the deliverability of the proposed capital plans.

However, we note that the Premier is also asking IPART to have regard to:

> *"Opportunities to adjust project timelines within the price determination period and over the next ten years to minimise price impacts and, if necessary, to reduce the proposed capital programs in line with least cost planning principles…"* (IPART).

In the light of the step change in investment that is required in Australia, and the experience of the UK when investment is inadequate, WSAA sees considerable risks if investment is deferred purely for cost-of-living pressures. We do not believe ‘kicking the can down the road’ is a viable option under the current circumstances.

We suggest that targeted assistance measures are a better approach to help those who struggle to pay their water bill.

An additional approach is for governments to accept lower returns from their water utilities. We note that IPART sets the maximum prices customers can be charged. It does not set the minimum. The government could consider setting prices below the maximum if it wished to directly address cost of living pressures. Under the corporatisation model the impact of this cost of living adjustment would be borne by the state government shareholder through lower dividends or tax equivalent payments.

In the case of NSW, we note that according to the Budget Papers the government estimates that NSW water utilities will make tax equivalent and dividend payments to the NSW Government of over $3.1 billion dollars, or roughly $800 million dollars a year between 2024-25 and 2027-28.[2] We therefore consider the government has scope to provide additional relief to water customers should it choose to do so.

While we have focussed on NSW, this comment applies to all governments in Australia. The direct lever to manage cost of living issues is preferable to running the risk with Australia’s water future.

Contact

WSAA welcomes the opportunity to discuss this submission further.

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[22] NSW Budget 24-25, Budget Paper No1, Chapter 7 page 8.