

REVIEW OF PRICES FOR HUNTER WATER CORPORATION FROM 1 JULY 2020



Overview

March 2020

Draft Report

Overview

The Independent Pricing and Regulatory Tribunal of NSW (IPART) has made Draft Decisions on the maximum prices Hunter Water Corporation (Hunter Water) can charge for the water, wastewater and stormwater drainage services it provides for the next four years (1 July 2020 to 30 June 2024 – the 2020 determination period).

We have also:

- ▼ Set draft maximum prices for Hunter Water's trade waste services and miscellaneous services.
- ▼ Reviewed its recycled water prices.

We have released our Draft Report to:

- ▼ Present our draft prices and how these would affect residential and non-residential customers.¹
- ▼ Explain how we reached our draft decisions and how our draft prices compare to Hunter Water's proposed prices that it put to us in July 2019.²
- ▼ Outline our next steps including how you can provide feedback on our draft decisions (see page 13 for information about our process and how to make a submission).

We will consider all feedback we receive before we make our final decisions. We will then release a Final Report and Determination (which gives legal effect to our decisions) in June 2020. New prices will apply from 1 July 2020.

¹ All dollar figures quoted in this overview are presented **before** inflation, unless stated otherwise.

² <https://www.ipart.nsw.gov.au/Home/Industries/Water/Reviews/Metro-Pricing/Prices-for-Hunter-Water-Corporation-from-1-July-2020>

Our draft prices are lower than Hunter Water proposed

A Hunter Water bill for most customers includes amounts for **water usage**, **water service** and **wastewater service**, and in some areas, for **stormwater drainage**. Non-residential customers' bills will also have an amount for **wastewater usage charges**.

In July 2019, Hunter Water proposed prices that were significantly higher than those currently charged. This was in large part due to an increase in operating and capital expenditure, and a faster rate of depreciation of its assets. Hunter Water's proposed prices reflected its intent to lift expenditure in key areas to improve or maintain environmental compliance, service reliability, public health, public safety and employee safety.

Our draft prices are generally lower overall than current prices. This is driven by two factors:

1. A reduction in the Weighted Average Cost of Capital (WACC) that we use to calculate the return on the assets used to provide services.
2. We have made some adjustments to Hunter Water's proposed expenditure.

Our draft prices result in lower bills than Hunter Water proposed

Change in a typical bill after 4 years, including inflation

For a typical customer in a house



For a typical customer in an apartment



We have set draft prices to allow for operating and capital expenditure allowances over the next four years (2020-21 to 2023-24) of \$614.5 million and \$646.0 million, respectively.

We are confident our draft decisions would provide Hunter Water with sufficient revenue to efficiently deliver its water, wastewater and stormwater services, while complying with its operating licence and other regulatory requirements.

The increase in capital expenditure has been offset by a reduction in the cost of capital (WACC). Hunter Water used a WACC of 4.1% at the time it calculated proposed prices. Based on current market data, the WACC has fallen to 3.2%, using the same calculation methodology.

However, the assets funded by the capital expenditure will last for many decades, and remain in the RAB for the extent of their lives. If the WACC increases in the future, this higher capital expenditure would increase customer bills. It is therefore important that capital expenditure is justified and efficient. We will also do an ex-post review of capital expenditure at our next price review, before including it in the RAB going forward.

What are our draft prices for water, wastewater and stormwater?

Water prices

- ▼ We have accepted Hunter Water's proposed water usage charge of \$2.41/kL for 2020-21, which will gradually increase to \$2.49/kL by 2023-24. This price level reflects the best current estimate of the long-term costs of water supply.
- ▼ The water service charge would decrease significantly in 2020-21, to \$4.18 per year for residential customers, and non-residential customers with 20mm meters (compared to \$100.40 in 2019-20).

After four years, the water usage price will be \$0.12/kL (or 5.1%) higher than today's usage charge before inflation, and the fixed service charge will only increase with inflation.

A higher variable component will give customers greater control over their bills – meaning they pay less if they use less water.

Wastewater prices

- ▼ The wastewater service charge for houses would reduce marginally in 2020-21 (ie, from its current level of \$649.28 to \$645.63) and then remain constant for the next four years.
- ▼ The wastewater service charge for apartments would increase gradually over the next four years from \$535.66 to \$597.21 in 2023-24 (before inflation). This is to gradually transition the charges for apartments to those of houses.
- ▼ The wastewater usage charge will remain at \$0.67/kL, before inflation.

We have also decided to remove the deemed wastewater discharge amount from service charges for all non-residential customers. Instead, they will pay a meter based service charge and a usage component based on estimates of their actual discharges to the wastewater network.³

³ Actual discharges are estimated by multiplying a customer's metered water usage by its discharge factor.

Stormwater prices

- ▼ Houses and apartments subject to stormwater prices would pay \$78.04 and \$28.87, respectively, in 2020-21 (2% fall).
- ▼ Prices for non-residential customers would also fall by 2% in 2020-21. Actual prices depend on the area of each customer's property.

Not all customers are subject to stormwater prices – it depends on their location.

Draft residential prices for four years

Our draft prices for the next four years for water, wastewater and stormwater services (and the total percentage change) are provided in the table below for residential customers.

Draft prices for residential services (\$2019-20 – ie, excluding inflation)

Charge description	2019-20 (Current)	2020-21	2021-22	2022-23	2023-24	Change 2020-24
Water						
Usage (\$/kL)	2.37	2.41	2.44	2.46	2.49	5.1%
Service – houses & apartments	100.40	4.18	4.18	4.18	4.18	-95.8%
Wastewater						
Houses	649.28	645.63	645.63	645.63	645.63	-0.6%
Apartments	535.66	548.79	564.93	581.07	597.21	11.5%
Stormwater						
Houses	79.63	78.04	78.04	78.04	78.04	-2.0%
Apartments	29.47	28.87	28.87	28.87	28.87	-2.0%

Note: The wastewater price has been calculated as a base meter connection charge multiplied by a discharge factor (75%) with a deemed usage allowance (120kL pa at \$0.67/kL) added.

Residential bill impacts

Under our draft prices, assuming the same water usage over time, residential customers' combined water, wastewater and stormwater **bills typically would fall in 2020-21, and only increase by inflation (or slightly above the rate of inflation) in subsequent years.**

Over the 4 years of the 2020 determination period, including the effects of inflation, our draft prices would result in:

- ▼ A 0.5% bill increase for a typical house that uses 189 kL of water and is subject to stormwater charges, and

- ▼ A 3.5% bill increase for a typical apartment that uses 115 kL of water and is subject to stormwater charges.

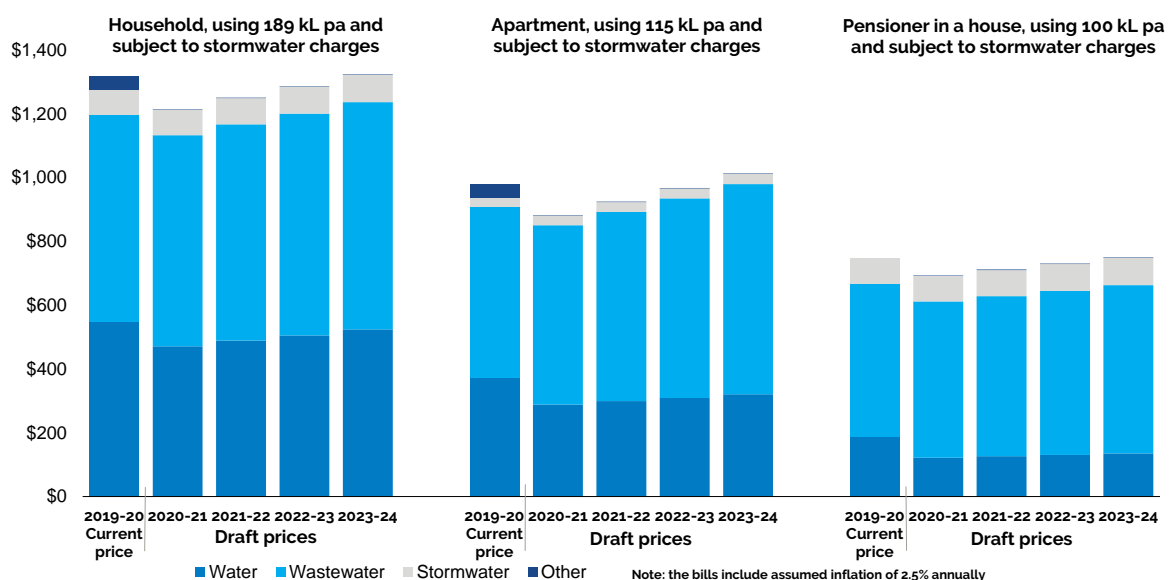
Bills for apartments would increase at a greater rate than bills for houses due to our draft decision to continue to transition the wastewater service charge for apartments to align with that of houses.

Indicative bills for typical residential customers with stormwater services (\$nominal - ie, including inflation)

Customer type (annual usage)	2019-20 (Current)	2020-21	2021-22	2022-23	2023-24	Change 2020-24
House (189kL)	1,318	1,214	1,251	1,286	1,324	
<i>Annual change</i>	-	-7.9%	3.0%	2.8%	3.0%	0.5%
Apartment (115 kL)	979	882	925	968	1,013	
<i>Annual change</i>	-	-9.9%	4.8%	4.6%	4.7%	3.5%
Pensioner (100 kL)	748	693	712	731	750	
<i>Annual change</i>	-	-7.4%	2.7%	2.6%	2.7%	0.3%

Note: Includes discretionary charges.

Indicative annual bills for a typical house, apartment and pensioner (\$nominal - ie, including inflation)



Affordability was the key issue raised in the majority of stakeholder submissions to our Issues Paper, particularly in the context of general increases in the costs of living including other essential services. A number of people also expressed concern that customers had limited ability to reduce their bills.

Our draft decision to increase the water usage price, in line with Hunter Water’s proposal, and lower the fixed water service charge, increases the ability of customers to reduce their bill by reducing their water usage.

Draft non-residential prices for four years

Our draft decisions on Hunter Water’s non-residential prices for water, wastewater and stormwater services are reflected in the table below. Water prices are the same as for residential customers, except for large users.

Draft prices for non-residential services (\$2019-20 – ie, excluding inflation)

Charge description	2019-20	2020-21	2021-22	2022-23	2023-24	Change 2020-24
Water						
Usage ≤50,000kL pa (\$/kL)	2.37	2.41	2.44	2.46	2.49	5.1%
Usage >50,000kL pa		Variable and location specific – see our draft report				
Service - small customers (20mm meter stand-alone)	100.40	4.18	4.18	4.18	4.18	-95.8%
Service - 25mm meter equivalent	156.88	6.53	6.53	6.53	6.53	-95.8%
Wastewater						
Usage (\$/kL)	0.67	0.67	0.67	0.67	0.67	0%
Service - small customers (20mm meter stand-alone)	758.51	753.64	753.64	753.64	753.64	-0.6%
Service - 25mm metre equivalent	1,185.17	1,177.57	1,177.57	1,177.57	1,177.57	-0.6%
Stormwater						
Small (≤1,000m ²) or low impact	79.63	78.04	78.04	78.04	78.04	-2.0%
Medium (1,001 to 10,000m ²)	260.08	254.87	254.87	254.87	254.87	-2.0%
Large (10,001 to 45,000m ²)	1,654.10	1,620.98	1,620.98	1,620.98	1,620.98	-2.0%
Very large (>45,000m ²)	5,255.48	5,150.26	5,150.26	5,150.26	5,150.26	-2.0%

Note: Service charges increase proportionally for larger meter sizes. For wastewater service charges, the charge in the table above is to be multiplied by a discharge factor that is specific to each property, so the actual price would be lower than that in the table.

The **impact on non-residential customers' bills** depends on their meter size and discharge factors, as well as their water and wastewater usage, and land area.

We found that for different types of non-residential customers, annual average bill changes over the 4-year determination period would range from -2% to +3% (including the effects of inflation).⁴ Most non-residential customers would likely see a reduction in their combined water, wastewater and stormwater bill in 2020-21.

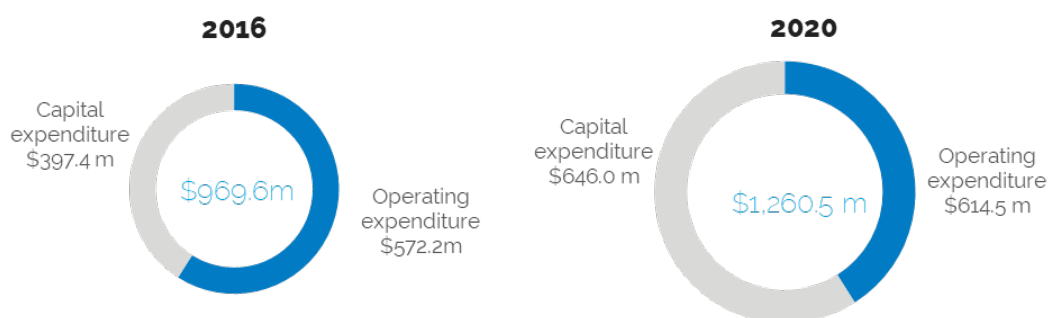
We reduced Hunter Water's proposed expenditure

We assessed Hunter Water's proposed operating and capital expenditure to be recovered via prices, and **made some reductions for efficiency**. We made project specific reductions, and applied a 0.8% ongoing efficiency factor to encourage Hunter Water to seek and capture future efficiencies.

- ▼ Our draft operating expenditure allowance for the next four years is 2% lower than Hunter Water proposed.
- ▼ Our draft capital expenditure allowance for the next four years is 8.5% lower than Hunter Water proposed.

Nonetheless, the total expenditure allowance for Hunter Water under our draft decisions is about 30% higher than that used when we set prices in 2016. The lower WACC reduces the impact this has on our draft prices.

Comparison of total expenditure allowed (\$2019-20)



⁴ The impacts on larger customers (ie, those that use over 50,000 kL of water per annum) may be larger due to our draft decision to remove location-based discounts for these users.

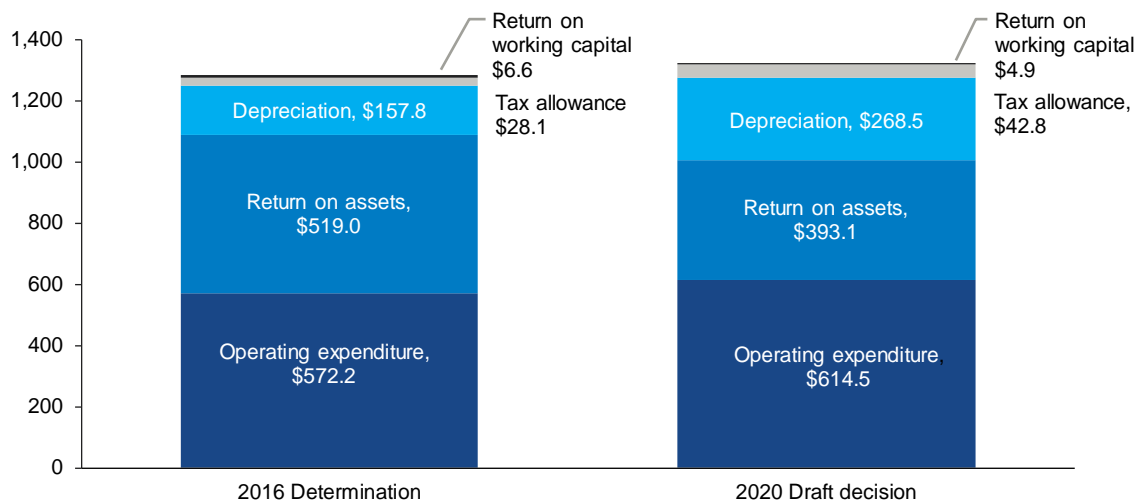
Our draft decision on the capital expenditure program would result in an increase in Hunter Water’s Regulatory Asset Base (RAB) of around \$0.4 billion over four years, to reach \$3.2 billion. We use the RAB to generate an appropriate return on and of capital over the life of the assets.

Hunter Water would recover less revenue than it proposed

We set prices so that Hunter Water could recover its notional revenue requirement. Its notional revenue requirement is our assessment of its efficient costs of delivering its services.

After accounting for all revenue requirements (including expenditure, return on asset, depreciation etc), Hunter Water proposed a total revenue requirement of \$1,480 million for the next 4 years. Our draft decision is for a total revenue requirement of \$1,324 million, or \$331.0 million per year, on average. This is \$40.1 million, or 3.1%, higher than we used when setting prices in 2016 and 10.5% lower than Hunter Water’s proposal.

Total revenue requirement – draft decision compared to 2016 determination (\$ millions, \$ 2019-20)



Key issues

We have moved to a higher water usage charge

Our draft decision is to **increase the water usage charge each year**, to reflect the long run marginal costs (LRMC) of water supply. The LRMC of water supply is the additional cost to Hunter Water of permanently increasing water supply or, in other words, the costs of ensuring that water supply meets demand over the long-term.

We favour setting water usage prices for metropolitan water utilities with reference to the best available estimate of the LRMC of water supply, to encourage efficient water consumption, as this sends an appropriate signal about the cost of meeting sustained increases in water demand over the long-term. In doing so, we accepted Hunter Water's proposed prices, and its observation that most of its customers prefer to maintain, or increase the usage charge.

This gives customers a **greater degree of control over their bills**. Under our draft prices:

- ▼ A typical household using 189 kL per year would save around \$69 per year if it reduced its usage by 15%
- ▼ A typical apartment using 115 kL per year would save \$42 for the same 15% reduction in water use (ie, savings are smaller as total water use is lower).

The Environmental Improvement Charge has been removed

Currently, Hunter Water levies an **Environmental Improvement Charge (EIC)** on customers that receive a wastewater service, of \$41.01 per customer. It proposed removing this charge on 30 June 2020, and we have agreed to remove the charge.⁵

The EIC had been in place to partly fund the connection of wastewater services to some townships under a sewerage backlog scheme. Hunter Water proposed to discontinue the EIC from 1 July 2020 in the absence of Government direction to fund and deliver further backlog sewerage services.

⁵ The EIC was used to provide sewerage services to the Wyee 'backlog' area as well as an additional five projects in the Lower Hunter. Hunter Water observed our recent approach in the 2018 Developer Charges Determination, where the existing property owner is liable for Hunter Water's cost of building an extension of the wastewater network to the connecting property.

We favour an approach based on the ‘impactor pays’ principle, where owners are responsible for the costs of the service (as they create the need to incur the cost), unless there are identifiable broader benefits to the community (eg, health and environmental benefits), in which case costs could be shared with the wider customer base.

We have allowed discretionary expenditure to be recovered via prices

At our last price review, we noted that we would consider, and could allow, ‘discretionary’ expenditure to be recovered via regulated prices. **Expenditure is discretionary when it is not needed to meet mandated service standards.** We stated we would require clear evidence that customers are willing to pay for programs that exceed mandated standards, and that the proposal would best fit with the utility’s responsibilities.⁶

Our Final Report on our 2019 review of our approach to regulating recycled water prices also noted that we would allow for the value of external benefits of a recycled water scheme to be recovered from the utility’s broader water and/or wastewater customer base (thus offsetting the costs of the recycled water scheme and the prices paid by recycled water customers), as evidenced by the broader customer base’s willingness to pay.⁷

Our draft decision is to approve Hunter Water’s proposal to recover \$11.3 million to improve the amenity of stormwater assets, and \$6.0 million to irrigate public spaces with recycled water from regulated prices. These are both discretionary projects and, under our draft determination, costs will be recovered from residential customers through a \$1.43 annual discretionary charge. At our next review, we would ensure that Hunter Water has provided the discretionary services that customers expect.

We have made changes to our pricing approach and structure

We have made decisions to improve the cost reflectivity of prices and charges to promote more equitable and cost-reflective prices.

Hunter Water proposed phasing out **location based water usage pricing** that applies to 19 large customers, which provides discounts based on estimates of cost differentials in different zones. Our draft decision is to phase out the discounts, commencing in 2021-22. Removing the discounts would result in a reduction for all other customers. All customers would pay the same water usage charge from 2024-25.

⁶ IPART, *Review of prices for Sydney Water Corporation*, Final Report, June 2016, p 37.

⁷ IPART, *Review of pricing arrangements for recycled water and related services*, 1 July 2019.

In our 2016 review, we included a **demand volatility adjustment mechanism**. Under this mechanism, if Hunter Water's actual water sales were 5% higher or lower than the forecast sales we used to set its prices, we would consider an adjustment in future periods to address Hunter Water's under- or over-recovery of revenue. Hunter Water has reported higher water sales than forecast over the first three years of the 2016 determination period, and our draft decision is to return \$10.3 million to customers over the 2020 determination period.


We have also retained the demand volatility adjustment mechanism for the 2020 determination period. Hunter Water proposed (in its submission to our Issues Paper) an **annual** adjustment mechanism to apply in periods of water restrictions, but we have not accepted this proposal.

We have largely accepted Hunter Water's changes to trade waste charges

We have accepted almost all of Hunter Water's proposed restructure of its trade waste prices. This means that trade waste bills would increase significantly for some customers. The main changes are that:

- ▼ Administration charges would mostly increase (except for moderate agreement customers).
- ▼ The combined biochemical oxygen demand/total suspended solids charge that currently applies would be replaced by a separate charge for each.
- ▼ The variable charges for tankered customers would be replaced by one volumetric charge.

Hunter Water also proposed a price increase (from \$5.95 to \$9.20 per kL) in 2023-24 for tankered customers, which would have been to provide modifications to receiving stations, including 24-hour disposal services. Our draft decision is to not accept this, but we invite Hunter Water to provide more information on the associated capital program to provide us with greater assurance and certainty on the timing and efficiency of the proposed capital project.



We will **consider all feedback** when making our final decisions.

We will **accept stakeholder** feedback on this stage of our review **until Thursday 9 April 2020**.

There are two ways to have your say:

1. Make a submission to our Draft Report

Our **Draft Report** contains more details and analysis on a range of topics, and includes all of our draft decisions.

You can make a submission until 9 April 2020, by following the links on our **Hunter Water review** page on our website – www.ipart.nsw.gov.au.

You can make a formal submission on our website or by post.



Postal address:

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Sydney, NSW 1240

2. Provide feedback on our website

You can provide your comments by 9 April 2020 in the comment boxes provided on the **Hunter Water review** page on our website.