IPART

Independent Pricing and Regulatory Tribunal

New South Wales

WATER NSW GREATER SYDNEY

REVIEW OF MAXIMUM CHARGES FROM 1 JULY 2020

Final Report

June 2020

Content

1. Overview

- Overview of Water NSW Greater Sydney (GS) price review
- Key themes of the Water NSW GS review

Overview of 2020 Water NSW GS price review

Form of regulation

- 4-year determination period
- Price structures remain predominantly fixed to match WaterNSW's cost structure

Efficient costs and planning

- Lower opex by 10.1% compared to 2016 opex allowance
- Higher capex by 33.2% compared to 2016 efficient ex-post level
- Improving water planning processes

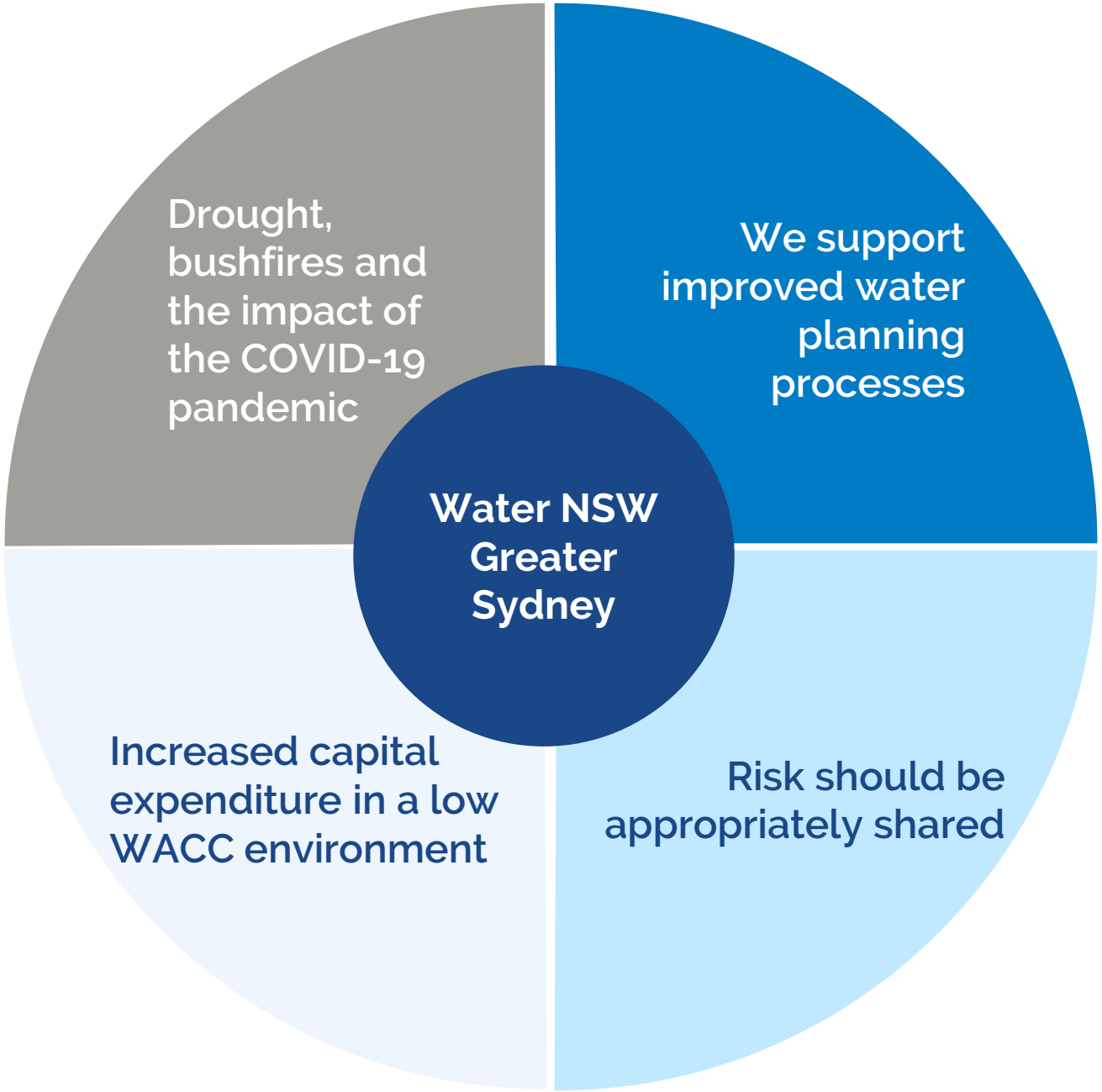
Risks and impacts

- Refined the mechanisms available to Water NSW to manage its risks
- Balanced outcomes for Water NSW, its customers and broader community

Demand and Pricing

- Dynamic usage pricing approach
- Non drought prices and bills for all customers will decrease by about 8.3% from 1 July 2020

Key strategic themes of the 2020 Water NSW GS price review



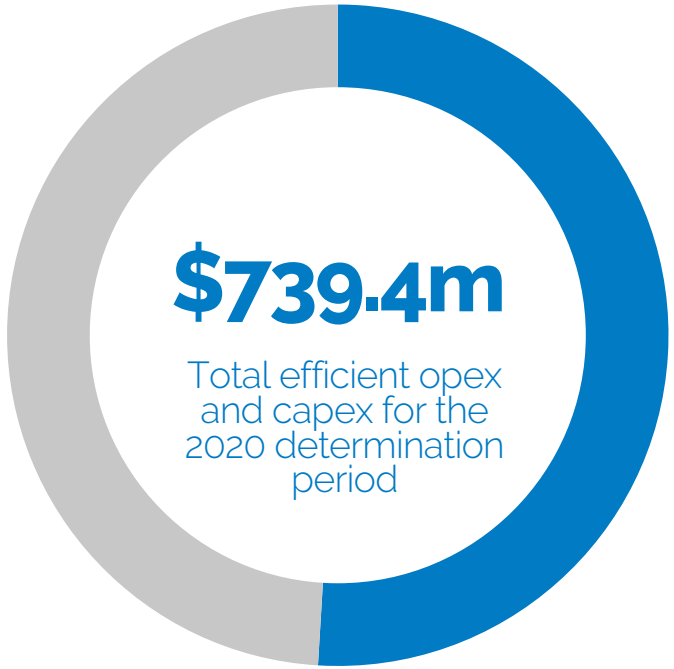
2. Expenditure

- Operating expenditure (opex)
- Capital expenditure (capex)
- Key expenditure issues raised by Water NSW

Expenditure decisions

Opex: $366.4m

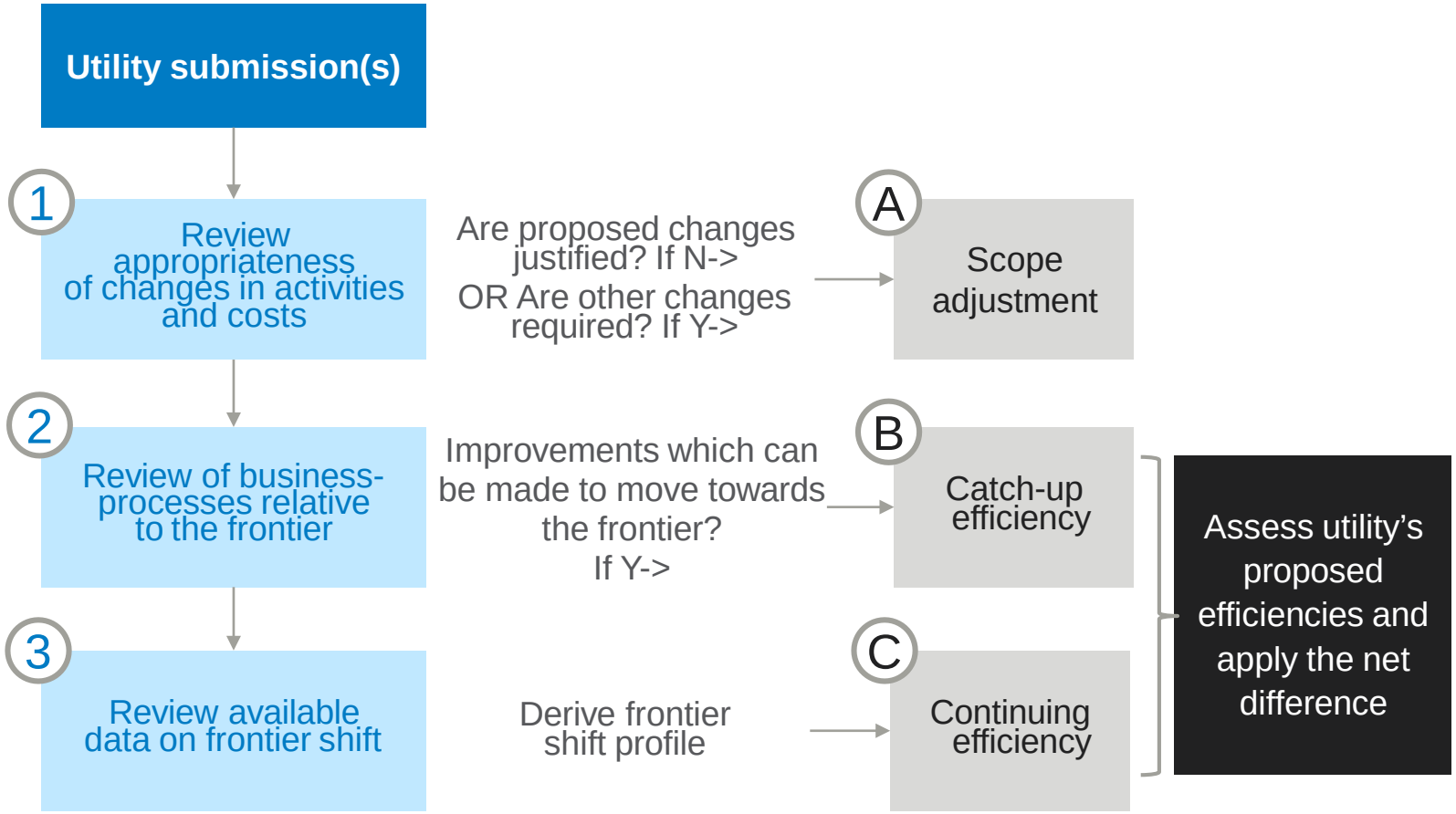
This is **4.7% lower** than Water NSW's proposed expenditure, and **10.1% lower** than the 2016 allowance



Capex: $373.0m

This is **33.2% higher** than the 2016 ex-post efficient level and **16.4% lower** than Water NSW's proposed expenditure (excluding Avon Deep Water Access)

The approach in establishing efficient expenditure



Key issues we considered for operating expenditure

COVID-19

Pause on continuing efficiency in response to COVID-19

Bushfires

Opex for internal fire planning/ management, post-bushfire catchment rehabilitation

Weather events

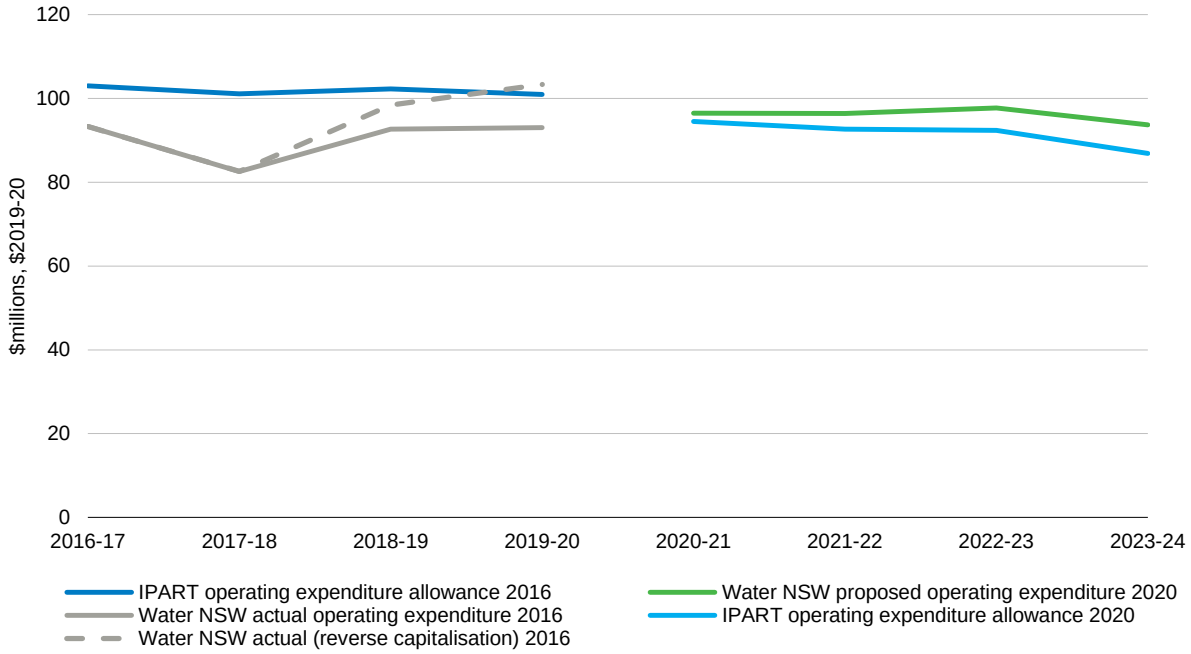
Proposed water quality monitoring activities in light of heavy rainfall in February 2020

Operating expenditure

Final decision on opex is $366.4m over the 2020 determination period

- Specific adjustments of $8.9m
- Catch-up efficiency adjustments of $8.5m (0.9% pa)
- Continuing efficiency adjustments of $4.5m (0.0% in year 1 then 0.8% pa, which is about 0.5% weighted-average over four years)
- Higher than our draft decision by $6.8m
- Similar to Water NSW's 2016 actual opex (slightly lower if add back additional opex capitalised due to a policy change)

Opex over 2016 and 2020 determination periods



Key issues we considered for capital expenditure

Capex increase

Over 30% increase in capex compared to efficient 2016 levels

COVID-19

Pause on continuing efficiency in response to COVID-19

Efficient planning

Funding to plan drought response projects

Weather events

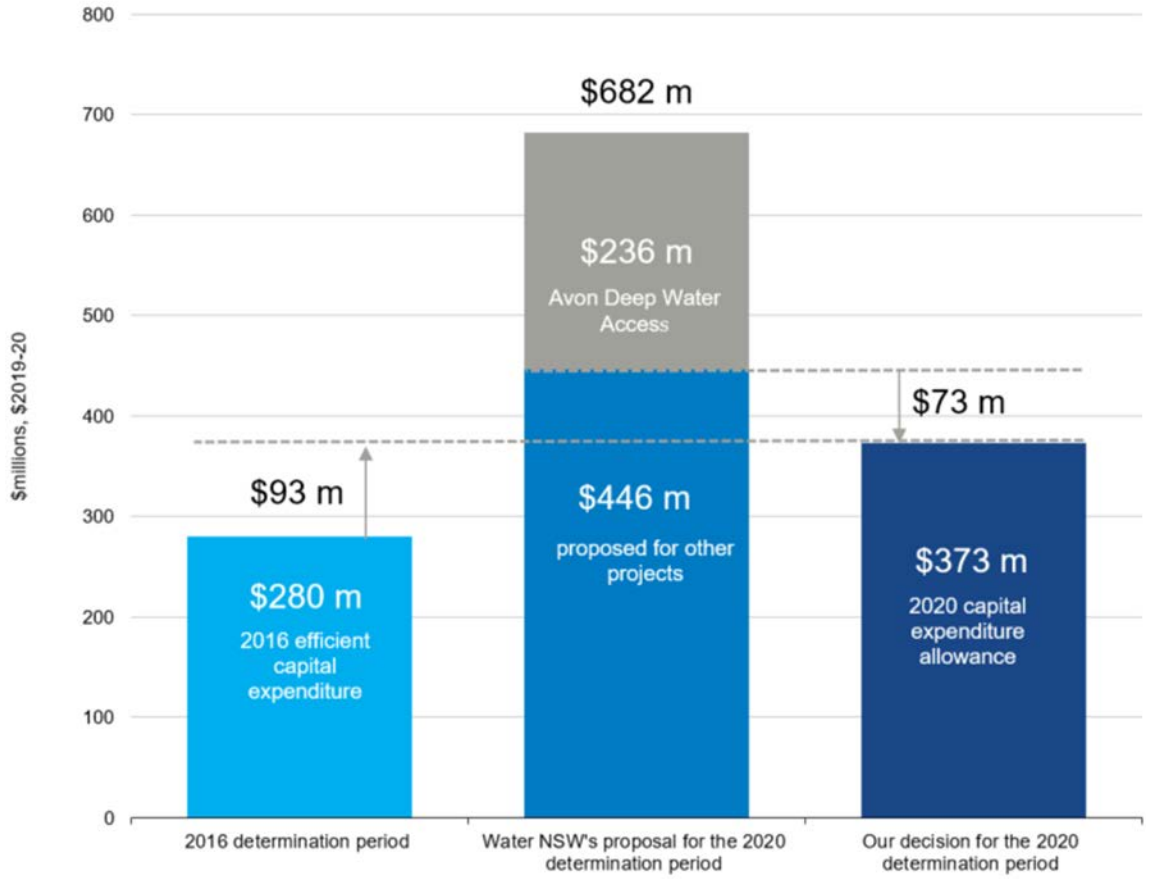
Heavy rainfall changed the prudency of projects

Capital expenditure

Final decision on capex of $373.0m for 2020 determination period

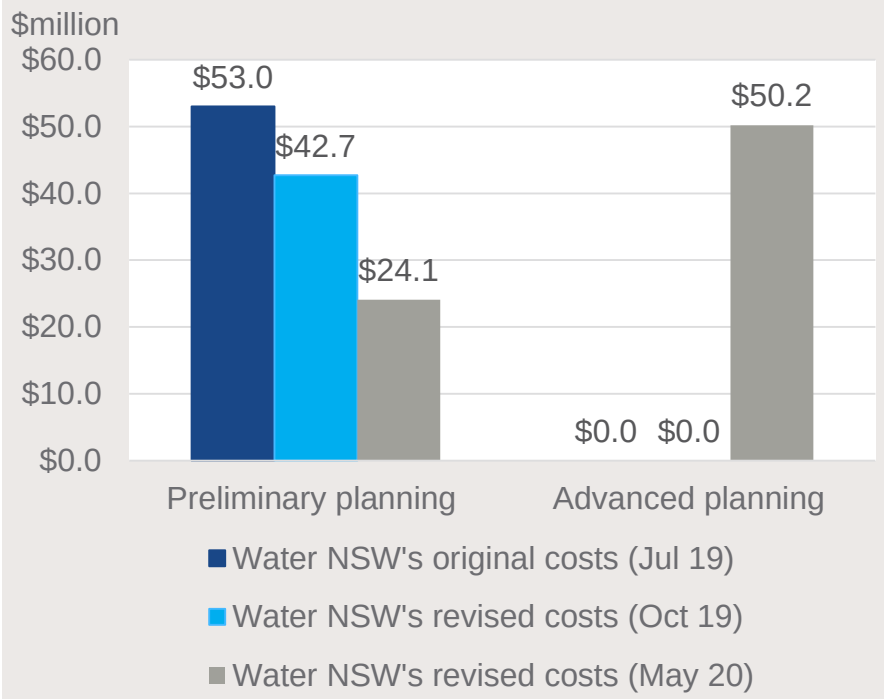
- Specific adjustments of $48.9m (excluding Avon Deep Water Access)
- Catch-up efficiency adjustments of $20.0m (2.1% to 7.3% pa)
- Continuing efficiency adjustments of $4.4m (0.0% in year 1 then 0.8% pa, which is about 0.5% weighted-average over four years)
- Similar to our draft decision ($0.9m difference)

Capex over 2016 and 2020 determination periods



Planning for drought response projects

Water NSW has revised planning costs for its **drought response projects** several times over the review



Our decisions

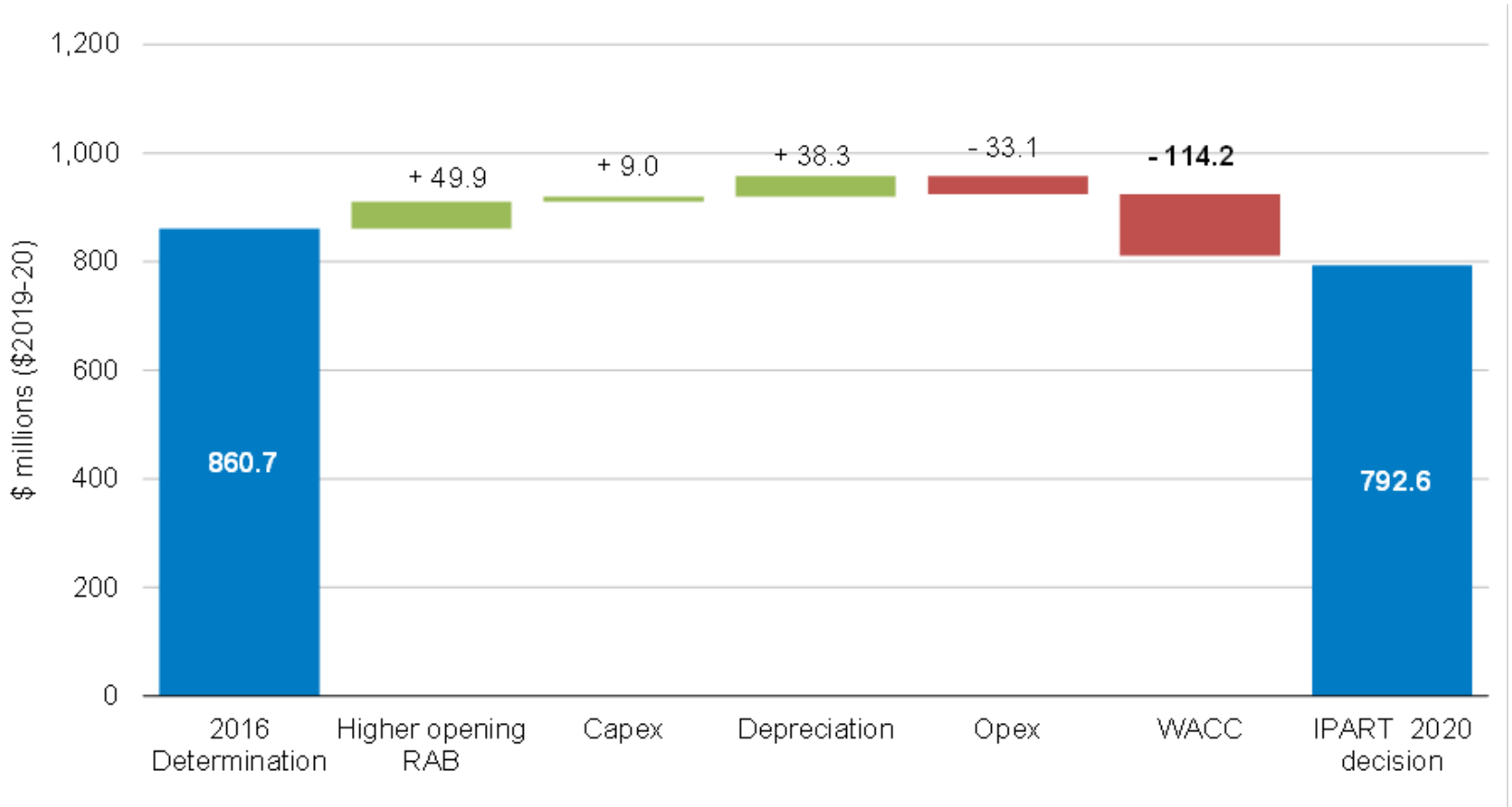
- Preliminary planning costs **are prudent**
- Advanced planning costs **are not prudent**

There is strong merit in the Government and the utilities actively planning, prioritising and implementing drought resilience measures while climatic conditions are favourable – to avoid hurried, constrained decisions once water is in short supply.

3. Notional Revenue Requirement (NRR)

- NRR
- WACC and inflation

Key changes from our 2016 NRR and our 2020 NRR



The 2020 NRR is lower than the 2016 NRR because of lower WACC and opex allowance, which were partially offset by higher opening RAB, higher capex and depreciation allowance.

Weighted average cost of capital

We applied our standard 2018 WACC method with:

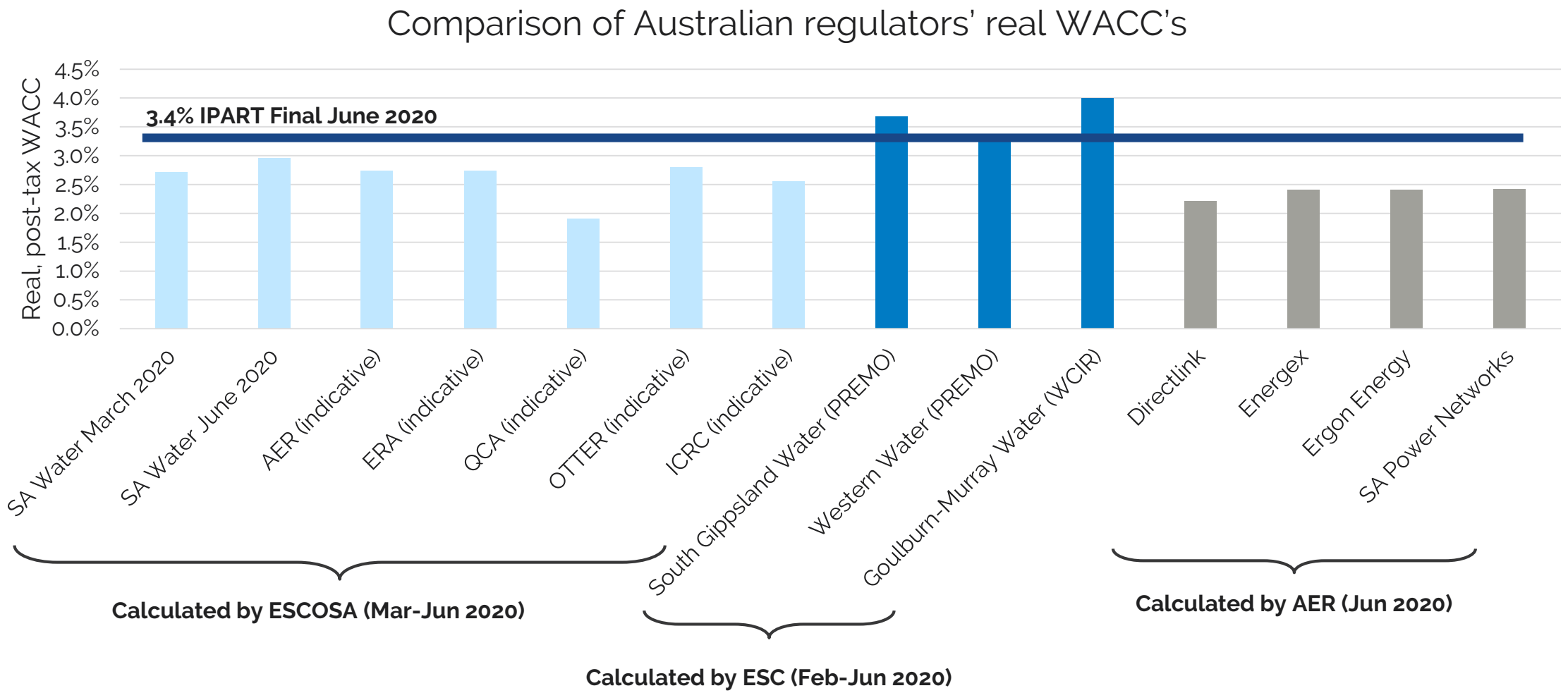
- An estimate of inflation expectations of 2.3%
- Taking the midpoint of current market data and long term averages

In response to concerns from the water utilities, we found:

- The WACC we set is efficient, is relatively high compared to other regulators, and would allow the utilities to remain financeable
- Maintaining a transparent and objective approach is appropriate, when there is no clearly superior method for estimating inflation expectations
- An adjustment to prices, for the difference between expected and actual inflation, is not appropriate

Adjusting one element of the WACC in isolation is problematic because it ignores the fact that many WACC parameters are interrelated. WACC parameters should be considered together on a holistic and internally consistent basis through periodic WACC reviews.

Our WACC is currently high compared to other jurisdictions



4. Forecast water sales and prices

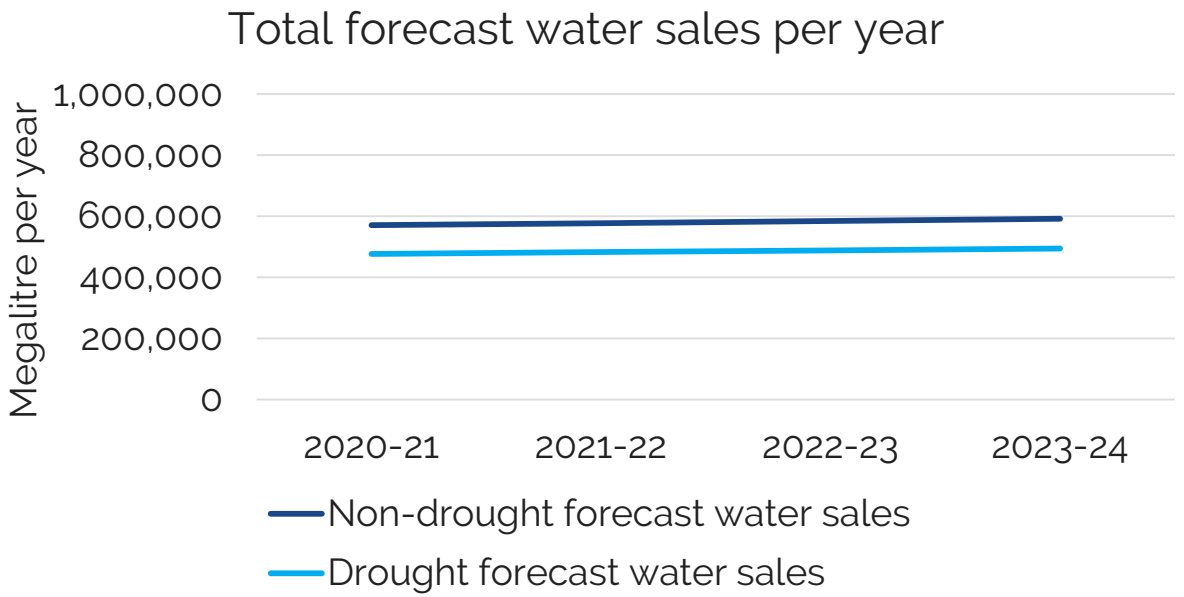
- Forecast water sales
- Dynamic usage pricing
- Prices for all customers

Forecast water sales

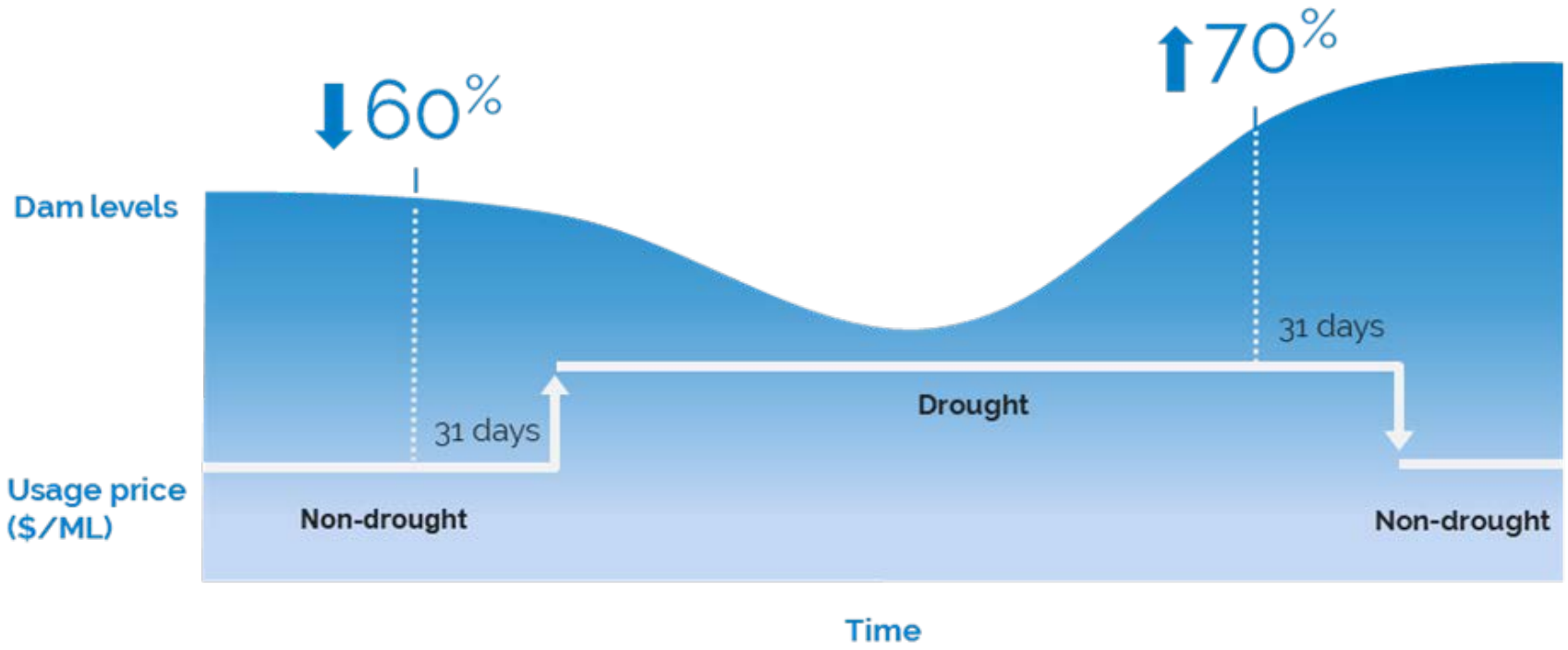
There are two sets of water sales forecasts:

- When dam levels are above 60%, the 'non-drought' forecasts will apply
- When dam levels fall below 60%, the 'drought' forecasts will apply until dam levels go above 70%

Forecast water sales over the determination period



Dynamic water usage pricing



Prices for Sydney Water will fall by around 8% under non-drought scenarios

	2019-20 ($2019-20)	2020-21 ($2020-21)	2021-22 ($2020-21)	2022-23 ($2020-21)	2023-24 ($2020-21)	% change
Sydney Water						
Fixed charge ($million/year)	173.5	160.6	160.6	160.6	160.6	-7.4%
Non-drought usage ($/ML)[a]	78.8	69.7	69.7	69.7	69.7	-11.6%
Drought usage ($/ML)[a,b]	na	83.3	83.3	83.4	83.4	na

a These usage charges to Sydney Water assume SDP and the Shoalhaven Transfer Scheme are not operating.
b Water NSW did not propose drought prices so there is no comparable drought usage charge.

Prices for council customers will fall by around 8% under non-drought scenarios

	2019-20 ($2019-20)	2020-21 to 2023-24 ($2020-21)	% change
Fixed charge			
Wingecarribee Shire ($/year)	1,104,880	1,013,214	-8.3%
Shoalhaven ($/year)	20,716	18,998	-8.3%
Goulburn-Mulwaree ($/year)	24,860	22,797	-8.3%
Usage charge			
Non-drought usage ($/ML)	57.6	52.8	-8.3%
Drought usage ($/ML)[a]	na	63.2	na

a Water NSW did not propose drought prices so there is no comparable drought usage charge.

Prices for raw and unfiltered water customers will fall by around 8% under non-drought scenarios

	2019-20 ($2019-20)	2020-21 to 2023-24 ($2020-21)	% change
Raw water customers			
Fixed charge ($/year)	-	-	-
Non-drought usage ($/ML)	730.0	669.4	-8.3%
Drought usage ($/ML)[a]	na	801.3	na
Unfiltered water customers[b]			
Fixed charge ($/year)	111.14	101.92	-8.3%
Non-drought usage ($/ML)	1,270.00	1,164.64	-8.3%
Drought usage ($/ML)[a]	na	1,393.99	na

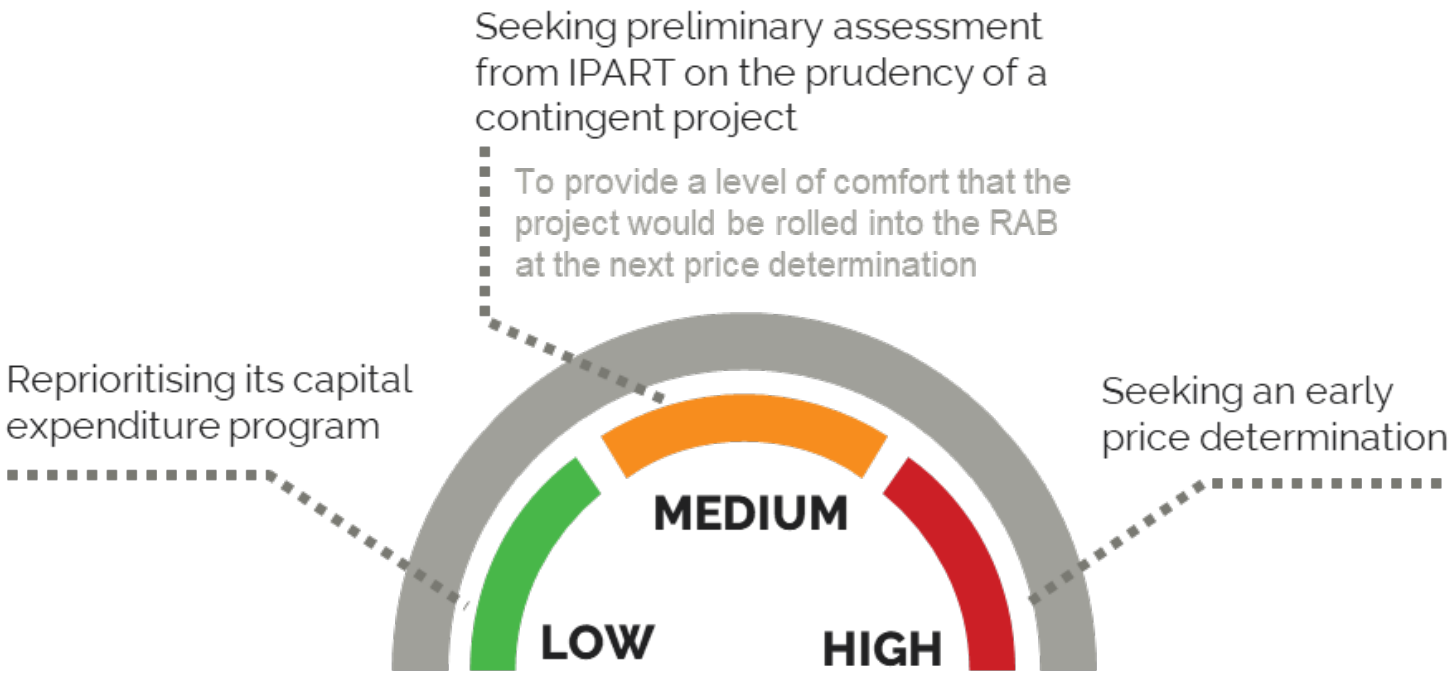
a Water NSW did not propose drought prices so there is no comparable drought usage charge.
b For unfiltered customers, there are separate fixed charges for 20mm, 25mm, 30mm, 32mm, 40mm, 50mm, 80mm, 100mm, 150mm and 200mm meter connections. We only present the fixed charges for 20mm connections in this table.

5. Risk allocations

- Managing contingent projects
- Shoalhaven cost pass through
- Managing revenue risks

Managing contingent project risks

During the determination period,
Water NSW can manage contingent project risk by:



This provides appropriate incentives for the utilities and the NSW Government to undertake proactive, coordinated and robust planning across the region

Improved the Shoalhaven transfer formula

Shoalhaven Transfer Scheme

Cost pass-through

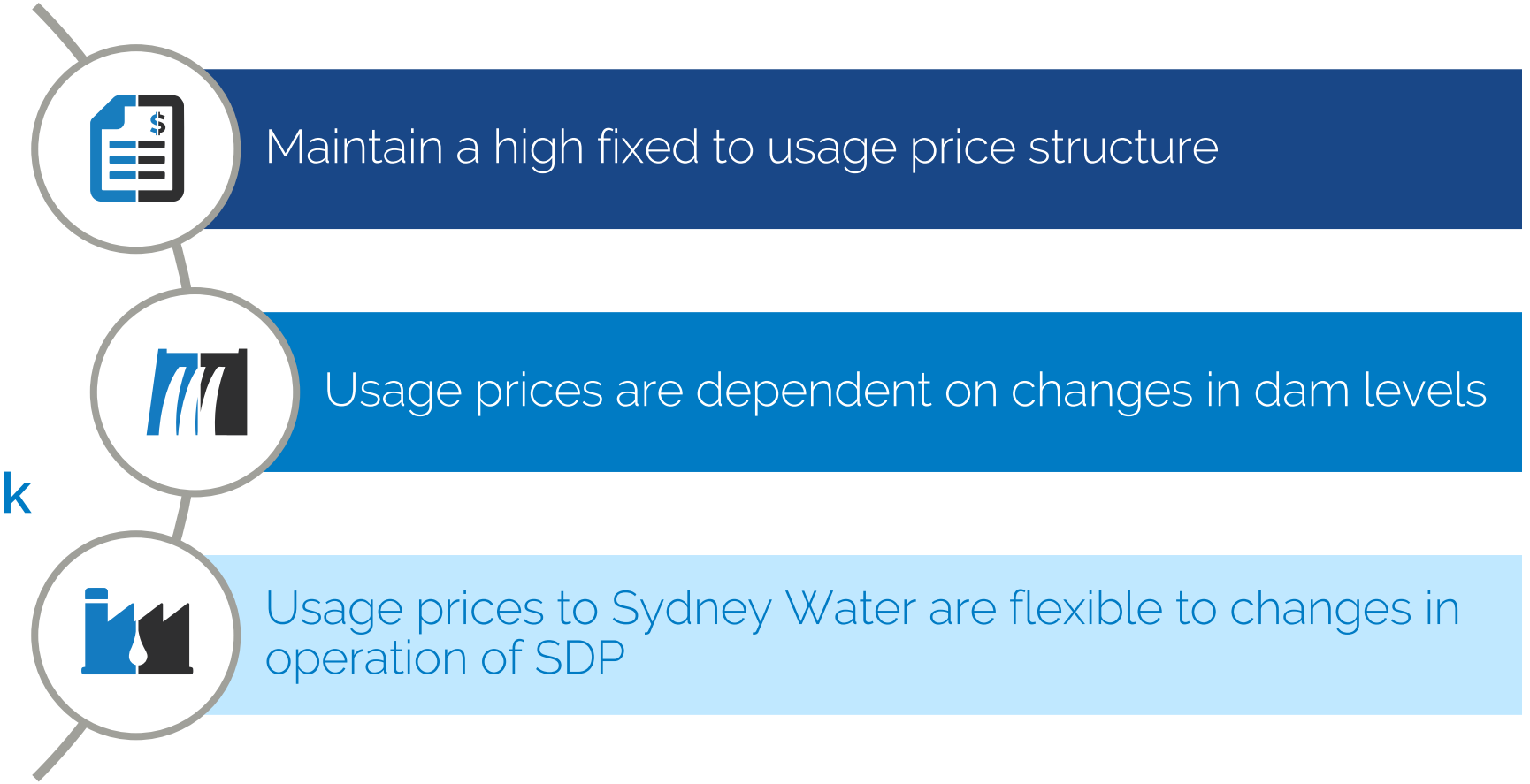
We have maintained the mechanism to pass through the efficient cost of pumping water from Shoalhaven to Sydney through the usage price to Sydney Water

The benchmark energy price in our updated transfer formula:

- Includes all components of energy costs
- Incentivises Water NSW to enter into efficient energy contracts
- Incentivises Water NSW to prioritise operating the Shoalhaven transfer scheme during off-peak periods

Managing revenue risk

We have made decisions to help mitigate Water NSW's revenue risk



6. Impacts

- Overview
- Bills
- Financeability

Impacts of our decision

Impacts of the prices we set

Customers' bill impact

Bills to fall by 8.3% for all customers over the 2020 determination period.

Service standards

Prices are set to recover efficient costs of Water NSW's service standards obligations.

Financial viability

We did not identify a financeability concern for Water NSW that needs to be addressed in this review.

NSW Gov't Consolidated Fund

We provided a reasonable return on capital.

General inflation

The impact of Water NSW's services on general inflation is negligible.

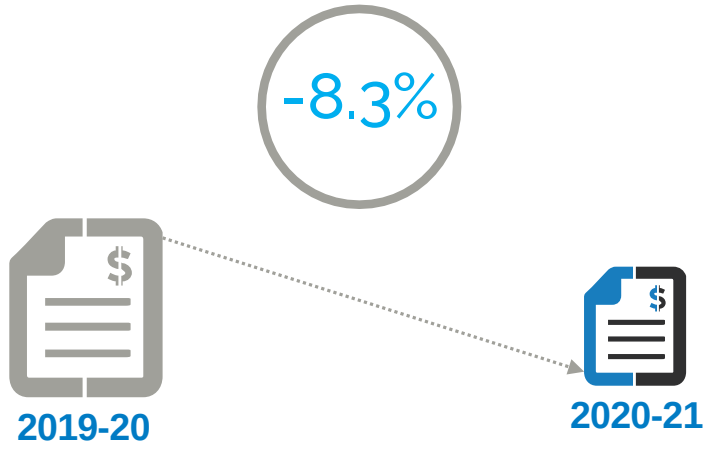
Environment

Prices are set to recover efficient costs of Water NSW's environmental obligations.

Customer bills are lower from 1 July 2020

- Bills fall by around 8.3% from 1 July 2020 for all customers.
- The decline in bills is mostly driven by falls in interest rates since the 2016 price review.
- When the next dry period occurs, the bulk water usage price will increase to offset the reduction in bulk water sales.
- The net effect of this is that average bulk water bills and Water NSW's total revenue are expected to be the same in both drought and non-drought periods.
- This reduction in wholesale bulk water costs will result in about a 1% reduction in Sydney Water's customer bills from 1 July 2020.

Water NSW's customer bills from 1 July 2020



Financeability test

We analysed Water NSW's ratios and did not identify a financeability concern :

- There is significant headroom in ICR
- FFO over Debt is slightly below the target level
- Gearing ratios meets our target of below 70%
- Regulatory mechanisms have moderated financial risks to Water NSW
- Transparent and predictable regulatory framework results in revenue predictability

Benchmark Test