



Detailed paper G – Notional Revenue Requirement

Submission to IPART for prices from 1 July 2021 for water management services provided by the Department of Planning, Industry and Environment-Water and the Natural Resources Access Regulator on behalf of the Water Administration Ministerial Corporation

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Detailed paper G – Notional Revenue Requirement

Total revenue

All three agencies responsible for the delivery of the water management services that are funded through WAMC prices – DPIE Water, NRAR and WaterNSW - are proposing an expansionary program of expenditure. The work programs seek to implement the Government's response to the recommendations of Matthews' independent investigation into NSW water management, improve compliance and accommodate legislative reform, respond to Section 44 audits and other Government priorities.

The changes strive to restore public and users' confidence in water management and provide accountability and transparency in service delivery with consequential significant increases in costs for both the Government and user shares (those costs recovered from users through prices and bills).

An independent review¹ of our consultation and engagement over the past five years, relating to WAMC activities, identified four themes that are important to customers. Customers want:

1. clear and transparent enforcement of the water management framework to ensure consistency and compliance
2. monitoring that customers can trust across programs and water sources
3. improved accountability for water management decisions through greater transparency and strong evidence, and
4. improving the information available to customers to provide certainty, help better inform their decisions, their feedback to the Department on specific issues and their understanding of the water management system.

Over the 2016 regulatory period, the NSW Government has stepped in to provide some additional funding, above funding through WAMC prices, to help deliver specific water management activities, such as the establishment of NRAR (contributing to theme 1 above).

In addition, Regional Water Strategies received significant external funding from the NSW Government's Snowy-Hydro Legacy Funding and the Priority Catchments funding program (contributing to theme 3 above.)

Over the same period, two Commonwealth external funding programs have contributed to our water management activities - Basin Plan Implementation (BPI) and Healthy Floodplains (HFP). These two programs contributed approximately \$45 million (\$2018-19) to the water management activities also funded through WAMC prices, of the \$49.6 million (\$2018-19) in external funding received between 1 July 2017 and 20 June 2019.

The level of proposed notional revenue requirements is a response to those external funding sources ending and the need to establish a longer-term funding base for NRAR. Our proposed expenditure enables our water management activities specified in the *Water Management Act 2000* to continue to develop a sound foundation for service delivery, from which to deliver more efficient services in future determination periods.

¹ KJA, DPIE IPART Price Submission – Stakeholder Engagement Plain English Summary and Final Report, 27 February 2020

We have calculated our Notional Revenue Requirement as the sum of:

- an allowance for DPIE Water and NRAR operating expenditure (\$201 million² over four years), and
- allowances for contributions to the MDBA (\$22.8 million over four years) and the BRC (\$3.0 million over four years).

We are not forecasting capital expenditure over the 2021 regulatory period and as such our revenue requirement does not include:

- an allowance for a return on the regulatory asset base, or
- allowances for a return of assets (regulatory depreciation), tax obligations, and a return on working capital.

Operating expenditure

A significant driver of our operating cost increases is the need to secure longer-term funding for NRAR and implement the recommendations of the 2017 Matthews independent investigation into NSW water management and the Ombudsman's 2018 Special Report to the NSW Parliament. Both found chronic underfunding of water compliance and recommended additional investment.

NRAR is implementing a range of strategies to ensure efficiency and to explore alternative sources and methods of funding, which include:

- developing efficiency savings plan to avoid around \$9.5 million per year of increased costs by better managing increasing demand for compliance services;
- preparing a business case to the Commonwealth for around \$1.0 million compliance auditing and other services in the Basin;
- hypothecating a forecast \$0.5 million, raised through fines and charges; and
- proposing to separately recover around \$1.8 million from controlled activity approval holders.

In relation to DPIE Water's water management activities, increased costs result in an additional \$43.6 million over four years to meet new priorities including to:

- implement better management of environmental water and continue delivery of priority programs, to realise the benefits of the investment by the Commonwealth and State Governments in environmental water and floodplain harvesting for users and regional economies, set out in the NSW Government's 2018 Water Reform Action Plan,
- increase resourcing to update water sharing plans, including improving the DPIE Water knowledge base to ensure critical water management decisions are based on accurate and timely evidence, and management decisions and frameworks can be evaluated and updated as required by law and
- implement the regional water strategies to deliver secure, reliable and resilient water sources for users while balancing social, environmental, cultural and economic outcomes for twelve regions across the state.

DPIE Water's impacts on price increases are mitigated by a small efficiency saving compared to the 2016 Determination for its ongoing or business as usual water management activities through its water sector reforms, together with the development of plans to seek to

² All expenditures are expressed in \$2020-21, as required by IPART and described in the Administrative Information paper accompanying this paper.

avoid around \$9 million a year of identified additional costs through process redesigns and operational improvements.

The following table shows the operating costs required (by DPIE Water and NRAR) to deliver water management activities over the 2021 regulatory period after these strategies and efficiencies have been incorporated.

Our forecast revenue requirement for the 2021 regulatory period is approximately 80% more than that found by IPART to be prudent and efficient in 2016 (for the same subset of services and excluding MDBA and BRC contributions). This is driven by our enhanced compliance and enforcement activities, as shown in table 2 below. Factoring in the reduction in proposed MDBA and BRC contributions the increase is 49%.

Table 1: Total Operating Expenditure (\$2020-21 '000)

Agency	2016 Ave Annual	2021/22	2022/23	2023/24	2024/25	2021 Ave Annual	Change
DPIE*	23,044	34,921	34,916	32,976	32,939	33,938	+47%
NRAR**	4,823	16,560	16,560	16,126	16,126	16,343	+239%
MDBA/BRC	10,154	6,427	6,487	6,487	6,487	6,472	-36%
Total this submission	38,021	57,909	57,963	55,589	55,552	56,753	+49%

*Does not include DPIE average annual fee-for-service revenue requirement of \$0.756 million on average

**Does not include NRAR average annual fee-for-service revenue requirement of \$0.563 million on average

The following table shows the full operating costs, broken down by activity code, required (by DPIE Water and NRAR) to deliver the water management activities required under the *Water Management Act 2000*.

Our forecast costs reflect the most efficient way of undertaking our activities. We maintain relatively constant expenditures, even for project-based activities, and introduce efficiencies by assigning staff and resources within and across projects to maximise the productive time for each staff member and resource.

Table 2: Total operating expenditure by activity code – DPIE Water and NRAR (\$2020-21 '000)

Activity code	2021/22	2022/23	2023/24	2024/25	Ave Annual
W01-05 Surface water ecological condition monitoring	314	314	314	281	305
W04-01 Surface water modelling	3,558	3,558	3,558	3,558	3,558

Activity code	2021/22	2022/23	2023/24	2024/25	Ave Annual
W04-02 Groundwater modelling	1,071	1,071	1,071	1,071	1,071
W04-03 Water resource accounting	602	602	602	602	602
W05-01 Systems operation & water availability management	2,755	2,755	2,755	2,755	2,755
W05-03 Environmental water management	1,129	1,129	1,129	1,129	1,129
W05-04 Water plan performance assessment & evaluation	3,661	3,661	3,661	3,661	3,661
W06-01 Water plan development (Coastal)	1,752	1,752	1,752	1,752	1,752
W06-02 Water plan development (Inland)	2,976	2,976	2,976	2,976	2,976
W06-03 Floodplain management plan development	2,172	2,172	1,547	1,469	1,840
W06-04 Drainage management plan development	543	542	542	542	542

Activity code	2021/22	2022/23	2023/24	2024/25	Ave Annual
W06-05 Regional planning & management strategies	6,614	6,614	5,292	5,292	5,953
W06-06 Development of water planning & regulatory framework	2,278	2,278	2,278	2,278	2,278
W06-07 Cross border & national commitments	1,981	1,971	1,971	2,037	1,990
W07-01 Water management works	2,872	2,878	2,884	2,891	2,881
W08-02 Consents management & licence conversion	643	643	643	643	643
W08-03 Compliance management	15,975	15,975	15,541	15,541	15,758
W09-01 Water consents transactions	1,327	1,327	1,327	1,327	1,327
W10-01 Customer management	585	585	585	585	585
Total	52,809	52,804	50,430	50,393	51,609

^note activity W09-01 is fee-for-service related expenditure and is excluded from water management entitlement and usage prices

Capital expenditure

Forecast capital expenditure

We are not forecasting capital expenditure for the 2021 regulatory period and therefore have not included information on capital related revenue requirements here. Further, revenue requirements related to the legacy regulated asset base (RAB) used to determine the 2021 opening RAB are included in the WaterNSW revenue requirement.

The reader should refer to the separate submission by WaterNSW regarding WAMC prices for the 2021 regulatory period for technical information on calculation of the WAMC RAB and the resulting revenue requirement.

The absence of capital related expenditure and revenue in this submission reflects that our forecast WAMC costs are anticipated to be operating only. WaterNSW are responsible for the operational and capital asset related water management activities of WAMC and have the technical capability and necessary financial information to calculate the WAMC regulated asset revenue requirements.

Readers should refer to submissions to IPART by WaterNSW for further information on their regulatory asset base and revenue requirement.

WAMC Revenue Requirement

The total WAMC revenue requirement is shown in table 5 below. The total combined WAMC revenue requirement is \$345 million over four years, or \$86.3 million each year on average.

Table 4: Total WAMC Revenue Requirement (\$2020-21 '000)

Agency	2016 Ave Annual	2021/22	2022/23	2023/24	2024/25	2021 Ave Annual	Total
DPIE	23,044	34,921	34,916	32,976	32,939	33,938	135,753
NRAR	4,823	16,560	16,560	16,126	16,126	16,343	65,373
MDBA/BRC	10,154	6,427	6,487	6,487	6,487	6,472	25,888
Total this submission	38,021	57,908	57,963	55,589	55,552	56,753	227,014
WNSW	25,141	26,880	28,902	30,558	31,690	29,507	118,030
Total WAMC	63,162	84,789	86,865	86,147	87,242	86,261	345,044

Forecast Revenue

Our water management price modelling is the culmination of information outlined in the following detailed papers:

- Detailed Paper D – Principles. This paper details the IPART impactor pays users shares of each WAMC activity code and the cost drivers we propose to use to allocate costs across water sources and valleys.
- Detailed Paper E – Expenditure by WAMC activity code. These costs sum to our total revenue requirement.
- Detailed Paper F – MDBA and BRC. These costs are added to the prices of valleys with the Murray-Darling and Border rivers catchments.
- Detailed Paper G – Notional Revenue Requirement (this paper). Our total forecast operational and capital costs requirements are shown above, and.
- Detailed Paper H – Licenses and volumes. We propose to use the volumes in this paper to set the final water management prices.

We are not pursuing full cost recovery prices across all valleys and water sources for the 2021 regulatory period. This means that the revenue we expect to receive is less than the IPART endorsed impactor pays user share of the total WAMC revenue requirement. We will provide updated advice to IPART on the transition to full cost recovery position as part of the 2025 pricing review process.

Based on the proposed combined WAMC revenue requirement (DPIE Water, NRAR, and WaterNSW) and the application of the impactor pays user shares, our modelling forecasts that capping prices at 5% per year will return slightly under 60% (over four years) of the total cost of delivering water management services. This equates to around \$190.9 million over four years out of a total combined WAMC user share revenue requirement of \$288.3 million, and \$345 million total (user and government share). The impactor pays government share is forecast to be \$56.8 million over four years.

Table 5 below shows the annual breakdown of forecast total WAMC revenue (for DPIE-Water, NRAR, and WNSW). The final impactor pays user and government shares will be determined by IPART's ruling on the total prudent and efficient cost of delivering the water management services that are funded through WAMC prices. IPART is scheduled to deliver their final decision on prices in May 2021.

We are proposing that the shortfall between the forecast revenue and the total efficient cost of delivering WAMC services be funded by a government subsidy. The government subsidy is forecast to be \$97.3 million in total over four years, meaning the total government contribution is \$154.1 million over four years (government subsidy plus impactor pays government share).

Table 5: Forecast WAMC revenue and Government subsidy amount (\$2020-21 '000)

	2020-21 (current)	2021-22	2022-23	2023-24	2024-25	Total (2021 to 2025)
Impactor pays user share of total	44,137	70,929	72,456	72,105	72,766	288,256
Impactor pays government share of total	16,714	13,860	14,409	14,043	14,476	56,787
Forecast revenue from users (capped prices)	44,137	44,528	46,664	48,916	50,818	190,926
Government subsidy needed for full cost recovery	-	26,402	25,792	23,189	21,948	97,330
Total	60,851	84,789	86,865	86,147	87,242	345,044