



Independent Pricing and Regulatory Tribunal

Review of private ferry fares from January 2016

Transport — Issues Paper
November 2015



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Invitation for submissions

IPART invites written comment on this document and encourages all interested parties to provide submissions addressing the matters discussed.

Submissions are due by 1 December 2015.

We would prefer to receive them electronically via our online submission form <www.ipart.nsw.gov.au/Home/Consumer_Information/Lodge_a_submission>.

You can also send comments by mail to:

Review of private ferry fares from January 2016
Independent Pricing and Regulatory Tribunal
PO Box K35
Haymarket Post Shop NSW 1240

Late submissions may not be accepted at the discretion of the Tribunal. Our normal practice is to make submissions publicly available on our website <www.ipart.nsw.gov.au> as soon as possible after the closing date for submissions. If you wish to view copies of submissions but do not have access to the website, you can make alternative arrangements by telephoning one of the staff members listed on the previous page.

We may choose not to publish a submission—for example, if it contains confidential or commercially sensitive information. If your submission contains information that you do not wish to be publicly disclosed, please indicate this clearly at the time of making the submission. IPART will then make every effort to protect that information, but it could be disclosed under the *Government Information (Public Access) Act 2009* (NSW) or the *Independent Pricing and Regulatory Tribunal Act 1992* (NSW), or where otherwise required by law.

If you would like further information on making a submission, IPART's submission policy is available on our website.

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1 Introduction

IPART has been asked by the Minister for Transport to review the maximum fares for the seven private ferry operators who provide regular passenger ferry services under contract to Transport for NSW (TfNSW). Each operator services a distinct route or routes in the Sydney, Central Coast and North Coast areas of NSW (Table 1.1). Operators may charge less than the recommended maximum fare if they wish.¹

The primary purpose of this Issues Paper is to outline:

- ▼ what factors we are required to consider under the Terms of Reference for this review
- ▼ how we propose to approach this review
- ▼ our indicative recommendations on fare changes in 2016
- ▼ what issues we have identified for consideration and comments by ferry operators and other interested stakeholders, and
- ▼ how stakeholders can provide input to this review.

Table 1.1 Private ferry services included in IPART's review

Operator	Routes
Central Coast Ferries	Woy Woy to Empire Bay
Church Point Ferry Service	Scotland Island and western foreshore of Pittwater
Clarence River Ferries	Iluka to Yamba
Cronulla and National Park Ferry Service	Cronulla to Bundeena
Brooklyn Ferry Service	Brooklyn to Dangar Island
Matilda Cruises	Circular Quay to Darling Harbour Circular Quay to Lane Cove
Palm Beach Ferry Service	Palm Beach to Mackerel Beach and the Basin Palm Beach to Ettalong and Wagstaffe

This review does not include fares for Sydney and Stockton Ferry services. IPART is currently reviewing fares for both these services as part of a separate public transport review. For more information, see our website <www.ipart.nsw.gov.au>. Also, we will not review the discount applied to concession tickets or the cost or availability of the Pensioner Excursion Ticket and Opal Gold as these are matters for the NSW Government.

¹ Subject to the provisions of the relevant service contract.

2 Factors we need to consider for the review

IPART makes recommendations to TfNSW for maximum fares to be charged for regular private ferry services under an arrangement approved by the Premier. This arrangement specifies the factors that we must consider when making recommendations.

These factors are:

- ▼ the cost of providing the services concerned and the need for greater efficiency in the supply of services so as to reduce costs for the benefit of customers
- ▼ relativities with Sydney Ferries' services in terms of service, efficiency, cost and ticketing products
- ▼ the protection of consumers from abuses of monopoly power in terms of prices, pricing policies and standards of service
- ▼ the need to maintain ecologically sustainable development
- ▼ the impact of the recommendations on customers
- ▼ standards of quality, reliability and safety of the services concerned (whether those standards are specified by legislation, agreement or otherwise and any suggested or actual changes to those standards), and
- ▼ the effect of any pricing recommendation on the level of Government funding provided to private operators under commercial contracts.

3 Our approach and process for this review

We received our terms of reference for this review on 26 October 2015. In order to make final recommendations to TfNSW in time for fare changes on 1 January 2016, we will need to expedite our usual review process. In particular, in this Issues Paper we have made indicative recommendations on maximum fares for 2016 on which we seek stakeholder comment.

3.1 Indicative recommendations on maximum fares in 2016

Our indicative recommendations are that in 2016 maximum fares for:

- ▼ Central Coast Ferries increase by between 20 to 30 cents (to \$8.00-\$8.10)
- ▼ Clarence River Ferries increase by between 20 to 30 cents (to \$7.90-\$8.00)
- ▼ Brooklyn Ferries increase by between 20 to 30 cents (to \$6.90-\$7.00)
- ▼ Church Point Ferry Service increase by between 20 to 30 cents (to \$7.90-\$8.00),
- ▼ Palm Beach Ferry Service increase by up to 30 cents (up to \$11.50 for the Ettalong service and up to \$8.00 for the Basin service)

- ▼ Cronulla and National Park Ferry Service do not change from 2015 levels (\$6.40), and
- ▼ Matilda Cruises do not change from 2015 levels (\$7.40 for both the Circular Quay to Darling Harbour and Circular Quay to Lane Cove services).

Operators may charge less than the recommended maximum fare if they wish.

3.2 How we made our indicative recommendations

For all ferry operators except Matilda Cruises, to make our indicative recommendations we have:

- ▼ applied the building block method incorporating efficient costs and an efficient fare for each ferry operator in 2016 (estimated as part of our review last year)²
- ▼ received updated cost and patronage information from some ferry operators (all operators except Matilda Cruises were invited to provide us with this information), and
- ▼ made a judgement as to the indicative fare increase that balances the impacts on customers and ferry operators (for those fares that need to increase towards the efficient fare in 2016).

As with our review last year, we have taken a different approach for fare recommendations for Matilda Cruises. Last year we did not use the building block approach for Matilda Cruises because these services are provided in a competitive market and the market-determined fares are below IPART's recommended maximum fare. Our indicative recommendation is that maximum fares remain unchanged at \$7.40 as these are still above the current market fares.³

3.3 How we propose to make our final recommendations

To make our final fare recommendations to TfNSW in December we propose to:

- ▼ commission a consultant and consider its advice on the reasonableness of ferry operators' updated costs,
- ▼ consider ferry operator and other stakeholder comments on our indicative fare recommendations and on other issues raised in this paper, and
- ▼ undertake our own analysis, including updating the weighted average cost of capital in the building block model (discussed further below).

² See Appendix B for more information on the building block method.

³ As at 28 October 2015, Matilda Cruises is charging \$7.00 per adult one way trip for both the Circular Quay to Darling Harbour and Circular Quay to Lane Cove services.

IPART seeks comments on the following

- 1 Do you agree with our indicative fare recommendations for 2016?
- 2 Do you agree with our proposed approach for making final fare recommendations for 2016?

4 Key issues for this review

In this section we discuss some key issues for this year's review on which we are seeking stakeholder comment.

4.1.1 Return on capital

Reviewing the efficient costs of providing ferry services involves estimating an appropriate return on capital (ie, cost of capital). We calculate the allowance for a return on capital by multiplying the weighted average cost of capital (WACC) by the value of the Regulatory Asset Base (RAB). The WACC is estimated as a weighted average of the return on debt and equity.⁴ The return we allow is commensurate with the efficient financing cost of a benchmark efficient entity providing ferry services. We update the estimate of the WACC for different industries biannually to inform stakeholders of our WACC inputs on a regular basis.⁵

In the 2014 review, we used our standard approach for estimating the WACC.⁶ For our indicative fare recommendations, we have adopted the same industry-specific parameters as in our 2014 final decision, but updated the market-based parameters to 30 September 2015. Our indicative fare recommendations apply the midpoint WACC of 5.9% real post-tax (see Table 4.1). Appendix B provides a summary of WACC parameters underlying our preliminary view on WACC.

Table 4.1 Real post-tax WACC range and midpoint

	Low	Mid	High
Real post-tax WACC	5.6%	5.9%	6.2%

Note: Market data sampled to 30 September 2015.

Source: IPART calculation.

⁴ IPART, *Review of fares for private ferry services and the Stockton ferry service for 2015 – Final Report*, December 2014, p 52 (Appendix C).

⁵ [IPART - Fact Sheets & Information Papers](#).

⁶ For information on IPART's methodology for estimating the WACC, see http://www.ipart.nsw.gov.au/Home/Industries/Research/Reviews/WACC/Review_of_method_for_determining_the_WACC.

IPART seeks comments on the following

- 3 What do you consider an appropriate cost of capital for ferry operators, including the underlying cost of capital parameters?

4.2 Estimating the external benefits of private ferry services

Generally, in setting fares for public transport such as trains, buses and Sydney Ferries, we estimate the value of external benefits to determine the share of public transport costs that should be funded by the Government. For example, using public transport leads to lower road congestion, and lower air pollution and greenhouse gas emissions than if these journeys had been taken by private vehicle. Therefore, we have considered that it is appropriate to set the Government subsidy broadly in line with the estimated value of these external benefits.

Some private ferry operators also receive subsidies from the Government to assist in meeting the costs of providing the services. For these operators we propose to consider the level of any external benefits provided by these services with the subsidy being funded by the Government.

Private ferries are an important part of the transport system and for local economies, for example, by transporting residents and for tourism. These private benefits are enjoyed by both individuals and local businesses (through increased sales/profits) and by private ferry operators (through increased patronage). As private benefits are already captured by the affected parties, there is no need to separately account for this in our analysis. Only external benefits need to be separately accounted for.

We are currently conducting a major review of public transport fares in Sydney and surrounding areas. As part of this review, we are updating our approach to estimating the external benefits of public transport. In December 2014, we released a Draft Report on the external benefits of public transport. The Draft Report included a wider set of external benefits and costs associated with using public transport than we have previously included.

The major component of external benefits of public transport use is avoided road congestion. As people move to public transport instead of driving, congestion is reduced for existing road users. This is an external benefit of public transport use, as it is a benefit external to those using public transport. Reduced congestion saves time, reduces vehicle operating costs, and increases the reliability of journey times for existing road users. However, two of the ferry operators provide a service to islands (Scotland and Dangar) with limited alternative transport options. There is no avoided road congestion associated with travel to and from the islands. For these two operators we do not consider that there are any external benefits associated with passenger travel.

For the other operators who are receiving subsidies, we propose to use the results from our December 2014 analysis to estimate the net external benefits for ferries on a per passenger journey basis.⁷ Our December 2014 draft report provided a range for the net external benefits of ferry travel. The range results from different assumptions regarding the price elasticity of demand (that is, how responsive people's demand for public transport is to a change in fares)⁸. As we review fares annually we propose to base our estimates on the low and mid-range elasticity.⁹ These estimates are consistent with short run elasticity in Australian and international literature.

We propose to estimate the value of external benefits by:

- ▼ Estimating the amount of patronage in the peak period. We propose that there is no justification for a subsidy based on external benefits for leisure or tourist travel as there is little avoided congestion in off peak periods. Data on peak travel is not available so we propose to review the ferry timetable and make a judgement on which services are provided for peak commuters.
- ▼ We propose for those journeys taken during the peak period we apply our current estimate of net external benefits per passenger journey for Sydney Ferries, ranging from \$0.12 to \$1.42.¹⁰ We propose to make a judgement on what point within this range is appropriate for each operator given the local context, and noting that the estimates of net external benefits are based on avoided road congestion around the Sydney CBD.
- ▼ We would calculate the total annual external benefit of travel in the peak by estimating the proportion of daily commuter services to total daily services multiplied by annual patronage multiplied by the per passenger journey estimate of the net external benefits. This results in our estimated annual external benefit.

⁷ For further information please refer to IPART, *Review of external benefits of public transport - Draft Report*, December 2014; http://www.ipart.nsw.gov.au/Home/Industries/Transport/Reviews/External_Benefits_of_Public_Transport/External_Benefits_for_Public_Transport.

⁸ The price elasticity of demand affects our estimate of the excess burden of taxation. The higher the elasticity, the more price sensitive demand is, and for a given change in patronage a smaller subsidy is required, and consequently there is a smaller deadweight loss. Taxes distort the economic decisions of labour, consumers, investors and producers by changing the incentives to work or invest, and influencing consumption and production patterns. These distortions lead to a reduction in economic efficiency and loss in consumer welfare, referred to as the deadweight loss or excess burden of taxation. This burden or loss is a measure of the economic costs associated with these distortions.

⁹ The SSTM is a disaggregated choice model which uses Household Travel Survey to build up people's behavioural preferences. The elasticities estimated by the SSTM and those discussed in the literature are estimates of the short run price elasticity of demand.

¹⁰ IPART, *Transport externality model*, February 2015, available at http://www.ipart.nsw.gov.au/Home/Industries/Transport/Reviews/External_Benefits_of_Public_Transport/External_Benefits_for_Public_Transport. The range is based on our short- and medium-term estimates of price elasticity.

Table 4.2 provides the results of our proposed approach using 2013-14 data. As the results indicate the net external benefits of ferry travel are small. This reflects the fact that additional road congestion related costs would be small if people didn't travel on these ferry services.

Table 4.2 External benefits associated with private ferry services

	Palm Beach to Ettalong	Cronulla to Bundeena	Central Coast to Empire bay
Net external benefit per passenger journey	\$0.12 to \$1.42	\$0.12 to \$1.42	\$0.12 to \$1.42
Estimates total external benefit	\$5,207 to \$61,610	\$5,976 to \$70,711	\$1,950 to \$23,080

Note: We have not published patronage numbers in this table for the purpose of confidentiality.

Source: IPART calculations.

IPART seeks comments on the following

- 4 Do you agree with our proposed approach for estimating the value of external benefits?

4.3 Recommending fares

In the past, we recommended to TfNSW maximum fares for single adult tickets. Under this approach if more passengers travel under discounted fares, then (all else equal) the non-discounted fare needs to be higher to ensure the operator recovers its total efficient costs.

Table 4.3 summarises the multi-trip tickets that are available on private ferry services as set out in our 2014 Final Report.¹¹

¹¹ http://www.ipart.nsw.gov.au/Home/Industries/Transport/Reviews/Private_Ferries_and_Stockton_Ferry/Review_of_Fares_for_Private_Ferries_and_the_Stockton_Ferry_for_2015/19_Dec_2014_-_Final_Report/Final_Report_Review_of_maximum_fares_for_private_ferry_services_and_the_Stockton_ferry_service_for_2015_-_December_2014, p 27.

Table 4.3 Summary of multi-trip ticket information provided by operators

	Multi-trip ticket type (trips per ticket)	Discount rate implied by current ticket price
Brooklyn	Ferry Ten (10)	9%
	Ferry Twenty (20)	14%
Central Coast	Ferry ten (10)	47%
Church Point	Total Adult 12 (12) ^a	35%
Clarence River	Info not available	Info not available
Cronulla	Weekly (10) ^b	36%
	10 Ride (10)	16%
	Family (6) ^c	6%
Palm Beach	Ferry Ten (10)	11% for Ettalong
		10% for Mackerel

^a Church Point sells other multi-trip tickets such as *Adult Return*, *Concession 13*, *Concession Return* and *Child Return*,

^b Weekly ticket allows unlimited trips per week, but we assumed 10 trips per week for the purpose of calculating the implied discount rate.

^c Family ticket allows two adults and up to four children.

Source: Central Coast Ferries, <http://www.centralcoastferries.com.au/>; Church Point Ferry Service, <http://churchpointferry.com.au/>; Clarence River Ferries, <http://www.clarencriverferries.com/>; Cronulla and National Park Ferry Service, <http://www.cronullaferries.com.au/>; Palm Beach Ferry Service, <http://www.palmbeachferries.com.au/> accessed 4 September 2015.

For the 2015 review, we propose to continue to recommend maximum fares for the regulated ferry services. Our indicative fare recommendations are made on this basis.

IPART seeks comments on the following

- 5 Do you agree that we should continue to recommend the maximum fares for each private ferry operator?

4.4 Mid-year fuel review

We commenced the practice of a mid-year review of fuel prices in 2008 when we used an index approach to setting fares, to mitigate short term impacts on operators and passengers of spikes (up or down) in fuel prices. If fuel costs are found to have increased or decreased by more than 10% from the average daily diesel price used in adjusting the ferry cost indices at the previous review, we may recommend a mid-year fare change for private ferries.¹²

¹² IPART, *Review of fares for private ferry services and the Stockton ferry service for 2015 – Final Report*, December 2014, p 6.

Since we introduced mid-year reviews in 2008 there have been three occasions (2009, 2011 and 2015) where fuel costs increased/decreased by more than 10%. In June 2009 and 2015, diesel prices reduced by 21.5% and 24.6% respectively and we recommended that fares be reduced. In June 2011, we recommended an increase in fares due to an 11.4% increase in diesel prices. Diesel prices in all other years have changed by less than 10%.¹³

As we now recommend fares based on an annual review of efficient costs we consider there is less need for a mid-year fuel review. We are considering whether to continue the ongoing review of fuel prices. It is our preliminary view that we should no longer undertake a review of fuel prices outside the annual fare review process.

IPART seeks comments on the following

- 6 Do you agree that we should no longer continue to review fuel prices outside the regular fare review cycle?

4.5 Financial viability of private ferry operators

In our previous reviews, we found that ferry operators were particularly concerned about the financial viability of their private ferry operations. Increasing the number of people using these services would increase fare revenue and therefore support ferry operators' businesses. We are interested in stakeholders' comments on how patronage could be increased on the ferry services under review.

IPART seeks comments on the following

- 7 What is the scope for increasing patronage on the ferry services under review?

We also invite comment on any other issues raised in the Terms of Reference listed above.

¹³ Information provided by FUELtrac, September 2015.

5 How stakeholders can provide input to this review

We are now seeking submissions from interested parties on this Issues Paper and our indicative fare recommendations. Submissions are due by 1 December 2015.

We would prefer to receive them electronically via our online submission form <www.ipart.nsw.gov.au/Home/Consumer_Information/Lodge_a_submission>.

You can also send comments by mail to:

Review of private ferry fares from January 2016
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PO Box K35
Haymarket Post Shop NSW 1240

We will make a final recommendation to TfNSW in December, taking into account the factors we are required to consider and the comments provided to us in submissions to this paper.

The timetable for the review is set out in Table 5.1.

Table 5.1 2015 Private ferries review timetable

Milestone	Date
Release Issues Paper and indicative fare recommendations	3 November 2015
Submissions due	1 December 2015
Final Report and Recommendations to TfNSW	December 2015

If you are interested in keeping informed of our review, you can register for updates on our website <http://www.ipart.nsw.gov.au/Home/Footer_Links/Subscribe_for_updates>.



Appendices

A Terms of Reference



Premier
& Cabinet

Reference: A1346228

26 OCT 2015

Dr P J Boxall AO
Chair
Independent Pricing and Regulatory Tribunal
PO Box K35
Haymarket Post Shop
NSW 1240

Dear Dr ~~Boxall~~ ^{Peter}

I am writing to request that the Independent Pricing and Regulatory Tribunal review the maximum fares for regular private ferry services. Please find enclosed a Reference under section 9 of the *Independent Pricing and Regulatory Tribunal Act 1992* for the Tribunal to perform this service.

If your officers wish to discuss this matter, they should contact Amy Persson, Acting Executive Director, Department of Premier and Cabinet, on 02 9228 5002.

Yours sincerely

MIKE BAIRD MP
Premier

cc The Hon A Constance MP, Minister for Transport and Infrastructure

**INDEPENDENT PRICING AND REGULATORY TRIBUNAL ACT 1992
PRIVATE FERRY INDUSTRY FARE REVIEW**

I, Hon Mike Baird, Premier, pursuant to Section 9(2) of the *Independent Pricing and Regulatory Tribunal Act 1992*, approve the Independent Pricing and Regulatory Tribunal (IPART) entering into arrangements with Transport for NSW for two years to 2 August 2017 to provide services to Transport for NSW that are within its area of expertise. The services to be provided by IPART are the conduct of an investigation into, and the preparation of a report concerning, maximum fares for regular private ferry services under the *Passenger Transport Act 1990*.

In providing these services, IPART should consider:

- i) the cost of providing the services concerned and the need for greater efficiency in the supply of services so as to reduce costs for the benefit of customers;
- ii) relativities with Sydney Ferries' services, including in terms of service, efficiency, cost and ticketing products;
- iii) the protection of customers from abuses of monopoly power in terms of prices, pricing policies, and standards of service;
- iv) the need to maintain ecologically sustainable development;
- v) the impact on customers of the recommendations;
- vi) standards of quality, reliability and safety of the services concerned (whether those standards are specified by legislation, agreement or otherwise and any suggested or actual changes to those standards); and
- vii) the effect of any pricing recommendation on the level of Government funding provided to private operators under commercial contracts.

The services to be provided by IPART will include a public consultation process through which IPART will invite submissions from the private ferry operators and other stakeholder groups including user groups.

The services are to be provided through the provision of one or more reports to Transport for NSW, as agreed between Transport for NSW and IPART.


The Hon Mike Baird MP
Premier
Minister for Western Sydney

26 OCT 2015

Dated at Sydney.....2015

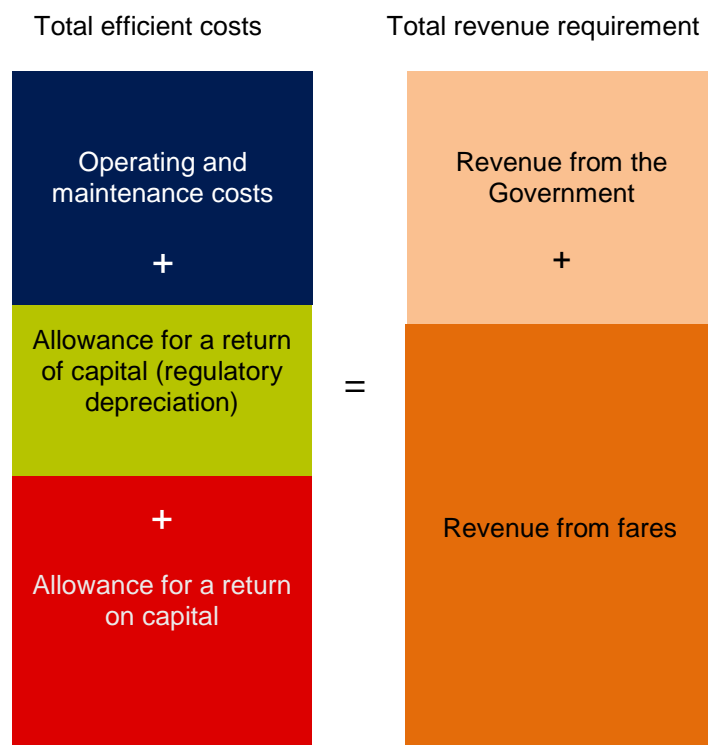
B Building block approach

In our 2014 review, we recommended fares based on the efficient costs of providing ferry services listed in Table 1.1 for all operators except Matilda. We used a building block method to calculate the efficient costs for each ferry service which include the following components:

- ▼ an efficient level of operating expenditure (operating, maintenance and administration expense)
- ▼ a return on assets that ferry operators used to provide their services
- ▼ a return of those assets (regulatory depreciation), and
- ▼ an allowance for working capital and for meeting tax obligations.

We then estimated an 'efficient fare' so that passengers pay for the total efficient costs, less total payments from the Government. Figure B.1 summarises our building block approach.

Figure B.1 Revenue requirement under the building block approach



Note: Our building block model also includes allowances for regulatory taxation and working capital. These are not shown in Figure 1 because they represent a small proportion of the total revenue requirements for private ferries and the Stockton Ferry service. The figure is not to scale.

Our 2014 review established a framework:

- ▼ if the then current maximum fare was the same or higher than the 2015 efficient fare, we made a decision to freeze the current maximum fare (in nominal terms)
- ▼ if the then current maximum fare was lower than the 2015 efficient fare, then we made a decision to increase the current maximum fare to the lesser of:
 - the 2015 efficient fare from our building block model, or
 - the maximum fare, plus the change in the operator's costs since our last review measured using our ferry cost index, plus an additional 10 cents.¹⁴

In our 2014 review, we recommended Matilda Cruises two ferry services should not be subject to price regulation, as they are provided in a competitive market and the market-determined fares are below IPART's recommended maximum fare.

¹⁴ We adopted a conservative approach last year to prevent price shocks for passengers as well as revenue shocks for operators. Unlike the operators of rail, metropolitan and outer metropolitan bus services, Sydney Ferry and Stockton Ferry, who receive contract payments to provide public transport services, private ferry operators are dependent on fare box revenues. Our approach resulted in fare increases of between 10 cents and 40 cents per journey.

C Weighted average cost of capital (WACC)

One of the elements in the building block model is an efficient return on assets. The rate of return is a key input to our calculation for the allowance for a return on assets. We calculate the allowance for a return on assets by multiplying the weighted average cost of capital (WACC) by the RAB.

Our preliminary view on WACC

In the 2014 review, we used our standard approach for estimating the WACC.¹⁵ For our indicative recommendations, we have adopted the same industry-specific parameters as in our 2014 final decision, but updated the market-based parameters to 30 September 2015. Our indicative fare recommendations are based on the midpoint WACC of 5.9% (see Table C.1).

Table C.1 Real post-tax WACC range and midpoint

	Low	Mid	High
Real post-tax WACC	5.6%	5.9%	6.2%

Note: Market data sampled to 30 September 2015.

Source: IPART calculation.

The tables below set out the market-based and industry-specific parameters underlying our preliminary view on WACC. For our final decision, we will update the market-based parameters to 2 December 2015 and respond to any matters raised in submissions.

Table C.2 Market-based parameters as of 30 September 2015

	Risk free rate	Debt margin	Market risk premium	Inflation adjustment
40-day average	2.7%	2.8%	9.2% ^a	2.5%
10-year average	4.7%	2.9%	6.0% ^a	2.5%
Midpoint	3.7%	2.9%	7.6%	2.5%

^a Midpoint estimate.

Table C.3 Industry-specific parameter for private ferries

	Equity beta	Gearing ratio
Low	0.8	60%
Mid	0.9	50%
High	1.0	40%

Source: IPART, *WACC Biannual Update*, August 2015, p 2.

¹⁵ For information on IPART's methodology for estimating the WACC, see http://www.ipart.nsw.gov.au/Home/Industries/Research/Reviews/WACC/Review_of_method_for_determining_the_WACC.

