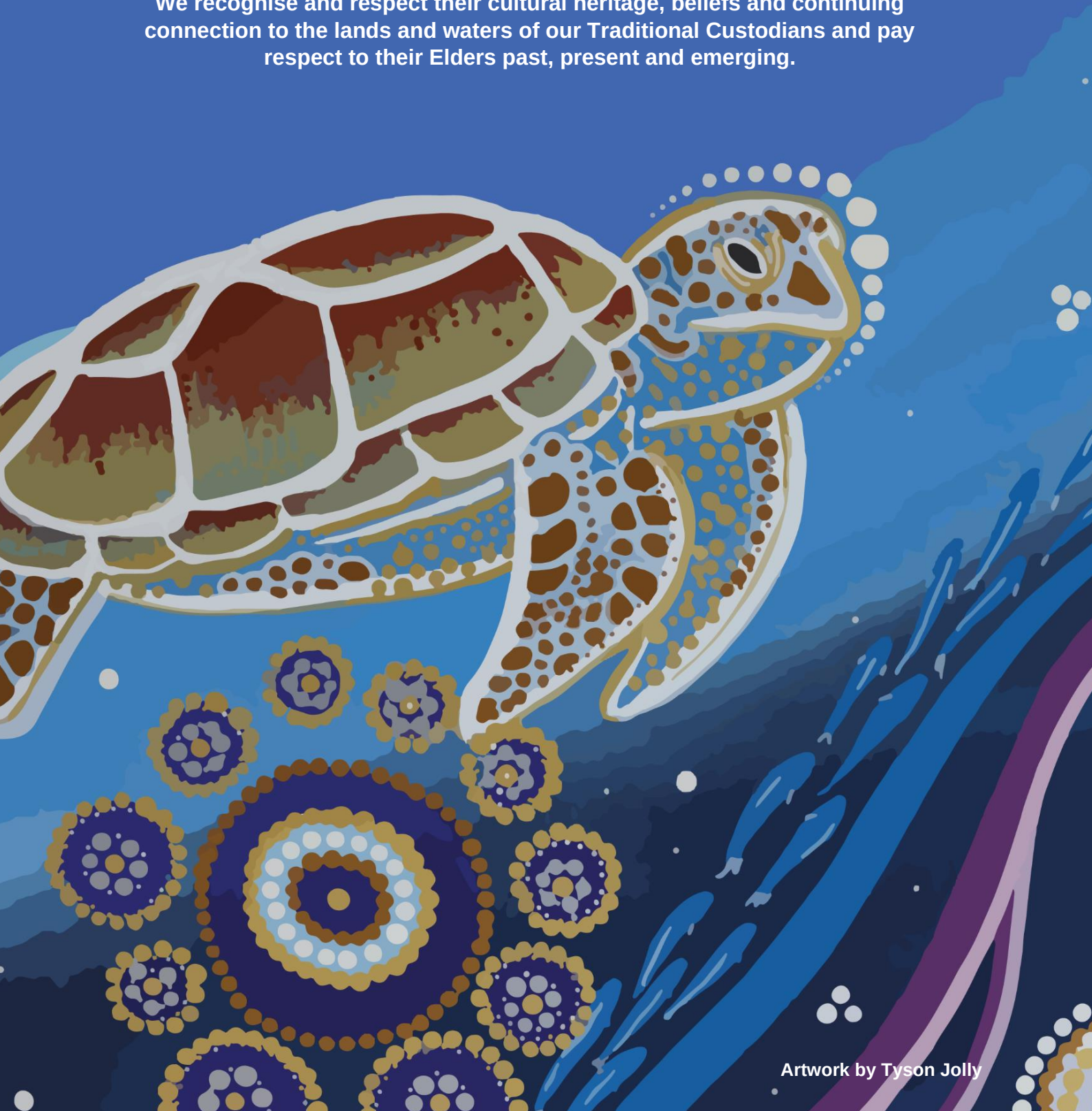
REVIEW OF PRICES FOR HUNTER WATER - RESPONSE TO IPART'S DRAFT DETERMINATION

MAY 2025

ACKNOWLEDGEMENT OF COUNTRY

Hunter Water acknowledges the Traditional Countries of the Awabakal, Gaewegal, Darkinjung, Wonnarua and Worimi peoples on which we operate and the Countries beyond where our water flows.

We recognise and respect their cultural heritage, beliefs and continuing connection to the lands and waters of our Traditional Custodians and pay respect to their Elders past, present and emerging.



Artwork by Tyson Jolly

Our response to IPART's draft determination

Hunter Water welcomes the release of IPART's draft determination of our prices to apply from 1 July 2025. We thank IPART for the opportunity to provide a submission in response.

The draft determination acknowledges our customer focus and how we have prioritised expenditure to balance affordability concerns with the need to maintain essential services in the long-term interest of customers. IPART's draft decision is to set prices at a level that we believe will be affordable for most of our customers.

The new 3Cs regulatory framework has empowered us to continue transforming into a customer-led business. It also introduces new challenges that increase our financial and reputational risk compared to previous pricing periods.

Hunter Water largely support the positions IPART has adopted in their draft determination. There are a small number of issues that we request IPART consider in reaching their final determination.

Table 1 summarises our response to IPART's draft decisions. Where required, we explain our positions in more detail in Sections 1 to 5. We request that IPART's final determination:

1. Does not introduce prospective changes to the tax allowance received for assets free of charge.
2. Include an updated forecast of our developer charge revenue.
3. Apply regulatory discretion and judgement when determining future rewards and penalties under the Capital Efficiency Sharing Scheme (CESS) and Efficiency Benefit Sharing Scheme (EBSS).

Table 1: Hunter Water's response to IPART's draft decisions

Issue / decision	IPART's draft decision	Hunter Water's position
Customer engagement	• Recognised that Hunter Water demonstrated effective customer engagement at an 'Advanced' level. • Recommended that next time Hunter Water should engage on costs more broadly to provide customers a comprehensive understanding of what they pay for.	 Hunter Water's pricing proposal represented a step change improvement in our customer engagement. We intend to continue to work with IPART, our customers, and other stakeholders between pricing reviews to develop a common understanding about how to best enable customers to shape our future pricing proposals and outcomes.

Issue / decision	IPART's draft decision	Hunter Water's position
Customer outcomes	• Found that Hunter Water's performance outcomes and measures were developed through strong community consultation and an understanding of key customer priorities. • Recommended additional measures for the customer report card to broaden the scope of outcome reporting and improve the visibility of performance.	 Hunter Water is open to adding measures to broaden the scope and improve the visibility of our performance. In Section 4 we suggest how this can best be achieved, informed by what we have heard from our customers.
Capital expenditure	• Include all of Hunter Water's actual capital expenditure since 2019-20, and $1.6 billion of proposed efficient capital expenditure into Hunter Water's notional revenue requirement. • Hunter Water's proposed expenditure represents a reasonable balance of risk, affordability and delivery of priority customer outcomes. • Consider it is prudent and efficient to include the Belmont desalination plant costs in Hunter Water's envelope of efficient expenditure. • Sought stakeholder views on whether the Belmont desalination plant delivers the most important outcomes for customers in this pricing period.	 We have put forward a proposal that will enable us to maintain our services and meet customer expectations, with bill impacts that remain affordable for most customers. IPART's draft report recognises the challenging trade-off and prioritisation decisions that were required to strike this balance between risk, affordability and customer outcomes. We did not directly ask customers, as part of our pricing proposal engagement, whether they would prefer to improve water security through the Belmont desalination plant rather than achieve other outcomes. However, we based this decision on what we had learnt from our customers about their priorities and expectations through engagement over the last five years.
Operating expenditure	• Hunter Water's proposed operating expenditure of $978.8 is efficient. • Accept Hunter Water's cost efficiency target of 1.0% per year over 6 years. • Noted that the $24.6 million in higher treatment operations costs that Hunter Water subsequently requested are likely to be accurate and were derived through a competitive tendering process. However, IPART determined there is scope for Hunter Water, as a mature organisation, to reprioritise, seek efficiencies and otherwise absorb these costs within our envelope of efficient expenditure.	 We maintain our position that given the scale of the increase in treatment operations costs, it will be very challenging to reprioritise or find offsetting efficiencies, on top of our existing efficiency commitments and other already excluded operating expenditure. Nevertheless, we understand and accept IPART's decision to not include these costs in customer prices. This will mean that Hunter Water will start the upcoming pricing period with forecast actual operating expenditure above the level used to set prices.

Issue / decision	IPART's draft decision	Hunter Water's position

Potential changes to calculation of tax allowances	• Set a tax allowance of $83.8 million using the established approach.
	• IPART is considering two changes to the tax allowance that, combined, may reduce Hunter Water's tax allowance to $42.5 million:
	  ○ Discontinuing the allowance for tax on assets free of charge.
	  ○ Refining how cash capital contributions account for tax to ensure internally consistent treatment within IPART's Building Block Methodology.
		
		Hunter Water is concerned about the reasonableness and potential impact of the change to the tax allowance for assets free of charge. It is inconsistent with Hunter Water's existing accounting treatment and compliance with tax law, our view about the applicability of the Victorian Power Networks case, and it introduces material financial risks.
		We think it's more consistent with the 3Cs framework to introduce a true-up mechanism or (negative) cost pass-through that is triggered if the ATO provide formal guidance regarding the accounting tax-treatment of assets free of charge.
		This matter is our top concern, and we respond in Section 1.

Demand forecasting	• Accept Hunter Water's forecast of its water demand for 2025-30 • Expect that Hunter Water develop an approach to including a price elasticity adjustment and that this be included in our forecasts for the 2030 pricing period.	 Hunter Water accepts IPART's view regarding a price elasticity adjustment. We will develop an approach and incorporate an adjustment in future water demand forecasts.
Pricing structures	• Accept Hunter Water's proposal to maintain the existing price structure of variable and fixed components for water and wastewater pricing. • Accept the proposed basis with which Hunter Water has set usage charges for water and wastewater services. • Do not accept Hunter Water's proposal to set a minimum service charge for non-residential customers with a common meter.	 Hunter Water accepts IPART's position regarding a minimum service charge for non-residential customers with a common meter. In retrospect, Hunter Water might have better informed or consulted with this subset of non-residential customers about the change, and demonstrated a stronger understanding of how the change may affect their businesses.
Forecast revenue from developer charges	• Accept Hunter Water's forecast revenue from developer charges and deduct this revenue from the Regulatory Asset Base (RAB).	 To date in 2024-25, we have received lower developer charge revenues than forecast. This has highlighted that the revenue forecast we included in our pricing proposal did not utilise the best available information for short-term forecasting. In Section 2 we provide an updated short-term forecast that is lower than that included in our pricing proposal. We ask IPART to consider this updated forecast in their final determination.

Issue / decision	IPART's draft decision	Hunter Water's position
Proposal grading	• Assessed Hunter Water's proposal as Advanced. • Partly deferred recovery of the 1.25% grading allowance by adding it to the RAB to be recovered over 12 years. The rationale for this decision was to address affordability concerns and cost-of-living pressures for our community.	 Hunter Water understands IPART's rationale for this decision, noting we have similarly been minded to addressing affordability throughout other aspects of our pricing proposal. It is noted that adding the allowance to the RAB means the additional revenue will not materially assist Hunter Water's ability to manage financial risks during the pricing period.
True-up for the deferral year	• Accept Hunter Water's proposal to forgo an $18.5 million true-up for efficient costs incurred in the 2024-25 deferral year. IPART agreed that it is in the short-term interests of customers to keep bills lower than they would otherwise be.	 Hunter Water and IPART's position on this issue reflects the exceptional affordability concerns that underpin this price review, and a commitment to keeping customer bills as low as possible.
Financial incentive schemes	• Apply the EBSS, CESS and ODIs using the default revenue adjustment cap of 1%	 We are concerned about how known and excluded operating expenditure increases, and deferred capital investments, would be treated under the EBSS and CESS in 2030. Our proposal is ambitious and may require us to spend beyond our allowances to competently manage risks during the pricing period. We request that IPART use their discretion and best judgement to appropriately evaluate under- and over-spends to ensure they truly demonstrate efficiencies or inefficiencies. We further explain our position in Section 3.

Issue / decision	IPART's draft decision	Hunter Water's position
Financeability	• Identifies that the Funds from Operations (FFO) over debt ratio not meeting the target under the benchmark or actual test for most of the pricing period. • However, IPART concludes that there is no financeability concern because the trend improves over the period to eventually reach target, and because the interest cover ratio shows cashflows are sufficient to cover annual interest payments.	 Hunter Water acknowledges IPART's view that despite not meeting the FFO/Debt targets, our 'base case' financeability results are acceptable. Howeves r, changes in key assumptions may put at risk our financial sustainability. The results show that we will be entering the pricing period in a position that is vulnerable to change and the need to manage risks as they arise. We request that IPART considers financeability in considering its position on the tax allowance for assets free of charge. In Appendix A, we provide scenario modelling that stress tests our financeability and highlights that there are valid concerns.
Cost of debt true-up	• Apply an end-of-period true-up approach for changes to the cost of debt that may occur during the 2025-2030 pricing period	 Hunter Water currently forecasts that the actual cost of debt will increase during the upcoming pricing period.

CONTENTS

I. Tax allowance

In setting maximum prices, IPART includes a tax allowance to reflect the regulated business' forecast tax liabilities. This tax allowance ordinarily includes an allowance for income tax that Hunter Water needs to pay on assets free of charge and cash capital contributions (including developer charges).

IPART's draft report states they are considering two changes for Hunter Water's final determination relating to the tax allowance:

> *We are currently reviewing our usual approach for assets free of charge tax allowances and are considering whether allowances should be provided to regulated water businesses for tax on assets free of charge going forward. We are also considering refining our usual approach of calculating tax allowances for cash capital contributions to account for imputation (franking) credits.*
>
> *Our draft decision on Hunter Water's tax allowance continues our usual approach to setting tax allowances. However, in reaching our final decisions we will consider refining our usual approach to remove tax allowances for assets free of charge, and to account for imputation credits in cash capital contribution tax allowances going forward.*[1]

IPART calculates that the combined impact of these two changes, all else being equal, would be to reduce Hunter Water's tax allowance by roughly half from $83.8 million to $42.5 million.

Treatment of tax on assets free of charge

IPART's consideration of discontinuing allowances for tax on assets free of charge (AFOC) is based on a recent ruling in the case of *Victoria Power Networks Pty Ltd v Commissioner of Taxation*, where the Federal Court of Australia ruled that gifted assets to Victoria Power Networks Pty Ltd were not assessable as income.

Hunter Water's assessment of the *Victoria Power Networks Pty Ltd v Commissioner of Taxation* ruling, concluded that while the case is relevant with respect to the receipt of assets provided by customers upon connection to the network, the specifics of the case, and the outcome, is not readily transferable to Hunter Water. The Australian Taxation Office acknowledges this in their most recent Decision Impact Statement; *"This decision is therefore one on special facts*".[2]

We understand the Commissioner is continuing to assess the potential impact of the decision on other infrastructure providers and regulated industries such as gas, water, telecommunications, rail and ports. However, the Commissioner does not consider the decision in relation to section 21A of the *Income Tax Assessment Act 1936* (ITAA 1936) to have wider application.[3]

Hunter Water has proactively sought guidance on the taxation treatment of assets free of charge, including expert independent taxation advice and consideration of obtaining a private binding ruling (PBR) from the Australian Taxation Office to confirm the application of the abovementioned Federal Court decision to our circumstances. A timeline of our activities in pursuit of this matter are provided in this section. We are liaising with the National Tax Equivalent Regime (NTER) regarding the Tax Counsel Network's (TCN) ongoing review of this issue, as well as with the Audit Office of NSW.

Should Hunter Water no longer be required to pay tax on assets free of charge, we agree that customers should not bear these costs. However, introducing this change prior to a decision of the Commissioner would be speculating on a future event in a way that is inconsistent with IPART's treatment of other costs within its framework, for example, costs required to manage a potential yet uncertain change in regulation.

[1] IPART, April 2025, Draft Report: Hunter Water prices 2025-30, page 60
[2] ATO, October 2020 Decision Impact Statement: https://www.ato.gov.au/law/view/document?docid=LIT%2FICD%2FVID237-240of2019%2F00001
[3] ATO, October 2020 Decision Impact Statement: https://www.ato.gov.au/law/view/document?docid=LIT%2FICD%2FVID237-240of2019%2F00001

Hunter Water proposes that rather than include this change prospectively into IPART's determination of Hunter Water's tax allowance, a more suitable approach would be to apply IPART's revenue-sharing framework, with a cost-pass through or true-up mechanism, triggered if or when the taxation decision becomes more certain.

In the section that follows we explain in further detail IPART's potential change to the tax allowance on assets free of charge, Hunter Water's actions to date, and our position regarding this change.

How Hunter Water's infrastructure is funded and delivered to service new development

Regional assets

Hunter Water directly funds and delivers infrastructure projects where there are wider regional benefits as part of our broader capital works program. Typically, this would occur where the asset provides servicing capacity for potential growth in a geographic region serving a broad population. These works are driven by a combination of compliance, operational and regional growth objectives

We refer to these broadly as 'regional assets'. The costs of these regional assets are included in our Regulated Asset Base (RAB) and recovered via water and wastewater customer tariffs, and developer charges.

Connecting assets

Developers are required to design and construct new water and wastewater mains and associated infrastructure to connect their development to our networks. In cases where these assets will also service adjacent or future developments, we may enter into a commercial agreement with the lead developer that involves us repaying the efficient costs of the infrastructure and transferring the title to Hunter Water.[4] This approach ensures that development activity and growth is not constrained by requirements we would otherwise place on the lead developer to 'right-size' infrastructure to service other future developments.

Because we ultimately fund the costs of this infrastructure, these costs are also included in our RAB and recovered via water and wastewater tariffs, and developer charges. The accounting recognition of these assets has no impact on our Income Statement.

Developer gifted assets / assets free of charge

Developers are required to fund and deliver water and wastewater reticulation assets that service the connected lots within their own development area. Reticulation assets may provide incidental capacity for subsequent developments in the longer term, but there is no obligation on other developers to contribute to these infrastructure costs.

After the developer has constructed this infrastructure, they transfer title to the asset (and ongoing management of that asset) to Hunter Water. This infrastructure is 'gifted' by the developer and received by Hunter Water as an 'asset free of charge'. The legal ability to require developers to fund and transfer infrastructure in this manner is provided by Section 50 of the *Hunter Water Act* 1991.[5]

Hunter Water does not make any payments or provide rebates to the developer and the receipt of these assets is recognised as income (at fair value) and treated as tax-assessable income to Hunter Water. Upon the transfer of title, Hunter Water recognises the asset as an addition to its fixed asset register and claims depreciation deductions over its effective life.

[4] The Lead Developer is the party instigating the need for the connecting asset(s)
[5] NSW Government, Hunter Water Act 1991, No 53

We have proactively sought guidance on tax-treatment of gifted assets since the Victorian Power Networks (VPN) case

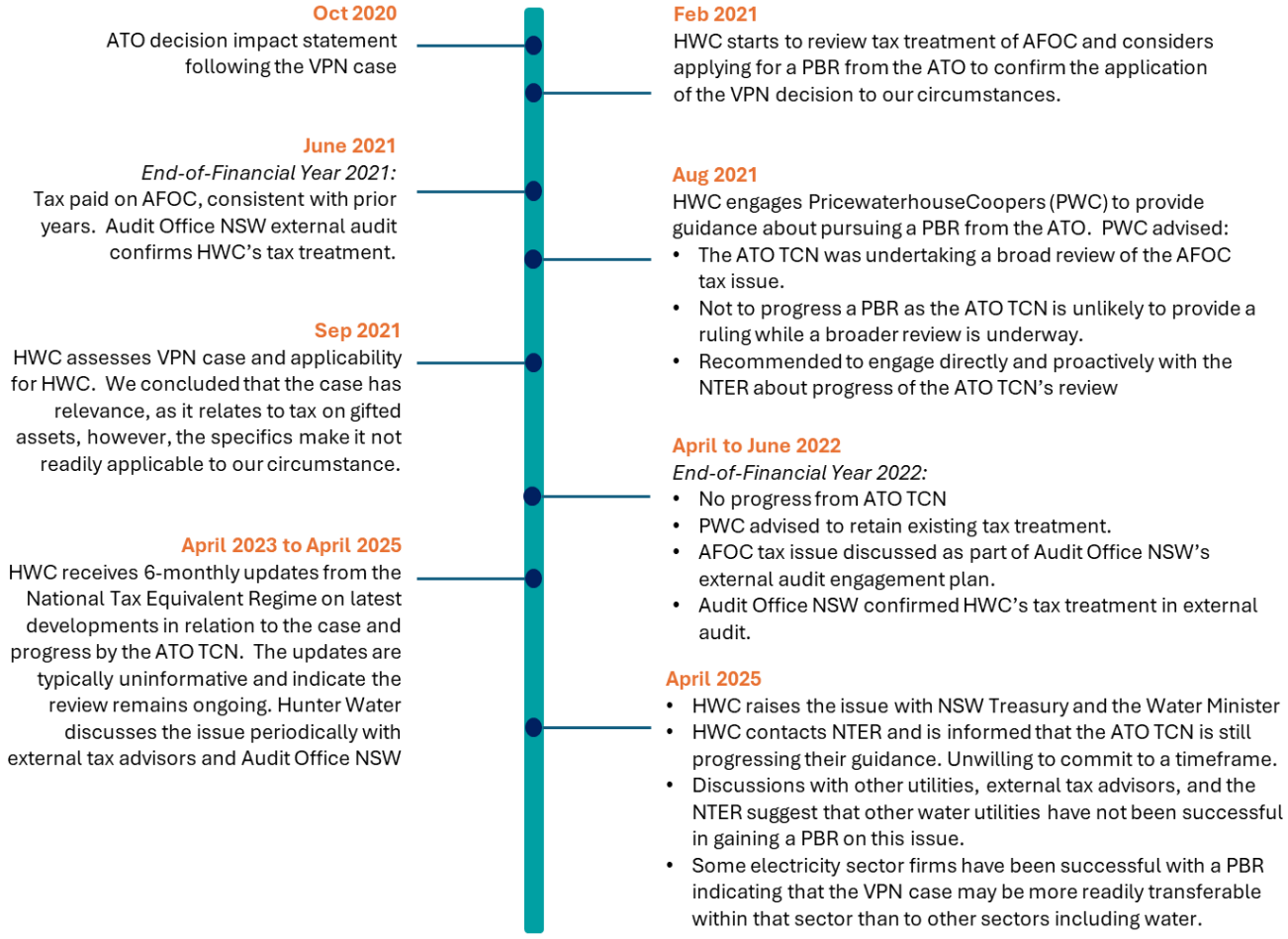
In October 2020, the Australian Tax Office (ATO) released their decision impact statement regarding the *Victoria Power Networks Pty Ltd v Commissioner of Taxation* case. This case considered the taxation treatment of gifted assets and cash contributions received by electricity distributors as part of the connection of new customers to their network and was ultimately heard in the Federal Court of Australia.

Upon the VPN decision, Hunter Water reviewed our taxation treatment of gifted assets and considered applying for a private binding ruling (PBR) from the ATO to confirm the application of the VPN decision to our circumstances. We engaged the support of external tax advisers (PricewaterhouseCoopers); discussed the matter at length with our external auditor (the Audit Office of NSW); and liaised with the National Tax Equivalent Regime (NTER) regarding progress of the ATO Tax Counsel Network's (TCN) ongoing review of this issue.

In Figure 1 we present a timeline of activities in relation to this matter.

We acknowledge that the ATO TCN guidance has not been timely to resolve, with the review ongoing for about four years.

Figure 1: Timeline of progress in Hunter Water considering the assets free of charge tax matter



In response to IPART's commentary in the draft report, we note specifically that:

- We were advised by independent taxation experts that pursuing a PBR was unlikely to be successful while the ATO was undergoing a broader review of the matter. We understand that it is the ATO's practice to delay resolving individual PBR requests where a matter is subject to active internal review or lacks settled guidance.
- As a participant in the National Tax Equivalent Regime (NTER), Hunter Water does not pay tax directly to the ATO. However, we recognise that the ATO's Tax Counsel Network provides interpretive guidance relevant to tax treatment across sectors. Despite our engagement via NTER channels, we have been unsuccessful in prompting a resolution to this issue.
- Based on our assessment and advice received, the facts of the VPN case differ from Hunter Water's circumstances, particularly in relation to the nature and regulatory treatment of the gifted assets received by Hunter Water.
- The ATO have acknowledged the matter is complex, nuanced, and not immediately transferable to the water sector.[6] Therefore, we do not believe that Hunter Water's lobbying is based on strong grounds and is likely to affect a faster resolution by the ATO.
- External audits conducted by the Audit Office of NSW have confirmed that our current tax treatment of gifted assets remains appropriate.
- To date, we are unaware of any water utility being successful in gaining a PBR on this matter.

We agree with IPART that, theoretically, a competitive benchmark business operating in a reasonably efficient market (and with non-Government shareholders) may be more motivated to proactively seek a binding ruling to minimise their taxation payments, relative to a State-Owned Corporation whose Government Shareholders are effectively incentivised as the recipient of the tax payable by Hunter Water. However, we believe this does not reflect Hunter Water's actions in practice – the timeline presented highlights we have proactively pursued this matter.

[6] See ATO Decision Impact Statement: https://www.ato.gov.au/law/view/document?docid=LIT%2FICD%2FVID237-240of2019%2F00001

Our view has been that the specifics of the VPN case are not directly applicable to Hunter Water

The VPN case involves complex and nuanced taxation matters. At its essence, the matter centres on the question of what is the revenue value that should be recognised by the recipient of an asset free of charge.

The Full Federal Court's decision in the VPN case concerned the amount of the transferred asset brought to account as a non-cash business benefit (gifted asset) under section 21A of the *Income Tax Assessment Act 1936* (ITAA 1936).

Hunter Water's assessment of the VPN case concluded that while the case is relevant to taxation on assets free of charge in a similar regulatory regime, the specifics of the case mean the outcome cannot be readily transferred to Hunter Water. The ATO acknowledges this, stating: *"This decision is therefore one on special facts*" in their October 2020 Decision Impact Statement.

Significant uncertainties remain over if or how the ATO will form a position on this matter more broadly, and how this would apply to Hunter Water's circumstance, given the specifics of the VPN case.

Key differences are:

- **Rebates:** In the VPN case, the electricity distributor pays a rebate to the customer and the value of gifted assets for income tax purposes is reduced accordingly (to nil). Hunter Water does not provide rebates to developers on the transfer of gifted assets. Even if the facts of the case were readily transferred, we cannot reduce the value of these assets to nil without a rebate amount.
- **Regulatory Asset Base (RAB):** Under both "Options" outlined in the VPN case the RAB was increased due to either the electricity distributors expenditure on the new connection assets (Option 1) or by the value of the rebate from the distributor to the customer (Option 2). Hunter Water does not provide rebates to developers who gift assets, and these gifted assets are not added to Hunter Water's RAB.
- **Industry/regulatory environment:** The case relies on the *Electricity Industry Guideline No. 14: Provision of services by electricity distributors*. The guideline contemplates uneconomic connections and the calculation of a 'shortfall' amount. It is uncertain how this would apply to the water sector and Hunter Water as our underpinning legislation, regulations, and arrangements with customers (developers) are different to those of the electricity sector.

In summary, for taxation purposes under paragraph 21A of the ITAA 1936 the value brought to account as income for Hunter Water is the "arm's length value", consistent with the tax outcomes from the VPN case. Hunter Water believes further implications of the case do not apply as we cannot seemingly reduce the value of this assessable income to nil – because we do not provide rebates to developers under these arrangements.

In our view and supported by external taxation advice, our current taxation treatment remains appropriate, and the VPN case does not provide Hunter Water strong grounds to lobby otherwise.

This view, coupled with the opacity of the ATO's considerations and lack of PBR precedents for the water sector, means we have no reason to anticipate that the ATO's technical review will conclude differently.

Additionally, there is no certainty of a near-term resolution to this matter.

Paying tax on AFOC without recovery via the tax allowance would materially impact Hunter Water's financeability

IPART's determination locks in maximum prices and revenues for a five-year period. By June 2025, IPART must decide an appropriate tax allowance for Hunter Water for that five-year period.

A key risk for customers is that after IPART's final determination, the ATO forms a position relevant to Hunter Water that taxes are no longer payable on assets free of charge – this would result in customers overpaying for their water and wastewater services by compensating Hunter Water for taxes that are no longer incurred.

If Hunter Water no longer pays tax on assets free of charge, we agree that customers should not bear these costs. If we had surety about the change, we would support the change IPART is considering.

However, if IPART excludes tax on assets free of charge from the tax allowance in their determination of Hunter Water's maximum prices, based on an assumption of a future ATO decision and / or prior to an ATO decision, and Hunter Water continues to be obliged to pay tax in practice – this would introduce a material financial risk for Hunter Water.

In Appendix A, we present scenario analysis that assesses our financeability to the change that IPART is considering. The results highlight that this change would leave our financial resilience in a concerning position. This poses a risk for customers that Hunter Water may be forced to further cut costs and / or service provision to ensure we remain financeable, ultimately impacting the quality of our service delivery and performance.

The change would incentivise a shift away from assets free of charge

We previously described how Hunter Water funds regional assets, connecting assets and reticulation assets within development areas (assets free of charge). It is our understanding that each water utility differs, to some extent, in which assets they choose to fund and what type and extent of assets they are gifted as assets free of charge.

Removing the tax allowance on assets free of charge would mean that Hunter Water recovers the costs we incur in funding regional assets and connecting assets via customer prices but does not recover the costs we incur (taxes) when receiving assets free of charge. This introduces a disincentive for Hunter Water to continue receiving assets free of charge and have developers making this direct contribution to the costs of their development areas.

There would be an incentive for Hunter Water to repay developers for the costs of reticulation assets (or to design and deliver these assets ourselves), such that they can be added to our RAB and recovered via water and wastewater tariffs, and developer charges.

This approach would appear to increase the burden of servicing growth on existing customers and introduce cross-subsidy with reticulation assets included in catchment-wide developer charges instead of contributed directly by the benefiting developer.

A true-up mechanism or 'negative' cost-pass through would be more consistent with IPART's 3Cs framework

Current advice indicates that the ATO is still reviewing this taxation matter. The outcome of this review, and the taxation obligations Hunter Water will incur during the pricing period, are therefore somewhat uncertain.

We understand the need to protect customers from a potential change in tax-treatment during the pricing period. However, introducing the change prior to an ATO decision would be speculating on a future event in a way that is inconsistent with IPART's treatment of other costs within its framework – for example, costs required to manage potential but uncertain changes in regulation.

Chapter 5 of IPART's handbook provides a revenue risk sharing framework that sets out principles and guidance about how and when costs should be recovered from customers.[7] Rather than build this change prospectively into IPART's determination of Hunter Water's tax allowance, we propose it is more suitable to consider applying the revenue risk sharing framework, such as a cost pass-through or true-up mechanism.

Cost pass-through mechanism

The cost pass-through mechanism typically contemplates situations where a business's costs increase during the pricing period. However, if key criteria is met, there is no reason why this mechanism could not be used to protect customers against the risk that a business experiences a material cost reduction during the pricing period. Table 2 shows that the tax allowance issue meets most of IPART's cost pass-through principles.

If the ATO provides guidance indicating tax is not payable on assets free of charge, then a negative cost pass-through could be made during the period, reducing prices for customers. The tax costs should remain in the revenue requirement to begin the pricing period, consistent with current regulatory practice and accounting treatment, as the cost uncertainty is that the ATO may provide guidance altering the status quo.

Table 2: Assessment against IPART's cost pass-through principles

Cost pass-through principle	Negative cost pass-through of lower tax on AFOC
There is a trigger event (to activate the cost pass-through), which can be clearly defined and identified in the price determination.	A decision, or review guidance by the ATO, is a clear external trigger outside Hunter Water's control.
The resulting efficient forecast cost associated with the trigger event can be fully assessed, including whether there are other factors that fully or partially offset the direct cost of the event.	Hunter Water's tax costs on AFOC can be readily assessed. The ATO's decision is uncertain but will potentially either support the status quo tax-treatment, or guide that no tax should be paid on AFOC. It seems less likely that tax costs would be reduced to an unknown level that sits partway between these book-end outcomes, but in any case, the impact can be fully assessed.
The resulting cost is assessed to exceed a materiality threshold. It must also represent a material risk for customers (in the absence of a pass-through).	The tax allowance for AFOC contributes about 1.6 per cent of Hunter Water's notional revenue requirement, which we consider to be material. The risk for customers is if Hunter Water's tax costs reduce during the pricing period due to ATO guidance, and prices are therefore inefficiently high during the pricing period. Scenario modelling shows the implications on Hunter Water's financeability of not receiving this revenue via customer prices if the ATO guidance does not result in no tax payable on AFOC.
The regulated business demonstrates that a cost pass-through is the most efficient and equitable way to deal with the event.	Compared to excluding the tax allowance from the revenue requirement, a cost pass-through is a more efficient and equitable means to balance risks between Hunter Water and customers of a change in tax-treatment for AFOC being introduced during the pricing period.
If the mechanism is triggered, there is a symmetric treatment of any over- or under-recovery of actual costs, relative to the efficient forecast cost included in the cost pass-through.	The tax allowance is based upon a benchmark, so there is no need to adjust for over- or under-recovery of actual tax costs. The treatment is symmetric.
The cost pass-through will result in customer prices that better reflect the efficient cost of service.	The tax allowance is set to recover the tax costs of an efficient business. A cost pass-through best aligns the regulatory tax allowance with actual tax payable.

[7] IPART, Water Regulation Handbook v2, July 2023, Chapter 5

True-up mechanism

The other relevant mechanism in IPART's revenue risk sharing framework is a true-up mechanism:

> *If costs change materially during a determination period, businesses can apply for a true-up of costs at the next price review. The costs that the business will incur can then be recovered from customers in the following period.*[8]

There are already two true-up mechanisms in place that are symmetrical and allow for under- and over-recovery to be adjusted in the subsequent pricing period. These are the Demand Volatility Adjustment Mechanism (DVAM) and cost of debt true-up.

Rather than reflect actual tax paid by Hunter Water, a true-up would be based upon IPART's benchmark calculation of the tax allowance, with and without tax on assets free of charge.

IPART has previously expressed a preference for true-ups to occur at the end of a pricing period, rather than to make within-period adjustments to prices. Hunter Water understands the advantages of this approach, even if it means that the business or customers must wait to be 'made good'.

Hunter Water does not have a strong preference about whether the adjustment is made as an end-of-period true-up or a cost pass-through to prices within the pricing period. An end-of-period true-up avoids the need to adjust prices within the pricing period and is consistent with how other key risks are treated in IPART's draft determination. That is our default preference, however, we would also support the use of a cost pass-through mechanism within the pricing period as it means customers get the benefit of any change in accounting treatment in a timelier way.

Treatment of tax on cash capital contributions

Through discussions with IPART, Hunter Water understands that the potential change to imputation credits on cash capital contributions (e.g. developer charges) is addressing an internal inconsistency between how tax is calculated on cash capital contributions in the RAB versus how tax is calculated in the tax building block.

This change appears logical if the tax is to be based upon a benchmark competitive business, operating in an efficient market, noting that Hunter Water does not actually apply imputation credits in practice. We have not interrogated this change in detail and understand it is only a minor contribution to the overall proposed reduction in value of the tax allowance.

We note that Hunter Water is required to pay the tax on developer charges in the year in which the developer charges are received. IPART adjusts these charges within the RAB, which results in Hunter Water receiving the tax allowance over a long period of time (e.g. 42 years for wastewater and 56 years for water). Therefore, IPART's tax approach on this issue is inconsistent with the Australian Tax Office's treatment, resulting in misalignment between Hunter Water paying the tax and receiving the associated tax allowance.

This funding misalignment impacts Hunter Water's financeability. Including the tax on developer charges within the tax building block, as opposed to the RAB, would address this issue. It would also correctly account for the associated imputation credits that IPART is trying to adjust for.

The tax allowance is complex, so there may be merit in IPART reviewing the methodology with stakeholders between price reviews, to ensure that the treatment of taxes is representative and consistent across all income types.

[8] IPART, Water Regulation Handbook v2, July 2023, page 57

2. Developer charges forecast

We request that IPART reduce our developer charges revenue forecast

IPART's draft decision adopts our forecast of developer charge revenue over the upcoming pricing period, as outlined in our pricing proposal.[9]

Developer charges were reintroduced by the NSW Government from 1 July 2023, after being set to zero since 2008. The reintroduction followed a phased implementation, with charges levied at 0 per cent in the first year (2023-24), followed by 25 per cent in the second year (2024-25), 50 percent in the third year (2025-26), and 100 per cent of the charge thereafter.

To date in 2024-25, the first revenue year post the reintroduction, we have received lower developer charge revenues than forecast. The forecast we included in our pricing proposal used the methodology and forecast of Equivalent Tenements (ETs) contained in our registered developer charges. The forecast was based upon long-term growth trends and did not consider information regarding in-train development applications and activity that can indicate the extent and location of growth in the short-term.

We have developed a new short-term revenue forecast that accounts for this intelligence. We request IPART adopt this updated forecast as it more accurately estimates our expected revenues and financeability in this upcoming pricing period.

As developer charges revenue is deducted from the RAB, the impact on the revenue requirement because of this change will be marginal and bills for a typical household would increase by around $1 ($2024-25).

How developer charge revenue affects the revenue requirement and our financeability

Developer charges revenue has a marginal impact on the calculation of our revenue requirement but materially impacts our funds from operations (FFO) used in credit metric analysis.

Developer charges are included in the regulatory framework as cash capital contributions

These contributions are deducted from our RAB to ensure we do not earn a return on, or of, capital expenditure that we have effectively recovered via the developer charges.

The developer charge forecast included in our pricing proposal reduces the RAB by $119 million by the end of the upcoming pricing period.[10] This results in a $17 million reduction in notional revenue requirements over the period and a reduction in our average annual bill increase for a typical household of $4 ($2024-25). The impact on revenues and average bills was dampened by the gradual phase-in of developer charges over the pricing period.

Developer charges are up-front cash payments

The receipt of developer charges upfront, at the time of development, allows quicker recovery of growth-related investment. If recovered from broader retail customers, revenues would be received over the regulatory life of assets. Therefore, revenue received from developer charges directly improves our short-term forecast of FFO – a measure of cash available.

We forecast to receive $179.5 million in cash payments from developer charges over 2024-25 and the upcoming pricing period. This compares to $17 million in cash that would have been received from broader retail customers over the pricing period, in the absence of developer charges.

9 Hunter Water's 2024 pricing proposal, page 177

10 When added to the RAB, cash capital contributions are added net of a 30 per cent tax component. The $179.5 million forecast to have been received through developer charges is deducted from the RAB at a value of $125.6 million. This is slightly offset by the impact on depreciation of $6.5 million – resulting in the RAB change of $119 million.

IPART financeability metrics presented in our pricing proposal reflect this improvement in cash-flow in the calculation of the 'actual' test:

- The additional cash-flow has a positive impact on our projected *real FFO over debt* credit metric, our weakest metric. Developer charge revenue provides an uplift in this metric of 1.5 per cent.
- The real interest cover metric is also impacted favourably by developer charge revenue. Developer charge revenue provides an uplift in this metric of 0.3.

Accurately forecasting developer charge revenue involves detailed understanding of current developer activity

To forecast developer charge revenue over the pricing period we multiply the registered developer charges for each development servicing area, by an expected growth in ETs. An equivalent tenement represents the total demand that an average single residential dwelling places on our system.[11]

IPART registered our current developer charges in December 2023. We have assumed the developer charges themselves remain at the registered level throughout the upcoming pricing period. The gradual phase-in of the charge from zero in 2023-24 to 100 per cent from 1 July 2026 is taken into consideration. In practice however, the developer charges will be re-calculated and re-registered with IPART prior to 30 June 2028, partway through the pricing period.

Forecasting growth in ETs is complex and requires us to estimate:

- Connection growth for each service (water and wastewater) in each development servicing area. This includes 9 different areas for water services and 20 areas for wastewater services.
- The timing of connection growth across the pricing period. This is particularly relevant given the phase-in of developer charges.
- The mix of growth between customer types (residential houses, residential multi-premises and non-residential customers). Each customer type is worth a different ET value. The mix of expected customers therefore impacts the overall revenue.
- The expected demand placed on our system by growth in non-residential customers. Forecasting developer charge revenue from non-residential customers is highly uncertain. It involves estimating the demand placed on our system by these new customers based on their water connection size, expected water usage and sewer discharge factors. To do this, would require accurate information about business types at the time of development application – this is not typically available.

As developer charges had been set to zero by the NSW Government since 2008, we had not been required to undertake developer charge revenue forecasts for the 15 years between 2008 and 2023. We also changed the way we value ETs between our 2008 and 2023 recalculation.

Given the proximity of the registration of charges (December 2023) to the development of our pricing proposal, we used the forecast ETs contained in our registered developer charges to derive the forecast revenue from these charges for our proposal. The developer charge calculation included ET values by location, service and financial year, between 1996 and 2050 – as required by IPART's methodology. These ET values were based on high-level long-term growth trends.

While a high-level, long-term forecast approach is appropriate for ETs in the calculation of the charges, in hindsight, it is not the best approach available to forecast ETs in the short-term for the purpose of revenue budgeting. Particularly, the next 2-3 years. Short-term ET and revenue forecasts are more reliably informed by a bottom-up calculation based on detailed knowledge about the number of developer applications in-train, growth plans for different areas, council intelligence on development activity, and other information contained in development applications such as the location, complexity and size of development.

11 Each single residential dwelling is worth 1 ET. Residential multi-premises are valued lower than 1 ET. Non-residential customers are valued based on the expected demand they place on the system relative to a single residential premise.

We have revised our developer charge revenue forecast downwards

As part of our annual Business Plan, we have re-forecast our developer charge revenue for the period of 2024-25 to 2026-27 using a 'bottom-up' calculation approach as described above.

Table 3 shows the variance between the forecast developer charge revenue used for our pricing proposal and IPART's draft decision, and our revised forecast.

We believe the revised forecast more accurately reflects the likely revenue that we will receive from developer charges over the pricing period. It is informed by our best available information regarding short-term growth and development activity in our area of operations.

We request IPART to adopt the revised forecast in their final decision. This would provide a more appropriate cash capital contribution deduction from the RAB, and more accurate calculation of our financial credit metrics. We expect this change would have a marginal impact on prices and increase the average yearly bill for a typical household by around $1 ($2024-25).

We will continue to develop and improve our developer charge forecasting capability during the pricing period including our understanding of the short to medium-term development pipeline.

Table 3 Revised developer charge revenue forecast, $2024-25 $million

Developer charge revenue forecast ($2024-25 million)	2023-24	2024-25	2025-26	2026-27	2027-28	2028-29	2029-30	Total
Water								
Pricing proposal	-	2.7	6.2	12.5	12.8	13.0	13.3	60.5
Revised	-	0.9	4.1	9.6	12.8	13.0	13.3	53.7
Difference	-	(1.8)	(2.1)	(2.9)	-	-	-	(6.8)
Wastewater								
Pricing proposal	-	5.4	11.9	24.4	25.1	25.8	26.5	119.0
Revised	-	1.6	6.9	16.4	25.1	25.8	26.5	102.3
Difference	-	(3.8)	(5.0)	(8.0)	-	-	-	(16.7)
Total	-							
Pricing proposal	-	8.1	18.0	36.9	37.9	38.8	39.8	179.5
Revised	-	2.5	11.0	26.0	37.9	38.8	39.8	156.0
Difference	-	(5.6)	(7.0)	(10.9)	-	-	-	(23.5)

3. Capital and operating expenditure

Hunter Water accepts IPART's draft decisions for operating and capital expenditure.

We were pleased that IPART's draft decision included the costs of the Belmont desalination plant in the efficient expenditure used to set customer prices and supported Hunter Water's proposed cost efficiency factor.

Our pricing proposal was ambitious and intended as our best and final offer. Throughout our engagement with customers and stakeholders we heard that affordability and cost-of-living are key concerns. These insights drove key elements of our proposal including:

- Committing to an ambitious but achievable cost-efficiency target; and
- Reprioritising and deferring investment; and
- Excluding uncertain and other known costs and investments from our proposed expenditure; and
- Taking on additional financial risk as a business rather than asking customers to pay more.

In taking on additional financial risk, our Shareholders will bear the burden of any additional expenditure above IPART's-determined expenditure envelopes that may be required to meet customer and regulatory commitments and prudently manage risks that arise during the pricing period. We believe this approach is consistent with how an efficient and mature business operating in a competitive market would respond to the current customer sentiment and broader macroeconomics conditions, seeking to maintain market share in the short-term by not passing these costs on through higher prices, resulting in lower profits and reduced returns to their Shareholder.

Continued cost pressures, market and wages tension, combined with elevated global and local economic uncertainty, is creating challenging financial conditions.

In February 2025, following our Pricing Proposal submission in September 2024, Hunter Water contacted IPART regarding the outcome of a competitive market procurement process for our treatment operations services. Our Pricing Proposal foreshadowed a cost increase; however, the final pricing was substantially higher than anticipated – $24.6 million higher across the five-year pricing period. The contract pricing reflects recent and current market conditions which are significantly less favourable than when the previous contract was awarded in 2014, with the key driver being increased input costs such as chemicals, fuel, and subcontractor fees.

Regarding our request for these higher treatment operations costs to be added to the efficient operating expenditure envelope, IPART's draft report explains that:

> *"We have reviewed the information provided to us by Hunter Water and consider that its proposed increase in costs for this purpose is likely to be accurate and is derived through a competitive tendering process. However, we consider there is scope for Hunter Water to absorb these costs within its envelope of efficient expenditure. As noted earlier, we have not made any adjustments to Hunter Water's proposed operating expenditure, and consider it is a mature organisation that is well equipped to reprioritise costs and seek efficiencies to absorb this proposed cost increase within its envelope of allowed expenditure."*

We maintain our position that given the scale of the increase, it will be very challenging to reprioritise or find offsetting efficiencies to absorb these costs within our expenditure envelope. Treatment operations are unavoidable direct costs essential to the provision of our core services.

We will need to manage these on top of our existing efficiency commitments and other known excluded operating expenditure increases. To absorb higher treatment operations costs, we would need to almost double the efficiency gains included in our proposal (from $36.4 million to $72.6 million).

Hunter Water is also incurring other known cost increases above CPI post its pricing submission in energy; grounds maintenance; insurance, rates and charges; software licences and subscriptions; and from the recently approved collective bargaining agreements (Fair Work Commission, April 2025). We highlight our

current forecast operating expenditure in Appendix B. We also have cost vulnerabilities to meet the updated PFAS regulations.

Nevertheless, we understand and accept IPART's decision to not include these costs in setting customer prices.

Hunter Water will start the upcoming pricing period with forecast actual operating expenditure above the level used to set prices. It will be very challenging for Hunter Water to manage cost pressures within our expenditure envelopes, therefore, it's important that IPART:

- Consider how this will impact the EBSS and CESS and use their judgement when applying these schemes to ensure they provide reasonable and meaningful incentives to be efficient.
- Does not incrementally implement a change to the tax allowance that may further weaken our financeability and financial resilience.

The impact of changes to PFAS and biosolids regulations

Australia is undergoing significant regulatory updates concerning per- and polyfluoroalkyl substances (PFAS), aiming to better protect public health and the environment. These efforts are being led by:

- **Drinking water standards:** the National Health and Medical Research Council (NHMRC)
- **Biosolids management:** the Heads of EPA Australia and New Zealand (HEPA) and NSW EPA.

Change in regulations relating to PFAS will drive additional costs for Hunter Water during the pricing period. The magnitude of these costs remains uncertain. This will primarily be higher operating expenditure for additional sampling and analysis, additional administrative and compliance costs, as well as operational changes and delivery of interim solutions required to ensure biosolids can continue to be beneficially reused.

Drinking water

The NHMRC is updating the Australian Drinking Water Guidelines (ADWG). The draft guidelines suggest significant reductions in permissible levels for certain PFAS. [12]

The NHMRC held a public consultation on these draft guidelines, which concluded on 22 November 2024. The publication date for the finalised guidelines remains uncertain. In the meantime, the 2018 guideline values continue to apply.

Hunter Water has been monitoring PFAS for over ten years. We have an extensive PFAS testing and reporting program across our water network. This program includes sampling for PFAS:

- In our catchments and untreated water
- At all six of our drinking water treatment plants
- At 83 locations across our drinking water network.

Hunter Water has undertaken significant work to review the impacts of the proposed ADWG PFAS guidelines, particularly in relation to the operation of the Tomago Sandbeds. The Tomago Sandbeds are an important water source, relied upon during drought and if there is a water quality issue in our main supply: Grahamstown Dam.

The Sandbeds have known PFAS contamination from historical Australian Defence Force activities. Operating the Sandbeds under the proposed new ADWG will require Hunter Water to undertake improved PFAS testing of water supplies and incur additional resourcing to manage the operation of this source. Although there will be additional costs required to meet the proposed PFAS ADWG values, our drinking water complies with the current Australian Drinking Water Guidelines for PFAS, and our analysis suggests it will also meet the proposed ADWG guidelines.

[12] NHMRC, 2024. Retrieved from: https://www.nhmrc.gov.au/health-advice/environmental-health/water/PFAS-review/draft-fact-sheet?utm_source=chatgpt.com

Biosolids management

In March 2025 HEPA published version 3 of the PFAS National Environmental Management Plan (PFAS NEMP 3.0). The EPA has advised it intends to update the regulatory framework for biosolids in NSW to align with PFAS NEMP 3.0.

Hunter Water included two major biosolids management investments in our proposed expenditure over the next 10 years. These investments are the Burwood Beach WWTP sludge upgrade and the Centralised biosolids upgrade.

One of the key drivers of investment for biosolids management is increased scientific and community understanding of contaminants of concern, including but not limited to PFAS. This increased understanding is informing changes to environmental guidance and regulation including the PFAS NEMP 3.0, and the NSW Biosolids Guidelines and Resource Recovery Framework.

The presence of PFAS in sludge currently released to the ocean from Burwood Beach WWTP, and the unknown environmental consequences of continuing this practice, is of particular concern to Hunter Water and the NSW EPA. We have developed plans for the Burwood Beach WWTP sludge upgrade to ensure compliance with environmental regulatory requirements for ocean discharges. The plan will need to be reviewed in light of any changes to regulatory settings for PFAS and other contaminants of concern.

Hunter Water has identified that a centralised approach to biosolids treatment is the best long-term solution to assess growth drivers across our 19 wastewater systems. Anticipated changes to the NSW Biosolids Guidelines, which are currently being reviewed by the NSW EPA, may require a step-change in treatment requirements to manage pathogens, stability, odour and contaminants of concern including PFAS.

Hunter Water understands the NSW EPA intend to release an update to the Resource Recovery Framework for biosolids in coming months. The Resource Recovery Framework allows wastes to be re-used when they can be shown to provide a benefit, be fit-for-purpose, and pose minimal risk of harm to the environment and human health. Producers of biosolids (such as Hunter Water and its contractors) have a responsibility to meet the requirement of the Biosolids Order, while biosolids customers or end-users have a responsibility to meet the requirements of the Biosolids Exemption.

While the specific content of any updates to the Biosolids Order and Biosolids Exemption remains uncertain, the EPA has advised they intend to include new chemical limits in biosolids for PFAS in line with PFAS NEMP 3.0, introduce land application thresholds based on maximum soil concentration, and include new monitoring requirements. They have also indicated other emerging chemicals of concern such as galaxolide, triclosan and PBDEs may be included. The implementation timeline for any changes, and any transitional arrangements, also remain uncertain.

Hunter Water continues to assess the implications of potential changes to the regulatory framework for biosolids on our current operations and future plans. Further work is required, but our preliminary assessment of the proposed changes is that they will necessitate new ongoing costs:

- Additional costs for sampling and analysis of PFAS and other contaminants of concern in biosolids we produce, and at land application sites.
- Additional staff resourcing costs associated with compliance and administration.
- Additional external operating costs for engaging expert agronomists as part of compliance and administration.
- Increased external operating costs for reuse contractors to comply with more stringent land application requirements.

While still uncertain, preliminary estimates suggest revised biosolids order and exemption to necessitate additional cumulative ongoing operational costs of up to $1 million per year.

Depending on the details of the finalised regulatory framework and more a robust understanding of the characteristics of the biosolids produced at each of our 19 wastewater treatment plants, further operational changes or infrastructure solutions may be required to ensure our biosolids land application program continues to be a cost-effective way to recover resources from wastewater and eliminate the need to landfill biosolids. Operational changes or new infrastructure options may include new storage facilities, blending and/or composting facilities, or air drying to ensure biosolids meet the required quality requirements for

beneficial reuse. If required, these solutions will incur significant additional capital and/or operating expenditure, as they are labour and resource intensive.

A key unknown is the background level of contaminants of concern at potential biosolids land application sites. Hunter Water's ability to beneficially reuse biosolids through land application could be impacted depending on the concentration of contaminants found to already exist in the soil at potential and existing reuse locations, necessitating increased transport and reuse costs to more remote sites.

There is a material risk to Hunter Water that biosolids become unfit for beneficial reuse due to market closure, resulting from either revised regulatory settings or market perceptions. If land application of biosolids becomes unavailable, Hunter Water must identify an alternative biosolids management pathway, which as a last resort may necessitate landfill disposal. Transport and landfill disposal costs have previously been estimated to add in the order of $20 million in operating costs per year. There is significant uncertainty about landfill operators' willingness to accept biosolids in large quantities, especially in the context of increasing regulatory and community focus on PFAS and other contaminants of concern.

In addition to interim solutions, the regulatory changes may necessitate or warrant bringing forward capital investment in biosolids treatment upgrades. There is a significant lead-time needed to optimally plan, design, and construct new infrastructure of this type and scale. Therefore, additional capital expenditure in the upcoming pricing period would more likely relate to planning and design of the preferred solution, rather than a significant proportion of the construction taking place.

Recycled Water

PFAS NEMP 3.0 has also identified ecological and human health risk thresholds for PFAS that may have implications for our recycled water schemes. It is not yet clear whether the Australian Guidelines for Water Recycling (AGWR) will be reviewed or updated in response to PFAS NEMP 3.0.

Hunter Water has been monitoring PFAS in our wastewater system and recycled water schemes for ten years. Hunter Water is currently reviewing the PFAS NEMP 3.0 to understand any changes required to our management approach for recycled water schemes. We may incur additional costs associated with:

- Additional sampling and analysis.
- Additional risk assessment and compliance activities.
- Development of a comprehensive PFAS management plan for our wastewater systems and recycled water schemes and implementation of any recommended actions.

IPART should use judgement when applying the EBSS and CESS, to ensure penalties and rewards are justifiable

In our pricing proposal and during development of IPART's 3Cs framework, we expressed reservations about the EBSS and CESS financial incentive schemes but decided that we were willing to try them:

> *We continue to have some reservations about the schemes. In particular, the CESS, and whether deviations in actual expenditure from a pre-determined level necessarily reflect efficiency gains or losses. However, we acknowledge the purpose of these schemes in driving better long-term performance – and we support that position.*[13]
>
> *In the spirit of a working trial, we are not proposing any up-front exclusions or carve-outs additional to those considered through IPART's financial incentive schemes working group. We are willing to try the schemes as designed – rather than try to pre-empt what should and shouldn't justifiably be included. However, we urge IPART to apply regulator discretion to review and adjust scheme payments if the incentive schemes do not work as intended, or where the payments do not reflect an efficient movement in costs.*[14]

Our position remains broadly the same following IPART's draft determination.

Our preference is for IPART to use their discretion and best judgement to appropriately evaluate the specifics and drivers of under- and over-spends against operating and capital expenditure allowances, before applying any financial rewards and penalties. Applying the schemes mechanically, without judgement, could lead to outcomes that are far removed from a meaningful picture of 'efficiency' or 'inefficiency'.

Efficiency Benefit Sharing Scheme

We understand the rationale for IPART's draft decision to exclude higher treatment operations costs from our envelope of efficient expenditure, despite these costs being market-tested, and unavoidable. However, we are concerned about how this and other known and excluded operating expenditure increases would be treated under the EBSS at the end of the pricing period.

It seems misleading and unreasonable for these costs to be badged as 'inefficiencies' if Hunter Water starts the pricing period knowing that it will be very challenging to absorb these within our operating expenditure envelope – i.e. the median ('P50') outcome is that we will need to exceed the envelope.

We estimate that if we assume these costs are incurred above the 'baseline expenditure' within the EBSS calculations, this will result in an approximately $6.8 million EBSS penalty to be paid in 2030 (see Table 4).

IPART's EBSS method allows adjustments for cost-pass through events. Our view is that a similar adjustment would be suitable if Hunter Water incurs these known costs above our expenditure envelope.

Table 4: Potential EBSS penalty to Hunter Water of being unable to absorb excluded costs

#	Scenario description	NPV of EBSS Penalty to be paid at the end of the pricing period ($million, $2024-25)[15]
1	Scenario 1 – Hunter Water is unsuccessful in absorbing the costs shown in Appendix B within our expenditure envelope – no cost pass-through	6.8
2	Scenario 2 – Hunter Water is unsuccessful in absorbing the costs shown in Appendix B within our expenditure envelope – cost pass-through included	0

[13] Hunter Water's 2024 pricing proposal, page 322
[14] Hunter Water's 2024 pricing proposal, page 323
[15] Note: The value of the EBSS incentive is based on a 3.2% WACC as determined in the Draft Report.

Capital Efficiency Sharing Scheme

Our proposal involved taking on additional risks to keep customer bills as low as possible. We deferred otherwise prudent investments, with the philosophy that if risks eventuate during the pricing period, we will adapt and invest as needed to manage these risks competently. This may require exceeding our regulated capital expenditure envelope. This approach places the burden of risk primarily with Hunter Water and its Shareholders, ensuring that customers pay no more than essential but do not receive markedly reduced levels of service.

By mechanically defining such increases above the envelope as 'inefficient', the CESS penalises this approach to risk management and theoretically disincentivises us from competently managing risks during the pricing period. In practice, our motivation to be a competent business and meet regulatory and legal obligations would outweigh this incentive.

4. Customer outcomes

Hunter Water's pricing proposal put forward six customer outcomes and ten performance measures.

We did not provide targets for three of these measures as we were in the process of introducing new survey methodologies and did not have enough baseline performance data to set an informed target. IPART's draft report requested that we confirm targets for these three measures and refine the targets for others to improve clarity.

IPART accepted most of Hunter Water's proposed customer outcome measures and targets. However, they have also recommended including additional measures to provide customers with a broader and more transparent view of our overall performance. IPART's draft report explains:

> *"We have found that Hunter Water's performance outcomes and measures were developed through strong community consultation and an understanding of key customer priorities. Hunter Water consulted on customer expectations to develop its performance outcomes, and sought feedback on the measures that would help customers understand what they pay for …*
>
> *However, in some areas there were insufficient measures to give customers a holistic picture of Hunter Water's performance. In these cases, we consider there is merit in Hunter Water broadening the scope of its outcome reporting to provide customers more visibility of how it is delivering customer value."*[16]

Hunter Water is open to adding new measures to improve the visibility of our performance.

Following IPART's draft recommendations, we surveyed our Community Panel and the Customer and Community Advisory Group (CCAG) to ask their views. We surveyed the Community Panel because of their involvement in developing our customer report card (during Phase 4 engagement), and the CCAG due to their overarching role as outlined in our Customer, Consumer and Community Procedures, required under our Operating Licence. This engagement has informed our proposed new performance measures.

In this section we:

- Provide targets for the three measures that were listed as 'TBC' in our pricing proposal
- Clarify some measures and targets, where requested by IPART
- Comment on IPART's suggested additional measures, and make our own suggestions, informed by what we have recently heard from our Community Panel and CCAG.

In Table 5, we present a revised summary of our customer outcomes, measures and targets – it now contains 13 measures. In Appendix C, we provide a 'mock-up' of what the customer report card may look like in practice, including our three proposed supplementary performance indicators.

[16] IPART, 2025, Hunter Water prices 2025-2030 Draft Report, page 97 and 99

Table 5 2025-2030 measures and targets summary

Outcome	What we're measuring	How we're measuring it	Our current performance	Target for 2025-26	2026-27	2027-28	2028-29	2029-30	Trend
High-quality water services	Drinking water safety	Percentage compliance with Australian Drinking Water Guidelines	99.95%	≥ 99.75%	≥ 99.75%	≥ 99.75%	≥ 99.75%	≥ 99.75%	Steady
	Our response time to rectifying service issues	Percentage of service delivery issues raised by customers addressed within target timeframes	88%	≥ 88%	≥ 88%	≥ 88%	≥ 88%	≥ 88%	Steady
	Customers who are repeatedly affected by a service issue (low water pressure, bad odour and/or wastewater overflows)	Cumulative number of customers removed from our repeat service issue register (low pressure, odour and wastewater overflow issues)	40 per year	≥ 80	≥ 180	≥ 320	≥ 550	≥ 1,000	Improve
	Service interruptions	Operating Licence service standards met for water continuity, water pressure, dry weather wastewater overflows and repeat dry weather wastewater overflows [1]	4/4	4/4	4/4	4/4	4/4	4/4	Steady
Value for money, affordable	Value for money	Percentage of survey respondents that agree Hunter Water delivers value for money (via survey)	51%	≥ 51%	≥ 50%	≥ 50%	≥ 50%	≥ 50%	Steady
	Support for vulnerable customers	Percentage of customers who are accessing, or have accessed, our support programs that agree the program is effective (via survey) [2]	**≥ 70%**	**≥ 70%**	**≥ 70%**	**≥ 70%**	**≥ 70%**	**≥ 70%**	Steady
Water security	Leakage in our supply system	The average volume of leakage and overflow from our supply mains and service reservoirs. Expressed in a daily volume (litres, per service connection, per day) [3]	83	≤ 65	≤ 55	≤ 45	≤ 45	≤ 40	Improve
	Delivering Belmont Desalination Plant	Key milestones met in the delivery of the Belmont Desalination Plant by 2028 [1]	On Track	On Track	On Track	First water June 2028	Plant complete	N/A	Improve
Environmentally sustainable	The impact of our activities on the swimming quality of beaches	Percentage of Beachwatch sites graded as good, or grading unaffected by our activities	100%	100%	100%	100%	100%	100%	Steady
	Greenhouse gas emissions	Percentage reduction in carbon dioxide equivalent emissions compared to a 2020-21 baseline	30 %	≥ 40%	≥ 50%	≥ 60%	≥ 70%	≥ 80%	Improve
	Environmental compliance	Number of major environmental incidents [1]	2	≤ 3	≤ 3	≤ 3	≤ 3	≤ 3	Steady
Great customer service	Customer satisfaction with our customer service	Percentage of customers that are satisfied with their most recent interaction with us (via survey) [2]	**≥ 70%**	**≥ 70%**	**≥ 70%**	**≥ 70%**	**≥ 70%**	**≥ 70%**	Steady
Community-focused	Community trust	Percentage of survey respondents that agree they trust Hunter Water (via survey) [2]	**≥ 75%**	**≥ 75%**	**≥ 75%**	**≥ 75%**	**≥ 75%**	**≥ 75%**	Steady

Notes: 1. Hunter Water's proposed additional measure are shown in (blue).
2. In our Pricing Proposal this target was shown as "to be confirmed" (TBC) **(bold)**.
3. The leakage targets differ to our pricing proposal but are consistent with IPART's Draft Report (Table 10.2). We updated this target due to a calculation error that understated the amount of improvement.

Water security

Clarifications

We have updated the targets proposed for our leakage performance. These are provided in our revised customer report card (Table 5) and were correctly reflected in Table 10.2 of IPART's Draft Report. This aligns with the Outcome Delivery Incentive (ODI) target included in our pricing proposal and corrects an error that understated the amount of improvement.

Additional measures

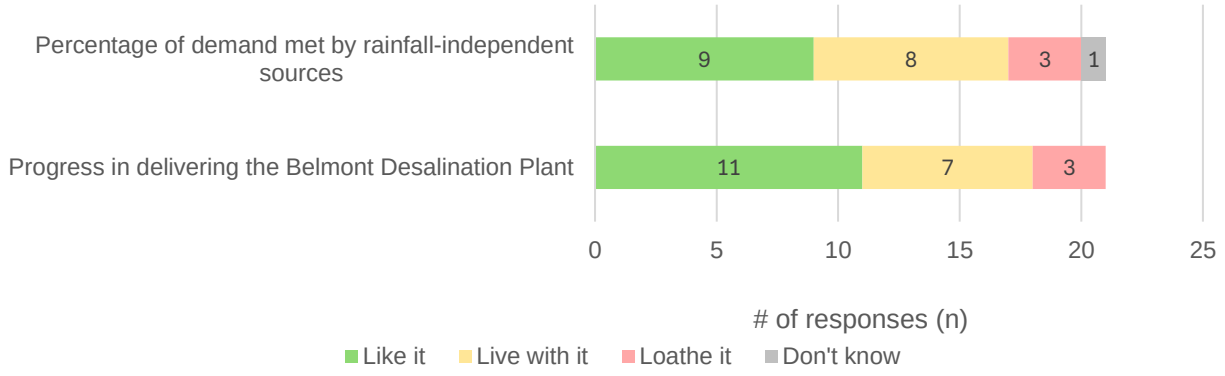
IPART's Draft Decision	Our Response
IPART considered that leakage, on its own, is not a sufficient measure of water security, particularly given the level of expenditure proposed on this outcome. However, IPART acknowledged that water security is not an easily measurable outcome.	✓ We propose to add the measure: *Delivery of Belmont Desalination Plant to major milestones*

We agree with IPART that there is scope to expand our performance reporting provide a more comprehensive view of water security. We asked our Community Panel and CCAG about two potential outcome measures:

- *Progress in delivering the Belmont Desalination Plant*
- *Percentage of demand met by rainfall-independent sources*

We did not ask about the *"number of days of water restrictions"* measure mentioned by IPART because it is overly influenced by weather/climate and doesn't necessarily indicate if water security in the Lower Hunter has been improved or not. This measure would also be adversely impacted by our current operational decision to maintain lower dam levels at Grahamstown Dam in response to identified dam safety risks.

Figure 2: Support for additional measure(s) of Water Security



We propose to include *"progress in delivering the Belmont Desalination Plant"* as an additional performance measure on the customer report card. This measure:

- Complements the leakage metric to provide a more complete picture of water security.
- Is preferred by our customers and is more readily understandable and meaningful than alternatives.
- Helps ensure Hunter Water is clearly accountable for delivering the largest investment we have proposed to make in the upcoming pricing period.

Environmentally sustainable

Clarifications

Measure included in proposal	IPART's view
Percentage of Beachwatch sites graded as good, or grading unaffected by our activities	• Considers this is a useful metric for reporting on environmental outcomes, and is a demonstrable measure of Hunter Water's impact on the water quality of swim sites across the Hunter region • IPART believes it should be calculated as a percentage of Beachwatch sites that could be affected by Hunter Water's operations, rather than as a percentage of all Beachwatch sites. This ensures the metric is closely tied in with Hunter Water's actual impact on Beachwatch ratings.

This proposed performance measure is based on data published in the *State of the Beaches* report, produced by the NSW Government through its Beachwatch program. Since 1989, Beachwatch has monitored water quality at beaches and bathing locations throughout the state. Under the program, swim sites are graded as *Very Good, Good, Fair, Poor,* and *Very Poor,* based on microbial risk, using National Health and Medical Research Council (NHMRC)'s aligned guidelines.

Seventeen of the 249 sites included in the report are in the Lower Hunter (specifically Lake Macquarie, Newcastle and Port Stephens). These sites are monitored regularly, with weekly results published online, and overall performance is annually assessed and reviewed in the detailed *State of the Beaches* report.

Our proposed target is to maintain "Good" or "Very Good" gradings of these 17 Beachwatch sites, ensuring no degradation below "Good" due to Hunter Water's activities. This measure is intended to reflect our role in maintaining safe, swimmable water quality in these locations, and responds to community interest in swimability and environmental health.

We agree with IPART that the measure should be focused on sites potentially influenced by our operations. We confirm that each of the 17 Hunter-based Beachwatch sites are located within a catchment area where Hunter Water's wastewater system (including treated effluent discharges and wet weather overflows) could plausibly impact water quality outcomes. Accordingly, the current proposed measure already aligns with IPART's recommendation, as it is calculated only over sites that *could* be affected by Hunter Water's operations.

Additional measures

IPART's Draft Decision	Our Response
NSW Environment Protection Authority (EPA) non-compliances are another important measure of environmental performance and could provide customers a more holistic picture of environmental value delivered through Hunter Water's expenditure.	✓ We propose to add the measure: *Number of major environmental incidents*

We considered including a performance measure to report against EPA non-compliances as part of our proposal. However, when we asked customers as part of our stage four workshop on customer outcomes and measures, we found that other sustainability measures were preferred. The results of this initial engagement are summarised in Figure 3.

Nonetheless, we agree with IPART decision that there is scope to expand the customer report card to include a measure of EPA non-compliances. We believe that a measure of major environmental incidents is the easiest to understand and most meaningful measure of EPA compliance. In response to IPART's draft decision, we asked our Community Panel about this additional measure, and they broadly supported it, as shown in Figure 4. Given this support, we propose to add it to the customer report card.

Figure 3: Pricing proposal customer engagement: voting on measures of environmental sustainability

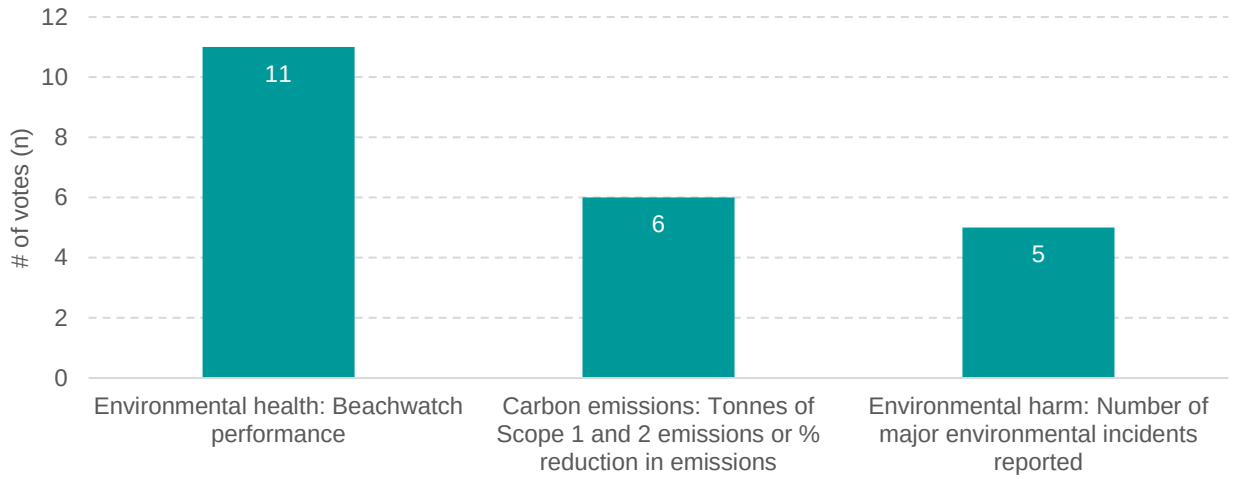
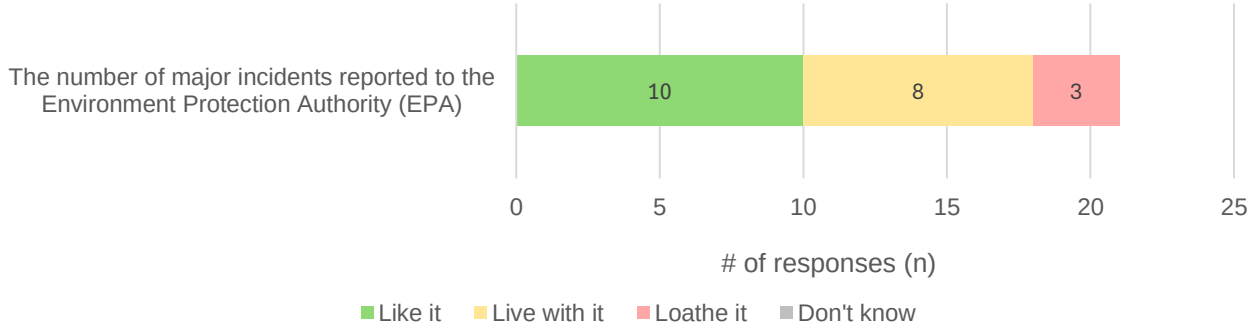


Figure 4: Additional measure for Environmentally Sustainable



High quality water services

Clarifications

Measure included in proposal	IPART's view
Percentage compliance with Australian Drinking Water Guidelines (ADWG)	• Since Hunter Water is already required to meet the ADWG guidelines under our Operating Licence, IPART don't consider this measure delivers any additional benefit to customers. However, IPART recognises there is merit in reporting ADWG compliance to provide transparency to customers in the event of future non-compliances. • Asks that Hunter Water clarify the basis of measurement of this target, including any averaging across test results for different compliance metrics.

Hunter Water customers identified "High Quality Water Services" as their highest-priority outcome through our extensive engagement program. This outcome reflects community expectations that drinking water should be safe, clean, and dependable throughout the year.

Hunter Water's proposed drinking water safety performance measure is reported as:

> *'The percentage of the total population serviced within the zones of the water supply system where compliance with the microbiological requirements of the water quality guidelines or standard is met in the reporting year.'*

This approach aligns with the latest guidance from the *National Performance Report Indicators and Definitions Handbook* for reporting against indicator '*H3: Percentage of population where microbiological compliance was achieved'.*[17]

It is advantageous to select a measure that is consistent with the NPR Handbook methodology, because:

- Standard definitions and common reporting allows comparison between utilities and jurisdictions.
- The methodology is subject to external audit which provides confidence that the results are reliable.

As outlined in our revised customer report card (Table 5), Hunter Water's target is 99.75% in each year of the pricing period. We consider this an appropriate target as it:

- Ensures we are compliant with the key microbial indicator for drinking water safety in the Australian Drinking Water Guidelines
- Responds directly to customer expectations for clean, safe water.
- Reflects our proposed investment in drinking water quality in the 2025-2030 period.

[17] Bureau of Meteorology, 2023, National Performance Report Framework: water and wastewater service providers: http://www.bom.gov.au/water/about/publications/document/NPR_Indicators_and_definitions_handbook_Feb_2025.pdf

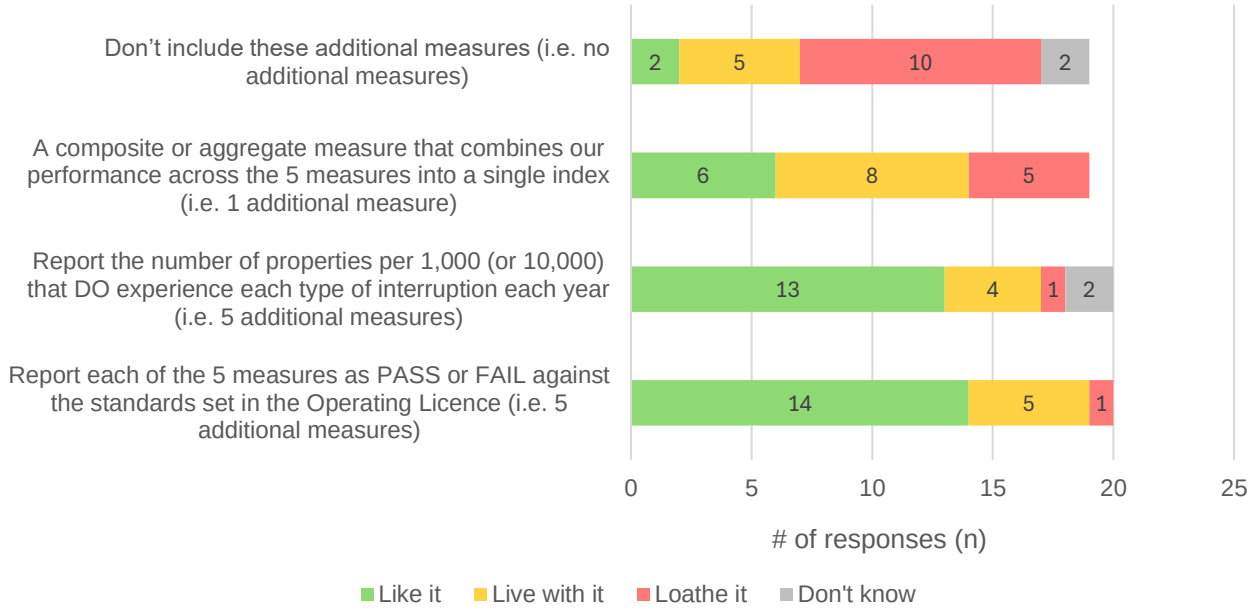
Additional measures

IPART's Draft Decision	Our Response
Hunter Water should expand its reporting on this outcome by including the following measures in its customer report card – the number of properties that experience: 1. An Unplanned Water Interruption that lasts for more than 5 continuous hours 2. Three or more Unplanned Water Interruptions that each last for more than one hour 3. Water Pressure Failure 4. An Uncontrolled Wastewater Overflow in dry weather 5. Three or more Uncontrolled Wastewater Overflows in dry weather.	 We propose to add a composite index measure so that the report card remains succinct and understandable for customers. Five additional measures for this outcome would take the total number of measures to 17 (including other new measures) and make the report card unwieldy, potentially reducing the focus on other measures.

Although we already publish our performance against these indicators annually in our *Compliance and Performance Report*, we agree with IPART that adding a broader view of core service performance to our customer scorecard would make our measurement of the 'high quality water services' outcome more comprehensive.

We asked our Community Panel and CCAG for their views about adding these measures to the scorecard. Our survey asked about four possible options for how/if to include these (see Figure 5).

Figure 5: Additional measure(s) for High Quality Water Services



The results indicate that our surveyed customers agree with IPART that there should be additional reporting of these service performance measures.

While customers preferred reporting against individual service interruptions (either using a pass or fail criteria or else reporting the number of properties experiencing each type of interruption/service failure), we propose to adopt the composite index approach, which would add one additional measure to the customer report card that captures performance across each of these measures.

We have three reasons for wanting to adopt a different position to our surveyed customers:

- An index provides customers with a clear statement of whether we have met our Operating Licence system performance standards or not. This will be more accessible for customers, with additional detail published annually in our Compliance and Performance report.

- Adding these five individual measures to the customer report card would take the total to seventeen, making it unwieldy and less effective and accessible. There is a balance between improving transparency and coverage, and ensuring the report card remains clear.
- It aligns with our preferred existing internal and external reporting of this performance (as published in our Annual Report).

Our proposed targets for each of the four elements in the composite service index is consistent with the existing system performance standard limits set out in our Operating Licence.[18]

We don't support adding the measure: *Three or more Unplanned Water Interruptions that each last for more than one hour* to either the index or individual reporting (if required by IPART). This measure was removed from our system performance standards at our 2020 Operating Licence review based upon customer engagement insights that indicated customers are relatively accepting of water interruptions if their service is restored promptly. Should IPART seek to include this measure, we recommend that it be published as an 'additional' or contextual measure alongside the customer report card.

Value for money, affordable

Clarifications

Measure included in proposal	IPART's view
Percentage of customers who are accessing, or have accessed, our support programs that agree the program is effective (via survey)	• IPART asks that Hunter Water propose a target for this measure in our response to the draft report.
Percentage of survey respondents that agree Hunter Water delivers value for money (via survey)	• Notes the proposed target of ≥50% by 2030 • Considers the target is 'considerably broad and does not demonstrate a sufficient step change improvement to customer value' • IPART asks that Hunter Water propose a more specific target for this measure

Customer support program effectiveness

Our proposal included a single performance measure focused on supporting vulnerable customers:

> *Percentage of customers who are accessing, or have accessed, our support programs that agree the program is effective.*

At the time of submission, we did not include performance targets for this measure. These targets have now been set and are shown in our revised customer report card (Table 5).

To strengthen the integrity of our reporting, we have reviewed our survey methodology and introduced an additional touchpoint. This was informed by external expert advice. Given the relatively small sample size, the quantitative results for this measure will be complemented by qualitative insights drawn from independently facilitated focus groups with support program participants. These insights will be provided to the Community Committee to inform their assessment of our performance against this outcome.

[18] IPART, 2022, Hunter Water Operating Licence 2022-2027

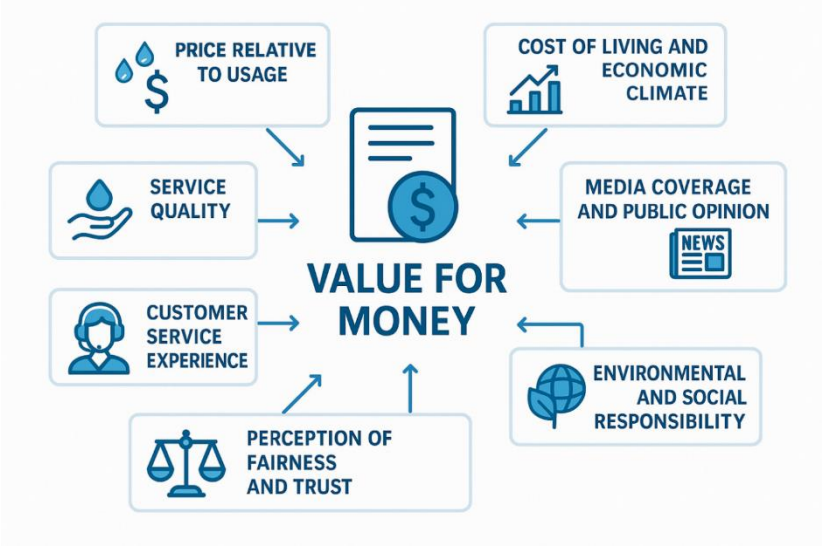
Value for money

Customers expect Hunter Water to keep bills as low as possible and deliver value for money.[19] The specific targets we have set for measuring value for money use the methodology determined by our customer research partner. Based on maintaining our existing performance, these targets are:

- At least 51% of survey respondents 'agree' or 'strongly agree' that Hunter Water provides value for money (for 2025-26)
- At least 50% or more of survey respondents 'agree' or 'strongly agree' that Hunter Water provides value for money (for 2026-27 through 2029-30)

In practice, customer's perception of "value for money" can be influenced by many factors (see Figure 6). Measuring value for money through a survey is less accurate and more subject to outside factors than using market-based prices and choice to reveal the value a customer places on a service. Broader cost of living pressures can influence how customers perceive value for money of their water provider.

Figure 6: Drivers of water utility customer's perception about 'value for money'



IPART has noted that our proposed target *"does not demonstrate a sufficient step change improvement to customer value"*. We agree it's not a step-change improvement, but we believe it will be sufficiently challenging to achieve and is a justifiable target. The target percentage is consistent with our baseline performance based on our current survey methodology – we are proposing to hold steady over time.

In our proposal, we have been clear that widespread cost pressures mean customers will need to pay higher prices to, effectively, continue to receive the same levels of service. The exceptions are the few targets on our customer report card that we have said will improve.

We expect that broader cost-of-living pressures (e.g. fuel, energy, insurance, food and housing) will continue to negatively impact customer perceptions about the value for money they receive from Hunter Water. This, coupled with rising water and wastewater prices, mean that holding steady on this measure would demonstrate that customers think the higher prices they are paying are broadly worth the service improvements they are receiving.

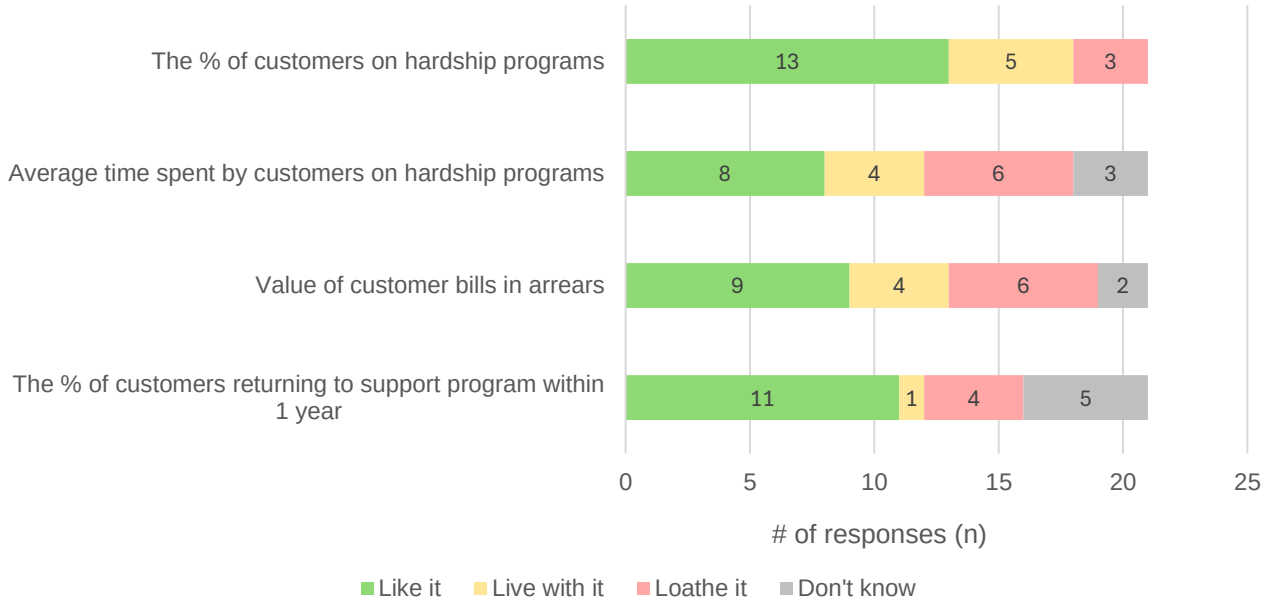
[19] Insync, September 2022, Hunter Water Stage One Engagement Summary Report

Additional measures

IPART's Draft Decision	Our Response
% of customers on hardship programs (no targets)	We support reporting against this measure.
Average time spent by customers on hardship programs (no targets)	We do not currently track this data. We are willing to start reporting against this measure, however, we propose an alternative measure that provides a better indicator of the effectiveness of support programs: *% customers returning to support program within 1 year*.
Value of customer bills in arrears (no targets)	We have concerns about the usefulness of reporting the *$ value of customer bills in arrears.* We propose an alternative measure that better captures the extent of customers struggling to pay their bills: *% of customers that do not pay by the final notice.*

IPART's draft report recommended reporting against three additional measures to provide more useful insights into affordability and improve comparability with other businesses. We asked our Community Panel and CCAG for their views about these three measures, and an additional measure that we think provides a better indicator of the effectiveness of our support programs: *% customers returning to support program within 1 year*. The results are shown in Figure 7.

Figure 7: Additional measures for Value for Money, Affordable



We have three concerns about the 'value of customer bills in arrears' measure:

- Without additional context, the total dollar value amount does not provide meaningful insight about affordability.
- We don't currently track this measure. We would need to develop a clear definition and implement a data capture and reporting process. Regarding the definition, we would need to decide specifics such as whether arrears are recorded as the first notice, second notice, or final notice to pay.
- The total dollar value could be swayed by outliers – for example, a single large non-residential customer that moves into arrears.

If IPART wants to introduce a measure of bills in arrears, we think a better measure to use would be the *% of customers that do not pay by the final notice*.

Based on our own views, and supported by insights from customers, we propose to report against three additional measures alongside our customer report card:

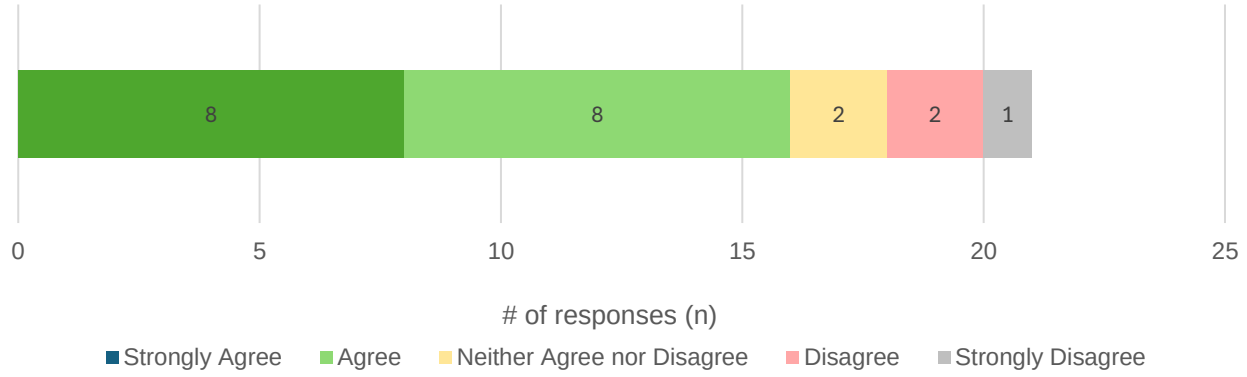
- *% of customers on hardship programs*
- *% customers returning to support program within 1 year*
- *% of customers that do not pay by the final notice*

Because these affordability measures are about providing additional insight, and do not have targeted performance levels, we propose to report these as supplementary information alongside our customer report card, rather than including them on the traffic light customer report card itself.

We also asked our Community Panel and CCAG whether they would look at the additional measures. The results in Figure 8 suggest that the additional measures would be used by customers.

Figure 8: Customer interest in vulnerability measures

How strongly do you agree or disagree that you will look at Hunter Water's performance against additional affordability measures related to assisting customers experiencing vulnerability at least once in the next 5 years?



The Justice and Equity Centre's (JEC) submission to IPART's Issues Paper on Hunter Water's prices encouraged the NSW Government to develop a report that contains broader affordability-related indicators. Hunter Water is open to participating with stakeholders in such an initiative.

Great customer service

Clarifications

Measure included in proposal	IPART's view
Percentage of customers that are satisfied with their most recent interaction with us (via survey)	• Hunter Water's proposal did not include a corresponding target for this measure. IPART asked that Hunter Water develop these targets for consideration in their Final Report.

In our proposal, we stated that we would measure this as the *'percentage of customers that are satisfied with their most recent interaction with us'*. Our customer experience measurement partner has recommended a revised approach that instead measures the percentage of customers who receive a 'great service' (scored at 8 or above out of 10), rather than using the mean score. This provides a focus on a different part of the distribution and aligns with modern best practice across service organisations. The data will be collected by surveying customers who have recently interacted with us via a variety of channels.

Targets for this measure are provided on our revised customer report card (Table 5).

Community-focused

Clarifications

Measure included in proposal	IPART's view
Percentage of survey respondents that agree they trust Hunter Water (via survey)	• Hunter Water's proposal did not include a corresponding target for this measure. IPART asked that Hunter Water develop these targets for consideration in their Final Report.

Hunter Water was unable to provide a target with our pricing proposal due to a change in survey methodology for this question. Now that a baseline performance has been measured, targets for this measure are provided on our revised customer report card (Table 8). This reflects us maintaining current high levels of community trust: that at least three quarters of our customers trust us.

5. Abbreviations and acronyms

Abbreviation/acronym	Description
3Cs framework	IPART's new regulatory framework that focuses on customers, costs and credibility
ADWG	Australian Drinking Water Guidelines
AFOC	Assets free of charge
ATO	Australian Tax Office
BBM	Building block methodology
CCAG	Customer and Community Advisory Group
CESS	Capital efficiency sharing scheme
CPI	Consumer price index
DVAM	Demand volatility adjustment mechanism
EBSS	Efficiency benefit sharing scheme
EPA	Environment Protection Agency
ET	Equivalent tenements
FFO	Funds from operations
HEPA	Heads of EPA Australia and New Zealand
IPART	Independent Pricing and Regulatory Tribunal
JEC	Justice and Equity Centre
NEMP	National environmental management plan
NHMRC	National Health and Medical Research Council
NTER	National Tax Equivalent Regime
ODI	Outcome delivery incentive scheme
PBR	Private binding ruling
PFAS	Per- and poly-fluoroalkyl substances
RAB	Regulatory asset base
TCN	Tax counsel network
VPN	Victoria Power Networks
WWTP	Wastewater treatment plant

Appendix A - Financeability outlook

IPART's draft report presents financeability modelling that shows Hunter Water does not meet the target r*eal funds from operations (FFO) over debt* ratio under either the benchmark or actual test.[20]

IPART concludes that this result does not reflect a financeability concern for the upcoming pricing period because:

- The trend in the benchmark FFO over debt ratio improves over the determination period and reaches the target ratio in the final year.
- The interest cover ratios indicate that Hunter Water will have cash flows that cover its annual interest payments.

Hunter Water accepts this rationale in-principle, but we point out that the results show our financeability outlook is not resilient to changes in key assumptions or events that may occur during the pricing period. Our proposal involved taking on additional financial risks. Therefore, it's essential that we are resilient to be able to manage these risks competently without financeability concerns creating pressure to cut expenditure (potentially reducing service levels for customers) or otherwise make sub-optimal decisions.

The key factors impacting our financeability include:

- **Known operating expenditure increases:** We forecast to incur higher operating expenditure than included in IPART's draft determination (explained in Section 3).
- **Regulatory change:** Change in regulation for PFAS will also necessitate uncertain but higher operating expenditure (explained in Section 3).
- **Developer charges:** We forecast to receive lower developer charges revenue than forecast in our pricing proposal (explained in Section 2).
- **Customer demand:** There is a risk that, contrary to our demand forecast, higher water prices will lead to reduced customer demand, resulting in lower revenue from water sales than forecast. While all water utilities with maximum price caps face some demand risk, our risk is heightened as our demand forecast does not include a price elasticity adjustment in response to higher water usage charges, as highlighted in IPART's draft report.
- **Cost of debt:** We forecast a material rise in the cost of debt during the pricing period, exposing us to additional interest cost risk (explained in Section 3).
- **Foregone revenue for the deferral year:** Our decision to forgo $18.5 million of trued-up revenue for 2024-25 impacts our credit metrics.
- **Grading allowance:** IPART's decision to defer recovery of the grading allowance (by capitalising it in the RAB) has reduced a potential mechanism we might have had to mitigate other financial pressures.
- **Tax allowance:** If IPART removes the tax on assets free of charge (AFOC), but Hunter Water continues to pay this tax in practice, our financeability will be negatively impacted.

[20] IPART Draft Report, page 148

In Table 6, we present sensitivity/scenario analysis that stress tests our financial sustainability considering some of the key factors above.

IPART's financeability tests (benchmark and actual) assess the sufficiency of revenue calculated by the building block methodology (BBM). The risks Hunter Water is exposed to mainly relate to our actual costs and revenues deviating from the assumptions included in the BBM. Therefore, rather than IPART's financeability tests we present our forecast credit rating based on financial metrics which consider our forecast actual cash inflows and outflows. Under Treasury Policy, State-Owned Corporations are required to maintain a minimum investment grade (BBB) credit rating.[21]

Table 6: Financeability scenarios indicate we are not resilient to changes in key assumptions

Scenario	Description	2025-26	2026-27	2027-28	2028-29	2029-30
1	• As per IPART's draft determination	BBB	BBB	BBB	BBB	BBB
2	• Higher operating expenditure	BBB	BBB	BBB	BBB	BBB
3	• Higher operating expenditure • Lower developer charges revenue	BBB	BBB	BBB -	BBB	BBB
4	• Higher operating expenditure • Water demand lower due to price elasticity	BBB	BBB	BBB -	BBB -	BBB
5	• Higher operating expenditure • Lower developer charges revenue • No tax allowance on AFOC	BBB	BBB	BBB -	BBB -	BBB
6	• Higher operating expenditure • Lower developer charges revenue • No tax allowance on AFOC • Water demand lower due to price elasticity	BBB	BBB -	BBB -	BBB -	BBB -

The scenarios modelled are:

- **Scenario 1:** As per IPART's draft determination.
- **Scenario 2:** As per Scenario 1 but assumes that during the pricing period Hunter Water incurs the higher operating expenditure provided in Appendix B – i.e. we are unsuccessful in absorbing these costs within our envelope.
- **Scenario 3:** As in Scenario 2 but assumes the revenue we receive from developer charges during the pricing period is lower than we forecast in our pricing proposal. The assumed cashflows are the updated developer charge revenue forecast presented in Table 3.
- **Scenario 4:** As in Scenario 2 but assumes that customers do reduce their water demand in response to higher water usage prices (price elasticity response).
- **Scenario 5:** As in Scenario 3 but assumes Hunter Water does not receive a tax allowance for AFOC, while continuing to incur tax on these assets in practice.
- **Scenario 6:** As in Scenario 5 but assumes that customers do reduce their water demand in response to higher water usage prices (price elasticity response).

The results show that in combination, changes in key assumptions are likely to weaken our financial health. This supports our request to not introduce a prospective change to the tax allowance on assets free of charge.

[21] NSW Treasury Policy and Guidelines: *Capital Structure and Financial Distribution Policy for Government Businesses* – https://www.treasury.nsw.gov.au/sites/default/files/2023-05/tpg21-10_v1-capital-structure-and-financial-distribution-policy.pdf?utm_source=chatgpt.com

Appendix B - Increases in operating expenditure

Hunter Water lodged its pricing proposal with IPART in September 2024. Our proposal outlined $15 million of operating expenditure that we excluded from our forecasts to keep bills as low as possible.[22]

Our current forecast of operating expenditure includes the following known and certain cost increases (shown in Table 7):

- **Treatment operations costs –** We finalised the outcome of a competitive market procurement process for our treatment operations services resulting in substantially higher costs than included in our proposal.
- **Energy network charges** – In May 2024, Ausgrid published revised network pricing for 2024-25 with pricing 20 per cent above existing rates. We excluded this from our proposal to keep bills as low as possible.
- **Labour price increases** – In April 2025, the Fair Work Commission approved our collective bargaining agreements with remuneration increases of 4.5 per cent for 2024-25 and 3.5 per cent for 2025-26. This increase was 0.5 per cent higher for 2024-25 than we included in our pricing proposal.
- **Digital expenditure –** Higher non-recurrent operating expenditure to replace essential end-of-life assets, and to invest in improving efficiency and our use of data. Consistent with our pricing proposal, we think it's in our customers best long-term interests for us to incur these digital costs but to excluded them from the operating expenditure allowance used to set prices. We are also vulnerable to an ongoing above-CPI trend in licence and subscription costs (note: this trend is not included in Table 7).

Treatment operations and energy network charges are unavoidable direct costs essential to the provision of our core services – there is no opportunity to adjust the scope or otherwise reduce or avoid incurring these costs. While the remuneration increase reflects the outcomes of a formal bargaining process ratified by the Fair Work Commission that is locked-in, we do have some discretion over the total size of our workforce and total labour costs. We also have some discretion over our digital expenditures.

In addition to these known costs, we also have uncertain vulnerabilities relating to insurance premiums (~$2 million), grounds maintenance (~$2 million), operation of the Belmont desalination plant (~$2 million), and additional costs driven by changes in regulation for PFAS (discussed in section 3)

Table 7: Build-up of Hunter Water's current forecast operating expenditure

$millions, $2024-25	2025-26	2026-27	2027-28	2028-29	2029-30	Total
IPART Determination	**193.0**	**194.2**	**197.0**	**197.8**	**196.9**	**978.8**
+ Treatment Costs	5.4	5.3	4.7	4.4	4.8	**24.6**
+ Energy network charges	1.2	1.2	1.2	1.2	1.2	**6.0**
+ Labour price increases	0.4	0.4	0.4	0.4	0.4	**2.0**
+ Additional digital expenditure	3.6	-	-	-	-	**3.6**
Total forecast regulated operating expenditure	**203.2**	**201.1**	**203.3**	**203.8**	**203.3**	**1,015.0**
Efficiency target built into IPART Determination	*4.0*	*5.7*	*7.1*	*8.9*	*10.7*	***36.4***

[22] Hunter Water's 2024 pricing proposal, page 163

Appendix C - Customer report card

Outcome	Performance measure	2025-26	2026-27	2027-28	2028-29	2029-30
Great customer experience	% of customers satisfied with their most recent interaction with Hunter Water (via survey)	G	A	A	G	G
Community focused	% of respondents who agree they trust Hunter Water (via survey)	G	A	G	G	G
High quality water services	% compliance with Australian Drinking Water Guidelines	A	G	G	A	G
	% of service delivery issues raised by customers addressed within target timeframes	A	A	A	R	A
	Number of customers removed from repeat service issue register (low pressure, odour and wastewater overflow issues)	R	G	G	G	G
	Operating Licence service standards met for water pressure, water continuity, dry weather wastewater overflow and repeat dry weather wastewater overflow	A	G	A	G	G
Value for money and affordable	% of respondents that agree Hunter Water delivers value for money (via survey)	G	G	G	G	G
	% of customers who are accessing, or have accessed, support programs who have a great experience (via survey and focus groups)	A	G	A	A	G
Water security	Average daily volume of leakage and overflow from supply mains and service reservoirs	G	A	G	G	G
	Delivery of Belmont Desalination Plant to major milestones	G	G	G	A	G
Environmentally sustainable	% reduction in carbon dioxide equivalent emissions compared to 2020-21 baseline	A	G	A	G	G
	% of Beachwatch sites graded as good, or grading unaffected by Hunter Water's activities	G	R	A	G	A
	Number of major environmental incidents	R	A	G	G	G
			G met	A on track	R not met	

Supplementary statistics and context	2025-26	2026-27	2027-28	2028-29	2029-30
Customers experiencing three or more unplanned water interruptions	#	#	#	#	#
Customers on hardship programs	#	#	#	#	#
Customers returning to hardship support within 12 months	#	#	#	#	#
Customers that do not pay by the final notice	#	#	#	#	#

Note: The Red/Amber/Green status shown is an example and doesn't reflect actual performance or target.

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Head Office
36 Honeysuckle Drive
Newcastle NSW 2300

Email
enquiries@hunterwater.com.au

Mail
Hunter Water
PO Box 5171
HRMC NSW 2310

Connect
hunterwater.com.au