INFRASTRUCTURE PARTNERSHIPS AUSTRALIA

9 December 2024

Independent Pricing and Regulatory Tribunal NSW
Via IPART Submission Portal

SUBMISSION TO THE NSW INDEPENDENT PRICING AND REGULATORY TRIBUNAL ON ITS REVIEW OF SYDNEY WATER'S PRICE PROPOSAL 2025-30

Infrastructure Partnerships Australia is pleased to provide this submission to the NSW Independent Pricing and Regulatory Tribunal on its review of Sydney Water's price proposal for the period 1 July 2025 to 30 June 2030.

Infrastructure Partnerships Australia is an independent think tank and executive member network, providing research focused on excellence in social and economic infrastructure. We exist to shape public debate and drive reform for the national interest. As the national voice for the infrastructure sector in Australia, our membership reflects a diverse range of public and private sector entities, including infrastructure owners, operators, financiers, advisers, technology providers and policy makers.

Infrastructure Partnerships Australia advocates for sensible infrastructure investment which accounts for long-term growth and asset renewal requirements to ensure adequate water service provision. In the face of contemporary challenges including an ageing asset base, growing demand for services and increasingly unpredictable climatic conditions, a significant but necessary increase in capital investment will be required by major water utilities in New South Wales. These capital works cannot be deferred to future pricing periods without risk of significant consequences resulting from underinvestment.

User charging for water infrastructure is the fairest way to ensure all beneficiaries contribute fairly to building and maintaining water infrastructure. It provides an equitable and sustainable way of paying for the maintenance and upgrade of the network. The capital investment required to meet demand for essential water infrastructure will ultimately result in higher water bills for users. In determining how much users should pay, the regulator must seek to appropriately balance the tension between asset investment, user bills and shareholder returns. International examples, such as in the United Kingdom, give fair warning of the consequences of not finding equilibrium, and this example is explained further in this document as a cautionary tale.

Long-term sustained investment in water infrastructure is necessary to meet demand, this should be reflected in pricing determinations

Australian water utilities' capital works investment has tended to be highly cyclical, with urgency often driven by fears of running out of water during periods of drought. Examples of this can be seen with the significant programs of works which were rolled out during the end of the Millennium Drought and towards the conclusion of the 2017 to 2019 Drought. While assets like the Sydney Desalination Plant have proven to be invaluable during subsequent extreme weather events, the best time for rolling-out sensible, long-term investment is when the dams are full.

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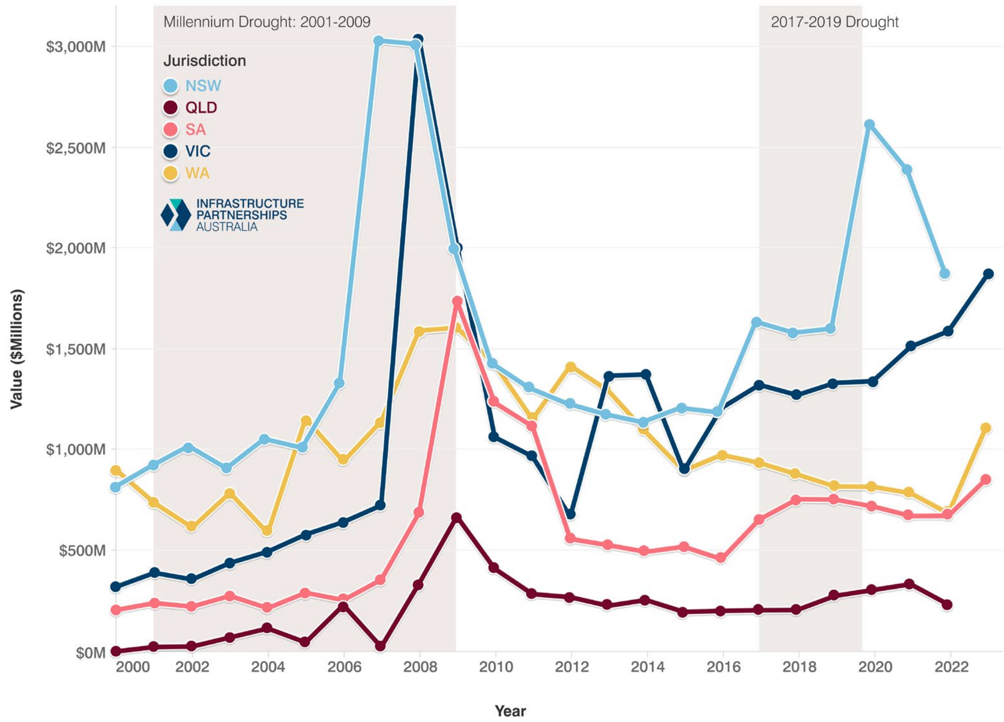
Figure 1 illustrates the average budgeted national capital allocations by water utilities in the five biggest states and territories[1] between 2000 and 2022 (2023 dollars), with shading representing periods of drought across much of the country. There is a trend of historic underinvestment during periods of higher storage levels across major water utilities, with subsequent uplifts in investment at times where water security has been at risk.

Figure 1 – Average budgeted capital allocations by major water utilities in the five biggest states and territories 2000-2022



Source: Infrastructure Partnerships Australia analysis of Budget Papers

In the face of an ageing asset base and increasing growth requirements, a reactive approach to significant capital investment is untenable. Sydney Water's price proposal anticipates $32 billion in investment is required over the next decade, with $86 billion capital expenditure required to 2050. While the pricing determination period considers water prices over a five-year period, consideration of price adjustments should be rooted in ensuring sustained delivery of the identified long-term capital investment requirements to underpin network reliability. This approach ensures both prudent decisions about what to invest in, and that those investments can be deployed effectively.

The historical underinvestment in infrastructure during periods of abundant water availability has had the effect of deferring the financial impacts of monitoring, maintaining and renewing the current asset base to future regulatory periods. This strategy is effective for keeping water bills comparatively low, until it isn't. Sydney Water users have in-part benefitted from inheriting a significant amount of water infrastructure from previous generations, which has been reflected in lower water bills compared to other jurisdictions. However, the era of benefiting from past

[1] New South Wales, Victoria, Queensland, Western Australia and South Australia. Data has been extracted from respective State and Territory Government Budgets. Annual data has been used, reflecting allocated capital spend by Public Non-Financial Corporations, so some smaller and private utilities are not captured.

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investments without paying the price may be drawing to a close. Sydney Water's infrastructure is ageing, with around 15 per cent of its water infrastructure assets fully depreciated and about 26 per cent past their theoretical end-of-life.[2]

Renewing the ageing asset base is just one of the factors underpinning Sydney Water's increased investment requirements. The other sizable task is delivering on the required growth in water infrastructure to service a rapidly expanding population. With the NSW Government committed to delivering 377,000 homes across NSW – greenfield and brownfield – under the National Housing Accord by June 2029, significant growth in the network is required. Greenfield sites which are currently unserviced will require new infrastructure at significant cost, while brownfield sites will present their own challenges in the medium- to long-term, placing further pressure on the existing network.

Sydney Water's price proposal presents a capital investment plan which reflects the necessary growth required to meet demand now and into the future. The proposed price for the current regulatory period reflects a longer-term outlook and identification of the necessary investment required in the network to effectively address current and approaching challenges. However, following a decade where Sydney Water, and other major urban utilities, delivered essentially flat or below inflation price rises for water users, the ramp up in capital works and prices presents a cost challenge. Nonetheless, a proactive, sustained investment approach ultimately minimises consumer costs in the long term.

It is an opportune time for Sydney Water to expand their capital program, with latent capacity emerging in the civil infrastructure market

The scale of investment required to deliver the necessary upgrades to the water network is substantial and will require an uptick in labour and resources to deliver it. The good news is that an opportunity is emerging in the infrastructure market, which the water sector is in a prime position to capitalise on.

The Australian infrastructure market is currently in the midst of one of the largest waves – in relative terms – of transport infrastructure ever seen in the country. With these historically large programs of work moving through their peak construction phases, the volume of transport projects replacing them in the pipeline pale in comparison. As Australia's transport infrastructure wave has crested and projects move through to completion, it was expected by many that a tsunami of energy projects would fill the capacity gap in the market. In practice, the energy sector has been impacted by significant delays, descoping, or deferrals of projects. This has created an Air Bubble of latent capacity in the infrastructure market. Across the major jurisdictions, the Air Bubble is most pronounced in NSW, as illustrated in Figure 2, with the tapering of expenditure on transport projects expected to occur in 2026. Despite the emergence of a significant Air Bubble, in the long-term NSW still holds a significant potential energy pipeline. As the State refines its planning and approvals processes, it is likely projects will increasingly move towards delivery and the Air Bubble – and the opportunity to capitalise on the availability in the market – will recede.

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[2] Sydney Water's *Price Proposal 2025-30*

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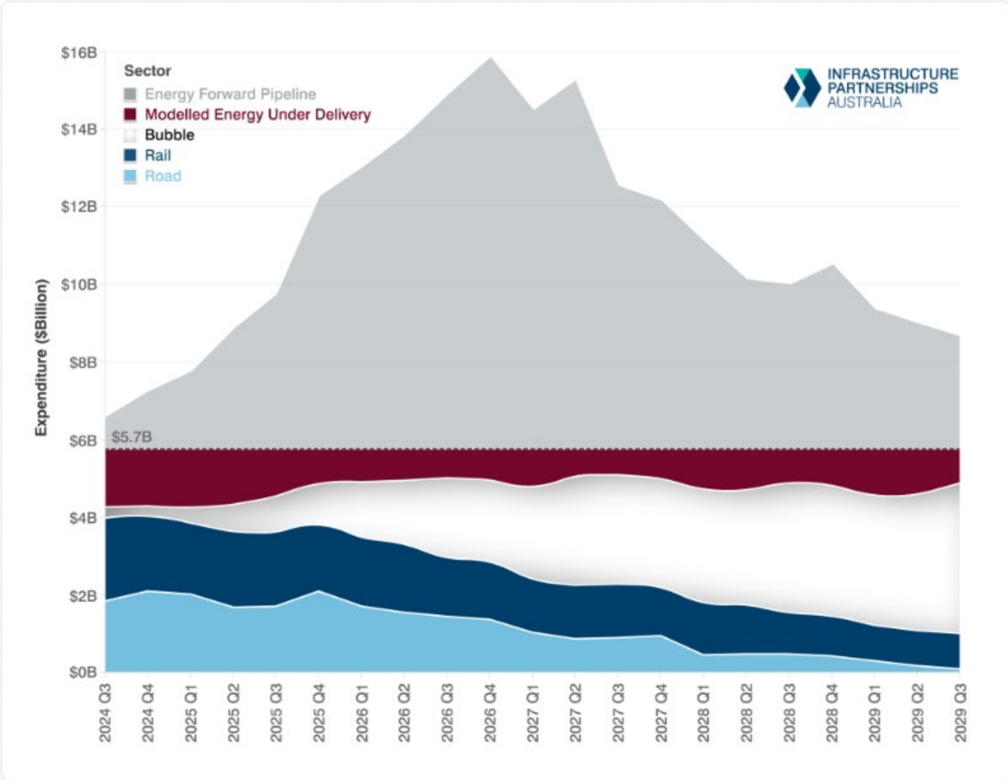
Figure 2 – Modelled expenditure on Transport and Energy in New South Wales



Source: Infrastructure Partnerships Australia

While not all skills requirements are transferable between assets, Infrastructure Partnerships Australia submits to IPART that this Air Bubble presents an opportunity for water utilities to deliver on their capital investment programs within favourable market conditions.

Regulation needs to effectively balance the inherent tensions between asset investment, shareholders and users

Regulators and water utilities must continuously look to manage the tripartite tension between ensuring the operational efficiency and capacity of assets, providing an appropriate return to shareholders (be they public or private), and managing impacts on consumers bills. This is a delicate balance that has far-reaching outcomes if not aligned appropriately. The current state of Sydney Water's asset base has been illustrated in their price proposal, estimating that between 12 and 23 per cent of current water and wastewater assets already have a high probability of failure. At the same time, consumers have benefited from lower or sustained bills in previous regulatory periods over the last decade. Meanwhile, the NSW Government (as shareholders) is expected to receive close to $2.6 billion through dividends (profit) and tax equivalent payments over the forward estimates. Overlooking the asset base in this equation risks deferring the responsibility of paying for renewals to future generations and may result in inadequate service provision. The longer assets are neglected, the higher these consequences become, an outcome we are already witnessing play out overseas.

The failure to appropriately manage this tension has been severely exposed in the United Kingdom's water sector – where consistent suppression of regulated prices over time resulted in owners extracting returns by under investing in assets. The resulting underinvestment in infrastructure left water utilities unable to adequately provide water and wastewater services. The consequence of this has been a failure in the provision of services, with millions of litres of untreated sewage pumped into the environment, and a sharp increase in consumer bills. While the United Kingdom's water utilities have a distinct set of challenges and a different structure to New South Wales, this case study serves to illustrate the consequences of prolonged underinvestment in water infrastructure.

The NSW Government has an important role to play in the regulatory process. During this pricing period we have seen the NSW Government exercise its power under section 13(1)(c) of the *Independent Pricing and Regulatory Tribunal Act 1992* directing IPART to consider cost-of-living impacts of price determinations, the effectiveness of existing rebates to manage the social impacts of price determinations, opportunities to adjust project timelines within the pricing period and over the next ten years and, if necessary, to reduce proposed capital programs in line with least cost planning principles, and the deliverability of capital plans based on market conditions. While all the above are important considerations, Infrastructure Partnerships Australia cautions against a scenario where essential capital works to meet demand are deferred unduly by the regulator's determination. This simply serves to push the problem down the road, running high risk of asset failure and more significant cost increases in future price periods which is ultimately counterintuitive to the long-term interest of customers.

Sydney Water customers recognise the impact of increased capital investment to enhance water security, a welfare system may support those who can't pay

Sydney Water's customer engagement program, undertaken to inform its price proposal, found a general acceptance from customers that water bills would likely rise and that customers understood the reasons for cost increases in their water bills. Customers also queried why investment had not begun earlier to stagger cost increases over time. Due consideration of customer preferences should be given in price-setting decisions. In this case, customers recognise the need for a price increase to safeguard long-term water security.

The engagement program also identified that, after access to clean and safe drinking water, affordable water and wastewater bills -and avoiding future cost spikes - are the second most important priority for customers. Sydney Water has proposed an increase in both usage charges (variable) and service charges (fixed), with larger increases to the fixed charge. To support vulnerable customers, rebates on the fixed component could be offered based on hardship assessments. This will help offset the higher costs of the variable charge if those customers need to use more water, ensuring financial assistance without discouraging conservation. If additional support is needed, the broader welfare system can step in, allowing Sydney Water to still generate the necessary revenue for ongoing infrastructure maintenance. Coming from a base of flat or low inflation price rises for water users, the ramp up in capital works and prices presents a cost challenge. Ultimately, a proactive and sustained investment approach to infrastructure delivery avoids volatility in service provision and pricing.

Infrastructure Partnerships Australia looks forward to further assisting the Independent Pricing and Regulatory Tribunal. If you require additional detail or information, please do not hesitate to contact [redacted].

Yours Sincerely,

[redacted]

[redacted]

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