



Review of Central Coast Council water prices – Regulatory background

Technical Paper

May 2022

Water >>



Tribunal Members

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The Independent Pricing and Regulatory Tribunal (IPART)

Further information on IPART can be obtained from [IPART's website](#).

Acknowledgment of Country

IPART acknowledges the Traditional Custodians of the lands where we work and live. We pay respect to Elders, past, present and emerging.

We recognise the unique cultural and spiritual relationship and celebrate the contributions of First Nations peoples.

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1 IPART regulates CCC Water's prices

IPART sets the maximum prices Central Coast Council can charge its customers for the water, wastewater and other services provided by it as a Water Supply Authority.

IPART also sets the maximum percentage by which Central Coast Council may increase its general income each year through the local government rate peg or special variations.

To ensure it is clear which of Central Coast Council's responsibilities IPART is referring to, throughout this report:

- we refer to the Central Coast Council's functions as a Water Supply Authority under the *Water Management Act 2000 (NSW)* as '**CCC Water**'
- we refer to the Central Coast Council's local government functions under the *Local Government Act 1993 (NSW)* as '**the council**'.

Further information is available in Box 1 on why we have done this.

We reviewed CCC Water's prices for its water-related services and have made decisions on the maximum prices it can charge for the 4 years from 1 July 2022 to 30 June 2026.^a Our review only considers prices and costs related to CCC Water. It does not consider those related to the council's general activities for which it charges local government rates and levies and other charges.^b

We consider our prices will allow CCC Water to deliver good quality water and improve services to the community – now and in the future.

This Technical Paper focuses on the regulatory background for this review, including our role in regulating CCC Water and the matters we must consider when setting prices.

^a As part of our review we must consider certain matters under the *IPART Act 1992 (NSW)* – detailed information is available in section 2 of this paper.

^b IPART can also review increases to the council's income from rates, but this is a separate review through the special variation process.

Box 1 Why we refer to Central Coast Council in its capacity as Water Supply Authority as CCC Water in this report

We have decided to use a new naming convention in referring to Central Coast Council functions because:

- Central Coast Council is unique in having functions as a council under the *Local Government Act 1993 (NSW)* and functions as a Water Supply Authority (WSA) under the *Water Management Act 2000 (NSW)*.
- These functions are funded separately and there are restrictions on how certain funds can be used. The revenue raised as a WSA from water and wastewater charges cannot be used for general council expenditure. However, under certain circumstances, some revenue raised as a WSA may be paid to the council in the form of a dividend and applied towards general council expenditure.
- In our 2019 water price determination we reduced prices for CCC Water. CCC Water had for several years spent less on operating costs than we had previously forecast it would need. It was unable to justify to us at the time that it needed to spend any more than it had been spending and there was not yet clear evidence that service levels were declining. The council then indicated publicly that a shortfall in funding over the 2019 water price determination period contributed to the financial problems for its functions as a council.
- IPART has a role in the regulation of both these functions and we consider it will improve transparency and accountability if we clearly identify when we are referring to Central Coast Council as a council (the council) and when we are referring to Central Coast Council as a Water Supply Authority (CCC Water).
- This is particularly important given IPART's recent decision on the Special Variation application made by the council (i.e. in its capacity as a council under the *Local Government Act 1993 (NSW)*). In this Report and the accompanying price determination, IPART has set prices that Central Coast Council may charge in its capacity as a Water Supply Authority (CCC Water).

1.1 We set maximum prices for water and water-related services provided by CCC Water

In this review, our role is to regulate the prices CCC Water can charge its customers for water, wastewater, and other water-related services. The goal of this review is to set prices that allow CCC Water to provide services of the quality its customers expect – now and into the future. We also want to ensure that CCC Water charges no more or no less than it needs to.

The way we regulate these prices is by setting the maximum prices CCC Water can charge for each water-related service in each year of the determination period. CCC Water can charge less than the maximum price with approval from the Minister for Lands and Water and the Treasurer, but it cannot charge more. For this review, we have decided on a 4-year period from 1 July 2022 to 30 June 2026.

Our role in setting CCC Water's prices is set out by the *Independent Pricing and Regulatory Tribunal Act 1992* (the IPART Act). The IPART Act sets out the matters that we must consider in making our pricing decisions. These matters are set out in section 2 of this paper.

While our review has focused on CCC Water's prices, we have also recommended the Minister gives us a referral to investigate and report on CCC Water's performance and progress in 2 years. This recommendation is explained in more detail in our [Information Paper – Improving performance](#).

1.2 CCC Water operates under a complex regulatory framework

The regulatory framework that CCC Water operates under is complex and unique. Central Coast Council is both a council under the *Local Government Act 1993 (NSW)*, and a Water Supply Authority under the *Water Management Act 2000 (NSW)*. Unlike the other water utilities we regulate (e.g. Sydney Water and Hunter Water), CCC Water does not have an operating licence that sets performance standards, compliance requirements or a customer contract.

The council appointed Kellogg Brown and Root (KBR) to review the current operating model of the Central Coast Council Water Supply Authority and to provide advice and recommendations to deliver the most sustainable future for both the council and the Water Supply Authority.¹

KBR analysed 3 different operating models²:

- Removing CCC Water from being subject to the *Local Government Act 1993 (NSW)*. Then incorporating CCC Water under the *Central Coast Water Corporation Act 2006 (NSW)*.
- Amending the *Local Government Act 1993 (NSW)* to remove certain financial restrictions on CCC Water.
- Removing CCC Water from the *Water Management Act 2000 (NSW)* such that it is no longer a Water Supply Authority.

KBR recommended the first option of removing CCC Water from the *Local Government Act 1993 (NSW)*. This was recommended due to the size and scope of the business, the ability to establish specific governance mechanisms, financial flexibility and the existing legislative mechanism.³

In response to our Draft Report, CCC Water highlighted the findings of KBR, noting that the council resolved to authorise the CEO to investigate these options as well as any other options that may be identified as part of this analysis. CCC Water stated that it has not yet had the opportunity to complete a cost benefit analysis, risk assessment or SWOT (Strengths, Weaknesses, Opportunity and Threats) analysis to determine the future outcome and best option for reform.⁴

1.2.1 Accounting requirements mean the way CCC Water reports some financial items differs from our approach

Both CCC Water's and the council's annual financial statements are prepared using accounting standards and procedures for all NSW Local Governments. The way that certain items are treated in those statements differs markedly from the approach we use to set maximum prices. Our approach to setting prices is set out in detail in our [Technical Paper – How we set the revenue level](#).

While it is important to note that we use economic principles to set prices and not accounting standards, our approach to certain items is not always well-suited to aligning with some items in CCC Water's financial statements. In particular:

- **Fixed assets** – the *accounting* value of non-current assets shown on CCC Water's balance sheet is based on how much it would cost to replace all its assets today, less a reduction for how long ago they were actually constructed.

When we set prices, our capital (or asset) allowances in our building block approach are based on CCC Water's regulatory asset base (RAB). The RAB is the *economic* value of CCC Water's assets and represents how much those assets can earn in total until they expire.

These differences in approach lead to a significant gap between our decisions on the residual value of CCC Water's assets (i.e. the RAB) and the accounting value that appears in CCC Water's financial statements.

- **Depreciation expense** – as with asset values above, there may also be a significant difference between the annual depreciation expense shown in CCC Water's operating statement, and our decision on the regulatory depreciation allowance. This is partly because of the difference between the different asset values as discussed above.

These, and other, differences mean that the way CCC Water reports its financial performance and position in its financial statements, may be significantly different from our decisions in setting prices.

1.3 Recent context for the Central Coast Council

At the time of our review, the Central Coast Council has been operating under different circumstances than usual. It has been under administration and a Public Inquiry was held into the financial management of the council:

- In October 2020, the councillors were suspended, and they were fully removed on 16 March 2022.⁵
- In October 2020, Mr Dick Persson AM was appointed as an interim Administrator. He was replaced in May 2021 by Mr Rik Hart, who has been appointed as Administrator until 31 October 2022.
- An independent Public Inquiry was held into the council and its financial management, with the findings released in March 2022.⁶

1.3.1 The Public Inquiry released findings and recommendations in March 2022

In April 2021, the NSW Government announced a Public Inquiry into the Central Coast Council to investigate its financial management and ability to serve the local community. The Inquiry report was tabled in Parliament on 17 March 2022.

Scope of the Public Inquiry

The scope of the Public Inquiry was to investigate and report on⁷:

- Whether the governing body met its obligations under the *Local Government Act 1993 (NSW)* in relation to:
 - maximising efficiencies and financial savings from the merger process
 - if the governing body disregarded the financial consequences of its decisions
 - if the governing body's decisions since 2017 contributed to the current financial position of the council.
- Whether, in exercising its functions under the *Local Government Act 1993 (NSW)*, the governing body ensured:
 - as far as possible, decisions taken by the governing body considered the financial sustainability of the council
 - that it reviewed the performance of the council, including that the council's spending was responsible and sustainable by aligning general revenue and expenses.
- Any other matter that warrants mention, particularly those that may impact on the effective administration of the council's functions and responsibilities or the community's confidence in the council being able to do so.

The Commissioner presented findings and recommendations:

The Public Inquiry indicated that Central Coast Council did not adequately ensure required management of restricted use funds, having found a long-standing practice of reallocating funds between the general fund and restricted funds.⁸ Key findings of the Commissioner were that:

- The governing body did not act in a manner which would have prevented efficiencies and savings to be realised from the merger in the future. Indeed, it was continuing with the implementation and completion of the merger processes.⁹
- The budget decisions of the elected body did contribute, and in a significant way, to the financial crisis of the council in 2020.¹⁰
- The governing body had the means to keep the financial performance of the council under review, but it failed to do so adequately.¹¹

Based on the findings, the Commissioner recommended that:¹²

- All civic offices at Central Coast Council be declared vacant, effective immediately.
- An Administrator be appointed until the election for Central Coast Council scheduled for 2022.
- The Administrator ensure the completion of the Business Recovery Plan as adopted and amended by Central Coast Council since October 2020.
- Prior to the next ordinary council election involving Central Coast Council, information sessions for prospective candidates be conducted to provide information about the obligations and burdens on future councillors.
- Within three months of the next ordinary council election involving Central Coast Council, mandatory training be provided to each councillor, including training relating to financial management specific to local government.
- Consideration be given to introducing as a mandatory requirement for all councillors, the completion of an accredited course for company directors, or a course of equivalent rigour developed specifically for local government councillors, within the first twelve months of their election, with refresher courses for councillors who have previously completed such courses.
- The *Local Government Act 1993 (NSW)* be amended to eliminate any asserted ambiguity in section 409(3) of that Act to make it clear that money received as a result of levying rates or charges under any other Act may not be used otherwise than for the purpose for which the rate or charge was levied.
- Alternatively, consideration be given to removing Central Coast Council as a Water Supply Authority under the *Water Management Act 2000 (NSW)* to enable it to administer its water supply and sewerage services in the same way as other NSW councils.

1.3.2 An Administrator has been appointed until 31 October 2022

An Administrator was first appointed to Central Coast Council on 30 October 2020. The Administrator's role is to perform the functions of the mayor and councillors. These functions would include those functions of the council in its role with CCC Water.¹³

Following from the Public Inquiry recommendations, an Administrator was appointed until 31 October 2022. However:

- If an election is held earlier, the Administrator will cease to hold office immediately before the first meeting of the new council.¹⁴
- The Governor may terminate the Administrator's appointment.¹⁵

2 We have considered matters under the IPART Act

We have considered certain matters as required under the *Independent Pricing and Regulatory Tribunal Act 1992* (the IPART Act) as part of our review of CCC Water's water, wastewater, stormwater and other related prices.

IPART is required under section 15(1) of the IPART Act to have regard to the following matters in making determinations and recommendations:

- a. the cost of providing the services concerned
- b. the protection of consumers from abuses of monopoly power in terms of prices, pricing policies and standard of services
- c. the appropriate rate of return on public sector assets, including appropriate payment of dividends to the Government for the benefit of the people of New South Wales
- d. the effect on general price inflation over the medium term
- e. the need for greater efficiency in the supply of services so as to reduce costs for the benefit of consumers and taxpayers
- f. the need to maintain ecologically sustainable development (within the meaning of section 6 of the Protection of the Environmental Administration Act 1991) by appropriate pricing policies that take account of all the feasible options available to protect the environment
- g. the impact on pricing policies of borrowing, capital and dividend requirements of the government agency concerned and, in particular, the impact of any need to renew or increase relevant assets
- h. the impact on pricing policies of any arrangements that the government agency concerned has entered into for the exercise of its functions by some other person or body
- i. the need to promote competition in the supply of services concerned
- j. considerations of demand management (including levels of demand) and least cost planning
- k. the social impact of the determinations and recommendations
- l. standards of quality, reliability and safety of the services concerned (whether those standards are specified by legislation, agreement or otherwise).

Table 2.1 outlines the information papers and technical papers that address each matter.

Table 2.1 How we have considered IPART Act section 15(1) matters

Section 15(1) matter	How this is addressed in our Report
a) Cost of providing the services	Our <i>Technical Paper – How we set the revenue level</i> sets out CCC Water's total efficient costs to deliver its regulated services over the determination period. Further detail is also provided in our <i>Information Paper – Operating and capital costs</i> .
b) Protection of consumers from abuses of monopoly power	We consider our decisions will protect consumers from abuses of monopoly power, as they reflect the efficient costs CCC Water requires to deliver its regulated services. This is addressed in our <i>Information Paper – Operating and capital costs</i> (where we establish the efficient historical and forecast expenditure) and our <i>Information Paper – Prices and bill impacts</i> (where we set out our pricing decisions).
c) Appropriate rate of return and dividends	Our <i>Technical Paper – How we set the revenue level</i> outlines that we have allowed a market-based rate of return on debt and equity which would enable a benchmark business to return an efficient level of dividends.
d) Effect on general price inflation	Our <i>Technical Paper – How we set the revenue level</i> outlines our estimate that the impact of our prices on general inflation is negligible.
e) Need for greater efficiency in the supply of services	Our <i>Information Paper – Operating and capital costs</i> sets out our decisions on CCC Water's efficient historical and forecast expenditure. These decisions will promote greater efficiency in the supply of CCC Water's regulated services.
f) Ecologically sustainable development	Our <i>Information Paper – Operating and capital costs</i> sets out CCC Water's efficient historical and forecast expenditure that allows it to meet all of its regulatory requirements, including its environmental obligations. Our <i>Technical Paper – Demand for water services</i> also considers impacts of climate change and climate risk.
g) Impact on borrowing capital and dividend requirements	Our <i>Technical Paper – How we set the revenue level</i> explains how we have provided CCC Water with an allowance for a return on and of capital; and our assessment of its financeability.
h) Impact on pricing policies of any arrangements that the government agency concerned has entered into for the exercise of its functions by some other person or body	Not applicable
i) Need to promote competition	In determining efficient costs, we have been mindful of relevant principles such as competitive neutrality (e.g. we have included a tax allowance for CCC Water as set out in our <i>Technical Paper – How we set the revenue level</i>).
j) Considerations of demand management and least cost planning	Our <i>Information Paper – Operating and capital costs</i> outlines how we have assessed CCC Water's efficient historical and forecast expenditure required to deliver its regulated services at least cost. Our <i>Information Paper – Prices and bill impacts</i> outlines how we have set prices to reflect efficient costs – such cost-reflective prices promote the efficient use and distribution of resources (all else being equal).
k) Social impact	Our <i>Information Paper – Prices and bill impacts</i> considers the potential impact of our pricing decisions on CCC Water and its customers.
l) Standards of quality, reliability and safety	Our <i>Information Paper – Operating and capital costs</i> details our consideration of CCC Water's efficient historical and forecast expenditure so that it can meet the required standards of quality, reliability and safety in delivering its services.

IPART is required under section 14A(2) of the IPART Act to have regard to the following matters:

- a. the government agency's economic cost of production
- b. past, current or future expenditures in relation to the government monopoly service
- c. charges for other monopoly services provided by the government agency
- d. economic parameters, such as discount rates, or movements in a general price index (such as CPI), whether past or forecast
- e. a rate of return on the assets of the government agency
- f. a valuation of the assets of the government agency
- g. the need to maintain ecologically sustainable development (within the meaning of section 6 of the *Protection of the Environment Administration Act (1991)* by appropriate pricing policies that take account of all the feasible options available to protect the environment
- h. the need to promote competition in the supply of the service concerned
- i. considerations of demand management (including levels of demand) and least cost planning.

Table 2.2 outlines the information papers and technical papers that address each matter.

Table 2.2 Consideration of section 14A(2) matters by IPART

Section 14A(2)	Report reference
a) Government agency's economic cost of production	Our <i>Technical Paper – How we set the revenue level</i> sets out CCC Water's total efficient costs to deliver its regulated services over the determination period. Further detail is provided in our <i>Information Paper – Operating and capital costs</i> .
b) Expenditures in relation to the government monopoly service	Our <i>Information Paper – Operating and capital costs</i> sets out our decisions on CCC Water's efficient historical and forecast expenditure.
c) Charges for other monopoly services	Our <i>Technical Paper – Trade waste and other prices</i> sets out our decisions on CCC Water's prices for other monopoly services.
d) Economic parameters, such as discount rates, or movements in CPI	Our <i>Technical Paper – How we set the revenue level</i> sets out how we have indexed CCC Water's regulatory asset base to account for inflation. Our <i>Information Paper – Prices and bill impacts</i> explains how we have set prices to raise revenue that recovers efficient costs over the determination period in net present value terms.
e) Rate of return on the assets of the government agency	Our <i>Technical Paper – How we set the revenue level</i> outlines how we have allowed a market-based rate of return on debt and equity which would enable a benchmark business to return an efficient level of dividends.
f) Valuation of the assets	Our <i>Technical Paper – How we set the revenue level</i> sets out the value of CCC Water's assets on which we consider it should earn a return on capital and an allowance for regulatory depreciation.
g) Ecologically sustainable development	Our <i>Information Paper – Operating and capital costs</i> sets out CCC Water's efficient historical and forecast expenditure that allows it to meet all of its regulatory requirements, including its environmental obligations.
h) Need to promote competition in determining efficient costs	We have been mindful of relevant principles such as competitive neutrality for example we have included a tax allowance for CCC Water as set out in our <i>Technical Paper – How we set the revenue level</i> .
i) Considerations of demand management and least cost planning	Our <i>Information Paper – Operating and capital costs</i> outlines how we have assessed CCC Water's efficient historical and forecast expenditure required to deliver its regulated services at least cost. Our <i>Information Paper – Prices and bills impacts</i> outlines how we have set prices to reflect efficient costs, including the usage price to reflect the approximate estimate of marginal cost of supply – such cost-reflective prices promote the efficient use and distribution of resources (all else being equal).

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- ¹ Central Coast Council, [Council reviews water and sewer operations model](#), accessed 14 February 2022.
 - ² Kellogg, Brown and Root, *Central Coast Council - Structural Review of the Water and Sewer Business*, December 2021, p vi.
 - ³ Kellogg, Brown and Root, *Central Coast Council - Structural Review of the Water and Sewer Business*, December 2021, p ix.
 - ⁴ CCC Water, [Submission to IPART Draft Report](#), April 2022, pp 63- 64.
 - ⁵ Central Coast Council, [Administrator appointment](#), accessed 14 February, 2022.
 - ⁶ NSW Office of Local Government, [Central Coast Council Public Inquiry](#), accessed 14 February 2022.
 - ⁷ NSW Office of Local Government, [Central Coast Council Public Inquiry](#), accessed 14 February 2022, p 4.
 - ⁸ NSW Office of Local Government, [Central Coast Council Public Inquiry](#), accessed 14 February 2022, pp 67, 75.
 - ⁹ NSW Office of Local Government, [Central Coast Council Public Inquiry](#), accessed 14 February 2022, p 84.
 - ¹⁰ NSW Office of Local Government, [Central Coast Council Public Inquiry](#), accessed 14 February 2022, p 85.
 - ¹¹ NSW Office of Local Government, [Central Coast Council Public Inquiry](#), accessed 14 February 2022, p 86.
 - ¹² NSW Office of Local Government, [Central Coast Council Public Inquiry](#), accessed 14 February 2022, p 88.
 - ¹³ *Local Government Act 1993* (NSW), s 258(1)(b).
 - ¹⁴ [Minister releases independent report into Central Coast Council - Office of Local Government NSW](#), accessed 23 March 2022.
 - ¹⁵ *Local Government Act 1993* (NSW), s 258(3).