

Central Coast Council Expenditure Review

Response to Central Coast Council's
submissions to IPART's Draft Report

IPART

May 2019

Contains *sensitive* information



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This document has 13 pages including the cover.

Document history

Job number: 5169240			Document ref:			
Revision	Purpose description	Originated	Checked	Reviewed	Authorised	Date
Rev 1.0	Draft for IPART review	SJI/GJ/SW	SJI/GJ	GJ	GJ	02/05/2019
Rev 2.0	Issued following IPART review	SJI/GJ/SW	SJI/GJ	GJ	GJ	02/05/2019
Rev 3.0	Comment on stormwater opex added	SJI/GJ/SW	SJI/GJ	GJ	GJ	15/05/2019

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1 Introduction

1.1 Terms of Reference

In September 2018 the Independent Pricing and Regulatory Tribunal of New South Wales (IPART) appointed the Atkins/Cardno consortium to carry out a detailed review of Central Coast Council's (Council) Water, Sewerage and Stormwater operating expenditure and capital expenditure. The purpose of this review was to inform the Tribunal's Determination on prices for the upcoming price control period which applies for up to five years, from 1st July 2019 to 30th June 2024. We submitted our final expenditure review report to IPART in March 2019. IPART then published their draft determination on Council's prices in April 2019. Council submitted their responses to IPART's draft report on 24th April 2019.

This report has been prepared in accordance with the Terms of Reference, scope item 4 set out in the contract between Atkins/Cardno and IPART commencing on 13 September 2018 to provide written advice in response to submissions to IPART's Draft Report.

1.2 Price base

We present all our expenditure figures in the CPI inflated 2018/19 price base unless otherwise stated. These CPI inflation factors were provided to Atkins by IPART at inception and correspond to the figures presented in the Council SIR and AIR submission. Unless otherwise indicated, expenditure in financial years is referred to by the calendar year in which the period ends, e.g. 2017-18 is referred to as 2018.

2 Questions posed by IPART

The questions posed to Atkins/Cardno by IPART are summarised below.

Question
<p>1. Capex:</p> <ul style="list-style-type: none"> a. Council does not support re-profiling specific capital projects and has provided new information on the progress of the Mardi to Warnervale pipeline project. Does the information in the submission impact your recommended capex profile for these projects? b. Council has also commented on the reduction to stormwater capex. Does the information in the submission impact your recommended level of stormwater capex?
<p>2. Council disagrees with using 2017-18 as the base for opex. We note that you did not include any increase in opex from 2017-18 levels where there was no justification provided by Council for higher forecast levels. Does the information in the submission impact your recommended level of future opex?</p>
<p>3. Council commented on output measure targets improving over time, as well as the additional output measures. Does the information in the submission impact your recommended output measures for the next determination period?</p>
<p>4. Council contends that the cash capital contribution for the Gosford CBD project should also be reduced by the efficiency factors applied to forecast capex. In order for us to form a view, we need to confirm that Council has in fact included the cost of the CBD project in the total annual forecast capex for water and sewerage for the years 2020 to 2022. We have reviewed Atkins' capex excel file provided in support of Atkins' report as well as Council's AIR but have not been able to confirm. Are you in a position to advise? Also, do you have any views on Council's submission on this point?</p>

Our responses to these four questions are set out in following four sections.

2.1 Capex

2.1.1 Mardi to Warnervale

Question:

Council does not support re-profiling specific capital projects and has provided new information on the progress of the Mardi to Warnervale pipeline project. Does the information in the submission impact your recommended capex profile for these projects?

(Section 3.2.2, 3.2.5, Appendix B and REF attachment.)

Our Response:

The Council response states that *Feedback received from EOI respondents to date is indicating a construction duration of 14-16 months which is also in line with Council's program and expenditure profile. Additionally, the M2WP Review of Environmental Factors (REF) has since been finalised and there are no foreseeable risks to the construction program for the project. The particular items of concern raised by Atkins Cardno (changes to Coastal SEPP and final fauna surveys) have been completed and included in the REF. There is no impact to the project program presented to Atkins Cardno in October 2018.*

Our original review concluded that the proposed expenditure on this project was prudent, but that the timing of Council's proposed expenditure was likely to be delayed because of the limited capacity within the Council to manage the project and because of the uncertainty around the timing of construction and the link to the revised Review of Environmental Factors (REF) for example. We therefore recommended a reprofiling of expenditure with completion in 2024 rather than 2022.

In its submission, Council has highlighted the good progress made since our review, the results of market engagement and the planning which has now been undertaken.

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In light of this, we have amended our recommended reprofiling of expenditure to reflect the potential for Council to deliver the project earlier than indicated by our previous recommendation. We still consider it likely that much of the expenditure will be after 2022 and have reflected this in what we consider a more realistic expenditure profile.

Table 2-1 M2WTM - Re-phasing capex in future determination period

Year ending June: (\$k 18-19)	2019 (current PP)	2020	2021	2022	2023	2024
Council proposed expenditure	640	4,031	39,061	13,748	0	0
Atkins/Cardno original recommendation	640	4,031	13,202	13,202	13,202	13,202
Atkins/Cardno <u>revised</u> recommendation	640	4,031	23,764	23,764	3,961	1,320
Recommended adjustments (revised)	0	0	-15,297	10,016	3,961	1,320

This has the impact of updating the following two tables in our expenditure review report.

Table 2-2 Water Service: Summary of Efficient Capital Expenditure¹

CCC PROPOSAL - CAPEX - WATER							
(\$M 2018/19) year ending June	2020	2021	2022	2023	2024	2020-23 Total	2020-24 Total
Wyong renewals	5.2	5.6	7.7	8.0	2.6	26.5	29.1
Wyong other projects	7.3	52.4	19.4	2.9	1.4	82.0	83.5
Gosford renewals	7.3	8.1	11.6	8.0	2.6	34.9	37.5
Gosford other projects	1.9	3.7	7.4	4.4	2.2	17.4	19.6
Total	21.7	69.7	46.2	23.3	8.7	160.9	169.6
Atkins/Cardno recommended adjustments for specific programs or projects							
Water Renewals	-7.0	-8.1	-13.8	-10.5	0.4	-39.4	-39.0
Mardi to Warnervale Trunk Main	0.0	-15.3	10.0	4.0	1.3	-1.3	0.0
Mangrove Creek Dam Spillway Upgrade	0.0	0.0	-1.2	0.7	0.5	-0.5	0.0
ADJUSTED EXPENDITURE BEFORE APPLICATION OF EFFICIENCY TARGETS							
Wyong renewals	1.7	1.5	0.8	2.8	2.8	6.8	9.6
Wyong other projects	7.3	37.1	29.5	6.9	2.7	80.7	83.5
Gosford renewals	3.8	4.0	4.7	2.7	2.8	15.2	17.9
Gosford other projects	1.9	3.7	6.3	5.1	2.7	16.9	19.6
Total	14.7	46.3	41.2	17.5	10.9	119.6	130.6
Atkins/Cardno recommended additional capital efficiency targets (beyond those applied by the company)							
Continuing efficiency (%)	0.25%	0.50%	0.75%	1.00%	1.25%		
Catch-up efficiency (%)	3.25%	7.50%	10.75%	13.00%	14.25%		
ATKINS/CARDNO ASSESSMENT OF EFFICIENT EXPENDITURE							
(\$M 2018/19) year ending June	2020	2021	2022	2023	2024	2020-23 Total	2020-24 Total
Wyong renewals	1.7	1.4	0.7	2.4	2.3	6.1	8.5
Wyong other projects	7.0	34.1	26.1	5.9	2.3	73.1	75.5
Gosford renewals	3.6	3.7	4.2	2.3	2.3	13.8	16.1
Gosford other projects	1.8	3.4	5.5	4.4	2.3	15.1	17.4
Total Efficient Expenditure	14.1	42.6	36.5	15.1	9.3	108.2	117.5
*We have assumed the CCC projects are a 50/50 split for water due to historic JWS agreement between the two former councils							
Former Wyong	8.7	35.5	26.8	8.3	4.6	79.3	83.9
Former Gosford	5.4	7.1	9.7	6.7	4.6	29.0	33.6
Total CCC	14.1	42.6	36.5	15.1	9.3	108.2	117.5

¹ This table replaces Table 4-12 of the Final Report issued 28 March 2019

Please note that, although the adjustments to the Mardi to Warnervale Trunk Main project just involve moving capex between years, the total 2020-24 capex is now higher than in the previous version of the report (\$116.4M) because the capital efficiency targets are lower in the earlier years so have less of an impact on the Mardi to Warnervale project now that the expenditure is assumed to occur earlier.

Table 2-3 Total Capex: Summary of Efficient Capital Expenditure²

CCC PROPOSAL - CAPEX - SUMMARY							
(\$M 2018/19) year ending June	2020	2021	2022	2023	2024	2020-23 Total	2020-24 Total
Water Wyong	12.5	57.9	27.2	10.9	4.0	108.5	112.5
Water Gosford	9.1	11.8	19.0	12.4	4.8	52.3	57.1
Sewerage Wyong	14.5	12.9	18.0	13.2	9.4	58.7	68.1
Sewerage Gosford	25.3	21.5	23.9	20.9	13.0	91.5	104.4
Stormwater Wyong	5.1	4.4	4.8	5.2	6.8	19.4	26.2
Stormwater Gosford	5.3	6.1	5.9	5.5	3.4	22.8	26.2
Total	71.8	114.5	98.7	68.1	41.4	353.2	394.5
Atkins/Cardno recommended adjustments for specific programs or projects							
Water Renewals	-7.0	-8.1	-13.8	-10.5	0.4	-39.4	-39.0
Mardi to Warnervale Trunk Main	0.0	-15.3	10.0	4.0	1.3	-1.3	0.0
Mangrove Creek Dam Spillway Upgrade	0.0	0.0	-1.2	0.7	0.5	-0.5	0.0
Sewerage Renewals Wyong	-4.7	-2.2	-4.0	-2.3	1.5	-13.2	-11.7
Sewerage Renewals Gosford	-9.8	-4.6	-8.4	-4.8	3.1	-27.6	-24.5
Stormwater Renewals Wyong	-0.3	0.2	-0.5	-0.7	-0.5	-1.2	-1.6
Stormwater Wyong other projects	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Stormwater Renewals Gosford	0.0	-0.3	-0.4	-0.6	0.5	-1.3	-0.7
Stormwater Gosford other projects	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Total	-21.7	-30.2	-18.2	-14.2	6.8	-84.4	-77.6
ADJUSTED EXPENDITURE BEFORE APPLICATION OF EFFICIENCY TARGETS							
Water Wyong	9.0	38.6	30.3	9.7	5.5	87.5	93.0
Water Gosford	5.6	7.7	10.9	7.8	5.5	32.1	37.6
Sewerage Wyong	9.8	10.7	14.0	10.9	10.9	45.5	56.4
Sewerage Gosford	15.5	16.9	15.5	16.0	16.0	63.9	80.0
Stormwater Wyong	4.8	4.6	4.3	4.5	6.3	18.2	24.6
Stormwater Gosford	5.3	5.8	5.5	4.9	3.9	21.5	25.4
Total	50.1	84.3	80.5	53.9	48.2	268.8	317.0
Atkins/Cardno recommended additional capital efficiency targets (beyond those applied by the company)							
Continuing efficiency (%)	0.25%	0.50%	0.75%	1.00%	1.25%		
Catch-up efficiency (%)	3.25%	7.50%	10.75%	13.00%	14.25%		
ATKINS/CARDNO ASSESSMENT OF EFFICIENT EXPENDITURE							
(\$M 2018/19) year ending June	2020	2021	2022	2023	2024	2020-23 Total	2020-24 Total
Water Wyong	8.7	35.5	26.8	8.3	4.6	79.3	83.9
Water Gosford	5.4	7.1	9.7	6.7	4.6	29.0	33.6
Sewerage Wyong	9.5	9.9	12.4	9.4	9.2	41.2	50.4
Sewerage Gosford	15.0	15.5	13.7	13.8	13.6	58.0	71.6
Stormwater Wyong	4.7	4.2	3.8	3.8	5.4	16.6	21.9
Stormwater Gosford	5.1	5.3	4.8	4.2	3.3	19.5	22.9
Total Efficient Expenditure	48.4	77.6	71.3	46.3	40.7	243.5	284.2
For information summary by former council							
Former Wyong	22.9	49.6	43.0	21.5	19.2	137.0	156.2
Former Gosford	25.5	27.9	28.3	24.8	21.5	106.5	128.0

2.1.2 Mangrove Creek dam spillway

Our original review concluded that this investment was likely to be prudent. However, Council was not able to provide us with a business case and it was unclear to us how ready Council would be to implement the project within its proposed timeframe. We therefore reprofiled the expenditure with completion in 2024 rather than 2023.

In its submission, Council has not provided any information to give reassurance that its proposed timescales are realistic. We have therefore not changed our recommendation for this item.

² This table replaces Table 4-15 of the Final Report issued 28 March 2019

2.1.3 Stormwater capex

Question:

Council has also commented on the reduction to stormwater capex. Does the information in the submission impact your recommended level of stormwater capex?
(Section 5.5.1.)

Our Response:

We consider that the information in Council submission does not impact on our recommended level of stormwater capex.

2.2 Opex

Question:

Council disagrees with using 2017-18 as the base for opex. We note that you did not include any increase in opex from 2017-18 levels where there was no justification provided by Council for higher forecast levels. Does the information in the submission impact your recommended level of future opex?

(Section 3.1 and 5.5.1.)

Our Response:

Council has not presented any information which changes our view that 2017-18 is the most appropriate base year for projecting opex in the future determination period. As we stated in our report, we have limited confidence in the 2018-19 projections provided to us. They were derived using zero-based budgeting and we found that Council was not able to provide robust explanations for the variances between the 2018-19 budget and prior year expenditure levels.

In its submission, Council has identified operational costs in a number of areas which it considers do not form part of base operational costs and therefore require an increase relative to base year opex. These are discussed by category below.

Full Time Employees

Our recommendation was to accept Council's proposed labour expenditure for the future determination period. Council has not provided any new information or made clear what it is requesting given that its proposed expenditure was accepted. As such, this does not change our recommendation.

Plant & Fleet

Council has provided a simple statement that 2017-18 actuals do not reflect the revised pricing structure now levied. Without further explanation as to what the change in pricing structure is and why it leads to higher charges we have not changed our recommendation.

Consultancy Expenditure

Council has identified a number of periodic consultancy engagements which it considers are not adequately taken into account in our recommended opex because these items were not undertaken during 2017-18.

It should be remembered that the purpose of our recommendation is to estimate the overall amount of efficient and prudent expenditure and not to state which consultancy projects should or should not go ahead.

Some projects which were not undertaken during 2017-18 are indeed likely to need to be carried out in the future Determination period. At the same time, some of the projects undertaken during 2017-18 may not need to be undertaken again within the next Determination period.

We have not amended our recommendations on the basis of Council's response. We comment on the individual periodic consultancy engagements identified in the Council's response below.

- Central Coast Integrated Water Resources Project. The Council's Special Information Return (SIR) gives details of the proposed expenditure for this study¹, with the bulk of the expenditure in 2018-19 and 2019-20. However, the net impact of the study on opex according to the SIR is only \$160k because of the negative adjustments Council makes against this item in subsequent years. We understand that these negative adjustments represent the capitalisation of the consultancy against projects emerging from the study. Given the Council's own submission suggests that nearly all of the expenditure will eventually be allocated to capex, we do not consider that the Council has provided sufficient justification

¹ SIR Opex_CCC

that this project represents a significant increase in net opex and have not amended our recommendation.

- Tunnel and Outfall Inspections. The Council's SIR identified \$300k of expenditure for this item in 2018-19 with no expenditure identified in the next Determination period². The Council has not provided information which would allow us to understand (a) how much spend it would involve and (b) how different 2017-18 is from other years in terms of the overall amount spent on similar tasks (e.g. inspection of other asset types). As such we have not amended our recommendation.
- Major revision of 2007 northern growth corridor servicing strategy. Council has not set out the impact on net opex and why this expenditure would not be capitalised in the same way as its submission assumes the other strategies named in SIR Opex_CCC will be³ and whether this replaces other similar studies.
- Critical pressure main strategic review and condition assessments. Council has not provided sufficient information to allow us to understand how much expenditure is involved, how much will be capitalised and whether this replaces a previous program or is a significant step up in activities.
- Supervisory Control And Data Acquisition (SCADA). Council has not provided sufficient information on prior and proposed expenditure of this type for us to adjust our recommendation.

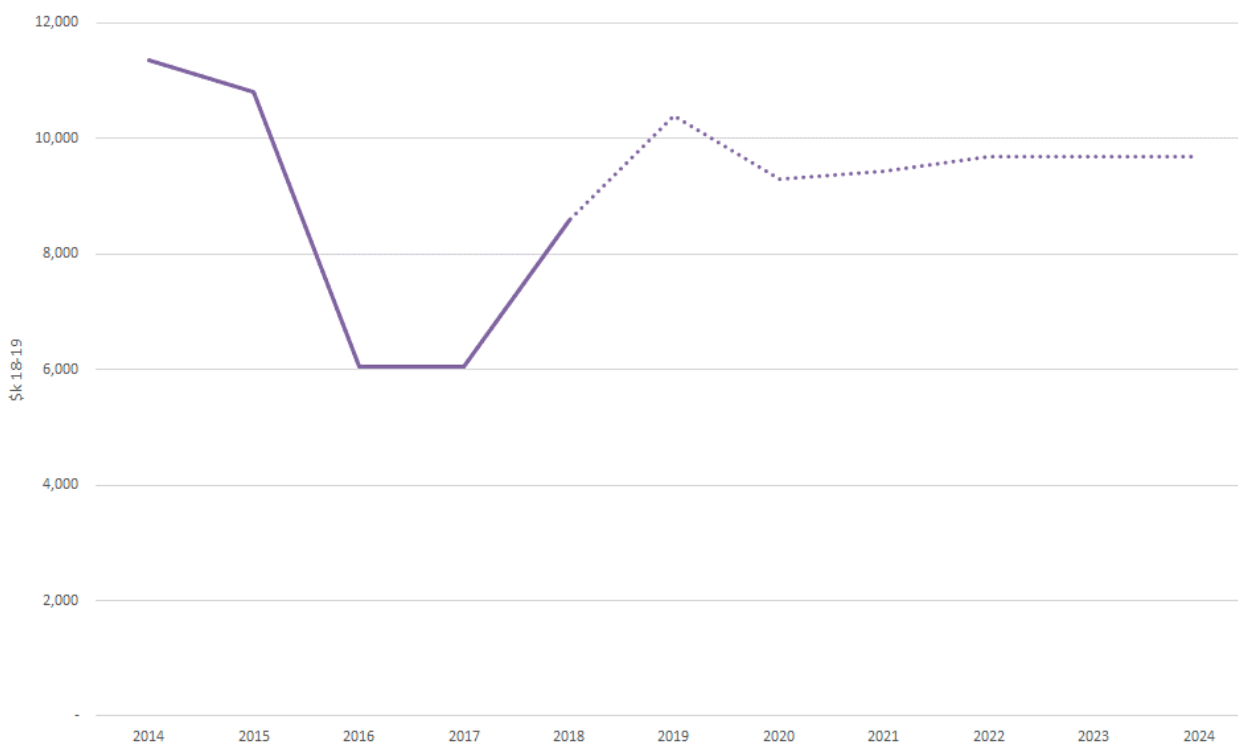
Materials

We recommended using 2017-18 as the base for materials expenditure, except for an increase from 2020 related to change in dosing approach at Mardi WTP.

Council has provided information about three years of water treatment plant chemicals expenditure and asserted that 2017-18 should not be used because of favourable weather conditions.

However, as can be seen in Figure 3-19 of our report and in the graph below, it is clear that total materials expenditure in 2017-18 was not unusually low. Indeed, it was significantly higher than in the two preceding years. As such Council's response does not provide any information which would change our recommendation.

Figure 2-1 Historical and Council projected materials expenditure



Source: 'Opex by item_CCC'

Stormwater opex

Council has stated that it considers that 2017-18 opex is not representative because of restrictions on recruitment and resources arising from the Council's amalgamation. It states that the proposed opex will have a significant impact on stormwater service levels including a potential reduction in full time employee numbers.

Rather than being unrepresentatively low, stormwater opex in 2017-18 was actually higher than in the two preceding years. Council's projected expenditure for 2018-19 was higher again, at a level not seen since 2014-15. Rather than showing any efficiency or benefits of amalgamation, Council projected that opex would continue to increase again in real terms in 2019-20. No justification was provided for these increases and no new information has been provided in the submission.

As such, we see no reason to amend our recommended stormwater opex.

Figure 2-1 Historical and projected stormwater opex



Source: 'Opex by item_CCC'

² SIR Opex_CCC

³ E.g. Odour and Corrosion Strategy and Water Quality Strategy expenditure both have zero net opex in SIR Opex_CCC as a result of subsequent negative opex adjustments assumed to be due to capitalisation

2.3 Output Measures

Question:

Council commented on output measure targets improving over time, as well as the additional output measures. Does the information in the submission impact your recommended output measures for the next determination period?

(Chapter 4.)

Our Response:

The Council mentions that it, *“has specific concerns regarding the level of proposed improvements to the unplanned interruptions and water main breaks performance measures. These significant performance improvements cannot be sustained without an associated increase in capital expenditure on water main and critical water valve renewals”*.

The information presented in the Council's submission does not impact on our recommended output measures for the next determination period. As we mention in our Final Report Council's forecast renewal expenditure requirements are not based on predicted asset deterioration, output measure performance, environmental factors or the impact (benefit) to customers. We consider it appropriate that Council at least maintain current output performance levels.

For unplanned interruptions the Council was proposing higher numbers than the average of recent year average actuals (2015 to 2018). We consider recent year average actuals to be a better measure of the performance Council should be attaining without the need to increase capital expenditure. There are numerous operational strategies that can be employed to reduce the number of unplanned interruptions.

For water main breaks the Council was proposing higher numbers than the average of recent year average actuals (2015 to 2018). We consider recent year average actuals to be a better measure of the performance Council should be attaining without the need to increase capital expenditure on mains or critical valve renewals.

2.4 Gosford CBD project

Question:

*Council contends that the cash capital contribution for the **Gosford CBD project** should also be reduced by the efficiency factors applied to forecast capex. In order for us to form a view, we need to confirm that Council has in fact included the cost of the CBD project in the total annual forecast capex for water and sewerage for the years 2020 to 2022. We have reviewed Atkins' capex excel file provided in support of Atkins' report as well as Council's AIR but have not been able to confirm. Are you in a position to advise? Also, do you have any views on Council's submission on this point?*

(Section 3.2.3)

Our Response:

Gosford CBD reinforcement projects were included in in the CCC SIR submission, in 'Capex by project_Gosford'. The total for the project in the Council's submission was \$37M AUD, split \$11M for water and \$26M for sewerage. We did not specifically review this project in the interviews with CCC. However, both line items were included within our 'non-renewals' or other capex items for analysis purposes. We were not provided any additional documentation which mentioned the level of Government contributions, our analysis would have assumed that the total amounts in the SIR submission were indeed the total for the project as we have not made any additional adjustments.

	2019	2020	2021	2022	2023	Total 2019- 2024
	Actual	Projecti ons	Projecti ons	Projecti ons	Projecti ons	
Gosford CBD Water Infrastructure Reinforcements	11	1,656	2,848	5,883	483	10,880
Gosford CBD sewerage infrastructure reinforcements	11	7,098	6,209	11,015	1,796	26,130

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