Hunter Water price review

7 September 2015

WHAT

IPART has begun its review of prices that Hunter Water can charge for its:

- water
- sewerage, and
- stormwater drainage services.

As part of this review, we will also set prices for trade waste and some ancillary and miscellaneous services, decide whether to set charges for wholesale water services and monitor recycled water prices.

WHY

Prices set for Hunter Water at our last review were to conclude on 30 June 2017. At Hunter Water's request, we have brought forward the timing of this price review. The new prices will apply from 1 July 2016.

Hunter Water's pricing proposal is available on our website here.

IPART's Issues Paper summarises and responds to Hunter Water's proposal.

IPART is seeking views from stakeholders and the public on issues for the review, which are detailed in the Issues Paper.

HOW

IPART has an established way of conducting a price review. Consultants assist us to review Hunter Water's capital and operating expenditure proposals. We then set prices to reflect its efficient costs.

We also make decisions on:

- length of time for which we set prices
- forecast water sales and customer numbers
- how to address risks and other uncertainties that Hunter Water faces, and
- how to incorporate efficiencies or other benefits for customers.

Finally, we consider the impacts of these decisions on Hunter Water, customers and other stakeholders.

WHEN

The key dates for this price review are:

- 5 October 2015 – Submissions due in response to the Issues Paper
- 2 November 2015 – Public Hearing
- late-March 2016 – IPART releases Draft Report and Draft Determination
- mid-April 2016 – Submissions due in response to the Draft Report
- mid-June 2016 – IPART releases Final Report and Determination
- 1 July 2016 – New prices take effect.

WHAT NEXT

Submissions are due by 5 October 2015.

We prefer submissions via our online form. You can also send comments by fax to (02) 9290 2061, or by mail to:

Review of prices for Hunter Water

Independent Pricing and Regulatory Tribunal
PO Box K35
Haymarket Post Shop NSW 1240

Unless they are identified as confidential, we plan to put all submissions on our website soon after the closing date for submissions.

1 Hunter Water's pricing proposal

Hunter Water has submitted its pricing proposal to IPART for new prices for its water, wastewater, stormwater drainage and other services to apply from 1 July 2016.

Hunter Water's pricing proposal at a glance

Hunter Water proposed a revenue requirement of $1,156 million over the 4-year period 2016-17 to 2019-20. This is about $13 million (or 1%) higher than the revenue allowed for in the 2013 Determination ($1,144 million)[1], which covered the 4-year period from 2013-14 to 2016-17.[2]

Hunter Water's proposed prices for major services

Hunter Water has proposed to maintain its (variable) water usage price at the current level in real terms (ie, to increase the price in line with inflation only). However, it proposed increases to its (fixed) water service charges, sewerage service charges for flats/units, and stormwater drainage charges. The figures in Table 1 below are in $2015-16, and exclude the effects of inflation.

Table 1 Hunter Water's proposed prices for major services from 1 July 2016 ($2015-16)

	2015-16[a]	2016-17	2017-18	2018-19	2019-20
Water					
Residential and Non-residential water usage charges ($/kL)[b]	2.24	2.24	2.24	2.24	2.24
Annual change		*0.0%*	*0.0%*	*0.0%*	*0.0%*
Residential service charges					
Houses, flats and units service charges	17.89	17.14	30.92	44.82	58.72
Annual change		*-4.2%*	*80.4%*	*45.0%*	*31.0%*
Non-Residential service charges					
Small non-residential customers' service charges (20mm meter stand-alone)	17.89	17.14	30.92	44.82	58.72
Annual change		*-4.2%*	*80.4%*	*45.0%*	*31.0%*
Other non-residential customers' service charges (25mm meter equivalent)[c]	29.2	31.01	55.86	80.84	105.75
Annual change		*6.2%*	*80.1%*	*44.7%*	*30.8%*
Sewerage					
Non-residential sewerage usage charges ($/kL)[d]	0.67	0.65	0.64	0.62	0.61
Annual change		*-3.0%*	*-1.5%*	*-3.1%*	*-1.6%*
Houses sewerage service charges	598.13	589.22	575.51	562.08	549.07
Annual change		*-1.5%*	*-2.3%*	*-2.3%*	*-2.3%*

1 According to our Final Report (IPART, *Hunter Water Corporation's water, sewerage, stormwater drainage and other services – Review of prices from 1 July 2013 to 30 June 2017 – Final Report*, p 46) Hunter Water's Target Revenue was set at $1,054.4 million in $2012-13. This was subsequently increased by $3.4 million to make a CPI adjustment to IPART's reporting of the carbon cost allowance.

2 Hunter Water's revenue requirements are compared over four years. However at Hunter Water's request this review has been bought forward by 1-year, which means that the 2013 determination period will now conclude a 30 June 2016, and run for three rather than four years.

	2015-16[a]	2016-17	2017-18	2018-19	2019-20
Flats/units sewerage service charges	433.64	441.91	479.59	515.24	549.07
Annual change		*1.9%*	*8.5%*	*7.4%*	*6.6%*
Non-residential small customers sewerage service charges (20mm meter stand-alone)	598.13	589.22	575.51	562.08	549.07
Annual change		*-1.5%*	*-2.3%*	*-2.3%*	*-2.3%*
Other non-residential customers sewerage service charges (25mm metre equivalent)[c,e]	1857.22	1916.63	1908.67	1906.42	1896.3
Annual change		*3.2%*	*-0.4%*	*-0.1%*	*-0.5%*
Environmental Improvement Charge	38.67	38.67	38.67	38.67	38.67
Annual change		*0.0%*	*0.0%*	*0.0%*	*0.0%*
Stormwater drainage					
Houses	72.41	73.38	74.35	75.34	76.43
Annual change		*1.3%*	*1.3%*	*1.3%*	*1.4%*
Flats/Units	26.79	27.15	27.51	27.88	27.97
Annual change		*1.3%*	*1.3%*	*1.3%*	*0.3%*
Non-residential					
Small (1,000m^2 or less) or low impact	72.41	73.38	74.35	75.34	76.43
Annual change		*1.3%*	*1.3%*	*1.3%*	*1.4%*
Medium (1,001 to 10,000m^2)	130.89	132.62	134.39	136.17	138.14
Annual change		*1.3%*	*1.3%*	*1.3%*	*1.4%*
Large (10,001 to 45,000m^2)	832.55	843.56	854.8	866.18	878.68
Annual change		*1.3%*	*1.3%*	*1.3%*	*1.4%*
Very large (>45,0000m^2)	2645.21	2680.19	2715.9	2752.07	2791.78
Annual change		*1.3%*	*1.3%*	*1.3%*	*1.4%*

a 2015-16 prices are estimates made by Hunter Water as the appropriate inflation to apply for the 2015-16 prices was not available at the time it was finalising its pricing proposal. The actual 2015-16 prices, available on Hunter Water's website, may differ eg, the actual water usage price for 2015-16 is $2.22 per kL.

b Different usage charges may apply to large industrial customers for water use in excess of 50,000 kL per year.

c This charge is for a 25 mm meter equivalent. Customers with a larger meter will pay a multiple of this charge depending on the size of the meter.

d This charge applies to the imputed volume of sewage in excess of the discharge allowance.

e Charges are for a 100% discharge factor.

Source: Hunter Water pricing proposal to IPART, June 2015, p 4 and IPART calculations.

Impact of Hunter Water's pricing proposal on bills

Hunter Water estimated that annual bills for houses are likely to increase in line with inflation over the four years to 2019-20. However, for flats and units, customers would face a real increase in their bills due to the increase in both the water service and sewerage service charge. The figures in Table 2 below include the forecast effects of inflation.

Table 2 Indicative annual bills for residential customers under Hunter Water's pricing proposal ($ nominal per year)

	2015-16	2016-17	2017-18	2018-19	2019-20
House 185 kL/yr					
Water and sewerage	1069.09	1086.65	1112.51	1141.06	1170.52
Annual change		*1.6%*	*2.4%*	*2.6%*	*2.6%*
Water, sewerage and drainage	1141.5	1161.86	1190.63	1222.2	1254.88
Annual change		*1.8%*	*2.5%*	*2.7%*	*2.7%*
Flat or unit (150 kL/yr)					
Water and sewerage	826.2	855.16	929.48	1006.27	1084.07
Annual change		*3.5%*	*8.7%*	*8.3%*	*7.7%*
Water, sewerage and drainage	852.99	882.99	958.38	1036.29	1114.95
Annual change		*3.5%*	*8.5%*	*8.1%*	*7.6%*
Pensioner owned house (100 kL/yr)					
Water and sewerage	563.37	570.32	584.28	599.32	615.02
Annual change		*1.2%*	*2.4%*	*2.6%*	*2.6%*

Source: Hunter Water Price Submission Summary, June 2015, p 3.

For non-residential customers, the bill impacts of Hunter Water's proposal depend on the nature of their business and their demand for water, sewerage, stormwater and trade waste services. Hunter Water estimated that, on average, annual bills for these customers would increase by less than 1% in real terms (ie, excluding the effects of inflation) over the 4-year period.[3]

Cost drivers

Hunter Water's proposed prices are driven by its proposed costs, which include operating expenditure, capital expenditure and its cost of capital (or 'Weighted Average Cost of Capital' (WACC), which reflects factors such as interest rates).

Hunter Water proposed the following:

- An average annual increase in operating expenditure of about 1.2%, relative to its estimated operating expenditure this year, to reflect increases in electricity usage, increasing costs to service growth, higher rates and taxes, and regulatory requirements.
- Capital expenditure similar in size to its actual expenditure in the current period, with the majority of the investment program driven by mandatory standards and asset service reliability (73%) and connections growth (18%).
- A WACC of 4.6% which is the same WACC that was used to set current prices.

[3] Hunter Water pricing proposal to IPART, June 2015, Executive Summary, p vi.

2 Have your say

List of issues in the Issues Paper

IPART would like to hear your views

The following table lists the issues raised in the Issues Paper and provides a brief summary of Hunter Water's proposal and IPART's initial position. IPART is seeking stakeholders to share their views on these issues.

	Hunter Water's proposal	IPART's initial position
1. Should an Efficiency Benefit Sharing Scheme (EBSS) apply to Hunter Water for the 2016 Determination?		
2. Should a Weighted Average Price Cap (WAPC) apply to a subset of Hunter Water's customers, such as large non-residential customers, for the 2016 Determination?		
3. Should IPART's decisions on changes to Sydney Water's form of regulation (including decisions on an EBSS and WAPC) also apply to Hunter Water for the 2016 Determination?		
4. What should be the length of this determination period?	A 4-year determination period, from 1 July 2016 to 30 June 2020.	Our preliminary view is to accept Hunter Water's proposal.
5. Is alignment of Hunter Water's determination period with other utilities' determination period important? If so, which utilities and why?		
6. Are Hunter Water's proposed operating costs over the 2016 determination period efficient, taking into account drivers of this expenditure and service levels achieved?	Forecast increases in the next four years due to increasing labour costs, electricity costs, forecast Lower Hunter Water Plan costs, chemical costs and complying with EPA licence requirements etc.	We will engage an expert consultant to review the efficiency of the proposed expenditure.
7. What scope is there for Hunter Water to achieve further efficiency gains over the 2016 determination period?		
8. Is Hunter Water's capital expenditure over the 2013 determination period prudent and efficient, taking into account drivers of this expenditure and service outcomes achieved?	Actual capital expenditure over the current determination period is expected to be $286 million, or $95 million per year on average.	We will engage an expert consultant to conduct a review of Hunter Water's past capital expenditure.
9. Is Hunter Water's forecast capital expenditure program over the 2016 determination period efficient, taking into account expenditure drivers, scope for efficiency gains, and service outcomes achieved?	Proposed capital works program is similar in size to that delivered in the current period - $97 million per year in the next price period compared with $95 million per year in the current period ($2015-16). The main drivers of forecast expenditure are mandatory standards and asset service reliability (73%) and connections growth (18%).	We will review: ▼ Hunter Water's long-term investment plans and asset management systems and practices, and ▼ evaluate that the forecast capital programs are based on a robust evaluation / justification process, and are delivered efficiently.
10. Are Hunter Water's proposed new output measures reasonable?	Proposed output measures to help determine the delivery effectiveness, and value for money achieved, from its capital program.	We will review the appropriateness of Hunter Water's proposed output measures.

	Hunter Water's proposal	IPART's initial position
11. What is the appropriate regulatory treatment of asset disposals?	Proposed to remove from the asset base the regulatory value of assets sold.	Our preliminary view is to accept Hunter Water's proposal. Where the regulatory value of an asset is not known, we propose that the regulatory value be based on the ratio of the regulatory asset base to depreciated replacement cost at the time the asset base was established multiplied by the sale value of the asset.
12. Are Hunter Water's proposed average asset lives of 100 years for all new assets and 70 years for all existing assets appropriate?	Proposed to use average asset lives of 100 years for all new assets and 70 years for all existing assets.	We will review the appropriateness of Hunter Water's proposed asset lives.
13. What is a suitable rate of return on Hunter Water's assets?	Proposed a transitionary arrangement to give a higher weighting to long-term debt to better reflect its actual debt profile, rather than adopt IPART's position of equal weightings of long-term and short-term debt when estimating the cost of debt.	We do not intend to change our long-term and short-term debt mix to calculate the cost of capital. Our objective in determining the WACC is to establish a value that reflects the efficient cost of capital for a benchmark entity, rather than replicate the actual cost of capital of any particular regulated utility.
14. Are Hunter Water's forecast water sales volumes and customer numbers reasonable?	Forecasting residential (0.2% per year) and non-residential demand (1.9% per year) to increase over the four years to 2019-20. It is also forecasting growth in residential and non-residential connections.	We will examine, the key assumptions used to forecast water demand and customer connections over the 2016 determination period.
15. What regulatory mechanism, if any, should we use to account for sales volatility?	Has not proposed a demand volatility mechanism.	We are inclined to maintain provision for a demand volatility adjustment mechanism to mitigate the potential for over- or under-recovery of revenue resulting from differences between forecast and actual water consumption.
16. Is Hunter Water's proposed water usage charge reasonable? If so, why?	To maintain its current water usage charge (excluding location based usage charges) in real terms (ie, $2.24 per kL).	We will consider Hunter Water's proposal, taking into account any available estimates of the long run marginal cost of water supply (LRMC), views of customers and other stakeholders, and price impacts. We will seek to derive updated estimates of Hunter Water's LRMC based on best available information. If a supply augmentation is not required in the Lower Hunter for the next 20 years, then we would expect that an updated estimate of LRMC would be lower than the existing LRMC estimate.

	Hunter Water's proposal	IPART's initial position
		We note that a reduction to the water usage charge would mean an increase to the (fixed) water service charge (all other things being equal).
17. If a revised estimate of the long run marginal cost (LRMC) of water supply for Hunter Water is lower than the current estimate, should the water usage price be reduced over the 2016 determination period to reflect this lower long run marginal cost?		
18. Should the water usage charge be set with reference to the long run marginal cost (LRMC) of water supply, or should greater weight be placed on customer preferences?		
19. Should the 2016 determination for Hunter Water include a cost pass-through mechanism for alternative sources of water in times of relative water scarcity? If so, for which measures and how should this flow through to water prices?		
20. Are Hunter Water's proposed location-based water usage charges reasonable?	To maintain location-based water usage charges, with slight variations in the usage price.	We will consider Hunter Water costs of servicing these customers and the potential impact on those customers and the wider customer base. We will also consider how these prices might apply under a WAPC.
21. Are Hunter Water's proposed water service charges for residential and non-residential customers reasonable?	The water service charge for residential customers and small non-residential customers to increase from $17.89 to $58.72 by 2019-20. The non-residential water service charge for a 25mm meter to increase by $76.55, from $29.20 in 2015-16 to $105.75 by 2019-20. Other non-residential customers on larger meter sizes would face a proportionate increase.	In past reviews, we have set the water service charge to recover the costs not recovered from water usage revenues. That is, the water service charge is largely dependent on the water usage charge. We intend to follow the same approach for this review.
22. Is Hunter Water's proposal to equalise the sewerage service charge for flats/units with houses by 2019-20 reasonable?	Increase the sewerage service charge for flats/units so that by 2019-20 it is equal to the sewerage service charge for houses.	We will consider taking into account our views expressed to date, our approach for other utilities, our modelling of customer bill impacts (factoring in any adjustments we may make to Hunter Water's proposed revenue requirement), and stakeholder comments.
23. Are Hunter Water's proposed sewerage usage charges and discharge allowances for non-residential customers reasonable?	Retain the current sewerage usage charge for non-residential customers in nominal terms (ie decrease in real terms). Proposed that the deemed sewerage discharge allowance for non-residential customers should continue to transition over the regulatory period to 150 kL by 2019-20.	Our preliminary view is to accept Hunter Water's proposals, subject to stakeholders' comments and our own analysis. The proposal for the discharge allowance is consistent with our intention at the 2013 Determination – to ultimately align the discharge allowance for non-residential and residential customers.

	Hunter Water's proposal	IPART's initial position
24. Is Hunter Water's proposal to maintain the current method of calculating service charges according to historical residential and non-residential revenue shares reasonable?	Maintain the current method of calculating service charges according to historical revenue shares and not rebase them to 20mm meter equivalents, until the transitioning of flats/units sewerage service charges to equal that of houses is complete.	We will consider taking into account stakeholders' views and impacts on customers, particularly flats/units, once we have reached draft decisions on Hunter Water's efficient costs.
25. Is Hunter Water's proposed Environmental Improvement Charge (EIC) reasonable?	A 3-year extension of the annual EIC of $38.67 ($2015-16) to be held constant in real terms over the next price period. This is to cover the costs of connecting Wyee to Hunter Water's sewerage system.	We will consider whether it is appropriate for the current EIC charge to be extended for an additional three years to fund the backlog sewer works.
26. Are Hunter Water's proposed stormwater drainage charges reasonable?	Increase stormwater drainage charges in real terms for houses by about 6%, flats and units by 4%, and non-residential customers by 6% over the four years to 2019-20.	We will engage an expert consultant to review the efficiency of Hunter Water's proposed expenditure on stormwater assets. This will guide us in the prices we set. We note that in the current period, its stormwater charges have been decreasing.
27. What is the most appropriate name for the current fixed 'service charge'?		Our preferred option is 'availability charge', as this seems to best indicate that the fixed component of a bill represents the customers' ability to use the system (ie, that they are connected to the system), rather than actual use of the system.
28. Are Hunter Water's proposed trade waste charges reasonable?	Proposed to increase its existing charges in line with inflation and introduce a new tankering charge.	Our preliminary view is to accept Hunter Water's proposal, subject to feedback from stakeholders, and our own review, including the merits of its new tankering charge.
29. Is Hunter Water's proposed bulk water charge to the Central Coast councils appropriate?	Maintain the interchange price of $0.65 per kL in real terms. This charge is based on the short run marginal cost of water supply.	Our preliminary view is to accept Hunter Water's proposal, subject to feedback from stakeholders, and our own analysis.
30. Is Hunter Water's proposed sewerage levy for Clarence Town appropriate?	Maintain the levy at $78.86 in real terms until 30 June 2019 (which is when it was scheduled to be removed).	Our preliminary view is to agree with Hunter Water, subject to feedback from stakeholders, and our own analysis.
31. Are Hunter Water's proposed unfiltered water prices appropriate?	Increase the price of unfiltered water, by reducing the discount applied to its proposed potable water usage charge. The discount is to be $0.37 in 2015-16 decreasing to $0.19 by 2017-18 and thereafter.	Our preliminary view is to agree with Hunter Water's approach to applying a discount to the potable water usage charge. However, we will consider whether this discount requires revision or updating.

	Hunter Water's proposal	IPART's initial position
32. Are Hunter Water's proposed water prices for unmetered properties reasonable?	Maintain its current approach to charging unmetered properties – an amount equivalent to 180 kL of water usage plus the residential water service charge.	Our preliminary view is to agree with Hunter Water's approach. We will review the proposed deemed amount of 180 kL of water and consider stakeholder comments.
33. What are your views on Hunter Water's proposed methodology for calculating the major service connection charge for connecting existing properties to its wastewater system?	Proposed a methodology for calculating charges for connecting existing properties to its wastewater system rather than a specific price (or prices).	We will consider stakeholders' comments, and the possibility of considering these charges in a later consolidated review of developer charges for metropolitan water utilities.
34. What are the merits of regulating the major service connection charge as part the 2016 determination as opposed to a later consolidated review of developer charges?		
35. Are Hunter Water's proposed miscellaneous and ancillary charges reasonable?	Proposed a number of changes to its miscellaneous and ancillary charges, including increases to 19 charges, and decreases to six charges. It also proposed to discontinue some charges.	Our preliminary view is to support Hunter Water's proposal. We will further evaluate Hunter Water's proposed charges, particularly charges where substantial increases are proposed.
36. What is the most appropriate methodology or basis for setting wholesale prices?	Has not put forward a specific proposal on wholesale pricing.	Our preliminary view is that wholesale prices should be based on retail minus avoidable costs.
37. What is a reasonable retail-minus avoidable costs price cap to apply to all wholesale customers?		
38. Should wholesale prices be regulated under the Water Industry Competition (WIC) Act, IPART's price determination or a combination of both?		Our preliminary view is that we should determine temporary wholesale prices under the 2016 Determination, which would remain in place until a voluntary access undertaking covering wholesale services has been approved by IPART or prices have been agreed under the access regime of the WIC Act.
39. Are Hunter Water's proposed recycled water prices for Gillieston Heights and Thornton North (Chisholm) reasonable?	Maintain its recycled water usage charge of $1.94 and increase its recycled water service charge from $21.81 to $22.20 for its mandated recycled water schemes.	We intend to monitor Hunter Water's recycled water prices in accordance with guidelines for recycled water.