

# **GOSFORD CITY COUNCIL**

## **PRICES OF WATER SUPPLY, WASTEWATER AND STORMWATER SERVICES**

**Prices from 1 July 2003 to 30 June 2005**

**INDEPENDENT PRICING AND REGULATORY TRIBUNAL  
OF NEW SOUTH WALES**



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## PRICES OF WATER SUPPLY, WASTEWATER AND STORMWATER SERVICES

Prices from 1 July 2003 to 30 June 2005

**Determination No 1, 2003**

**May 2003**

ISBN 1 877049 71 9

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**INDEPENDENT PRICING AND REGULATORY TRIBUNAL  
OF NEW SOUTH WALES**

**REPORT TO THE PREMIER ON THE DETERMINATION OF MAXIMUM PRICES UNDER  
SECTION 11 (1) OF THE INDEPENDENT PRICING AND REGULATORY TRIBUNAL ACT,  
1992**

**Reference No:** 02/36  
**Report:** No 1, 2003  
**Agency:** Gosford City Council

**Declaration of government monopoly services under Section 4 of the Act.**

The Government monopoly services were declared by the Independent Pricing and Regulatory Tribunal (Water, Sewerage and Drainage Services) Order 1997, made on 5 February 1997 and published in Gazette No. 18 dated 14 February 1997 at page 558.



## SUMMARY

The Tribunal has conducted its 2003 review of prices for Gosford Council against a backdrop of one of the worst droughts in New South Wales history. The drought has further increased community awareness that water is a limited resource and that Gosford's supply, in particular, is constrained.

During this review, Gosford Council's customers faced mandatory water restrictions. These conditions have led to increased demands for higher water prices to encourage water conservation. The Tribunal is acutely aware of the constraints facing Gosford Council's supply but, in making pricing decisions, is required to balance competing pressures and interests. Further, it is concerned to ensure that pricing responses are developed as part of a comprehensive policy response and are likely to be effective.

The Tribunal has conducted an extensive public consultative process, reviewed all written submissions and held public hearings. Where necessary, stakeholders have been contacted to clarify submissions or make supplementary submissions where initial information was considered insufficient. The Tribunal engaged Halcrow Pacific Pty Ltd (Halcrow) to conduct a review of Gosford Council's capital expenditure, asset management and operating expenditure submissions across its water, wastewater and stormwater businesses. The Tribunal also engaged GHD Pty Ltd to review trade waste proposals, to assist with its decisions.

Gosford Council sought to abandon the CPI-X methodology for setting prices at the 2003 price determination and requested that the Tribunal set nominal prices in each year of the price path. The nominal price proposed by Gosford essentially equated to an increase in prices of 3 per cent above inflation in 2003/04 and an increase in line with inflation in 2004/05. The Tribunal did not accept this proposal. For the purposes of the 2003 determination, the Tribunal has initiated a modest price restructure. The water usage price will increase by 1 per cent above inflation in both 2003/04 and 2004/05. This will be offset by a real decrease in the water service charge of 1 per cent in both 2003/04 and 2004/05. The wastewater service charge will also fall by 1 per cent in real terms, while the non-residential wastewater usage charge will increase by 1 per cent above inflation.

By increasing the water usage charge, the Tribunal is contributing to the overall policy solution to Gosford City's growing water demand and supply imbalance. In doing so however, the Tribunal emphasises that price by itself is unlikely to have a significant impact on demand but has a part to play as a commitment of a wider package. The Tribunal did not make a substantial increase in water usage charges at this price review due to limited information on customer impacts. However, at the previous pricing determination in 2000, the Tribunal removed the pre-paid water allowance pricing structure which has resulted in a greater emphasis on the usage component of customers' bills.

Increasing the water usage charge is expected to help increase the awareness amongst Gosford Council customers of the scarcity value of water, along with the need for behavioural change. Other policies will be needed to translate this awareness to incentives for customers to take action.

Water demand outstripping existing water supplies is a growing concern as it drives to the heart of issues surrounding environmental sustainability and services to customers. It is hoped that efforts by Gosford Council through its demand management program,

government assessment of environmental flows and decisions from a joint review of bulk water supplies undertaken by Gosford and Wyong Councils will be better known at the 2005 price review. This will allow the Tribunal to set prices within an overall policy framework for managing the demand and supply imbalances.

The Tribunal is also concerned about how drainage assets and expenditure are apportioned between the Council's General Fund and the water and sewerage fund. The Tribunal's consultant, Halcrow noted that some of Gosford Council's costs were obscured by transfer payments. In particular, Halcrow commented that under the current arrangements, budgeted increases in operating costs for drainage works in 2002/03 and beyond were not a proper operating expenditure of the water and sewerage business. These budgeted increases essentially represent a transfer from the water and sewerage business to the Council's General Fund.

On the advice of Halcrow, the Tribunal decided to exclude the \$2.54 million drainage transfer in 2001/02 from Council's base year operating expenditure requirement for price setting purposes. The Tribunal has discussed this issue at length with officers of Gosford Council and intends to work closely with Council to ensure appropriate alignment of stormwater responsibility, revenue collection and expenditure between the Council's General Fund and the water supply authority in the future.

The revenue outcome in 2003/04 and 2004/05 should ensure that Gosford Council maintains its strong financial position and the resulting rates of return are expected to be within the band required for efficient investment for such assets.

Improvements in Gosford Council's asset planning and management processes will be expected to allow a better investigation of expenditure proposals at the next price review. The Tribunal expects Council to be able to link outputs and outcomes to expenditure levels and customer preferences and considers that the benefits from this approach for customers, the environment and Gosford Council may be substantial.

## 1 INTRODUCTION

The Independent Pricing and Regulatory Tribunal of New South Wales (the Tribunal) has completed its 2002 review of metropolitan water businesses. Based on this review and its own detailed decision making process, it has determined the maximum prices Gosford City Council can charge for water supply, wastewater and stormwater services for the period 1 July 2003 to 30 June 2005.

### 1.1 Overview of determination

The Tribunal has decided that Gosford Council's overall revenue can increase by slightly more than the rate of inflation in 2003/04 and approximately in line with inflation in 2004/05.<sup>1</sup> However, the prices it can charge for water services will be restructured so that usage charges constitute a greater proportion of customer water bills. The water usage price will increase by 1 per cent in real terms in both 2003/04 and 2004/05, while the water service charge will decrease by 1 per cent in each year.

These changes aim to help increase customers' awareness of the scarcity and value of water, and encourage them to use it carefully. However, they are expected to have a limited impact on an average water user's total bill in real terms.

In addition, the Tribunal has decided to maintain the stormwater levy at its current level. It is concerned about the complexity of the funding arrangements for stormwater services in Gosford. It requires Gosford Council to improve the transparency of these arrangements prior the next price review. As a result of this decision, customers are likely to experience a real decrease in stormwater charges in both 2003/04 and 2004/05.

The Tribunal's pricing decisions are expected to result in Gosford Council earning a pre tax real rate of return of 5.6 per cent in 2003/04 and 5.6 per cent in 2004/05. This should ensure Gosford Council's financial viability over the period of the determination.

### 1.2 Structure of report

This report explains the Tribunal's determination in detail, including why it reached its decisions and what those decisions mean for Gosford Council, its customers and the environment. It is structured as follows:

- Chapter 2 outlines the review and decision-making process the Tribunal used to reach its decisions
- Chapter 3 provides an overview of the regulatory approach it used to regulate Gosford Council's revenue and prices
- Chapter 4 examines the financial analysis the Tribunal based its decisions on, and the implications of these decisions for Gosford Council, including the expected impacts on its revenue, operating and capital expenditure, return on assets and overall financial viability
- Chapter 5 focuses on the implications for Gosford Council's customers, including residential, industrial and commercial

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<sup>1</sup> Assuming that the rate of inflation, as measured by the rate of change in the consumer price index (CPI), is approximately 3.1 per cent in 2003/04 and 3.0 per cent in 2004/05.

- Chapter 6 discusses the implications for the environment
- Chapter 7 summarises the pricing decisions for all Gosford Council's services
- Chapter 8 provides an overview of issues arising from the review that the Tribunal believes Gosford Council should better address in the lead up to the 2005 price review.

The Tribunal members who considered this determination were Dr Thomas Parry (Chairman), Mr James Cox (Full-time member), and Ms Cristina Cifuentes (Member).

## 2 TRIBUNAL'S REVIEW AND DECISION-MAKING PROCESS

The Tribunal has made its price determination for Gosford Council in accordance with section 11(1) of the *Independent Pricing and Regulatory Tribunal Act, 1992* (the IPART Act). It reached its decisions after a thorough review and decision-making process.

The Tribunal's review included an extensive investigation and public consultation. As part of this review, the Tribunal:

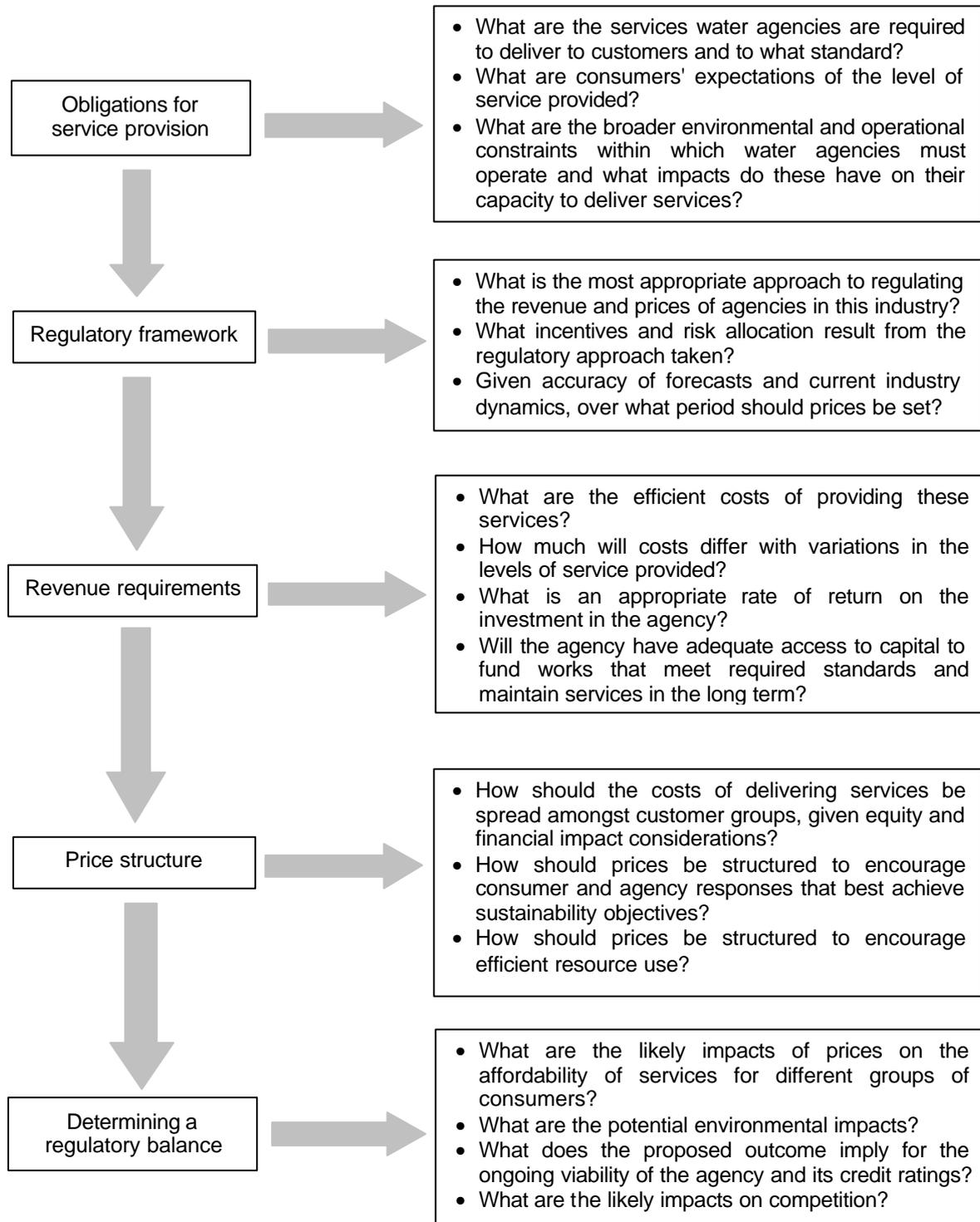
- released an issues paper in June 2002
- invited Gosford Council to provide a submission detailing its pricing proposals, and required it to provide extensive financial and performance data on the future capital and operating expenditure it believes will be necessary to maintain customer service levels and respond to regulatory and customer demands
- invited other interested parties to respond to submissions from Gosford and other water agencies and received 30 written responses (see Appendix 1 of a list of respondents to all agencies)
- held a public hearing on 10 December and, where it considered it appropriate, invited some of the parties who made written submissions to appear and make presentations at this hearing (see Appendix 2 for a list of presenters)
- engaged Halcrow Pacific Pty Ltd (Halcrow) to conduct a review of Gosford Council's capital expenditure, asset management and operating expenditure submissions across its water, wastewater and stormwater businesses
- gave Gosford Council the opportunity to respond to the Halcrow review, both formally in writing and through direct meetings between representatives of Gosford Council and the Tribunal Secretariat
- engaged GHD Pty Ltd (GHD) to review Gosford Council's proposals in relation to trade waste prices
- gave Gosford Council the opportunity to respond in writing to the GHD review of trade waste pricing proposals.

In addition, the Tribunal explicitly considered all the matters outlined in Section 15 of the IPART Act (see Appendix 3). These matters can be grouped as follows:

- **consumer protection** – protecting consumers from abuses of monopoly power; standards of quality, reliability and safety of the services concerned; social impact of decisions; effect on inflation
- **economic efficiency** – greater efficiency in the supply of services; the need to promote competition; effect of functions being carried out by another body
- **financial viability** – rate of return on public sector assets including dividend requirements; impact on pricing of borrowing, capital and dividend requirements of agencies
- **environmental protection** – promotion of ecologically sustainable development via appropriate pricing policies; considerations of demand management and least-cost planning.

The Tribunal took all these matters, together with the information and analysis obtained through its investigation and public consultation, into careful consideration as it worked through a decision-making process. Figure 2.1 provides a high-level summary of the key stages in this process.

**Figure 2.1 The Tribunal’s decision-making process**



In reaching its decision on water, wastewater and stormwater issues, the Tribunal had to weigh the diverse needs and interests of Gosford Council's stakeholders against each other. For example, Gosford Council's customers need an affordable water supply and acceptable service standards. The general community needs water services to be supplied in a way that is sustainable in the long term, does not compromise the environment, and is economically efficient. Gosford Council needs prices that are high enough to ensure its financial viability and enable it to earn an appropriate rate of return on its assets, and signal the costs to customers to encourage efficient resource use.

In addition, the price review was undertaken during one of the worst droughts in New South Wales history,<sup>2</sup> at a time of heightened concern about water supply and demand imbalances and appropriate investment in renewals and maintenance of the water, wastewater and stormwater systems.

Because of the diversity of these interests and concerns, the Tribunal was often required to trade off customer affordability issues with environmental impacts and the maintenance of the overall quality of Gosford Council's service delivery. It took active steps to ensure that these trade-off decisions are well informed during the course of this price review.

The Tribunal's consideration of the matters listed in Section 15 in relation to specific pricing decisions is discussed throughout the report. Appendix 3 provides references for where each matter is discussed. Further information relating to the Tribunal's review, including copies of all submissions, can be found at the Tribunal website: [www.ipart.nsw.gov.au](http://www.ipart.nsw.gov.au).

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<sup>2</sup> Dr Coughlan, Head of the National Climate Centre, as reported in the Weekend Australian, 29 March 2003, p 12.

### 3 REGULATORY APPROACH TAKEN

Gosford Council proposed that the Tribunal change its previous approach for setting maximum prices for its water and wastewater service, and set a nominal price for each service for each year of the pricing period. However, the Tribunal decided to continue to use a form of regulation known as CPI±X.<sup>3</sup> The Tribunal prefers this approach, as it does not require prices to be set based on assumptions about inflation, and therefore ensures that its pricing decisions lead to the outcome it intended in real terms. In addition, it prefers to use a consistent approach for all the metropolitan water agencies.

With this approach, the Tribunal estimates the amount of revenue the Council requires in each year of the determination period using the building block revenue methodology.<sup>4</sup> Given forecast demand prices are then set to generate this amount of revenue. At the same time, the Tribunal calculates the amount by which these prices can rise or fall in each subsequent year of the period, to account for movements in general inflation,<sup>5</sup> efficiency improvements, and significant changes in the operating environment such as new environmental standards or customer service standards.

The building block methodology involves the addition of cost blocks that represent forecasts of the regulated agency's efficient operating expenditure, depreciation and a return on assets, to determine its overall efficient revenue requirements. This methodology is outlined briefly below, and is described in more detail in Appendix 4:

- **Operating expenditure.** This cost block was determined by reviewing Gosford Council's proposed operating expenditure, and estimating the amount of operating expenditure an efficiently run business could be expected to need, to operate effectively and maintain the quality of its services.
- **Depreciation (or capital maintenance):** This cost block was determined by calculating a straight line depreciation allowance based on the regulatory asset base, using an assumed average asset life of 70 years. This, combined with a return on assets, ensures that sufficient revenue is allowed for essential renewals and maintenance capital expenditure (see Appendix 4 for a detailed explanation).
- **Return on assets.** The return on assets is determined by multiplying Gosford Council's regulatory asset base (RAB) by an appropriate rate of return. The RAB represents the financial value of the Council's investment in its water business, and bears no direct relationship to the value attributed to the physical assets of the business. To calculate this cost block, the Tribunal used the RAB it established in its 2000 review of Gosford Council's prices, and rolled this forward into the 2003 to 2005 regulatory period by adding an allowance for prudent capital expenditure,<sup>6</sup> and

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<sup>3</sup> This is the most common form of incentive regulation. A detailed explanation of CPI±X is provided in Appendix 4.

<sup>4</sup> The building block methodology is the main method used by economic regulators in Australia and abroad for determining prices for monopoly services. Alternative approaches include the use of index based approaches such as total factor productivity or data envelopment analysis to determine X factors. These techniques are under ongoing consideration by the Tribunal but are not at this stage intended to replace the building block approach. The building block methodology was used at each of the previous metropolitan water reviews conducted by the Tribunal.

<sup>5</sup> Measured as the change in the consumer price index, average of all cities on an annual 4 quarter to 4 quarter March on March basis.

<sup>6</sup> Capital is determined to be prudent on the basis of both an engineering examination of individual capital projects, and a review of asset management planning processes within the agency.

accounting for inflation and depreciation. It then determined an appropriate rate of return for Gosford Council using the weighted cost of capital approach, and multiplied the rolled forward RAB by this rate. The Tribunal proposes to maintain this approach for calculating the return on assets in subsequent price reviews.

The determination of future operating and capital expenditure required the Tribunal to form a view on the efficiency gains that could reasonably be achieved. The purpose of incorporating these efficiency gains in the price regulation approach is to provide a guide for the agency about the potential for it to improve the efficiency of its operating and capital expenditure without reducing the quality of the services it delivers to customers, and to provide a basis for the Tribunal's revenue allowance decision. The incentive to pursue efficiency gains arises from the fact that prices have been set for the period of the determination and are not linked to costs actually incurred. If the agency more than achieves these targets it can expect to earn a higher return than forecast by the Tribunal.

In deciding on an appropriate allowance for capital expenditure, renewals and maintenance capital expenditure which has been based on sound asset management practices and where it has been appropriately justified by the agency, has been incorporated in full in revenue building blocks for price setting. Where the agency seeks easy cost savings by delaying essential renewals and maintenance expenditure, then this is at their own risk, and not a result of the regulatory pricing approach. A detailed explanation of this investigation is contained in Appendix 4.

In relation to efficiency targets for capital expenditure, the Tribunal is concerned that the incentives in the current regulatory approach may not sufficiently encourage water agencies to minimise capital costs through innovation and efficiency. Further, it is not satisfied that the current approach has resulted in water businesses sufficiently linking capital expenditure programs to demonstrated regulatory and customer expectations. The Tribunal therefore proposes to review the approaches it has used to date to better assess and allow for capital expenditure programs in its pricing determinations. It will assess options for creating stronger incentives for businesses to pursue capital efficiencies and improve asset management practices (see section 4.4.1).

This price determination has been limited to a two year period. The Tribunal was persuaded that the circumstances facing the industry generally, and specific agencies particularly, over the short to medium term, indicated that a two year price period was appropriate for all the metropolitan water agencies. These circumstances include Wyong and Gosford Councils' joint review of their bulk water supply, the current uncertainty about the effect of environmental flow requirements on water supply, the NSW Government's ongoing review of stormwater institutional structures, and problems associated with Sydney Water meeting its operating licence demand management targets. In addition, a two year price path will allow the Tribunal to conduct the next price reviews for the Sydney Catchment Authority and Sydney Water concurrently, and to review their operating licences at the same time.

**Box 1 Overview of Gosford Council's Water Business**

Gosford City Council provides water, wastewater and stormwater services to a permanent population of approximately 150,000 people. Its area of operations covers approximately 1,028km<sup>2</sup> of the Central Coast region of NSW. It provides some 61,000 properties with both water and sewerage supply services and a further 2000 properties with water supply services only. Council's supply system currently consists of approximately 930km of water main and 1,381km of sewer main.

The Council manages its own bulk water supplies in conjunction with Wyong Shire Council, through the Gosford/Wyong Council's Water Authority. This authority is currently undertaking a major review of the Gosford/Wyong water supply system.

Gosford Council operates under the *Local Government Act 1993*, but it is also a statutory water supply authority operating under section 285 of the *Water Management Act 2000*. Stormwater assets and the responsibility for stormwater expenditure in Gosford currently lie with the General Council. It is subject to the following key legislative instruments:

- The *Water Management Act 2000* which determines how water resources are shared.
- The *Protection of the Environment Administration (POEA) Act 1991*, from which the powers of the Environment Protection Authority of NSW (EPA) are derived.
- The *Protection of the Environment Operations (POEO) Act 1997*, which further regulates Council's discharges.

Unlike the Sydney and Hunter Water Corporations, Gosford Council does not have an operating licence that requires it to meet minimum system performance and customer service standards; rather, the Council sets these standards through a public annual management planning process. The Tribunal does not conduct annual audits of its compliance with these standards.

However, the Council is regulated through several other means. The Tribunal regulates the maximum prices it can charge. The EPA and the Department of Land and Water Conservation (DLWC) impose licences on it in relation to abstraction from and discharge to the environment. The National Health and Medical Research Council (NHMRC) and the NSW Health Department set and regulate guidelines and standards in relation to water quality.

## 4 FINANCIAL ANALYSIS THAT UNDERPINS THE DETERMINATION, AND ITS IMPLICATIONS FOR GOSFORD COUNCIL

The Tribunal has determined that Gosford Council's overall revenue requirement is \$41.6 million in 2003/04 and \$41.9 million in 2004/05 in dollars of 2002/03, and has set maximum prices for each of its services to generate this amount of revenue. The Tribunal reached this determination after considering Gosford Council's proposed annual revenue requirements and capital and operating expenditure programs, together with analysis of these programs provided by Halcrow and GHD, and its own analysis of the impact of its determination on Gosford Council's financial viability, on its customers and on the environment.

The key implications of this determination for Gosford Council over the price path are as follows:

- The Tribunal has used higher water consumption projections than those provided by Gosford Council to set prices, in line with its view that consumption assumptions used in price setting should reflect longer term consumption patterns, not the effects of short term fluctuations.
- As a result of these projections, Gosford Council's overall revenue is expected to increase in 2003/04, and remain at approximately the same level during 2004/05 (in real terms).
- The Tribunal has allowed \$9.4 million less during the pricing period for water and wastewater operating expenditure than Gosford Council proposed. This reflects its expectation that the Council can save \$293,000 in 2003/04 compared to 2002/03 and \$290,000 less in 2004/05 compared to 2003/04 through efficiency gains during the price path, its decisions to remove drainage transfer payments from the calculation of Council's base year operating expenditure, and to allow the Council's proposed expenditure on green energy.<sup>7</sup>
- It has allowed for capital expenditure largely in line with the expenditure Gosford Council proposed.
- Overall, the Tribunal's price decisions should allow Gosford Council to maintain its currently sound financial position, and generate a real pre tax rate of return to the regulatory asset base of 5.6 per cent in each year of the determination.

In addition, the Tribunal is seeking alignment of the revenue Gosford Council raises to fund drainage capital works with the expenditure of this revenue, and to strengthen incentives for the Council and other metropolitan water agencies to achieve operating and capital efficiencies in the next price review.

This chapter discusses each of these implications and issues going forward in more detail, and explains the financial analysis that underpins the Tribunal's decisions.

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<sup>7</sup> In the case of Gosford Council, the Annual Information Return and Special Information Return spreadsheets (which are required to be submitted to IPART for modelling purposes) could not be reconciled. This essentially means that some cost increases which were proposed by Gosford in the AIR but not reflected in the SIR were disallowed by Halcrow but can not be separately identified.

#### 4.1 Tribunal has used higher water consumption projections to set prices

*Finding 1: For the purposes of setting prices, the Tribunal assumed that consumption in the Gosford supply area would be equal to 16.8GL in 2003/04 and 16.9GL in 2004/05.*

As discussed in Chapter 3, the Tribunal determined the maximum prices for Gosford Council's water and wastewater services by calculating the total revenue requirement of its water business for each year of the price path. It then set prices to generate this amount of revenue, using financial modelling.

One of the critical variables used in this financial modelling is the projected level of water consumption during the period of the price path. The assumed level of consumption used in the Tribunal's financial model has a significant impact on the forecast rate of return and, indirectly, on pricing decisions.

Gosford Council, provided projected consumption data that appears to have been adjusted, particularly for the year 2003/04, to reflect the current mandatory water restrictions that apply in its areas of operations.

However, the Tribunal believes that, as a matter of principle, the assumed level of consumption it uses for price setting purposes should reflect longer term consumption patterns. It should not attempt to account for or predict the effects of shorter term weather patterns. This may mean that in periods when water restrictions apply, water businesses will recover less revenue than forecast, while in periods when demand is high and no restrictions apply, they will recover more revenue than forecast.

In line with this belief, for each of these agencies, the Tribunal has plotted a trend line along the last nine years of metered consumption data and projected this forward into the two years of the coming determination. It has used this as a starting point for considering specific consumption assumptions for modelling purposes.

For Gosford Council, the outcome of this approach is that the Tribunal has used a metered consumption assumption for modelling purposes of 16.8GL per annum in 2003/04 and 16.9GL in 2004/05. The Tribunal's assumed consumption is 12.0 per cent higher in 2003/04 than Gosford Council's projected consumption (Table 4.1).

**Table 4.1 Water consumption—projected by Gosford Council and assumed by Tribunal (GL per annum)**

	2000/01 Actual	2001/02 Actual	2002/03 Forecast	2003/04 Forecast	2004/05 Forecast
Gosford Council's projected consumption	17.0	16.1	14.8	15.0	16.9 <sup>8</sup>
Tribunal's assumed consumption	17.0	16.1	14.8	16.8	16.9

<sup>8</sup> In an email dated 28 February 2003, Gosford Council commented that mandatory water restrictions were likely to continue in 2004/05 and that the figures for forward consumption projections should be revised to reflect the anticipated decline in water sales. Gosford Council suggested that at that time a more appropriate forecast of consumption in 2004/05 would be 15.2GL.

The Tribunal accepts that actual consumption could differ from these estimates due to the impact of weather conditions and the possibility that water restrictions will be tightened.

## 4.2 Gosford Council's overall revenue expected to increase

*Finding 2: The Tribunal found that, in real terms, a revenue requirement of \$41.6 million in 2003/04 and \$41.9 million in 2004/05 was appropriate for setting maximum prices for water, wastewater, stormwater and ancillary services provided by Gosford Council.*

To calculate the revenue requirement for Gosford Council's water business, the Tribunal estimated how much operating and capital expenditure an efficiently run water business could be expected to need, to operate effectively and earn an appropriate rate of return for efficient investment in capital infrastructure. It found that a revenue requirement of \$41.6 million in 2003/04 and \$41.9 million in 2004/05<sup>9</sup> (in real terms) is appropriate. These amounts are somewhat lower than those proposed by Gosford Council (Table 4.2).

**Table 4.2 Tribunal's estimate of Gosford Council's total revenue requirement**

<b>\$ millions, 2002/03</b>	<b>2002/03</b>	<b>2003/04</b>	<b>2004/05</b>
Gosford Council's proposal*	39.7	42.9	43.6
Tribunal finding		41.6	41.9
Difference		-1.3	-1.7

Source: IPART financial model for Gosford Council.

Although the Tribunal has set maximum prices that are expected to generate this amount of revenue, the actual revenue Gosford Council generates will depend on its water sales and customer numbers. If it sells more water than the Tribunal assumed in its financial modelling, then it will earn more revenue. Similarly, if its customer numbers increase by more than expected, its revenue will also grow faster than expected. However, if actual water consumption is less than that assumed by the Tribunal, revenue may be lower than anticipated.

In making this finding on Gosford Council's revenue requirement, the Tribunal considered Gosford Council's proposed revenue requirement, and Halcrow's recommendations based on its review of the Council's proposed operating and capital expenditure. Its specific findings in relation to operating expenditure, capital expenditure, and financial viability and return to assets are discussed in the following sections.

## 4.3 Tribunal has allowed \$9.4 million less for operating expenditure

*Finding 3: The Tribunal found that, in real terms, operating expenditure of \$24.0 million in 2003/04 and \$23.8 million in 2004/05 was appropriate for the setting of maximum prices for water, wastewater, stormwater and ancillary services provided by Gosford Council.*

<sup>9</sup> Assuming 3.1 per cent in 2003/04 and 3.0 per cent in 2004/05.

The Tribunal has decided to allow for operating expenditure of \$24.0 million in 2003/04 and \$23.8 million in 2004/05 (in real terms). These amounts are significantly less than those proposed by Gosford Council (Table 4.3). The Tribunal has allowed \$9.4 million less during the pricing period for water and wastewater operating expenditure than Gosford Council proposed. This reflects its expectation that the Council can save \$293,000 in 2003/04 compared to 2002/03 and \$290,000 less in 2004/05 compared to 2003/04 through efficiency gains during the price path, its decisions to remove drainage transfer payments from the calculation of Council's base year operating expenditure and the decision to allow the Council's proposed expenditure on green energy. The Tribunal's rationale for each of these decisions is discussed in the sections below.

**Table 4.3 Projected annual operating expenditure**

<b>\$million, 2002/03</b>	<b>2002/03</b>	<b>2003/04</b>	<b>2004/05</b>
Gosford Council's proposal	28.7	28.9	28.3
Tribunal finding		24.0	23.8
Difference		-4.9	-4.5

#### **4.3.1 Gosford Council expected to make operating efficiency savings of \$583,000**

*Finding 4: The Tribunal found that an operating efficiency target of 1.2 per cent was appropriate for Gosford Council. This equates to an efficiency saving of \$293,000 in 2003/04 compared to 2002/03 and \$290,000 in 2004/05 compared to 2003/04.*

In reaching its finding on operating expenditure, the Tribunal undertook detailed analysis of the financial data provided by Gosford Council, and considered Halcrow's findings and recommendations in relation to this expenditure and Gosford Council's response to these recommendations.

Gosford Council proposed approximately the same level of operating expenditure for each year of the determination period as for 2002/03. It claimed that it has reduced its expenditure on operating and maintenance activities and management, supervision and customer service conducted by water and sewerage staff over the current pricing period. However, the corporate costs incurred by its governance, finance, human resources, information technology and management functions have increased. It argued that this has imposed additional overheads on the water and sewerage business that are outside its control.<sup>10</sup>

Halcrow reviewed the proposed operating expenditure presented in the Council's submission and interviewed senior Council staff. Based on this review, Halcrow believes that the Council can achieve further operating cost savings. In particular, it noted that some of its costs are higher than commercial levels. It believes these higher costs could be attributed to:

- the Council's new enterprise bargaining agreement
- the current constraints on compulsory redundancy

<sup>10</sup> Gosford Council Submission, September 2002, p 10.

- the fact that the Council's recruitment policy prevents it from transferring staff who have been made redundant
- the low use of outsourcing
- the Council's decision to purchase more green energy than the Government requirement.<sup>11</sup>

Halcrow noted that although the Council's enterprise agreement was expected to increase costs in the short term, it was intended to deliver efficiencies in the longer term.<sup>12</sup> As such, it was reasonable to assume that future efficiency gains are achievable. It also pointed out the Council's low use of outsourcing suggests it probably has not yet exploited the full potential of contestability. In addition, by benchmarking Gosford Council's costs against those of other water agencies, it identified potential cost savings in the Council's operations and maintenance areas.

Halcrow concluded that Gosford Council can achieve further operating cost savings of 1-1.5 per cent. It recommended the Tribunal reduce the Council's operating expenditure allowance by 1.2 per cent to provide it with an incentive to achieve these savings.<sup>13</sup>

Gosford Council noted that it has recently restructured its water and sewerage business and expects these changes will result in efficiency gains.<sup>14</sup> However, the gains may not be realised within the Water and Sewer Directorate for several years. It argued that setting efficiency targets that it could not achieve in the short term may have an adverse effect, as it could affect its ability to achieve its longer term objectives, such as reducing operating costs and improving the level of service for the community.

The Council also noted that if the Tribunal set maximum prices for it based on a revenue requirement that was too low, a sharp price increase might be necessary in the next determination. It was particularly concerned about this, as it believes water has traditionally been underpriced.

The Tribunal carefully considered Gosford Council's justifications for its proposed operating expenditure and Halcrow's recommendation. It decided to accept Halcrow's recommendation, and has allowed \$293,000 less in 2003/04 compared to 2002/03 and \$290,000 less in 2004/05 compared to 2003/04 for water and wastewater operating expenditure as an efficiency saving. This decision reflects the Tribunal's belief that Gosford Council should be continuously seeking efficiencies.

The Tribunal also took particular note of increases in the Council's costs, including odour control, electricity, biosolids disposal, staff, restructuring and real labour costs, when making this decision. Where it considered these costs to be reasonable, it allowed them in full.

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<sup>11</sup> Halcrow, *NSW water agencies review - Gosford Council*, 2002, p 9.

<sup>12</sup> Halcrow, *NSW water agencies review - Gosford Council*, 2002, p 21.

<sup>13</sup> Halcrow, *NSW water agencies review - Gosford Council*, 2002, p 22.

<sup>14</sup> Letter to IPART, 28 February 2003, p 3.

**Box 2 Halcrow methodology for calculating proposed operating expenditure**

Halcrow's review of Gosford Council's proposed operating expenditure involved analysing data provided by the Council, and information obtained through interviews with its senior staff. By focussing on drivers for cost changes and program priorities, the cost basis for projections, and projected efficiencies, Halcrow estimated the operating costs an efficiently operating Gosford Council would need to deliver its water services to customers.

The detailed estimates involved establishing a base line operating expenditure for 2001/02, by considering the details underlying the actual cost presented by Gosford Council. Where abnormal items were identified in 2001/02, these were excluded. Halcrow then assumed that the base year operating expenditure should (in real terms) be sufficient for the delivery of services in subsequent years, assuming that service levels remained constant.

This base amount was varied in subsequent years after considering a range of factors, such as electricity price rises, real labour cost increases and staff and restructuring costs. Where capital expenditure was expected to result in operating cost efficiencies, then these were also explicitly considered.

From this modified operating expenditure, Halcrow applied an expected efficiency factor, reflecting its view on the savings a competitive water business should seek to achieve every year. This factor is based on Halcrow's experience in similar water businesses, both within Australia and overseas.

**4.3.2 Drainage transfer payments removed from base year operating expenditure**

*Finding 4: The Tribunal has decided that drainage transfer payments totalling \$2.54 million in 2001/02 are to be excluded from the calculation of Gosford Council's base year operating expenditure. This decision is in line with Halcrow's advice that, while the assets lie in the Council's General Fund, these transfer payments are not a proper operating expenditure of its water and sewerage fund.*

In its submission to the Tribunal, Gosford Council noted that it had recently decided to increase the contribution the Water and Sewerage Fund (its water business) makes towards drainage works.<sup>15</sup> It noted that in 2001/02, the water business contributed \$2.54 million towards drainage works, and that this contribution was forecast to increase to \$3.0 million in subsequent years.

In its review of Gosford Council's operating expenditure, Halcrow put the view that the increase in the contribution towards drainage is not a proper operating expense of the water business, as it essentially amounts to a transfer payment to the Council's General Fund. It also noted that changes to transfer payments make it difficult to see the true operating expenditure trends of the water business. It therefore recommended that the Tribunal not make an allowance for the proposed increase in this transfer payment when calculating Council's required level of operating expenditure for price setting.

In response, Gosford Council commented that, in relation to drainage management, the Water Management Act 2000 makes provision for an Authority to construct new works, modify or remove existing works, restore and rehabilitate land and to give effect to the objects of the Act. Council suggests that an implied term is that all things necessary and ancillary may be carried out and that Gosford City Council is therefore authorised to use

<sup>15</sup> Gosford Council Submission, September 2002, p 4.

funds raised as a service levy to carry out capital works and other things authorised by the Act. This may include investigation, planning, design, construction, maintenance, repair, replacement and removal of drainage works. Council also notes that funds may be used for administration and the repayment of loans.

In a letter dated 28 February 2003, Gosford Council commented that for convenience the water and sewer business has engaged the general purpose Council to carry out some of the drainage works of the Authority. This engagement is convenient because of the structure of the Council and is a cost saving to the business because it avoids duplication in respect of drainage works. Council subsequently proposed to remove drainage costs from the individual opex account of water and sewer and to treat the contribution as a capital acquisition<sup>16</sup>.

After considering the advice of Halcrow, Gosford Council's written comments and further discussion with senior officers of Gosford Council, the Tribunal has decided to accept Halcrow's recommendation. In addition, it believes that if the increase in the drainage transfer payment is not a proper operating expenditure, then the entire transfer payment is also not a proper operating expenditure. It has therefore decided not to make an allowance for the proposed \$0.46 million increase in the transfer payment, and to remove the \$2.54 million transfer payment from Council's base year operating expenditure.

The Tribunal has ongoing concerns about the funding arrangements for Gosford Council's stormwater services. Under the current arrangements, the Tribunal is not able to establish a clear relationship between the revenue raised by charges levied specifically to fund drainage capital works – such as the stormwater drainage levy – and the expenditure of this revenue. The Tribunal requires the Council to make this relationship transparent by aligning revenues and expenditure within one business unit. This concern and the Tribunal's requirements are discussed further in section 4.6.1.

#### 4.3.3 Green energy costs allowed

*Finding 5: The Tribunal determined that additional green energy costs amounting to \$45,000 in 2003/04 and \$45,000 in 2004/05 in real terms should be incorporated in Council's operating expenditure for price setting purposes.*

Based on its review of Gosford Council's operating expenditure proposal, Halcrow was concerned about the Council's policy decision to purchase 6.0 per cent green energy. Halcrow put the view that it was not required by Government to purchase green energy, and therefore the Tribunal should not allow for the increased operating costs it involved. These costs amount to an additional \$27,000 in water service operating costs and an additional \$18,000 in sewerage operating costs.<sup>17</sup>

Gosford Council argued that these additional costs should be allowed, since both the Federal and the NSW Governments have adopted policies and programs aimed at achieving ecologically sustainable development. It said that while these programs are still in the initial stages of development, the Federal Government requires the Federal organisations to purchase of 8 per cent green energy and the NSW Government requires "budget dependent

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<sup>16</sup> Letter to IPART dated 28 February 2003.

<sup>17</sup> Halcrow (2002), *NSW Water Agencies Review – Gosford Council*, 2002, p 22.

agencies” to purchase 6 per cent green energy.<sup>18</sup> Therefore, its decision to purchase 6 per cent green energy is in line with Government policy, and should be considered a requirement of the business and a legitimate operating expense.<sup>19</sup>

The Tribunal acknowledges that Gosford Council’s policy on green energy goes beyond State or Federal Government requirements. However, it also recognises the importance of reducing greenhouse gas emissions for ecologically sustainable development, and that the Council’s policy is in accordance with Government policies aimed at achieving ecologically sustainable development. It believes the additional costs associated with purchasing green energy can legitimately be passed through to customers, and has decided to allow for these costs.

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<sup>18</sup> Budget dependent agencies include Government agencies such as the NSW Premiers’ Department and NSW Department of Education.

<sup>19</sup> Letter from Gosford Council to IPART, 28 March 2003, p 3.

#### 4.4 Tribunal has allowed most of the proposed capital expenditure

*Finding 6: The Tribunal found that \$12.2 million in 2003/04 and \$14.1 million in 2004/05 was an appropriate allowance for Gosford Council's capital expenditure program. The 2003/04 allowance is less than the Council proposed, because the Tribunal believes expenditure on some of the proposed capital projects is likely to carry over into the next pricing period.*

Gosford Council proposed a capital expenditure program of approximately \$14.3 million in 2003/04 and \$13.9 million in 2004/05 (Table 4.4).

**Table 4.4 Gosford Council's projected capital expenditure by business activity**

<b>\$millions, 2002/03</b>	<b>2002/03**</b>	<b>2003/04</b>	<b>2004/05</b>
Water	3.6	5.6	7.7
Wastewater	5.2	8.7	6.2
Corporate	-	-	-
Total	8.8	14.3	13.9
Percentage change on previous year		62.5	-2.8

Source: Special information return (SIR) 2002 for Gosford Council.

\*\* Revised 2002/03 breakdown provided by Gosford Council.

This represents a significant increase in capital expenditure in 2003/04 compared with capital expenditure in 2002/03, largely because the implementation of several large capital projects planned for the 2000 to 2003 pricing period was delayed (Table 4.5).

**Table 4.5 Comparison of actual and expected capital expenditure**

<b>\$ million of the day</b>	<b>2000/01</b>	<b>2001/02</b>	<b>2002/03</b>
Actual capital expenditure	4.2	5.3	8.8*
2000 Tribunal expected capital expenditure	11.2	6.1	4.0
Difference	-7.0	-0.8	4.8

Source: 2000 Gosford Council determination and IPART Regulatory Financial Model for Gosford Council

\* Revised 2002/03 estimate provided by Gosford Council.

Gosford Council proposes to use most of its proposed water-related capital expenditure budget on the Gosford/Wyong Joint Works, and most of wastewater-related budget on growth and renewals and maintenance (Table 4.6).

**Table 4.6 Gosford Council's projected capital expenditure by driver**

<b>\$ million (2002/03)</b>	<b>2003/04</b>	<b>2004/05</b>
<i>Water</i>		
- growth	0.9	0.8
- renewals and maintenance	0.9	0.8
- joint works	3.6	5.9
- other	0.2	0.2
<i>Total</i>	5.6	7.7
<i>Wastewater</i>		
- growth	7.0	4.9
- renewals and maintenance	1.7	1.4
- mandatory standards	0.0	0.0
- discretionary standards	0.0	0.0
- efficiency	0.0	0.0
<i>Total</i>	8.7	6.2
<b>Total</b>	<b>14.3</b>	<b>13.9</b>

Source: Special information return (SIR) 2002 for Gosford Council.

The Tribunal has carefully considered Gosford Council's proposal, and the findings and recommendations of Halcrow's review of this proposal. Halcrow found that the Council's proposed capital expenditure program was, for the most part, of a reasonable order of magnitude, but was still more than the amount it believes the Council needs to undertake its functions.

In relation to water-related capital expenditure, Halcrow found that all the proposed projects appeared to be prudent and reasonable.<sup>20</sup> However, it recommended that the proposed program be adjusted in some places, particularly to reflect the fact that some slippage into the next pricing period is likely. In addition, it noted an inconsistency between Gosford Council's and Wyong Council's forecasts for expenditure on joint works<sup>21</sup> After discussions with both councils, Halcrow recommended that Wyong Council's lower estimates be used in each case.

In relation to wastewater-related capital expenditure, Halcrow found that the proposed program was reasonably justified and well documented. It recommended minor adjustments only to this program.<sup>22</sup>

In relation to the potential for capital cost savings through efficiency gains, Halcrow found Gosford Council's opportunities were limited. This was due to the difficulties of achieving capital efficiencies within a two-year price path, and because its review of the Council's asset management practices and past and future capital expenditure did not identify any significant opportunities for capital cost savings. It therefore recommended that no efficiency targets be imposed on the Council during 2003/04 and 2004/05.

The Tribunal accepted the above recommendations, and has therefore made only minor changes to Council's total allowance for capital expenditure (Table 4.7). In making this

<sup>20</sup> Halcrow, *NSW Water Agencies Review – Gosford Council*, 2002, p 38.

<sup>21</sup> This inconsistency was due to the fact that Wyong Shire Council had access to more recent cost estimates than Gosford City Council at the time that submissions were formulated.

<sup>22</sup> Halcrow, *NSW Water Agencies Review – Gosford Council*, 2002, p 54.

decision, the Tribunal has ensured that Gosford Council has sufficient capital to complete essential works during the determination period. It has also taken into consideration the difficulties of achieving capital efficiencies in a two-year pricing period.

**Table 4.7 Projected capital expenditure used in the Tribunal's financial analysis**

\$ million (2002/03 )	2002/03	2003/04	2004/05
Gosford Council's proposal	8.8	14.3	13.9
Tribunal finding		12.2	14.1
Difference		-2.1	0.2

Source: Halcrow (2002) NSW Water Agencies review –Gosford Council and IPART Regulatory Financial Model.

It is important to note that although the Tribunal considered Gosford Council's capital expenditure requirements on a project basis, it has not formed a view on the appropriateness of individual project expenditure. The Tribunal is more concerned about the outcomes of capital expenditure, than the specific projects involved in delivering those outcomes.

#### 4.4.1 Asset management practices improving

As part of its review of Gosford Council's proposed capital expenditure, Halcrow reviewed the Council's asset management practices. It assessed these practices against a checklist of eight primary asset management factors,<sup>23</sup> and 54 secondary factors, and rated the Council's performance on a scale of 1 to 5. It found that Gosford Council's performance was adequate for the factors related to forecasting, service standards, cost base and efficiencies, planning for growth and higher standards, planning asset maintenance and procurement strategy. However, it found that its performance for asset knowledge was poor.

Halcrow commented that in general, Gosford Council's asset management planning processes were improving, and that this should result in soundly based expenditure projections at the 2005 price review. However, it believes the Council's asset renewals program is too low, and requires better planning. It also believes the Council's level of asset renewal will need to be increased in the next determination.

Halcrow's conclusions on asset management practices were discussed with the Tribunal Secretarial and Gosford Council. Gosford indicated that they did not necessarily concur with all the conclusions reached by Halcrow. The Tribunal considers sound asset management practice to be critical for maintaining long term system performance standards in the most efficient manner and, for this reason, will continue to take a close interest in the practices and performance of regulated businesses in this area.

At the next price review, the Tribunal will be looking for evidence that the Council has undertaken further work to ensure continual improvement in asset management practices, and that these practices are resulting in the allocation of sufficient funds to essential renewals work. Halcrow recommended that the Tribunal require Gosford Council to develop a risk and serviceability approach for inclusion in its next price submission (due in 2004).

<sup>23</sup> The primary factors are, forecasting, asset knowledge, service standards, cost base and efficiencies, planning for growth and higher standards, planning asset maintenance, procurement strategy, program management. Detailed results are included in Appendix 9.

## **4.5 Gosford Council expected to maintain strong financial position**

The Tribunal believes that its pricing decisions will not adversely affect Gosford Council's strong financial position. Its analysis and financial modelling indicate that the maximum prices set should enable the Council to retain its current investment category ratings, and earn a reasonable rate of return. However, in setting prices, the Tribunal has not allowed for the payment of dividends or tax equivalent payments to the Council's General Fund.

### **4.5.1 Investment category ratings expected to be retained**

The Tribunal's analysis indicates that Gosford Council will retain its current investment category rating for all of the key financial indicators. In addition, the Council's extremely low levels of debt suggest that it is well positioned to maintain this strong financial position into the future. Further details of the financial viability indicators are provided in Appendix 8.

**Table 4.8 Financial indicators and credit ratings for Gosford Council**

	2001/02	2002/03	2003/04	2004/05
<b>Ability to service debt</b>				
1. EBITDA interest cover	73.54	(4.89)	(10.10)	(7.81)
NSW Treasury ratings (2002)	<b>AAA</b>	<b>AAA</b>	<b>AAA</b>	<b>AAA</b>
2. Funds from operations interest coverage	106.44	(5.50)	(10.81)	(8.11)
Standard and Poors US ratings (1995)	<b>AA</b>	<b>AA</b>	<b>AA</b>	<b>AA</b>
3. Pre-tax interest coverage	25.86	(0.36)	(4.33)	(3.53)
Standard and Poors US ratings (1995)	<b>AA</b>	<b>AA</b>	<b>AA</b>	<b>AA</b>
<b>Ability to repay debt</b>				
4. Funds flow net debt payback	(1.20)	(1.90)	(1.86)	(2.13)
NSW Treasury ratings (2002)	<b>AAA</b>	<b>AAA</b>	<b>AAA</b>	<b>AAA</b>
5. Funds from operations/total debt (%)	131%	282%	499%	574%
Standard and Poors US ratings (1995)	<b>AA</b>	<b>AA</b>	<b>AA</b>	<b>AA</b>
6. Debt gearing (regulatory value)	-9%	-12%	-16%	-18%
NSW Treasury ratings (2002)	<b>AAA</b>	<b>AAA</b>	<b>AAA</b>	<b>AAA</b>
Standard and Poors US ratings (1995)	<b>AA</b>	<b>AA</b>	<b>AA</b>	<b>AA</b>
<b>Ability to finance investment from internal sources</b>				
7. Internal financing ratio	577%	195%	187%	167%
NSW Treasury ratings (2002)	<b>AAA</b>	<b>AAA</b>	<b>AAA</b>	<b>AAA</b>
8. Net cash flow/capital expenditure (%)	839%	216%	199%	172%
Standard and Poors US ratings (1995)	<b>AA</b>	<b>AA</b>	<b>AA</b>	<b>AA</b>
<b>NSW Treasury overall score and rating</b>				
NSW Treasury total score (0 -10)	10.00	10.00	10.00	10.00
Overall rating	<b>AAA</b>	<b>AAA</b>	<b>AAA</b>	<b>AAA</b>
9. Net debt (\$m of the day)	(22.82)	(30.78)	(41.48)	(51.05)

## Notes:

- (i) The Tribunal particularly relies on indicators based on cash flows because these are not as subjective as indicators that use components derived from estimates (eg asset value and depreciation).
- (ii) The information in this table should be read and understood only after reviewing Appendix 10 and the explanations and qualifications mentioned there.

#### 4.5.2 Rate of return expected to be reasonable

*Finding 7: The Tribunal found that Gosford Council should be expected to earn a pre tax real rate of return of 5.6 per cent in 2003/04 and 5.6 per cent in 2004/05.*

The rate of return to Gosford Council's regulatory asset base is expected to be around 5.6 per cent for each of the two years of the price path<sup>24</sup> (Table 4.9), provided that the assumptions used in the Tribunal's modelling of the financial impacts of its pricing decisions are correct and that the Council achieves the efficiency targets the Tribunal has set.

<sup>24</sup> The weighted average cost of capital (WACC) range for the metropolitan water agencies was estimated to be between 5.2 per cent and 6.7 per cent. The detailed assumptions used to generate this range are given in Appendix 7.

**Table 4.9 Expected and actual rates of return (% real, pre-tax)**

2000/01	2001/02	2002/03	2003/04	2004/05
5.0	5.0	3.0	5.6	5.6

Source: IPART financial model for Gosford Council.

Note: The low rate of return for 2002/03 reflects a transfer payment from the water business to the General Fund for stormwater-related expenses. The calculation of the expected rates of return for 2003/04 and 2004/05 exclude this transfer payment.

This rate of return is relatively low compared with some competitive industries, however, the Tribunal believes this is sufficient to allow the Council to make appropriate efficient investments. It also believes it is reasonable given that Gosford Council operates in a low risk environment. (The main risk it faces is the impact of weather conditions on its revenue.)

In making its findings on Gosford Council's revenue requirements and operating and capital expenditure needs, the Tribunal explicitly considered all the matters listed in section 15 of the IPART Act. It considered the implications of these findings on the Council's rate of return to assets and its ability to borrow funds and meet its capital requirements. It also considered the social and environmental implications of its findings, including their impact on the affordability of water services, future standards of service quality, reliability and safety, and ecologically sustainable development.

#### **4.5.3 Dividend and tax equivalent payments not allowed for**

*Finding 8: The Tribunal found that in the absence of any changes to current legislation, it would be inappropriate to set prices on the assumption that Council will be able to make dividend payments from water and sewerage funds to the Council's General Fund.*

In its submission to the Tribunal, Gosford Council noted that the Federal Government's national competition policy requires all local councils to obtain a rate of return that includes tax equivalent and dividend payments. However, due to concerns over section 409 (3) (a) of the Local Government Act, it is not currently able to make these payments. Council noted that while tax equivalents and dividend payments have formed part of the Council's calculated revenue requirements, the inability at this stage to make such payments to Council's General Fund has eliminated these payments from the submission calculations<sup>25</sup>.

The Tribunal decided, since there have been no changes to the current legislation, to set prices for Gosford and Wyong Councils on the basis that dividends will not be paid by the Councils' water and sewerage business to its General Funds. The Tribunal will reassess this decision at the next determination if the relevant legislation has changed.

The Tribunal is satisfied that the social and environmental impacts of its pricing decisions are well balanced against a reasonable rate of return, given its view that Gosford Council has further potential to achieve operating efficiency gains.

<sup>25</sup> Gosford Council Submission, September 2002, p 5.

## **4.6 Issues Tribunal will consider going forward**

The Tribunal is concerned about the lack of transparency in Gosford Council's revenue and expenditure on stormwater services, and that the Council did not establish operating and capital efficiency targets based on the last price determination. These concerns and the steps it proposes to take to address them are outlined below.

### **4.6.1 Aligning stormwater revenues and expenditure**

The Tribunal is concerned that, under Gosford Council's current arrangements for funding stormwater services, it is not able to establish a clear relationship between the revenue raised specifically to fund drainage capital works (that is, through the stormwater drainage levy) and the expenditure of this revenue. This is because there is a misalignment between the current ownership and operation of stormwater assets within the Council.

The Tribunal has discussed these arrangements with senior officers of Gosford Council, and intends to work closely with the Council to improve and clarify these arrangements prior to the next determination. This is likely to involve establishing measures to ensure that Council's revenue and expenditure on stormwater can be aligned within a single business unit in the future.

### **4.6.2 Strengthening incentives for operating efficiencies**

To improve Gosford Council's incentives to achieve operating efficiencies, the Tribunal will expect the agency to demonstrate the gains it has made relative to the targets implied in this determination at the 2005 price review. The Tribunal will take any failure to achieve the expected efficiencies into consideration when formulating the base year operating expenditure to calculate efficient operating expenditure in the 2005 determination period.

### **4.6.3 Strengthening incentives for capital efficiencies**

The Tribunal is concerned the incentives created by the current regulatory approach for improving capital efficiencies are not adequate, given that the water agencies have responded to the efficiency targets set by the Tribunal principally by switching capital between projects<sup>26</sup>, or delaying projects. It is not clear whether these actions result in genuine efficiency gains, or how they affect the agencies' overall service provision given the long lives of these assets.

To improve the incentives, Halcrow recommended establishing a series of output targets, such as length of water main renewed. The Tribunal is concerned that this approach may create perverse incentives, and has therefore decided to not adopt this recommendation. However, it will seek further information on these indicators from the agencies on the approach as part of the 2005 price review.

In addition, the Tribunal will investigate other changes to its approach to regulating capital expenditure prior to the 2005 price review. Its objectives are to create an incentive for water agencies to pursue capital efficiencies, encourage better long-term asset management planning and enhance the connection between drivers of expenditure and capital

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<sup>26</sup> Switching capital expenditure away from proposed programs to new programs may reflect poor asset management planning, or changed priorities as new operating issues arise.

expenditure program. These drivers include changes to environmental standards or demonstrated customer preferences.

As part of this investigation, the Tribunal will consider the use of a four year efficiency carryover mechanism. Under this mechanism, the difference between the capital expenditure forecast and approved at the time of a determination and the actual capital expenditure will be borne by the business for four years rather than until the next determination is made. In practice, this would mean that expected capital expenditure would be initially rolled into the RAB and actual capital expenditure would replace the expected capital expenditure after four years has passed. Prior to the actual capital expenditure being rolled into the RAB, it would be subjected to a prudency review.

The effect of the four year efficiency carryover mechanism would be to allow Gosford Council to keep better than expected efficiency savings for the entire four year period. However, if it was unable to meet the efficiency savings targets, it would bear the cost for the entire four year period.

This kind of incentive mechanism could operate in several different ways:

- It could be based on an agreed program, whereby gains in one program could not be offset against over expenditure in another. This would limit expenditure flexibility, but would also create a strong incentive for Gosford Council to more effectively plan and manage its capital expenditure programs as the businesses would bear the heightened risks for inaccurate forward capital expenditure planning.
- Alternatively, it could be applied to the capital expenditure of the business in aggregate, allowing reallocation of capital expenditure during the course of a determination period without additional gain or penalty provided total expenditure matched forecasts.

The Tribunal will consult with Gosford Council and other key stakeholders about this approach in the lead up to the next determination. To enable it to be implemented, the Tribunal is likely to require the water agencies to provide a higher level of specification and justification for their forward capital expenditure programs. It will require this information anyway, to improve the link with agreed expenditure drivers such as growth and the meeting of mandatory standards. Where water businesses want to propose capital expenditure to meet performance standards in excess of those required by regulators such as the EPA they will need to clearly demonstrate that their customers are willing to pay for the enhancement of standards.

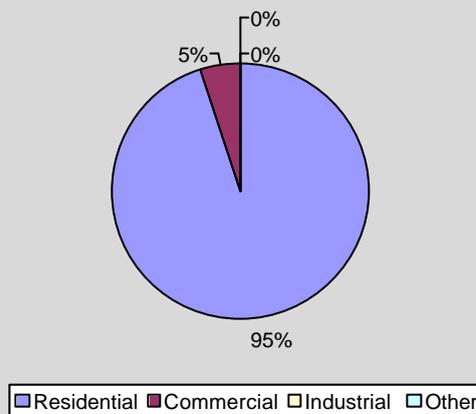
Gosford Council therefore has two years to develop adequate asset management planning processes to provide this information with a reasonable level of confidence. A summary of the issues which will be considered by the Tribunal in the future is contained in Chapter 8.

**Box 3 Gosford Council’s customer base**

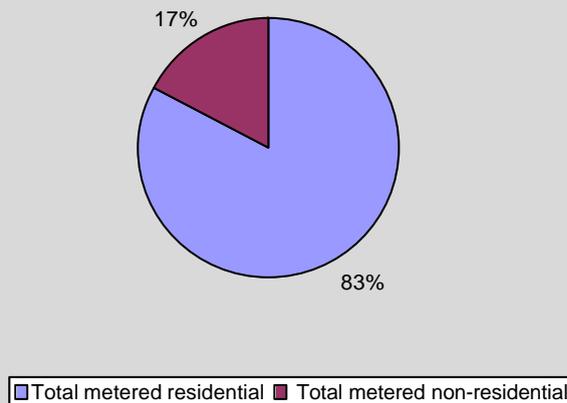
Gosford Council services around 150,000 people within its area of operations. Some 61,000 properties are connected to its water and sewerage systems, and a further 2,000 properties are connected to its water system only. Between 1986 and 1995, the population of the Gosford region grew by around 3.5 per cent per annum. This growth has now slowed to around 1 per cent per annum.

The Council's customer base includes residential and commercial customers, who use more than 16GL of water in aggregate per annum. Residential water customers represent 95 per cent of total customers, and use 83 per cent of metered water consumed. Commercial customers represent 5 per cent of total customer base and use 17 per cent of the total volume of metered water consumed.

**Figure 4.1 Gosford Council’s Customer Base in 2002**



**Figure 4.2 Metered Water Consumption by Customer Type 2002**



## 5 IMPLICATIONS FOR CUSTOMERS

In reaching its pricing decisions, the Tribunal explicitly considered the likely impact on Gosford Council's residential and commercial and industrial customers. In particular, it considered their impact on the affordability of water services for high and low water users, and on the quality of the services customers receive. The Tribunal's analysis indicates its decisions will have a minimal impact on customer bills: average residential customers are likely to pay marginally less for a combined water and wastewater bill in real terms in 2003/04 and 2004/05 than they did in 2002/03.

The key implications of this determination for customers are as follows:

- Prices for water services have been restructured so that usage charges make up a larger proportion of customer bills.
- For residential customers, the determination is likely to have little impact on average, water users,<sup>27</sup> whose combined water and wastewater bills will decrease by 0.5 per cent in real terms in 2003/04 and a further 0.5 per cent in real terms in 2004/05.
- For commercial and industrial customers, the determination is also likely to have little impact on an average water user's bill. Trade waste charges will also remain steady, but a new annual trade waste agreement will apply.
- Service standards are expected to be maintained over the price path, and the Tribunal intends to consider ways to better monitor these standards during the pricing period.

Each of these implications and issues going forward is discussed in more detail below.

### 5.1 Prices have been restructured

The Tribunal decided to increase the relative emphasis on water usage charges to provide a greater incentive to customers to reduce water use. Water usage charges will increase by 1 per cent above inflation in each year of the price path, while fixed water charges will decrease by 1 per cent in each year (in real terms).

This decision will help all customers to better manage their water bills. Most importantly, it may assist in encouraging more customers to control their overall water bills by adopting water saving technologies and controlling their water use.

The decision is consistent with the Council of Australian Governments (COAG) water pricing guidelines, which were developed as part of the national water reforms. These guidelines require, among other things, that 'externalities'<sup>28</sup> or environmental costs be included within an individual's water price. By increasing the emphasis on usage charges, the Tribunal is attempting to include the costs associated with expanding the water supply to meet rising demand into an individual's water use decisions. This means that those who use more water will pay a proportionately greater amount of the cost associated with reducing water demand or increasing water supply.

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<sup>27</sup> For the purposes of this analysis an average domestic customer is assumed to be one who is using 210 kl consumption per annum.

<sup>28</sup> An externality in this context is where a water user impacts on other water users, Gosford Council or the environment, but does not pay for the additional costs that those impacted water users bear. Appropriate pricing requires these additional costs to be borne by the individual who causes them.

Table 5.1 provides overview of the key pricing decisions affecting Gosford Council's customers. In addition to the price restructuring, these include:

- Maintaining the drainage levy at the current price for both 2003/04 and 2004/05. This decision reflects the Tribunal's concerns about Gosford Council's funding arrangements for stormwater services (see sections 4.3.2 and 4.6.1). It is likely to result in stormwater charges decreasing in real terms over the pricing period.
- Allowing Gosford Council to introduce a new \$65 annual trade waste fee for all trade waste customers.

**Table 5.1 Overview of pricing decisions for Gosford Council**

	2002/03	2003/04	2004/05*
Water			
- residential usage (\$/kL)	0.70	0.73	0.76
- service (\$)	70.00	71.47	72.90
Wastewater			
- service (\$)	340.30	347.14	354.08
- non-residential usage (\$/kL)	0.70	0.73	0.76
Stormwater			
- drainage levy (\$)	42.00	42.00	42.00

\*Assuming 3.1 per cent inflation in 2003/04 and 3.0 per cent in 2004/05.

## 5.2 Impacts on residential customers

Overall, the Tribunal expects that on average Gosford Council's residential customers will be slightly better off as a result of this determination. The combined water and wastewater bills of most residential customers are expected to decrease in real terms.

The Tribunal's analysis of the impact of the determination on customers with different types of homes and different water use patterns indicates that the bills of customers who live in apartments or units and have average water use will increase, in nominal terms, by 2.3 per cent in 2003/04 and a further 2.2 per cent in 2004/05 (this increase is expected to be less than the general rate of inflation). The bills of those that live in houses and have high water use will increase by around 3.0 per cent in 2003/04 (approximately in line with inflation) and by a further 2.9 per cent in 2004/05 (Table 5.2). The Tribunal notes that these customers are likely to have more potential to use water saving techniques to offset this impact.

**Table 5.2 Impacts of prices on residential customers by type of home and water usage (\$ nominal)**

Customer type	2002/03	2003/04		2004/05	
	Current	Annual Bill	Increase (\$)	Annual Bill	Increase (\$)
<b>Apartment / Unit</b>					
- Low (60kL)	494.30	504.64	10.34	514.77	10.13
- Average (135kL)	546.80	559.29	12.49	571.60	12.31
- High (150kL)	557.30	570.22	12.92	582.97	12.75
<b>House</b>					
- Low (130kL)	543.30	555.65	12.35	567.81	12.17
- Average (240kL)	620.30	635.80	15.50	651.18	15.37
- High (590kL)	865.30	890.85	25.55	916.42	25.58

An inflation rate of 3.1 per cent in 2003/04 and 3.0 per cent in 2004/05 was assumed.

Annual bill is calculated to include water, wastewater and drainage charges.

NB: Figures under increase represent absolute increases or decreases relative to the previous year.

**Table 5.3 Tribunal decision - annual residential water, wastewater and stormwater bills by water usage level (\$ nominal)**

Water usage (kL per year)	% of res customers	2002/03	2003/04		2004/05	
			Actual	Increase	Actual	Increase
<100	45.2%	504.80	515.57	10.77	526.13	10.56
100-150	25.8%	539.80	552.00	12.20	564.03	12.02
150-200	13.5%	574.80	588.44	13.64	601.92	13.48
200-250	7.4%	609.80	624.87	15.07	639.81	14.94
250-300	3.5%	644.80	661.31	16.51	677.70	16.39
300-400	2.7%	697.30	715.96	18.66	734.54	18.58
400-500	1.1%	767.30	788.83	21.53	810.33	21.49
500-1000	0.6%	977.30	1007.44	30.14	1037.68	30.24
1000<	0.2%	1502.30	1553.97	51.67	1606.07	52.10

NB: Figures under increase represent absolute increases or decreases relative to the previous year.

Actual bill is calculated to include water, wastewater and drainage charges.

The impact was calculated using the mid-point of water usage, 1500kL was used for >1000kL and 75kL was used for <100kL.

The impact of the determination on annual residential bills will vary according to the customer's total water usage, and will range from approximately \$10.56 per year (for customers who use less than 100kL per year) to approximately \$52.10 or more (for those who use 1000kL or more per year). For more than 99 per cent of customers, the total increase in their annual water bill for 2003/04 will be under \$22 (Table 5.3).

The Tribunal specifically considered the impacts on residential water customers and the financial implications of its pricing decisions, in line with section 15 of the IPART Act. It considers these impacts are well balanced with the other matters it is required to consider section 15, particularly ecological sustainable development.

### **5.3 Impacts on commercial and industrial customers likely to be minimal**

As for residential customers, the impact of the Tribunal's decision to restructure prices for commercial and industrial customers will vary depending on their level of water usage. Higher water users are likely to experience higher increases in their annual water bills than lower water users. However, because commercial and industrial customers are much more diverse in terms of their water usage patterns than residential customers, it is difficult to draw general conclusions about impact of this decision on these customers.

The Tribunal's decision to allow the Council to introduce a \$65 annual trade waste fee for all its 1086 trade waste customers is likely to have some impact on these customers. However, the Tribunal believes the decision is appropriate, as it will allow the Council to recover some of the costs incurred in servicing trade waste customers. In addition, it believes the introduction of the fee is reasonable given that Wyong and other metropolitan water agencies regulated by the Tribunal already charge customers a similar fee.

The Tribunal has considered the different customer impacts in line with its requirements under section 15 of the IPART Act, and is satisfied that the impacts of higher usage charges are warranted given the large supply augmentation and demand management costs which are likely to emerge as demand exceeds sustainable yield.

### **5.4 Service standards expected to be maintained**

When considering the impact of its pricing decisions on service quality, the Tribunal seeks to ensure that these decisions do not adversely affect the standards of service Gosford Council delivers to its customers. It sets prices with the expectation that service levels will be maintained and that cost reductions and efficiency savings will not be obtained at the expense of service standards. This is particularly important for both Gosford and Wyong Councils because, unlike other agencies regulated by the Tribunal, the Councils do not have an operating licence that requires them to meet minimum service standards. The Tribunal must therefore consider Gosford Council's own monitoring of customer service performance.

In its submission to the Tribunal, Gosford Council stated that it has established a variety of service standards which can typically be categorised as either mandatory or discretionary standards. Its mandatory standards are enforced through a number government agencies, including the EPA and the NSW Department of Health, and a variety of legislative requirements. Its discretionary standards include internally specified targets that aim to ensure it continues to meet customer needs and maintains a particular level of service. These targets are specified in Table 5.4.

**Table 5.4 Service level targets – Gosford Council**

<b>Business</b>	<b>Standard</b>	<b>2002/03 Target</b>
<b>Sewerage</b>	% Occasions where sewer choke removed and / or service restored in <= 5 hours	99%
	Main Chokes per 100km of main	45
	No. of discharges due to Pump Station failure	30
	% of effluent to licence requirement quality	100%
	Provide S26 advice within 14 days of application	95%
<b>Water</b>	% of timed releases made to satisfy operational requirements	98%
	No. of dirty water complaints/1000 properties	7
	Ave interruption time (hours) / 1000 properties	7
	% Occasions unplanned interruption to water service <= 5 hours	99%
	% of time water is produced to 1996 NHMRC guidelines	98%

Source: Gosford Council Submission, September 2002, p 8.

The Tribunal was not able to assess Gosford Council's service standards for this review, as it did not have any information on service quality other than that provided in the Council's submission. It is therefore considering developing a standard set of performance indicators as a precondition to better linking the Council's prices and service quality.

## **5.5 Issues Tribunal will consider going forward**

The Tribunal wishes to better identify the impacts of pricing decisions on customer groups, especially vulnerable groups. While the existing approach of analysing impacts by water usage groups provides a general indication of the likely impacts on a customer's bill, it gives a limited understanding of the impact within the overall household's income. The Tribunal has therefore decided to conduct a household survey to link water usage information to household income. It expects that this will enable a more comprehensive analysis of the customer impacts from pricing decisions to be undertaken in time for the 2005 price review.

## 6 WHAT ARE THE IMPLICATIONS FOR THE ENVIRONMENT?

Section 15 of the IPART Act requires the Tribunal to explicitly consider the impact of its pricing decisions on ecologically sustainable development.

For this price review, the key environmental issues related to water services facing the Gosford area is the need to improve demand management, and the possible future augmentation of the Gosford/Wyong Joint water supply. The Tribunal believes its pricing decisions will encourage customers to give greater consideration to the volume of water that they consume and help to promote a message of demand management. The key implications for the environment are as follows:

- Prices have been restructured by increasing water use charges to send a better conservation signal to water users.
- The Tribunal has decided not to set prices based on Gosford Council's water consumption projection (which take into account the effects of the current drought and water restrictions in the Gosford area), but to use a long-run average estimate of water consumption. This decision will reduce the likelihood that Gosford Council will receive windfall profits if the water restrictions fail to reduce consumption to the anticipated level.
- Gosford Council will need to continue to improve its demand management program to ensure the long term sustainability of the water supply in its area of operations

In addition, the Tribunal notes that the Gosford and Wyong Councils are examining options to improve the security of their water supply in the future, and will be interested in their findings.

Each of these implications and issues going forward are discussed in more detail below.

### 6.1 Prices have been restructured to better signal the need for demand management

The Tribunal's decision to restructure water prices, so that the variable usage charge comprises a larger proportion of most customers water bills should have a positive impact on ecologically sustainable development. This decision will mean that approximately 27.0 per cent of an average customer's water and wastewater bill will now be driven by water usage charges, compared with approximately 25.0 per cent in the previous determination.

In making this decision, the Tribunal intended to strengthen the incentive for water users to adopt water saving appliances and practices, and give them greater control over their overall water bills. This is expected to have some impact on total water use; however, this impact is likely to be relatively small. Empirical evidence throughout the world suggests customer water use patterns do not change significantly in response to changes in water prices,<sup>29</sup> although it may be that pricing has more impact on discretionary water use (such as watering gardens). However, it is important to note that price is not the only policy response to curb excessive water demand.

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<sup>29</sup> See for example summary in OECD, *The price of water: trends in OECD Countries*, OECD Paris, 1999.

The Tribunal is aware of work being undertaken by other agencies within the NSW Government on this issue. It hopes that a coordinated policy response will be available by the time of 2005 price review, to allow it to examine the impact of prices on water demand in more detail. In the interim, it proposes that further work be undertaken to consider the impact of price on water use.

## **6.2 Tribunal has used long-term average estimate of water consumption to set prices**

The Tribunal decided not to use Gosford Council's water consumption forecasts for the purposes of setting prices, as these forecasts appear to reflect the likely impact of the current drought and water restrictions. Rather, it has used its own estimate of the Council's customers' long-term average consumption (see section 4.2 for more information on this estimate).

The Tribunal notes that Gosford Council's consumption forecasts assumed a 10 per cent reduction in water sales during the period of the determination. This level of reduction may be desirable, and the Tribunal does not wish to discourage the Council from setting ambitious demand management targets. However, Halcrow found that the assumed reduction was overly optimistic and that a 2.5 per cent reduction in both years was more realistic.<sup>30</sup>

The Tribunal believes its decision to use a long-term average estimate of consumption for price setting is appropriate. It believes in principle, prices should not be set on predicted variations in demand due to short-term weather patterns. (This principle will be even more important for the 2005 review, when the Tribunal intends to set a longer price path.) Furthermore, if Gosford Council's consumption forecasts had been used, it would have created a perverse incentive for the Council, as it would have received a windfall profit as a result of not realising the assumed reductions.

In making this decision, the Tribunal accepts that actual consumption could differ from these estimates due to the impact of weather conditions and the possibility that water restrictions will be tightened. These risks are commercial risks which are borne by Gosford Council and are compensated for through a higher than risk free rate of return on the regulatory asset base.

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<sup>30</sup> Halcrow, *NSW Water Agencies Review – Gosford Council*, 2002, p 34.

### **6.3 Gosford Council needs to continually improve its demand management program**

The Tribunal considered the likely impact of Gosford Council's demand management program as part of the price review. This impact is relevant because an imbalance between water demand and sustainable water supply would increase the pressure on the Council and its customers to reduce demand, which the Tribunal may need to address through its price regulation. In addition, forecast demand for water over the determination period is one of the key inputs to the Tribunal's price setting approach.

The Tribunal found that the need to effectively manage water demand is very likely to become increasingly important in the coming years. Gosford Council has a demand management strategy in place, and currently has imposed mandatory water restrictions on customers because of ongoing low dam levels and impacts of the current drought. However, water restrictions represent a short-term response to low rainfall. The Tribunal believes the Council needs to continue to improve its longer term demand management program.

For example, the Council noted that there are opportunities for it to further reduce demand by improving its leakage control and pressure management, and by regulating plumbing fittings in new developments. The Tribunal would like to see Council pursue these opportunities over the pricing period. In addition, the Tribunal notes that Gosford and Wyong Council are undertaking a joint project to examine the options for improving the security of their water supply, including demand management options (see section 6.4). It hopes that the findings will enable the Council to significantly improve the effectiveness of its demand management program.

### **6.4 Gosford Council expected to be able to address specific environmental issues**

The environmental impacts of Gosford Council's water, sewerage and drainage activities are regulated in various ways—including through the Tribunal's price regulation, the Environmental Protection Authority's (EPA's) regulation of discharges to the environment, and the Department of Sustainable Natural Resources (DSNR) regulation of water abstraction from the environment. As a result of this regulation and other Government environmental policies, the Council needs to address several specific environment-related issues in the coming pricing period:

- The EPA is finalising a 'country' sewerage system licensing system. Once Gosford Council's licence is in place, it will be required to investigate the sewerage system over three to four years and identify environmental and public health requirements.
- As a result of the Healthy Rivers Commission Inquiry into the Hawkesbury River System, an expert panel was established to review the health of the Central Coast's rivers. This panel identified a number of issues, including the need to develop a streams management strategy, which the Council is pursuing.
- Water sharing plans under the Water Management Act are likely to influence capital expenditure by the Gosford Wyong Joint Board in the future. Although not currently a priority for DSNR, it may need to develop a water sharing plan for Wyong Creek. This could have an impact on Gosford Council, as some of Gosford's water may indirectly come from this source.

The Tribunal believes its decisions will allow the Council to successfully address these issues. However, it was not able to consider the impact of its decisions on the Council’s ability to meet any environment-related capital expenditure needs that could potentially result from Gosford and Wyong Councils’ joint review of bulk water supplies, as the findings of this review were not available in time for the determination

### 6.5 Issues for the Tribunal going forward

To address the ongoing problems relating to declining storage levels in the Gosford/Wyong supply area, the Gosford/Wyong Joint Water Authority has commissioned an examination of options for improving the security of its water supply, including demand management and supply augmentation options. The outcome of this project will be a key issue for both the Councils and the Tribunal going forward.

The Tribunal will be particularly interested in the findings, as they could potentially result in the addition of some large capital projects to Gosford Council’s future capital expenditure program. In addition, if a large supply augmentation is found to be necessary, there may be some future upward pressure on prices.

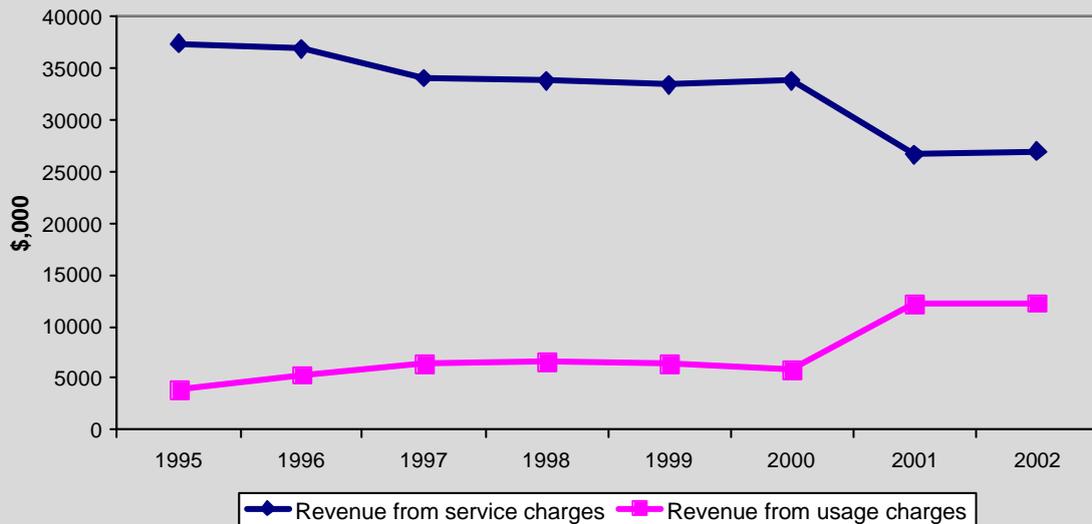
#### Box 4 Historical, water, wastewater and stormwater charges

Since its establishment in 1992, the Tribunal has been actively working to achieve efficient prices for Gosford Council that reflect its water service costs and provide it with appropriate incentives. This has led to more revenue being generated by water usage charges and less by property value based charges.

At the 2000 determination, the Tribunal removed the pre-paid water allowance and moved to a two-part tariff price structure. It understands that there has been little concern over these new arrangements, and as such it intends to continue this arrangement in the future.

Figure 6.1 shows that total revenue from service charges has declined since 1995 while total revenue from usage charges has increased during the same period.

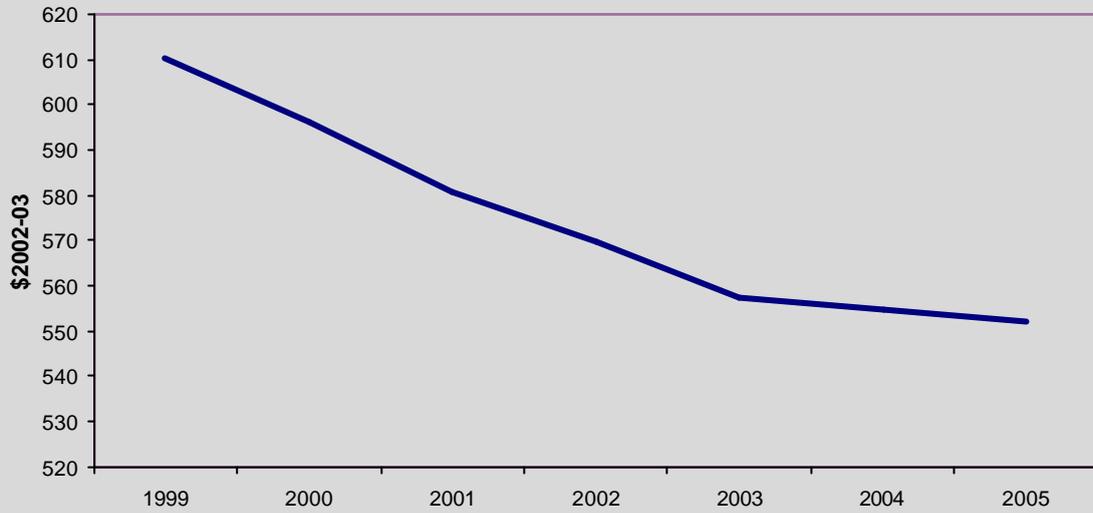
**Figure 6.1 Gross Revenue from usage and service charges**



Source: Gosford Council Annual Information Return

Figure 6.2 shows that Gosford Council customers have experienced a steady decline in real water bills since 1999.

**Figure 6.2 Average Residential Household Bill  
(assuming 210kL consumption)**



Source: IPART financial model for Gosford Council.

## 7 SUMMARY OF PRICING DECISIONS

In its submission, Gosford Council suggested that the Tribunal abandon the CPI-X methodology for setting prices, and proposed a series of nominal charges for 2003/04 and 2004/05. However, the Tribunal decided to continue using the CPI-X methodology, to maintain a consistent approach across each of the metropolitan water businesses. In addition, it prefers the CPI-X approach, as it provides more certainty about the outcomes of the Tribunal's pricing decisions in real terms.

The Tribunal considered the Council's pricing proposals for water, wastewater and stormwater services. It decided to increase prices overall, but by less than the rate of inflation in both 2003/04 and 2004/05, which is likely to result in a price decrease in real terms for most customers.

In making its pricing decisions the Tribunal has:

- increased the water usage charge but decreased water fixed charges
- increased the non-residential wastewater usage charge, but decreased wastewater fixed charges
- maintained stormwater charges in nominal terms
- accepted Gosford Council's proposals to introduce a \$65.00 trade waste agreement fee to apply from 1 July 2004 and maintain all other trade waste charges in nominal terms
- accepted Gosford Council's list of proposed miscellaneous charges for 2003/04 and determined that these charges should be maintained in nominal terms in 2004/05.

This chapter outlines the Tribunal's pricing decisions for each service and compares them with Gosford Council's pricing proposals and explains the Tribunal's rationale.

### 7.1 Water charges

In its submission to the Tribunal, Gosford Council proposed that water usage and water service charges be set in nominal terms for both 2003/04 and 2004/05 (Table 7.1).

**Table 7.1 Gosford Council's current and proposed water charges**

<b>\$ nominal</b>	<b>2002/03</b>	<b>2003/04</b>	<b>2004/05</b>
Usage charge (\$ per kL)	0.70	0.75	0.80
Service charge (\$ per annum)	70.00	70.00	70.00

1. The water service charge is based on the size of the meter connection to the property. This charge is calculated for a 20mm connection.

*Decision 1: The Tribunal decided to set maximum water charges in line with Table 7.2.*

**Table 7.2 Gosford Council's current and Tribunal determined water charges**

\$ nominal	2002/03	2003/04	2004/05
Usage charge (\$ per kL)	0.70	0.73	$0.73 \times (1.01 + \Delta\text{CPI})$
Service charge (\$ per annum)	70.00	71.47	$71.47 \times (0.99 + \Delta\text{CPI})$

1. The water service charge is based on the size of the meter connection to the property. This charge is calculated for a 20mm connection.

The Tribunal's anticipates that its decision to increase water usage charges and decrease water service charges will send an appropriate demand management signal to water users. The Tribunal's reasoning for this decision is discussed in section 5.1.

## 7.2 Wastewater charges

In its submission to the Tribunal, Gosford Council proposed that non-residential wastewater usage and residential wastewater service charges be set in nominal terms for both 2003/04 and 2004/05 (Table 7.3).

**Table 7.3 Gosford Council's current and proposed wastewater charges**

\$ nominal	2002/03	2003/04	2004/05
Residential wastewater service charge (\$ per annum)	340.30	363.00	374.00
Non-residential wastewater service charge (\$ per annum)	254.00	274.00	282.00
Non-residential wastewater usage charge (\$ per kL)	0.70	0.72	0.74

1. Based on 20mm wastewater service connection.

*Decision 2: The Tribunal decided to set maximum wastewater charges in line with Table 7.4.*

**Table 7.4 Gosford Council's current and Tribunal determined wastewater charges**

\$ nominal	2002/03	2003/04	2004/05
Residential wastewater service charge (\$ per annum)	340.30	347.14	$347.14 \times (0.99 + \Delta\text{CPI})$
Non-residential wastewater service charge (\$ per annum)	254.00	259.33	$259.33 \times (0.99 + \Delta\text{CPI})$
Non-residential wastewater usage charge (\$ per kL)	0.70	0.73	$0.73 \times (1.01 + \Delta\text{CPI})$

1. Based on 20mm wastewater service connection.

The Tribunal's reasoning for this decision is discussed further in section 5.1.

## 7.3 Stormwater charges

*Decision 3: The Tribunal decided to set maximum stormwater charges in line with Table 7.6.*

Gosford Council proposed that the drainage service charge be set at \$43.70 in 2003/04 and maintained in real terms in 2004/05.

**Table 7.5 Gosford Council's current and proposed stormwater charges**

\$ nominal	2002/03	2003/04	2004/05
Stormwater Drainage Levy(\$)	42.00	43.70	45.00

The Tribunal is concerned that, under Gosford Council's current arrangements for funding stormwater services, it is not able to establish a clear relationship between the revenue raised through the stormwater drainage levy and the expenditure of this revenue.

It has discussed its concerns with the Council, and agreed to work with it to simplify and clarify these arrangements by aligning asset ownership, revenues and expenditure over the next two years. In addition, it has decided to maintain the stormwater drainage levy at the 2003/04 level for both 2003/04 and 2004/05. It will reconsider this levy at the next price review.

**Table 7.6 Gosford Council's current and Tribunal determined stormwater charges**

\$ nominal	2002/03	2003/04	2004/05
Stormwater Drainage Levy(\$)	42.00	42.00	42.00

## 7.4 Trade waste charges

*Decision 4: The Tribunal has accepted Council's proposal to recover 50 per cent of the annual operating budget for administration and inspection of Gosford Council's trade waste section through an annual charge. This would require the introduction of an annual trade waste charge of \$65.00 levied on a total of 1086 trade waste discharges.*

Gosford Council proposed not to increase its trade waste charges (including adjustments for movements in the CPI) for 2003/04 or 2004/05. This proposal is in line with the Council's current trade waste pricing policy, which aims to encourage industry to move to the Gosford area by minimising the cost of treatment. Based on its review of the Council's trade waste pricing proposal, GHD advised the Tribunal that the current policy and charges regime is reasonable and of the right order of magnitude.<sup>31</sup> The Tribunal has therefore decided to maintain trade waste charges at the current level.

In addition, in a late submission,<sup>32</sup> Gosford Council noted that the Ministry of Energy and Utilities recently drafted guidelines on Water Supply, Sewerage and Trade Waste Pricing for local government organisations require all councils to levy an annual trade waste charge on all trade waste customers. Since Gosford Council does not currently have such a charge, it proposed to introduce a fee of \$65.00 per year.

The Tribunal decided to accept this proposal. It believes the introduction of an annual trade waste charge is appropriate, as it will allow the Council to recover some of the costs incurred in servicing trade waste customers and is consistent with the fees charged by other metropolitan water agencies.

<sup>31</sup> GHD *Review of trade waste pricing proposals by Sydney Water Corporation, Hunter Water Corporation, Gosford Council and Wyong Council*, March 2003, p 35.

<sup>32</sup> Letter to IPART, 31 March 2003, p 1.

**Table 7.7 Gosford Council's Tribunal determined Trade Waste charges**

<b>\$ nominal</b>	<b>2003/04</b>	<b>2004/05</b>
Acceptable quality excess volume (per kL)	\$0.20	\$0.20
Unacceptable quality volume (per kL)	\$1.30	\$1.30
Biological oxygen demand (per 1,000mg/litre)	\$1.30	\$1.30
Non-filterable residue (per 1,000mg/litre)	\$1.30	\$1.30
Re-inspection fee	\$74.00	\$74.00
Trade waste agreement fee	\$0.0	\$65.00

A detailed list of trade waste charges can be found in the attached determination (see schedule 3).

## 7.5 Miscellaneous charges

The Tribunal sets miscellaneous charges for the range of ancillary services Gosford Council provides, including special meter readings, statements of available pressure and flows and an application for water service connection. Although these charges do not account for a large proportion of the total revenue earned by Council, they can be significant for those customers who are required to pay them.

Since the last determination, the Tribunal established a working group of representatives from each of the water agencies and the Tribunal Secretariat to draw up and agree on a list of the 20 main miscellaneous services. This list formed the basis for the miscellaneous charges proposals for each of the agencies.

The Tribunal has not attempted to align the prices of each of these service charges across the four water agencies. This is because there may be significant cost justifications for the services being priced differently. Where prices varied substantially between the agencies, the agency was asked to provide a justification for the variation.

The water agencies adopted the following formula to calculate the level of charges:

$$\text{Miscellaneous charge} = \text{base cost} + \text{direct material cost}$$

The Tribunal has accepted Gosford Council's list of proposed miscellaneous charges for 2003/04 and determined that these charges should be maintained in nominal terms in 2004/05. A detailed list of these charges can be found in the attached determination (see schedule 4).

## 7.6 Vacant land charges

*Decision 6: The Tribunal has decided to set vacant land charges in line with Table 7.8.*

During its price review, the Tribunal looked closely at the issue of vacant land charges levied by Gosford Council, and concluded that the existing sewerage charge for holders of vacant land is not appropriate.

The residential sewerage charge is designed to recover both the costs of access to and usage of the sewerage system. Because vacant land does not make use of the sewerage system, the Tribunal has determined that the sewerage charge for vacant land will now be set at 75 per cent of the residential sewerage charge.

In its submission, Gosford Council noted that vacant land sewerage charges are included in the 2000 determination at section 3.1.2 under non-residential. The Council interpreted this to mean that these charges apply to non-residential vacant land only. It suggested that all vacant land should receive the same service availability charge, which should be equal to the non-residential charge for a 20mm meter.<sup>33</sup>

The Tribunal believes that as these customers do not utilise the system at all, charging the 75 per cent of the full sewerage charge appropriately reflects the costs of network availability only.

**Table 7.8 Gosford Council's Tribunal determined vacant land charges**

<b>\$ nominal</b>	<b>2002/03 Current</b>	<b>2003/04</b>	<b>2004/05</b>
Water	70.00	71.47	$71.47 \times (0.99 + \Delta\text{CPI})$
Wastewater	340.30	347.14	$347.14 \times (0.99 + \Delta\text{CPI}) \times 0.75$

## 7.7 Exempt properties

*Decision 7: The Tribunal has not set specific water access maximum charges for exempt properties.*

Gosford Council proposed that general water service or availability charges be specifically applied to properties exempt from service charges under the *Water Management Act 2000*. It did not propose a specific water usage charge for exempt properties.

The Tribunal has reviewed the water charges proposed by Gosford Council for these properties. In light of legal advice it has received, it has not set a maximum charge in the nature of a fixed or service charge for these properties.

<sup>33</sup> Gosford Council Submission, September 2002, p 22.

## **8 ISSUES ARISING FROM THIS DETERMINATION FOR GOSFORD COUNCIL TO CONSIDER PRIOR TO THE 2005 REVIEW**

The 2003 review of prices for Gosford Council's water, wastewater and stormwater services has raised a number of broader regulatory policy issues that the Tribunal wishes to consider in more detail during the two years leading to the 2005 price review. The most significant of these issues are:

- whether the water business can pay dividends to the general council
- responsibility for and structure of stormwater costs,
- the impacts of the joint review by Gosford and Wyong councils of water supply options
- Halcrow's suggestions for improving planning, documentation, systems, procedures and organisational capabilities
- The approach taken to regulating capital expenditure
- The effect of alternative pricing structures on demand

The Tribunal also intends to:

- review the developer charging methodology, including auditing development servicing plans and their relationship to annual charging

The Tribunal intends to establish a reference group that comprises representatives of each agency and other interested stakeholders, to allow the formal discussion of proposals as they are developed. Where needed, it will also release issues papers or undertake further consultation.

The Tribunal recognises that it may not be able to resolve all of these issues by the next price, and will try to prioritise the list tackling the most important issues first. Many of the recommendations that result from this process may, if implemented, require the water agencies to develop their information reporting capabilities. Where this is the case, the Tribunal will specifically discuss the requirements with each agency to identify how feasible meeting the information reporting needs will be.

**GLOSSARY**

CPI	Consumer price index
EPA	Environment Protection Authority of NSW
Halcrow	Halcrow Pacific Pty Ltd
IPART	Independent Pricing and Regulatory Tribunal of New South Wales
IPART Act	<i>Independent Pricing and Regulatory Tribunal Act, 1992</i>
kL	Kilolitre (1000 litres)
STP	Sewerage treatment plant
Tribunal	Independent Pricing and Regulatory Tribunal
WACC	Weighted average cost of capital

## APPENDIX 1 LIST OF SUBMISSIONS

### Submissions in relation to the Issues Paper of June 2002

Australian Water Association  
Central Coast Community Environment Network  
Colong Foundation for Wilderness  
Economic Planning Advocacy  
Environment Protection Agency of New South Wales  
Energy and Water Ombudsman  
Gosford City Council  
Gosford Wyong Joint Water Authority  
Hornsby Shire Council  
Department of Housing  
Hunter Water Corporation  
Incitec Pty Ltd  
National Standards Commission  
Nature Conservation Council of New South Wales  
National Parks and Wildlife Service of New South Wales  
Public Interest Advocacy Centre  
Stormwater Industry Association  
Sydney Catchment Authority  
Gosford City Council  
Total Environment Centre  
Urban Development Institute of Australia  
Warringah Council  
Wingecarribee Shire Council  
Wyong Shire Council

Mr R Banyard  
Mr F Keep  
Mr Walter Wood

## **APPENDIX 2 PRESENTERS AT THE PUBLIC HEARING**

**The list of presenters at the public hearing on 10 December 2002 were:**

Mr Peter Wilson, Gosford City Council  
Mr Rod Williams, Gosford City Council  
Mr John Davis, Gosford City Council

Mr John Dawson, Wyong Shire Council  
Mr David Cathers, Wyong Shire Council  
Mr Ken Grantham, Wyong Shire Council  
Mr Graeme Thomas, Wyong Shire Council

Mr David Murdoch, Gosford Wyong Joint Water Authority

Mr John Asquith, Central Coast Community Environment Network

## APPENDIX 3 IPART ACT REQUIREMENTS

Section 15 of the IPART Act 1992 details the matters to be considered by the Tribunal when making a determination. The section is reproduced in full below.

### 15 Matters to be considered by Tribunal under this Act

(1) In making determinations and recommendations under this Act, the Tribunal is to have regard to the following matters (in addition to any other matters the Tribunal considers relevant):

- (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 Environment 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 the 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).

(2) In any report of a determination or recommendation made by the Tribunal under this Act, the Tribunal must indicate what regard it has had to the matters set out in subsection (1) in reaching that determination or recommendation.

(3) To remove any doubt, it is declared that this section does not apply to the Tribunal in the exercise of any of its functions under section 12A.

(4) This section does not apply to the Tribunal in the exercise of any of its functions under section 11 (3).

Table A3.1 indicates where the matters have been considered throughout the report by the Tribunal in making this determination.

**Table A3.1 Consideration of section 15 matters by Tribunal for Gosford Council determination**

<b>Section 15(1)</b>	<b>Report reference</b>
(a) cost of providing the service	Sections 4.3 and 4.4
(b) protection of consumers from abuse of monopoly power	Chapter 5 generally
(c) appropriate rate of return and dividends	Section 4.5
(d) affect on general price inflation	Chapter 4 generally
(e) improved efficiency in supply of services	Chapter 4 generally
(f) ecologically sustainable development	Chapter 6 generally
(g) impact on borrowing, capital and dividend requirements	Section 4.5
(h) additional pricing policies	Section 7.4
(i) need to promote competition	Section 7.6
(j) considerations of demand management	Chapter 6
(k) the social impact on customers	Chapter 5
(l) standards of quality, reliability and safety of the services	Section 5.4

*Section 16 requirements*

Section 16 of the IPART Act requires the Tribunal to report on the likely impact to the Consolidated Fund if the price was not increased to the maximum permitted.

## APPENDIX 4 BUILDING BLOCK METHODOLOGY AND INCENTIVE REGULATION USING CPI ± X

### *Building Block Methodology*

The Tribunal has adopted a building block approach to calculate the revenue requirement needs of the metropolitan water agencies. The revenue requirement for a particular year in the price path can then be expressed as:

$$\text{Revenue Requirement} = \text{Operating Expenditure} + \text{Depreciation} + \text{Return on Assets}$$

The return on assets can be further broken down into:

$$\text{Return on Assets} = \text{Rate of Return} \times \text{Regulatory Asset Base}$$

Each element of the building block revenue requirement is considered in detail below.

### *Operating expenditure*

Operating expenditure is determined by reviewing the proposals of the water agency to determine what an efficiently operating business could be expected to need to operate the business effectively, without compromising service quality.

For this review, Halcrow was engaged to review operating expenditure for efficiency, which was a key input to the Tribunal's operating expenditure allowance decision. Halcrow's approach to reviewing operating expenditure involved starting with a base year (2001/02) actual operating expenditure. Efficient operating expenditure in subsequent years was calculated by increasing base year operating expenditure for reasonable uncontrollable cost rises, such as real wage increases, electricity cost rise, growth allowances, while assuming a degree of efficiency attainment by the business during the same period. The subsequent operating expenditure was Halcrow's view as to what an efficiently run water business in Gosford Council's position could be expected to operate the business for.

On the basis of Halcrow's review and comments by the agency, the Tribunal decided upon an allowance for operating expenditure for the periods of the price review.

### *Capital Maintenance*

An allowance is made for capital maintenance, recognising that during the provision of services to customers, the water agencies capital infrastructure will wear out. An efficiently operating water business will therefore allow for the cost of maintaining the financial capital base within current revenue requirements.

Capital maintenance is calculated on a straight line basis, over the average life of the assets. This means that the total value of the regulatory asset base is recovered within that period, which is assumed to be 70 years for water assets.

It is the combination of an allowance for capital maintenance, and a return of assets which ensures that the existing investment in the water business is maintained in perpetuity.

*Return on assets*

The return on assets is an allowance for a return to the capital investor in the water business. It ensures that efficient investment in capital continues into the future for the maintenance and growth of the infrastructure system.

It is calculated as a percentage of the regulated asset base, reflecting a commercial return to the financial assets of the business. All new investment is rolled into the regulatory asset base resulting in it earning a commercial rate of return, set by the Tribunal. The rate of return is determined with reference to the weighted average cost of capital – a measure of the cost to the business for investing in capital.

The building block methodology is an important part of the Tribunal's considerations when determining prices for the regulated agencies. However, it is not used in isolation from the exercise of the Tribunal's regulatory judgement, and may be modified reflecting the Tribunal's considerations of the social or environmental impacts of its pricing decisions.

*Incentive regulation using CPI±X*

The determination of the revenue requirement using the building block methodology gives the Tribunal an indication of the amount of revenue which an efficiently operated water business requires. An important part of regulation however, is to encourage the regulated water businesses to achieve the efficiency targets implied in the building block approach. This is what is known as incentive regulation, and the Tribunal's preferred approach is the use of CPI±X.

CPI±X means that once the revenue requirement is determined within a year, subsequent years prices are increased by general price inflation measured by the CPI index, modified by an X factor. The X factor represents positive or negative adjustments to prices, above or below general price rises.

The CPI±X approach provides an incentive to the business to achieve the efficiency targets, because of the potential for non-achievement to impact on the profits of the business. If the agency better the X factor efficiency target in its costs, then those gains are kept by the business for the duration of the price path. If the agency does not achieve the X factor efficiency improvements to costs, then this results in a lower than expected return to the capital investment, and profits to the owners of the business.

For example, if the Tribunal set prices which achieved revenue of \$100 million in year 1 of the price path, with a CPI-2 modification to prices in year 2, then the agency would be expected to decrease costs by 2 per cent in year 2, or \$2 million. If the agency failed to reduce costs by \$2 million, then profits would be lower than expected. If it reduced costs by more than \$2 million, then profits would be higher than expected.

It is through the interaction between X factors, efficiency targeting and profits that appropriate incentives are created for the achievement of efficiency improvements in the delivery of the business' services to customers.

## APPENDIX 5 PROVISION OF SUFFICIENT REVENUE FOR ESSENTIAL RENEWALS AND MAINTENANCE EXPENDITURE

The provision of infrastructure by regulated utilities, especially for water, electricity, gas and rail transport, is an integral part of the delivery of these services to customers. Infrastructure related costs account for a large proportion of the total annual costs for delivery of these services.

IPART, like many price regulators, allows funding of infrastructure related costs through its use of the building block revenue approach to calculating the revenue requirements of regulated utilities. Any annual operating costs relating to infrastructure, for example repairs and maintenance, is allowed for directly in the building block revenue. Capital expenditure to replace worn out infrastructure and due to an increase in customers is funded through an allowance for capital maintenance (depreciation) and a return on capital. This is calculated indirectly as capital expenditure is included in the regulatory asset base (RAB) which subsequently earns a rate of return and is depreciated.<sup>34</sup>

While this existing approach ensures that sufficient revenue is provided to fund capital expenditure and ongoing infrastructure operating expenditure, it relies on a number of key assumptions which have implications for the operation of the regulated utility.

First, it assumes that the utility can fund capital expenditure through debt or equity financing. Once the capital expenditure has been incurred, by inclusion in the regulatory asset base, it attracts a rate of return and is depreciated which should provide sufficient revenue to pay any debt or equity financing costs.

The ability of the utility to fund capital expenditure, through debt financing especially, depends on its overall financial viability and cash flow. If debt levels are already high, then the utility's inability to debt finance may become a limiting factor to the provision of infrastructure especially when unexpected capital expenditure is required to maintain the system. In a workably competitive market, it would be expected that in these circumstances the injection of additional equity from the owners may be required. For a regulated business, the regulator may also need to consider whether a temporary increase in prices to increase cash flows is appropriate.

Second, the building block approach to funding capital expenditure relies on an estimate of the average asset life of the assets. To the extent that this estimate is incorrect, then revenue shortfalls could occur unless significant price increases are allowed. For this reason the Tribunal uses conservative average asset lives of 70 years for water infrastructure. As the actual average asset life of these assets are likely to be well in excess of 70 years, the existing approach should amply provide for asset replacement.

Third, the utility may reduce investment in renewing infrastructure or reduce expenditure in essential repairs and maintenance, as an easy short term way of achieving cost efficiencies. The regulatory approach assumes that the utilities' capital expenditure priority setting process and operating budget allocation process assesses the risk to the business of reducing renewals related expenditure to achieve cost savings. To the extent that these risks are not considered by the business when reducing renewals expenditure, this may lead to problems in the medium to long term.

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<sup>34</sup> See Appendix 4 for further details on the building block approach and incentive regulation.

Finally, there appears to be general concern amongst regulated utilities about the need to fund renewals capital expenditure through existing depreciation allowances, reflecting an adversity to debt or equity finance renewals capital expenditure. As depreciation reflects past capital expenditure - many of which have been considered sunk costs by regulators - it need not equal current renewals capital expenditure requirements. Looking forward however, future renewals capital expenditure will be funded through depreciation allowances for the life of these new replacement assets rendering any comparisons with current depreciation allowances of limited value.

The validity of each of these assumptions can affect the regulated utilities ability to in practice ensure the continued maintenance of the infrastructure of their businesses. Where the availability of capital is limited, there is considerable uncertainty surrounding asset lives and where the business culture results in efficiency gains resulting in a reduction in expenditure on key repairs and maintenance then infrastructure may not be properly maintained.

The impact of regulation on the provision of sufficient revenue is of critical concern to the Tribunal. Assessing the use of asset management plans will increasingly become an approach adopted by the Tribunal to address this concern at future price reviews.

## APPENDIX 6 REGULATORY ASSET BASE AND RATE OF RETURN

**Table A6.1 FORECAST REVENUE REQUIREMENTS (pre-tax and excluding capital contributions and unregulated income) COMBINED BUSINESS (\$ millions, nominal)**

Financial year ending 30 June	2000	2001	2002	2003	2004	2005
Opening fixed asset value (\$ million)	-	218.7	229.9	235.8	246.3	261.1
plus net capital expenditure <sup>1</sup>	-	1.7	2.7	6.9	10.8	13.2
less disposals	-	(0.5)	(0.2)	(0.3)	(0.3)	(0.3)
less depreciation	-	(3.1)	(3.2)	(3.3)	(3.4)	(3.7)
plus indexation	-	13.1	6.6	7.2	7.8	8.0
Closing fixed asset value	218.7	229.9	235.9	246.3	261.1	278.4
Working capital (closing balance)	6.1	6.2	6.1	6.5	6.4	6.9
Total regulatory asset base	<b>224.8</b>	<b>236.1</b>	<b>241.9</b>	<b>252.8</b>	<b>267.5</b>	<b>285.3</b>
Operating expenditure (\$ million)	20.3	24.3	24.9	28.8	24.8	25.3
Depreciation	3.0	3.1	3.2	3.3	3.4	3.7
Tax payable (less franking credits)	-	-	-	-	-	-
Expected return on assets	17.1	11.8	12.1	7.6	14.7	15.6
Expected revenue	40.5	39.2	40.2	39.7	42.9	44.5
<i>Indexation of working capital</i> <sup>2</sup>	0.1	0.4	0.2	0.2	0.2	0.200
Return on assets (% , real pre-tax) <sup>2,3</sup>	<b>nc</b>	<b>5.0%</b>	<b>5.0%</b>	<b>3.0%</b>	<b>5.6%</b>	<b>5.6%</b>

Notes:

1. Net capital expenditure is capital expenditure net of all capital contributions.
2. The indexation of working capital (\$ value) is subtracted from the total expected return on assets to calculate the real return. The opening balance plus half of the change during the year is indexed, if working capital is included in the RAB.
3. The real return on assets is calculated on the average asset base for the year.

*What is the regulatory asset base, and how is it rolled forward?*

The regulatory asset base (RAB) is a measure of the financial value invested in the water business and bears no relationship to the value of the physical assets. It represents the value a market would place on the business if it was to be sold, given its potential to earn revenue and profits under existing prices.

The RAB exists as the basis for determining the return of and on capital in the revenue requirement calculation based on the building block approach. The reason for adopting a financial capital base for regulatory purposes is to ensure that an appropriate rate of return is given to the shareholder value of the business. It also ensures that efficient investment is made in the refurbishment and enhancement of existing assets, by allowing new financial investment to attract a commercial rate of return, reflecting risks associated with the business.

The regulatory asset base is rolled forward by adding new, prudent capital expenditure from the closing value of the previous year. The RAB is modified to account for inflation, disposal of assets and depreciation.

## APPENDIX 7 WEIGHTED AVERAGE COST OF CAPITAL PARAMETERS

The parameters used to generate the weighted average cost of capital are presented in Table A7.1 below.

**Table A7.1 Parameters used to generate the weighted average cost of capital**

<b>Parameter</b>	<b>Value</b>
Nominal risk free rate	5.1% <sup>1</sup>
Real risk-free rate	2.9%
Inflation	2.2% <sup>2</sup>
Market risk premium	5 - 6%
Debt margin	0.7 - 1%
Debt to total assets	60%
Dividend imputation factor (Gamma)	0.5 - 0.3
Tax rate	30%
Asset Beta	0.3 - 0.45
Debt Beta	0.06 - 0.14
Equity Beta	0.65 - 0.90
Cost of equity (nominal post tax)	8.4 - 10.5%
Cost of debt (nominal pre tax)	5.8 - 6.1%
WACC (nominal post tax)	5.2 - 6.3%
WACC (real post tax)	3.0 - 4.1%
<b>WACC (real pre tax)</b>	<b>5.2 - 6.7%</b>

Notes:

1. The nominal risk free rate is based on 20 days average of the 10 year Commonwealth bond rate up to 15 April 2003.
2. The inflation rate used in the WACC calculation is based on observed differences in nominal and real 10 year bond rate indexes. These differences reflect market expectations of the long term inflation rate.

The Tribunal reviewed its methodology for calculating the WACC range in 2002, and sought stakeholder comments on whether the WACC range should be presented in real or nominal terms - pre or post-tax. Additionally, it considered the advantages and disadvantages of using a statutory or effective tax rate.<sup>35</sup>

As the regulatory asset base is rolled forward in real terms, it is appropriate to report the WACC in real terms. Additionally, for consistency with previous water price determinations, the Tribunal has maintained the pre-tax WACC range, using a statutory tax rate for this price review.

The Tribunal has reviewed the WACC parameters used at the 2000 determination. This has resulted in a reduction in the upper bound of the equity beta to 0.9, reflecting a view that water utilities in general are likely to have lower than market risk characteristics. Additionally, the lower bound of the debt margin was reduced to 0.7, reflecting information on the debt margins charged by Treasury Corporation to the Government owned water businesses.

<sup>35</sup> For details of the alternative approaches see the Tribunal's discussion paper, *Weighted Average Cost of Capital*, DP56, August 2002.

The Tribunal is undertaking a comprehensive review of all of the parameters used to calculate the WACC range prior to the forthcoming distribution network service price review. This is expected to lead to additional revisions to the WACC parameters, and these will form the basis of a metropolitan water WACC range for the next price determination.

The combined impact of these parameter changes, including an update of the long term market inflation rate and 20 day average 10 year bond rate, resulted in the WACC range being 5.2 to 6.7 per cent.

## APPENDIX 8 FINANCIAL VIABILITY AND CREDIT RATINGS

	2001/02	2002/03	2003/04	2004/05
<b>Ability to service debt</b>				
1. EBITDA interest cover	73.54	(4.89)	(10.10)	(7.81)
NSW Treasury ratings (2002)	AAA	AAA	AAA	AAA
2. Funds from operations interest coverage	106.44	(5.50)	(10.81)	(8.11)
Standard and Poors US ratings (1995)	AA	AA	AA	AA
3. Pre-tax interest coverage	25.86	(0.36)	(4.33)	(3.53)
Standard and Poors US ratings (1995)	AA	AA	AA	AA
<b>Ability to repay debt</b>				
4. Funds flow net debt payback	(1.20)	(1.90)	(1.86)	(2.13)
NSW Treasury ratings (2002)	AAA	AAA	AAA	AAA
5. Funds from operations/total debt (%)	131%	282%	499%	574%
Standard and Poors US ratings (1995)	AA	AA	AA	AA
6. Debt gearing (regulatory value)	-9%	-12%	-16%	-18%
NSW Treasury ratings (2002)	AAA	AAA	AAA	AAA
Standard and Poors US ratings (1995)	AA	AA	AA	AA
<b>Ability to finance investment from internal sources</b>				
7. Internal financing ratio	577%	195%	187%	167%
NSW Treasury ratings (2002)	AAA	AAA	AAA	AAA
8. Net cash flow/capital expenditure (%)	839%	216%	199%	172%
Standard and Poors US ratings (1995)	AA	AA	AA	AA
<b>NSW Treasury overall score and rating</b>				
NSW Treasury total score (0-10)	10.00	10.00	10.00	10.00
Overall rating	AAA	AAA	AAA	AAA
9. Net debt (\$m of the day)	(22.82)	(30.78)	(41.48)	(51.05)

## Notes:

- (i) The Tribunal particularly relies on indicators based on cash flows because these are not as subjective as indicators that use components derived from estimates (eg asset value and depreciation).
- (ii) The information in this table should be read and understood only after reviewing Appendix 9 and the explanations and qualifications mentioned there.

1. EBITDA interest cover	(EBITDA excl capital contributions) / net interest
2. Funds from operations interest coverage	(Pre-tax funds flow + net interest) / (net interest)
3. Pre-tax interest coverage	(EBIT - capital contributions) / net interest
4. Funds flow net debt payback	(Debt - cash assets) / (NPAT + depreciation + tax expense - tax paid)
5. Funds from operations/total debt (%)	see note below for definition of funds from operations
6. Debt gearing (regulatory value)	(Debt - cash assets) / (regulatory value of fixed assets + working capital)
7. Internal financing ratio	(NPAT - cap cons + depreciation - dividends payable) / net capex
8. Net cash flow/capital expenditure (%)	(Funds from operations - dividends) / (capex net of capital contributions)
9. Net debt	Total debt less cash, short-term and long-term investments

## APPENDIX 9 FINANCIAL INDICATORS

The indicators of financial performance include notional credit ratings of regulated businesses. Indicative benchmarks supplied by Standard and Poor's (S&P) ratings group that are published from time to time<sup>36</sup> are used to estimate these ratings. The indicative ratios are used by S&P as one of its analytical tools in setting overall ratings, and the Tribunal uses the indicators in a similar manner, i.e. as part of the overall financial analysis of the regulated business. The overall ratings that have been or may be derived by S&P for a business cannot be derived from simple inspection of these ratios.

Indicative ratios for each ratio for each year during the medium term price paths set in 2000 were published in the Tribunal's Determinations for each of the regulated water businesses. In Tables 3.2 and 5.3, the Tribunal has

- calculated various financial ratios for the one year of results considered in this report in accordance with the methodologies used by S&P and
- indicated the rating applicable for each ratio based on the bands published by S&P.

The calculation and assessments are those of the Tribunal and not S&P.

The actual rating process used by S&P is very broad, involving subjective judgements of industry risk and cost structures, not just financial ratios. S&P use both qualitative and quantitative analyses in determining an entity's rating. The ratios used by the Tribunal in its financial analysis are part of the latter - they should be used as a guide rather than as blanket reasons for giving a certain rating. The overall ratings that have been or may be derived by S&P for a business cannot be derived from simple inspection of these ratios.

S&P divide its analysis into:

- business risk - including market position, technology, efficiency and management capabilities, the prospects for growth in the industry, and vulnerability to technological changes or labour unrest or regulatory changes and
- financial risk - looking at financial management policies, cash flow protection, capital structure and profitability.

S&P's analysis incorporates an evaluation of a company's business and financial risks. In its guideline ratios, S&P provided financial indicator ranges for each of 'above average' business position, 'average' business position and 'below average' business position. During the analysis undertaken in 2000 as part of the determination process, the Tribunal decided that each of the regulated water businesses had an 'excellent' risk profile.

An acceptable range of financial ratios for each rating category will differ from time to time according to the unique characteristics of the business. There may not be a perfect match between the ratios and the indicator rating; the ratios represent midpoints of ranges, and vary during an investment cycle, particularly the internal financing ratio. In addition, S&P's credit ratings are prospective, with ratings reflective of a company's expected financial

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<sup>36</sup> Two sets of ratios have been used, for consistency with the financial analysis undertaken by the Tribunal during the 2000 determination process. The 'NSW Treasury Rating' indicators are from *The Capital Structure for NSW Government Trading Enterprises* report produced in August 1994 by NSW Treasury as part of its financial policy framework for GTEs, and are based on ratios provided to Treasury by S&P. The "S&P" criteria are from S&P's Corporate Finance Criteria for 1995.

profile. For this reason, the ratings indicated by the ratios for each of the regulated businesses based on one year's financial results may not be the same as the actual rating given by S&P.

## APPENDIX 10 COMPARISON STATISTICS FOR KEY FINANCIAL AND PERFORMANCE DATA FOR METROPOLITAN WATER AGENCIES

The information following is for the period up to 30 June 2002 and is mainly taken from Annual Information Returns provided by the water agencies (Gosford City Council, Hunter Water Corporation, Sydney Water Corporation, Wyong Shire Council) to the Tribunal. Wherever possible, the information relates to the monopoly elements of each water business. Although the Tribunal regulates the Sydney Catchment Authority, this attachment does not analyse the Authority's performance. The Authority is a bulk supplier of water to Sydney Water without the large retail customer base of the four water retailers. These differences make performance comparisons inappropriate.

The four retail water agencies are similar in that they provide water, wastewater and stormwater services to large numbers of retail customers. However they vary in their size and in their operating environments and this can often explain differences in individual performance. Table A10.1 below provides an insight into those variations. When setting prices, of particular interest is the two corporations' obligation to pay tax equivalents and dividends and to have Operating Licences with the State Government. The licences are regulated by the Tribunal. While the councils currently do not pay tax equivalents or dividends, legislation has been proposed which, if passed, will allow the water business area of local councils to pay dividends to the general council area. This may affect prices in future determinations.

Sydney Water differs in one important respect to the other three water retailers. While Hunter Water, Gosford Council and Wyong Council are responsible for their own bulk water supplies, Sydney Water purchases water in bulk from the Sydney Catchment Authority. The creation of the Catchment Authority has influenced the trend in Sydney Water's costs since 2000. The cost of supplying bulk water has increased because the Authority is required to perform a greater range of activities in the catchment area than Sydney Water did when it had that responsibility.

**Table A10.1 Agency characteristics (for 2001/02)**

	<b>Gosford</b>	<b>Hunter</b>	<b>Sydney</b>	<b>Wyong</b>
Operating area (kms <sup>2</sup> )	1,028	5,400	13,000	827
Number of residential customers/properties	60,000	195,000	1,526,000	53,000
Number of employees	161	526	3,556	157
Metered consumption (GLs)	16	62	535	15
Gross tariff revenue (\$million)	39	115	1,247	35
Dividend/tax payments?	No	Yes	Yes	No
Operating licence?	No	Yes	Yes	No

**PRICING**

Figure A10.1 shows the change in the combined water and wastewater bill for a residential customer consuming 250kL per annum. The elimination of property based charges has heavily influenced the reductions in bills, while the wastewater portion of bills has reduced more than the water portion.

**Figure A10.1 Residential water and wastewater bills (250kL consumption)**

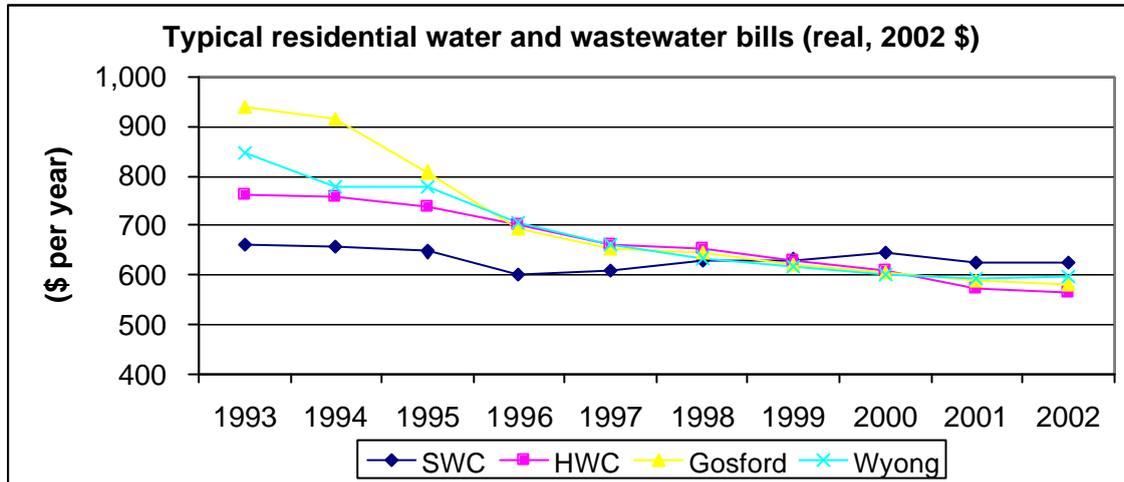
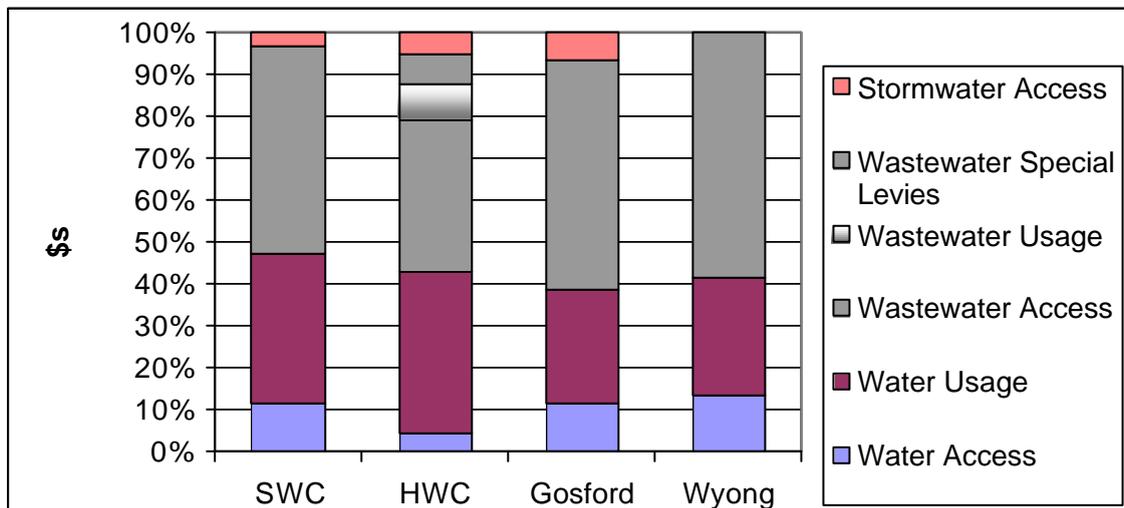


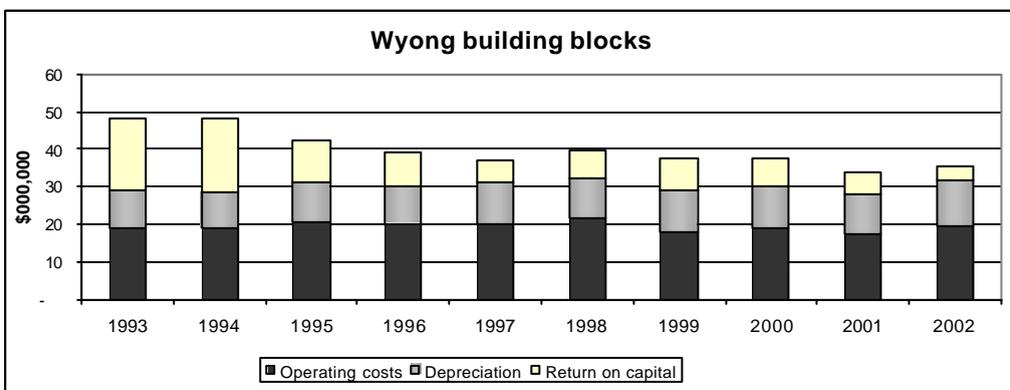
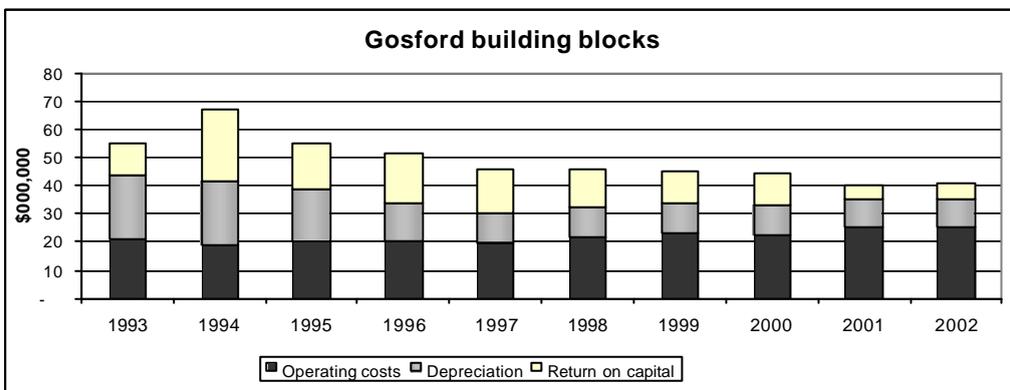
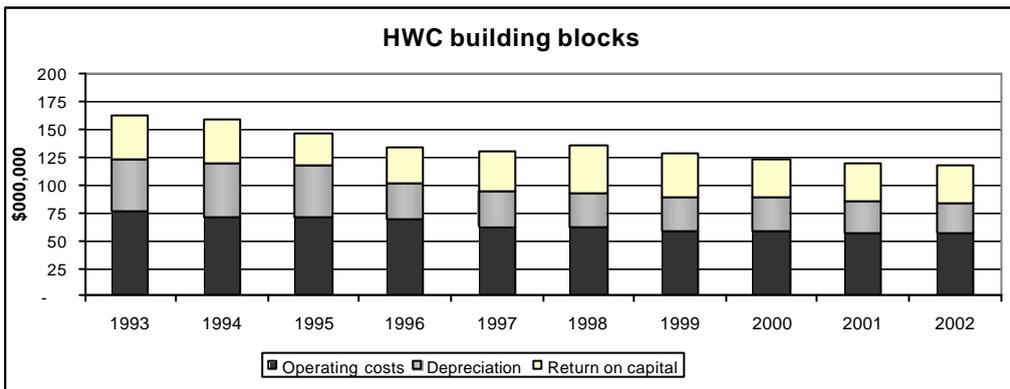
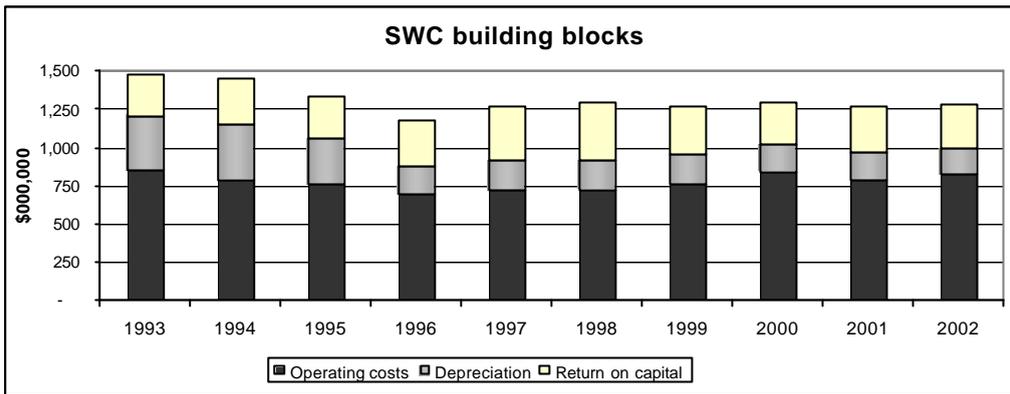
Figure A10.2 breaks the bill of a residential customer consuming 250kLs per annum into the various types of charges levied by the water agencies. The corporations' customers pay a significantly higher percentage of the water portion of their bills through usage charges than the councils' customers.

**Figure A10.2 Residential bill components (2002)**



The Tribunal uses a methodology to determine prices known as the building block method. Prices are formulated to provide levels of revenue calculated by adding forecast operating expenditure, forecast return of capital (sometimes measured by depreciation), and a return on capital. Figure A10.3 shows the movement in those building blocks since 1993.

Figure A10.3 Building block components (real, 2002\$s)



**CONSUMPTION**

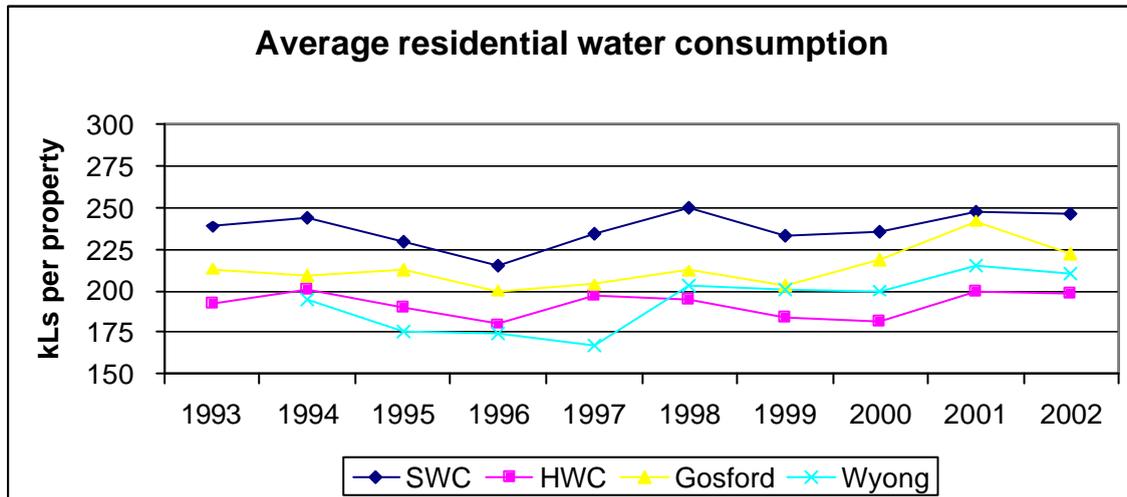
Table A10.2 shows the volume of water delivered to residential and non-residential properties.

**Table A10.2 Total metered water consumption (GLs)**

	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002
Sydney Water	477	495	472	447	480	516	495	508	537	535
Hunter Water	60	63	62	61	64	66	62	61	64	62
Gosford Council	14	14	15	14	15	16	15	16	17	16
Wyong Council	-	12	12	12	11	13	14	14	15	15

Figure A10.4 shows the change in water consumption on a per property basis for residential customers. Seasonal weather conditions and the introduction of usage pricing in the early part of the review period influenced interim reductions, but current average consumption levels are still at 1993 levels.

**Figure A10.4 Average metered residential water consumption (kLs/property)**



**REVENUE**

Figure A10.5 shows that total tariff revenue in real terms has declined since 1993. This has occurred while customer numbers have increased.

**Figure A10.5 Change in total tariff revenue (1993 as the base year)**

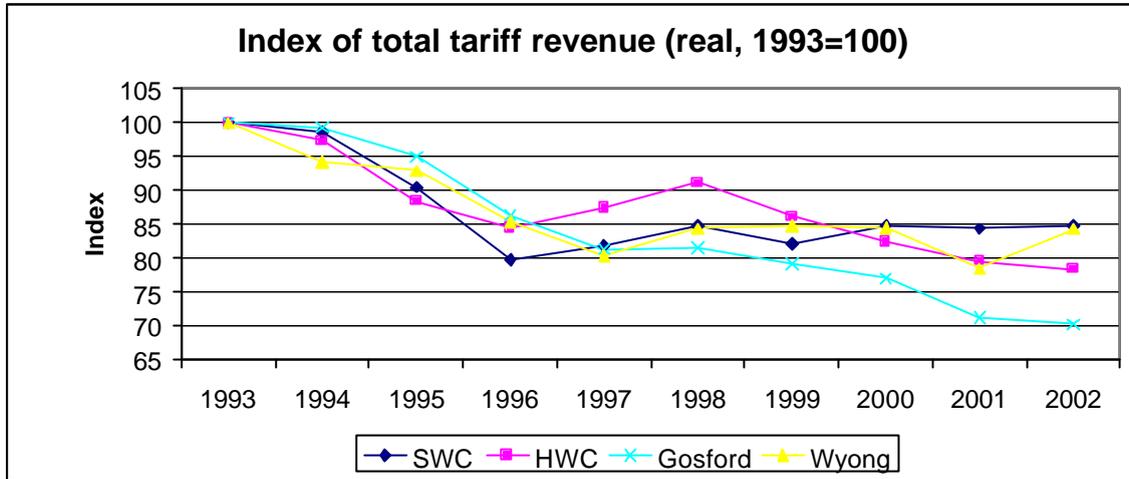


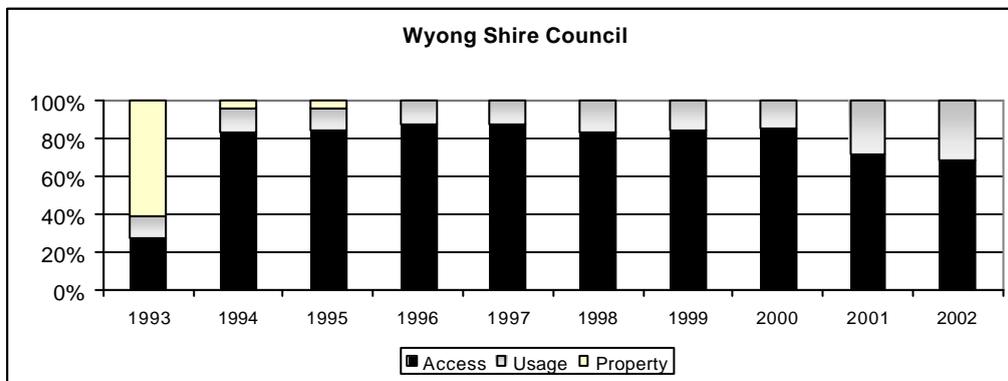
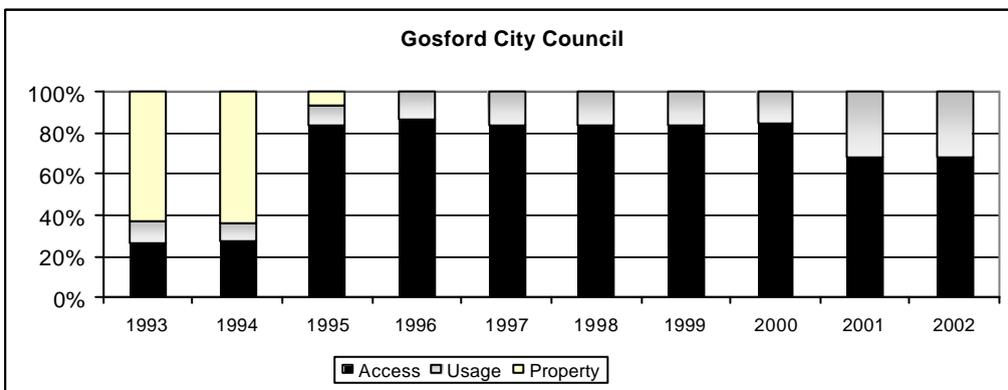
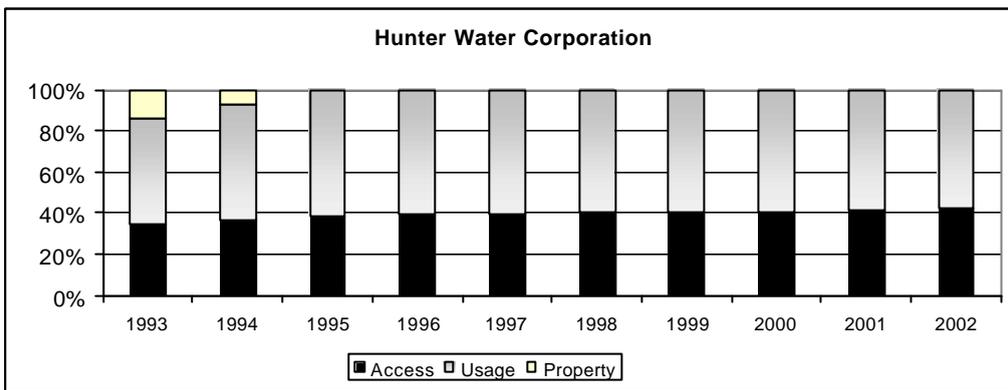
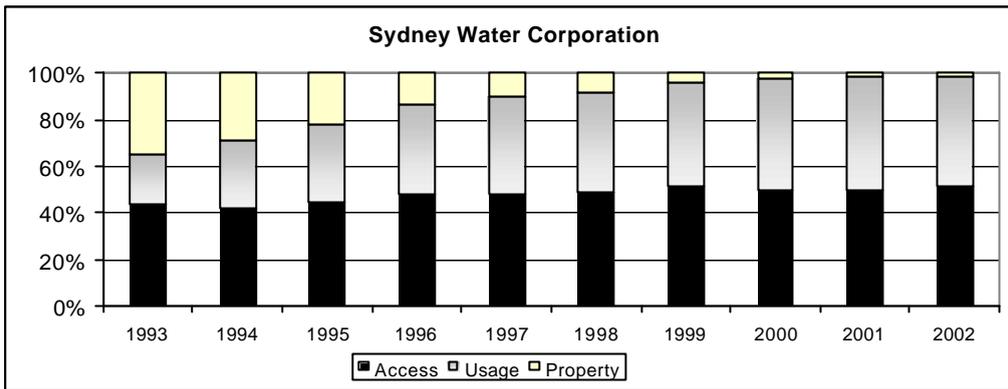
Table A10.3 shows the trend in residential and non-residential tariff revenue per property. Of note is that cross-subsidisation to residential in the early part of the review period has been progressively reduced.

**Table A10.3 Average water and wastewater sales revenue per property (real, 2002 \$s)**

	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002
<b>Sydney Water</b>										
Residential	565	601	610	553	570	599	587	605	591	597
Non-residential	7,434	6,475	4,880	3,859	3,748	3,575	3,148	3,084	2,999	2,809
<b>Hunter Water</b>										
Residential	542	548	515	460	489	478	461	439	430	424
Non-residential	4,938	4,299	3,358	3,520	3,637	3,031	2,892	2,831	2,514	2,383
<b>Gosford Council</b>										
Residential	938	907	822	719	648	625	620	597	571	546
Non-residential	2,551	2,530	2,885	3,006	2,937	3,199	2,537	2,390	1,905	2,081
<b>Wyong Council</b>										
Residential	836	739	711	647	595	625	621	601	539	565
Non-residential	3,414	4,097	3,773	3,046	2,750	2,350	2,193	1,554	1,431	1,659

Figure A10.6 shows how changes in agency pricing structures have changed revenue patterns over time. Property value based charges have been progressively replaced by service and usage charges. Removal of the councils' pre paid water allowances in 2001 has led to an increase in usage charges revenue.

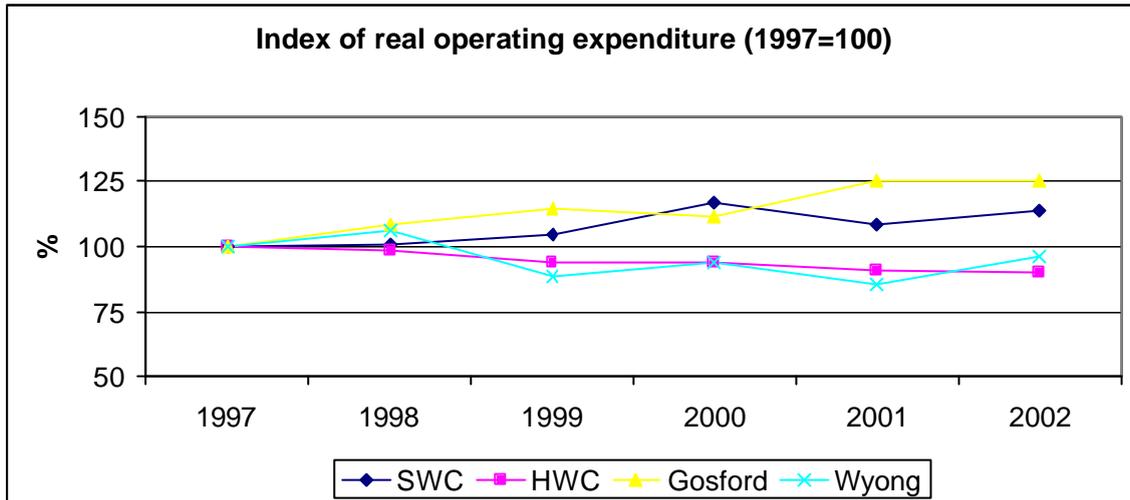
Figure A10.6 Sources of revenue (water and wastewater)



**OPERATING EXPENDITURE**

Operating costs are one of the most controllable areas of an agency’s operations. The Tribunal uses an incentive based process for price setting based on forecast levels of operating costs, return of capital and return on capital (ie building blocks). If agencies can control their operating costs, they can achieve a higher return on capital during the price path. Figure A10.7 shows the trends in operating expenditure.

**Figure A10.7 Index of operating costs**



Because each agency operates in its own unique environment, measuring performance is best achieved by analysing the trend in each agency’s performance over time rather than comparing one agency to another. Figure A10.8 shows those trends on a per kilolitre basis.

**Figure A10.8 Operating costs per volume sold (c/kL)**

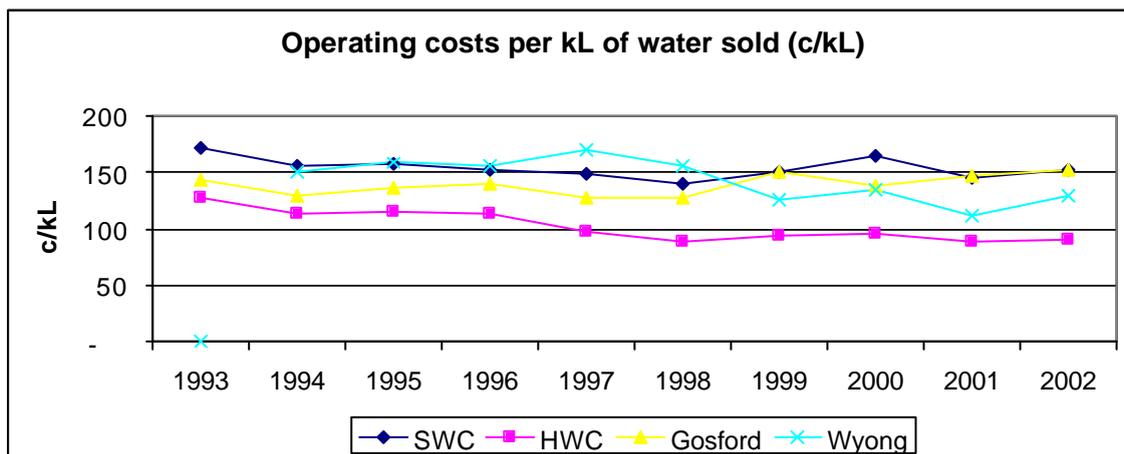
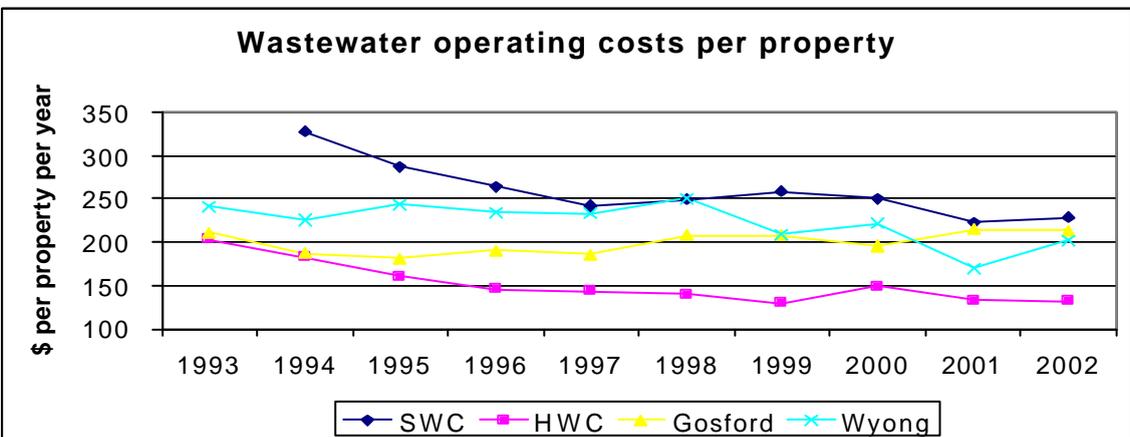
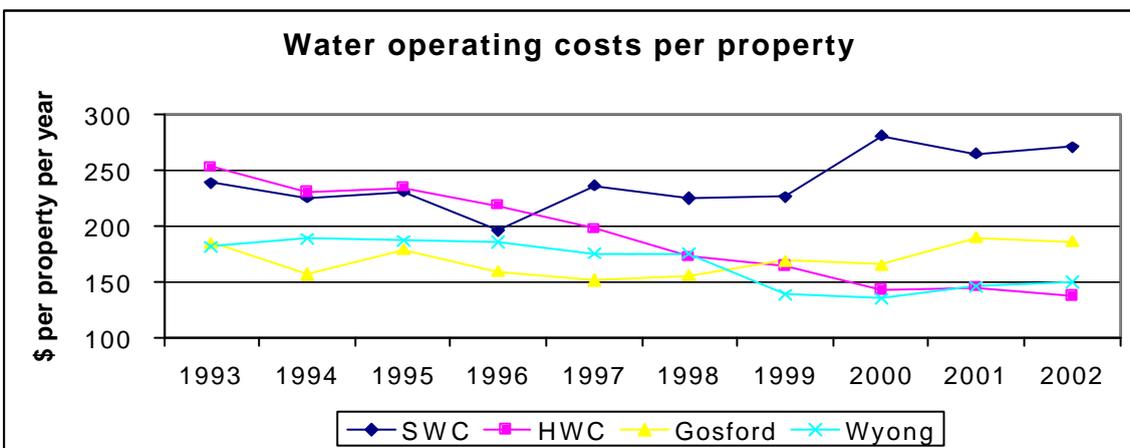
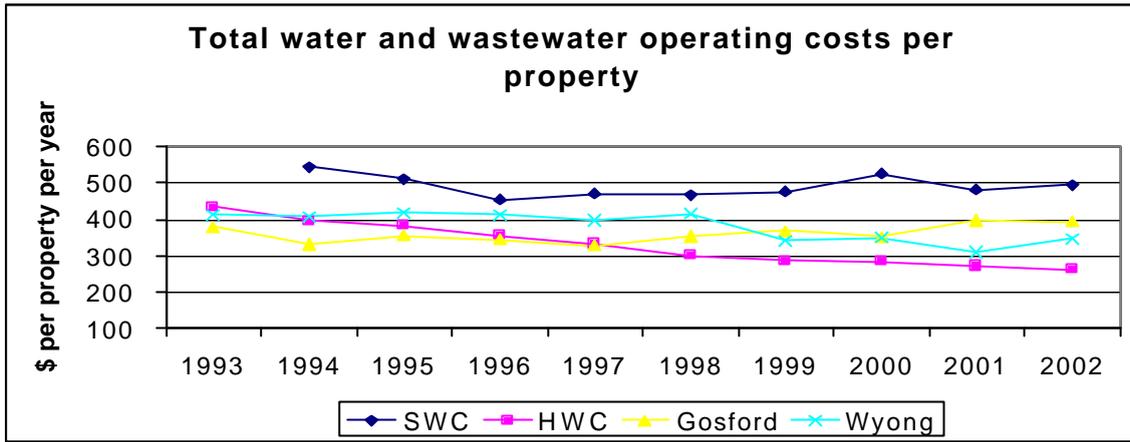


Figure A10.9 shows costs on a per property basis. This shows how costs have moved without the impact caused by increasing customer numbers. Note the increase in Sydney Water’s costs in 2000 after the creation of the Sydney Catchment Authority.

Figure A10.9 Water and wastewater operating costs per property (real, 2002 \$)



**CAPITAL EXPENDITURE**

Capital expenditure measures the expenditure needed to replace existing assets and purchase new assets. Figure A10.10 shows the trend in capital expenditure of the water agencies compared to 1993 levels.

**Figure A10.10 Index of capital expenditure**

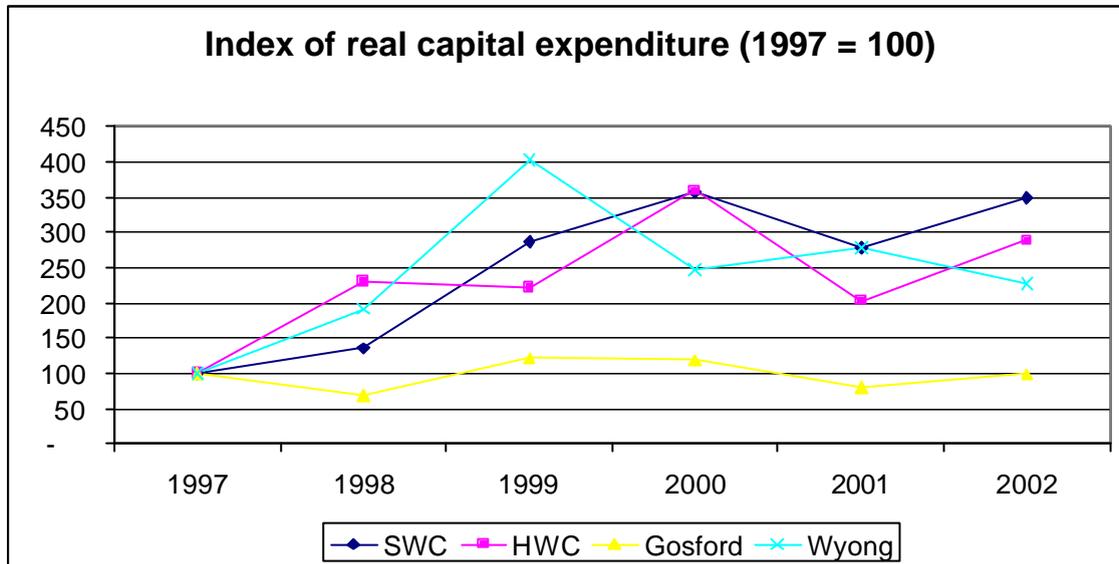
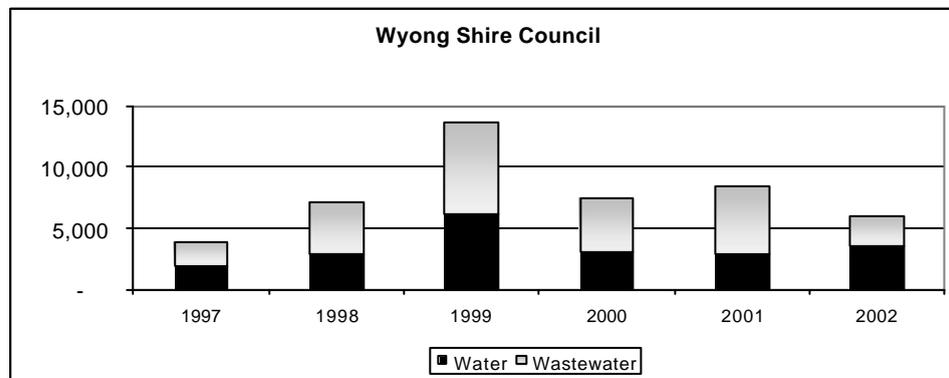
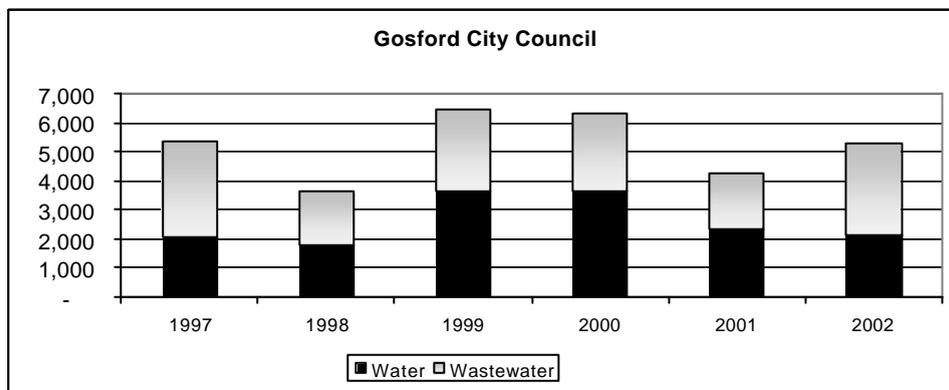
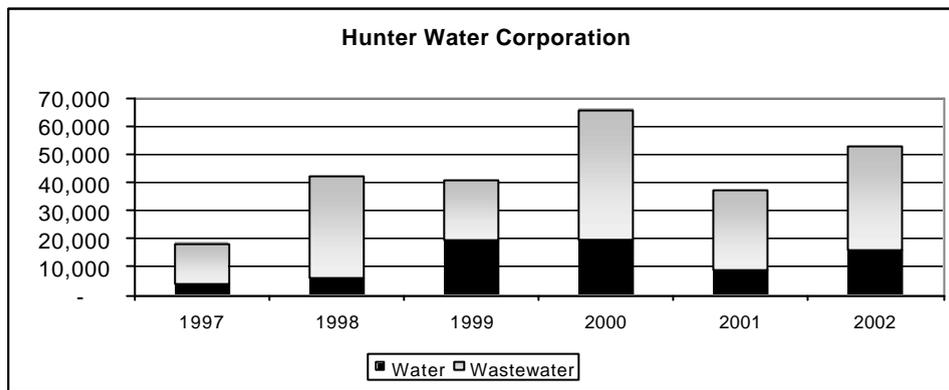
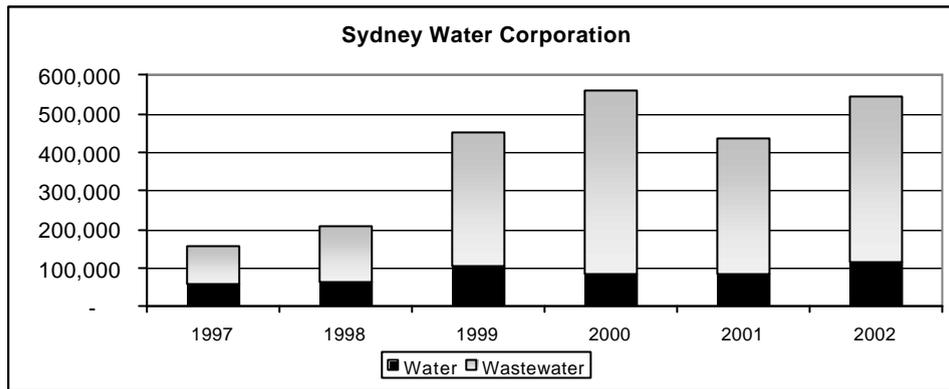


Figure A10.11 shows that SWC and HWC have directed the majority of their expenditure towards wastewater assets. The two councils are currently undertaking a study to determine the needs of their water supply system, the study initiated because of continuing low dam levels and influenced by the current drought conditions. With the potential introduction of environmental flow regimes, greater expenditure may soon be needed in the water areas of all agencies. In the Sydney area, capital expenditure on water supply assets will be incurred mainly by the Sydney Catchment Authority. The impact on Sydney Water will be as a result of increases in the cost of bulk water and will actually be recorded as increases in operating expenditure.

**Figure A10.11 Water and wastewater capital expenditure (000, 2002 \$s)**



## APPENDIX 11 PRINCIPLES FOR TRADE WASTE CHARGES

The application of appropriate pricing principles to trade waste requires that:

- Standards for acceptance should be set on the basis of the capacity of current systems to transport, treat and dispose of the wastes, having regard to the health and safety of wastewater workers;
- Trade waste charges should at least cover the costs to the water supplier of handling these wastes;
- Charges should vary to reflect differences in the cost of treating waste to the required standards at particular locations (for example, the inland treatment of works of Sydney Water Corporation)
- Water suppliers should set charges and standards in a manner that is transparent and accurate. The method of measurement should be reliable and the basis for setting charges should reflect costs incurred as far as possible.

Where environmental reasons are made for variations from the pricing principles detailed above then sufficient evidence needs to be available to justify these variations. The basis for calculating greater than cost charges where environmental justifications exist should also be justified.





**INDEPENDENT PRICING AND REGULATORY TRIBUNAL  
OF NEW SOUTH WALES**

**DETERMINATION UNDER SECTION 11 (1) OF THE INDEPENDENT PRICING AND  
REGULATORY TRIBUNAL ACT, 1992**

**Reference No:** 02/36  
**Determination:** No 1, 2003  
**Agency:** Gosford City Council



## Preamble

Section 11 of the *Independent Pricing and Regulatory Tribunal Act 1992* (the IPART Act) provides the Tribunal with a standing reference to conduct investigations and make reports to the Minister on the determination of the pricing for a government monopoly service supplied by a government agency specified in Schedule 1 of the IPART Act.

Gosford City Council (the Council) (as a water supply authority under the *Water Management Act 2000*) is listed as a government agency for the purposes of Schedule 1 of the IPART Act. Accordingly, the Tribunal may determine the prices for the Council's monopoly services.

The services of the Council that have been declared as monopoly services under the *Independent Pricing and Regulatory Tribunal (Water, Sewerage and Drainage Services) Order 1997* are:

- (a) water supply services,
- (b) sewerage services,
- (c) stormwater drainage services,
- (d) trade waste services,
- (e) services supplied in connection with the provision or upgrading of water supply and sewerage facilities for new developments and, if required, drainage facilities for such developments,
- (f) ancillary and miscellaneous customer services for which no alternative supply exists and which relate to the supply of services of a kind referred to in paragraphs (a) to (e),
- (g) other water supply, sewerage and drainage services for which no alternative supply exists.

In investigating and reporting on the pricing of the Council's monopoly services, the Tribunal has had regard to a broad range of matters, including the criteria set out in s.15(1) of the IPART Act. The s.15 criteria and other matters the Tribunal have considered are addressed in the Report to this Determination.

In accordance with s.13A of the IPART Act, the Tribunal has fixed a maximum price for the Council's monopoly services or established a methodology for fixing the maximum price.

By s.18(2) of the IPART Act, the Council may not fix a price below that determined by the Tribunal without the approval of the Treasurer.

## **Operative Provisions**

### **1. Application**

This Determination is made under section 11 of the Act.

This Determination sets the maximum prices that the Council may charge for the declared monopoly services listed in the Order and specified in this Determination

### **2. Term of determination**

This Determination commences on the later of 1 July 2003 and the date that it is published in the NSW Government Gazette.

If this Determination is published in the Government Gazette after 1 July 2003, it will, upon publication, also apply in relation to the period between 1 July 2003 and the date of publication (instead of determination No. 3 of 2000) and any bills issued to customers for the period between 1 July 2003 and the date of publication must be subsequently adjusted, if necessary, so as to comply with this Determination.

This Determination will apply until it is replaced or revoked. If this Determination continues after 30 June 2003, the prices in this Determination for the period 1 July 2004 to 30 June 2005 will continue to apply.

### **3. Continuation of Determination No. 9 of 2000 and Determination No. 4 of 1997**

Nothing in this Determination affects Determination No. 9 of 2000 and Determination No. 4 of 1997, which continue to apply within their terms to the services listed in paragraph (e) and paragraph (b) of the Order respectively.

### **4. Repeal of Determination No. 4 of 2000**

Tribunal Determination No. 4 of 2000 is repealed from the commencement of this Determination. The repeal does not affect anything done or omitted to be done, or rights or obligations accrued, under that determination prior to its repeal.

### **5. Schedules**

Schedules 1 – 6 apply.

# Schedule 1

## Water Supply Services

### 1. Application

This Schedule sets the maximum prices that the Council may charge for services under paragraph (a) of the Order (water supply services).

### 2. Categories for pricing purposes

Prices for water supply services have been determined for 2 categories:

- metered (residential or non residential) properties (other than vacant properties)
- vacant properties.

### 3. Charges for water supply services to metered properties (residential or non residential)

3.1 The maximum price that may be levied by the Council for the provision of water supply services to a metered residential property or a metered non residential property is the sum of the following:

- (a) the water service charge set out in Table 1 corresponding to the applicable meter size and period, and
- (b) the water usage charge set out in Table 2, corresponding to the applicable period, and
- (c) the fire service charge set in Table 3, corresponding to the applicable fire pipe service connection size and period, for a property that has a fire service pipe that is separate from the water service pipe and separately connected to the Council's water main.

3.2 The maximum price that may be levied by the Council for the provision of water supply services to a metered residential property or a metered non residential property, each with a combined fire service pipe and water service pipe that shares a connection to the Council's water main, is the sum of the following:

- (a) the water usage charge set out in Table 2 corresponding to the applicable period, and
- (b) which ever is the greater of
  - (i) the water service charge set out in Table 1, or
  - (ii) the fire service charge in Table 3, corresponding to the applicable meter or pipe size and period.

**Table 1 Water service charges for residential or non residential properties**

<b>Basis of charge</b>	<b>Maximum charge for the period 1 July 2003 to 30 June 2004</b>	<b>Maximum charge for the period 1 July 2004 to 30 June 2005</b>
<b>meter size</b>	<b>\$</b>	<b>\$</b>
20mm	71.47	71.47 x (0.99 + ΔCPI)
25mm	111.67	111.67 x (0.99 + ΔCPI)
32mm	182.96	182.96 x (0.99 + ΔCPI)
40mm	285.88	285.88 x (0.99 + ΔCPI)
50mm	446.69	446.69 x (0.99 + ΔCPI)
65mm	754.90	754.90 x (0.99 + ΔCPI)
80mm	1,143.52	1,143.52 x (0.99 + ΔCPI)
100mm	1,786.75	1,786.75 x (0.99 + ΔCPI)
150mm	4,020.19	4,020.19 x (0.99 + ΔCPI)
200mm	7,147.00	7,147.00 x (0.99 + ΔCPI)
For meter sizes not specified above, the following formula applies	$(\text{meter size})^2 \times 71.47/400$	$(\text{meter size})^2 \times (71.47 \times (0.99 + \Delta\text{CPI}))/400$

**Table 2 Water usage charge for residential properties or non residential properties**

<b>Basis of charge</b>	<b>Maximum charge for the period 1 July 2003 to 30 June 2004</b>	<b>Maximum charge for the period 1 July 2004 to 30 June 2005</b>
	<b>\$/kL</b>	<b>\$/kL</b>
Per kilolitre of water used	0.73	0.73 x (1.01 + ΔCPI)

**Table 3 Fire service charges for residential properties or non residential properties**

<b>Basis of charge</b>	<b>Maximum charge for the period 1 July 2003 to 30 June 2004</b>	<b>Maximum charge for the period 1 July 2004 to 30 June 2005</b>
<b>Service connection pipe size</b>	<b>\$</b>	<b>\$</b>
20mm	35.74	35.74 x (0.99 + ΔCPI)
25mm	55.84	55.84 x (0.99 + ΔCPI)
32mm	91.48	91.48 x (0.99 + ΔCPI)
40mm	142.94	142.94 x (0.99 + ΔCPI)
50mm	223.34	223.34 x (0.99 + ΔCPI)
65mm	377.45	377.45 x (0.99 + ΔCPI)
80mm	571.76	571.76 x (0.99 + ΔCPI)
100mm	893.38	893.38 x (0.99 + ΔCPI)
150mm	2,010.09	2,010.09 x (0.99 + ΔCPI)
200mm	3,573.50	3,573.50 x (0.99 + ΔCPI)
For pipe sizes not specified above	Half the service charge in Table 1, for the applicable meter size	Half the service charge in Table 1, for the applicable meter size

#### **4. Charges for water supply services to vacant properties.**

The maximum price that may be levied by the Council for the provision of water supply services to a vacant property (whether metered or not) is the water service charge set out in Table 4 corresponding to the applicable period.

**Table 4 Water service charge for vacant properties**

<b>Basis of charge</b>	<b>Maximum charge for the period 1 July 2003 to 30 June 2004 \$</b>	<b>Maximum charge for the period 1 July 2004 to 30 June 2005 \$</b>
Water service supply	71.47	$71.47 \times (0.99 + \Delta\text{CPI})$

#### **5. Levying water supply service charges on multiple premises residential and non residential properties**

- 5.1 Each premises in a multi premises (residential or non residential) property that has its own water meter is treated as a single property for the purposes of levying charges in this Schedule.
- 5.2 In relation to a multi premises (residential or non residential) property with a common water meter, the charges in this Schedule may be levied on the owners corporation, community association or other relevant body in respect of the multi premises property.

## Schedule 2

### Sewerage services

#### 1. Application

This Schedule sets the maximum prices that the Council may charge for services under paragraph (b) of the Order (sewerage services).

#### 2. Categories for pricing purposes

Prices for sewerage services have been determined for 3 categories:

- residential properties connected to the Council's sewerage system
- non-residential properties connected to the Council's sewerage system
- vacant properties.

#### 3. Charges for sewerage services to residential properties connected to the Council's sewerage system

The maximum prices that may be levied by the Council for sewerage services to a residential property connected to the Council's sewerage system is the sewerage service charge set out in Table 5 corresponding to the applicable period.

**Table 5 Residential sewerage service charge**

Charge	Maximum charge for the period	Maximum charge for the period
	1 July 2003 to 30 June 2004	1 July 2004 to 30 June 2005
	\$	\$
Sewerage service	347.14	347.14 x (0.99+ ΔCPI)

#### 4. Charges for sewerage services to non-residential properties connected to the Council's sewerage system

The maximum price that may be levied by the Council for sewerage services to a non residential property connected to the Council's sewerage system is the sum of the following:

- (a) the sewerage service charge set out in Table 6, corresponding to the relevant meter size and period, and
- (b) the sewerage usage charge set out in Table 7, corresponding to the applicable period.

**Table 6 Non-residential sewerage service charge**

<b>Basis of charge</b>	<b>Maximum charge for the period 1 July 2003 to 30 June 2004</b>	<b>Maximum charge for the period 1 July 2004 to 30 June 2005</b>
<b>Meter size</b>	<b>\$</b>	<b>\$</b>
20mm	259.33	259.33 x (0.99 + ΔCPI)
25mm	405.21	405.21 x (0.99 + ΔCPI)
32mm	663.90	663.90 x (0.99 + ΔCPI)
40mm	1,037.34	1,037.34 x (0.99 + ΔCPI)
50mm	1,620.84	1,620.84 x (0.99 + ΔCPI)
65mm	2,739.22	2,739.22 x (0.99 + ΔCPI)
80mm	4,149.34	4,149.34 x (0.99 + ΔCPI)
100mm	6,483.35	6,483.35 x (0.99 + ΔCPI)
150mm	14,587.54	14,587.54 x (0.99 + ΔCPI)
200mm	25,933.40	25,933.40 x (0.99 + ΔCPI)
For meter sizes not specified above, the following formula applies	$(\text{meter size})^2 \times 259.33/400$	$(\text{meter size})^2 \times (259.33 \times (0.99 + \Delta\text{CPI}))/400$

**Table 7 Non residential sewerage usage charge**

<b>Basis of charge</b>	<b>Maximum charge for the period 1 July 2003 to 30 June 200</b>	<b>Maximum charge for the period 1 July 2004 to 30 June 2005</b>
	<b>\$/kL</b>	<b>\$/kL</b>
Per kilolitres of water used	0.73 x df%*	0.73 x (1.01+ΔCPI) x df%

[\*Note - a discharge factor is applied to the charge based on the volume of water discharged into the Council's sewerage system].

## 5. Charges for sewerage services to vacant properties

The maximum price that may be levied by the Council for sewerage services on a vacant property is the sewerage service charge set out in Table 8 corresponding to the applicable period.

**Table 8 Sewerage service charge for vacant properties**

<b>Basis of Charge</b>	<b>Maximum charge for the period 1 July 2003 to 30 June 2004</b>	<b>Maximum charge for the period 1 July 2004 to 30 June 2005</b>
	<b>\$</b>	<b>\$</b>
Classification of land as vacant property	347.14	347.14 x (0.99 + ΔCPI) x 0.75

## **6 Levying sewerage service charges on multiple premises residential property or non residential property**

6.1 The sewerage services charges in this Schedule levied by the Council in relation to the following multi premises properties must be on the following basis:

- each premises with its own water meter in a multiple premises property is a single property for the purposes of levying the applicable charges in this Schedule;
- each residential strata title unit with a common water meter is to be treated as a single residential property for the purposes of levying the residential sewerage charges in this Schedule (with the entire charge for each service being levied on each unit, and not on the owners corporation);
- for a non residential strata title building where there is a common water meter, the non residential sewerage charges in this Schedule is to be levied on the owners corporation;
- a retirement village or other multi premises (residential or non residential) property which is not a strata title property and which has a common water meter is to be treated as a single non residential property for the purposes of levying charges in this Schedule (with the charge for each service being levied on the relevant body in relation to the multi premises property).

## Schedule 3

### Trade waste services

#### 1. Application

This Schedule sets the maximum prices that the Council may charge for services under paragraph (d) of the Order (Trade Waste Services).

#### 2. Categories for pricing purposes

Prices for trade waste services have been determined for 2 categories:

- non residential property with acceptable quality discharge
- non residential property with unacceptable quality discharge

#### 3. Trade waste charges to a non residential property for 'acceptable quality' discharge

3.1 The maximum price that may be levied by the Council on a non residential property connected to the Council's sewerage system for 'acceptable quality' trade waste discharge (as defined in the Trade Waste Policy) is the sum of the following:

- the trade waste discharge fee and inspection fee set out in Table 9, corresponding to the applicable period, and
- the trade waste agreement fee set out in Table 10, corresponding to the applicable period.

**Table 9 Trade Waste Charges for 'Acceptable Quality' Discharge**

Basis of charge	Maximum charge for the period	Maximum charge for the period
	1 July 2003 to 30 June 2004	1 July 2004 to the 30 June 2005
	\$	\$
<b>Trade Waste discharge</b>		
• per kilolitre of excess water used	0.20	0.20
<b>Inspection fee</b>	74.00	74.00

#### 4. Trade Waste Charges to non residential properties for 'unacceptable quality' discharge

4.1 The maximum price that may be levied by the Council on a non residential property connected to the Council's sewerage system for 'unacceptable quality' trade waste discharge as defined in the Trade Waste Policy is the sum of the following:

- the trade waste agreement fee set out in Table 10 corresponding to the applicable period and
- the trade waste discharge fee and inspection fee set out in Table 11 corresponding to the applicable period.

**Table 10 Trade waste agreement fees**

<b>Basis of Charge</b>	<b>Maximum charge for the period 1 July 2003 to 30 June 2004 \$</b>	<b>Maximum charge for the period 1 July 2004 to the 30 June 2005 \$</b>
Yearly establishment fee for provision of service	0.0	65.00

**Table 11 Trade Waste Charges for 'Unacceptable Quality' Discharge**

<b>Basis of charge</b>	<b>Maximum charge for the period 1 July 2003 to 30 June 2004 \$</b>	<b>Maximum charge for the period 1 July 2004 to the 30 June 2005 \$</b>
<b>Trade waste discharge</b>		
• Volume (per kilolitre)	1.30	1.30
• Biological oxygen demand (per 1,000mg/litre)	1.30	1.30
• Non-filterable residue (per 1,000mg/litre)	1.30	1.30
<b>Inspection fee</b>	74.00	74.00

## **Schedule 4**

### **Ancillary and miscellaneous customer services**

#### **1. Application**

- 1.1 This Schedule sets the maximum prices that the Council may charge for services under paragraph (f) of the Order (ancillary and miscellaneous customer services for which no alternative supply exists).

#### **2. Categories for pricing purposes**

- 2.1 Prices have been determined for the services listed in Table 12 and Table 13.

#### **3. Ancillary and miscellaneous charges**

- 3.1 The maximum charges that may be levied by the Council for the ancillary and miscellaneous services set out in Table 12 and Table 13 are the amounts listed in those Tables corresponding to the service for the relevant period.
- 3.2 A reference in Tables 12 or 13 to "NA" means that the Council does not, provide the relevant service.

**Table 12 Charges for ancillary and miscellaneous services**

Service No.	Description	Maximum price per service for the period 1 July 2003 to 30 June 2005 \$
1	<b>Conveyancing Certificate</b> <i>Statement of Outstanding Charges</i>	
	a) Over the Counter	20.00
	b) Electronic	NA
2	<b>Property Sewerage Diagram - Up to and including A4 size (where available)</b> <i>Diagram showing the location of the house-service line, building and sewer for a property</i>	
	a) Certified	15.00
	b) Uncertified	
	1. Over the Counter	15.00
	2. Electronic	NA
3	<b>Service Location Diagram</b> <i>Location of Sewer and/or Water Mains in relation to a property's boundaries</i>	15.00
	a) Over the Counter	
	b) Electronic	NA
4	<b>Special Meter Reading Statement</b>	45.00
5	<b>Billing Record Search Statement - Up to and including 5 Years</b>	15.95
6	<b>Building Over or Adjacent to Sewer Advice</b> <i>Statement of approval status for existing building over or adjacent to a sewer</i>	0.00
7	<b>Water Reconnection</b>	
	a) During business hours	30.00
	b) Outside business hours	30.00
8	<b>Workshop Test of Water Meter</b> <i>Removal and full mechanical test of the meter by an accredited organisation at the customer's request to determine the accuracy of the water meter. This involves dismantling and inspection of meter components.</i>	
	20mm	150.00
	25mm	150.00
	32mm	320.00
	40mm	320.00
	50mm	320.00
	60mm	320.00
	80mm	320.00
	100mm	NA
	150mm	NA
9	<b>Application for Disconnection - All Sizes</b>	38.00
10	<b>Application for Water Service Connection (up to and including 25mm)</b> <i>This covers the administration fee only. There will be a separate charge payable to the utility if they also perform the physical connection.</i>	38.00

Service No.	Description	Maximum price per service for the period 1 July 2003 to 30 June 2005 \$
11	<b>Application for Water Service Connection (32-65mm)</b> <i>This covers administration and system capacity analysis as required. There will be a separate charge payable to the utility if they also perform the physical connection.</i>	38.00
12	<b>Application for Water Service Connection (80mm or greater)</b> <i>This covers administration and system capacity analysis as required. There will be a separate charge payable to the utility if they also perform the physical connection.</i>	38.00
13	<b>Application to Assess a Water Main Adjustment</b> <i>(Moving a fitting and/or adjusting a section of water main up to and including 25 metres in length) This covers preliminary advice as to the feasibility of the project and will result in either:</i> 1. <i>A rejection of the project in which cases the fee covers the associated investigation costs</i> <i>Or</i> 2. <i>Conditional approval in which case the fee covers the administrative costs associated with the investigation and record amendment.</i>	250.00
14	<b>Standpipe Hire</b> Security Bond (all meter sizes)	596.00
15	<b>Standpipe Hire</b> Quarterly Fee (20mm) (32mm) (50mm) Monthly Fee (20mm) (32mm) (50mm)	See note 1  NA NA NA  NA NA NA
16	<b>Standpipe Water Usage Fee (All usage)</b>	As per standard water usage charges per kilolitre
17	<b>Backflow Prevention Device Application and Registration fee</b> <i>This fee is for the initial registration of the backflow device</i>	55.00
18	<b>Backflow Prevention Application Device Annual Administration Fee</b> <i>This fee is for the maintenance of records including logging of inspection reports</i>	22.00
19	<b>Major Works Inspection Fee</b> <i>This fee is for the inspection, for the purpose of approval, of water and sewer mains, constructed by others that are longer than 25metres and/or greater than 2 metres in depth</i> Water Mains (\$ per metre) Gravity Sewer Mains (\$ per metre) Rising Sewer Mains (\$per metre)	  5.50 7.00 7.00
20	<b>Statement of Available Pressure and Flow</b> <i>This fee covers all level whether modelling is required or not</i>	100.00

[Note 1 Standpipe hire charges for Gosford are determined on a pro rata basis with the charges being based on standard availability charges].

Service No.	Description	Maximum price per service for the period 1 July 2003 to 30 June 2005	
		\$	
		Fixed	Hourly
21	Cancellation Fee - Water and Sewerage Applications	50.00	NA
22	Sales of Building Over Sewer and Water Guidelines	10.10	NA
23	Section 307 Certificate	Dual Occupancies: 80.00	NA
		Commercial Buildings, Factories, Torrens Subdivision of Dual Occupancy etc: 120.00	
		Boundary Realign with Conditions: 200.00	
		Subdivisions: 590.00	
		Development without Requirement Fee: 45.00	
24	Inspection of Concrete Encasement and Additional Junction Cut-ins.	Inspection of concrete encasement: 135.00	NA
		Additional inspection (due to non-compliance): 45.00	
		Inspection of concrete encasement greater than 10m 135.00 plus 10.00 for every metre over 10 metres of encasement	
25	Sale of Specification for Construction of Water and Sewerage Works by Private Contractors	71.50 per volume	NA
26	Private Developers Plan Resubmission.	NA	50.00 for first hour and 30.00 for each hour thereafter
27	Approval of Developers Sewer Pump Station Rising Main Design	210.00	NA
28	Approval of Private Internal Residential Sewer Pump Station Rising Main Design	80.00	NA
29	Approval of Extension of Sewer/Water Mains to Properties Outside Service Areas	100.00	NA

Service No.	Description	Maximum price per service for the period 1 July 2003 to 30 June 2005	
		\$	
30	<b>Sale of Sewer Plan Books</b>	A3 Sheets in cardboard folder: 380.00	NA
		A3 Sheets in plastic pockets (3 folders): 495.00	
		Annual charge for monthly updating service: 265.00	
31	<b>Trade Waste Approvals</b>	0.00	0.00
32	<b>Water Service Connection fee for a 20mm meter</b>	262.00	NA
33	<b>Sewer Connection fees</b>	New Sewer connection: 170.00	NA
		Plus each additional WC: 60.00	
		Alterations: 110.00	
		Units/Villas (1 WC each flat or unit): 130.00	
		Plus for each additional WC: 60.00 (As above)	
		Caravan Connection Fee: 75.00	
		Sewer Re-Inspection Fee: 87.00	

## Schedule 5

### Stormwater drainage services

#### 1. Application

This Schedule sets the maximum prices that the Council may charge for services under paragraph (c) of the Order (stormwater drainage services).

#### 2. Categories for pricing purposes

Prices for stormwater drainage services have been determined for 1 category:

- residential and non residential properties.

#### 3. Charges for stormwater drainage services to residential properties or non residential properties

The maximum charge that may be levied by the Council for stormwater drainage services to a residential property or a non residential property is the charge set out in Table 13, corresponding to the applicable period.

**Table 13 Stormwater drainage levy for residential and non residential properties**

Basis of Charge	Maximum charge for the period	Maximum charge for the period
	1 July 2003 to 30 June 2004	1 July 2004 to 30 June 2005
	\$	\$
Drainage Levy	42.00	42.00

## Schedule 6

### Definitions and Interpretation

#### 1. DEFINITIONS

In this Determination:

**community association** has the meaning given to that term under the *Community Land Development Act 1989*.

**community development lot** has the meaning given to that term under the *Community Land Development Act 1989*.

**Community title property** means a community parcel as defined in the *Community Land Development Act 1989*.

**Council** means the Gosford City Council, a water supply authority under the *Water Management Act 2000*.

**Determination** means this determination, including all appendices, schedules, attachments, tables and documents forming part of or referred to in this determination.

**df%** or **discharge factor** means, in relation to a property, the percentage of water supplied to that property which the Council assess or deems to be discharged into the Council's sewerage system.

**GST** means the Goods and Services Tax as defined in *A New Tax System (Goods and Services Tax) Act 1999*.

**IPART Act** means the *Independent Pricing and Regulatory Tribunal Act 1992*.

**kL** means kilolitre or one thousand litres.

**meter** means an apparatus for the measurement of water, including any pipes and like fittings ancillary to such apparatus.

**metered property** means a residential property or a non residential property (as the case may be) that:

- (a) has a meter, and
- (b) is connected either directly or jointly with other properties to the Council's water supply system.

**Multi premises property** means

- (a) a strata title building
- (b) a company title building
- (c) a community parcel
- (d) a retirement village, or
- (e) a building comprised of separate premises

However, it does not include a hotel, motel, guest-house or backpacker hostel.

**non-residential property** means a property that is not a residential property.

[ Note: the main land uses that fall within the 'non-residential' property category are commercial and industrial].

**owners corporation** has the meaning given to that term under the *Strata Schemes Management Act 1996*.

**Order** means *Independent Pricing and Regulatory Tribunal (Water, Sewerage and Drainage Services) Order 1997* made on 5 February 1997 and published in Government Gazette No. 18 on 14 February 1997.

**premises** means each of the following within a multi premises property:

- (a) a strata title unit
- (b) company title unit
- (c) a community development lot
- (d) a retirement village unit, or
- (e) a part of a building lawfully occupied or available for occupation,

each of which has a direct or indirect connection to the Corporation's water supply system (in the case of water supply charges) or the Corporation's sewerage system (in the case of sewerage charges).

**property** means:

- (a) premises used for any purpose, or
- (b) land, whether built on or not. (However, if there are one or more premises on the land, then the land does not constitute a separate property in addition to those premises.)

**residential property** means a property where:

- (a) in the case of rateable land under the *Local Government Act 1993*, the land is categorised as residential under section 516 of that Act, and
- (b) in the case of each premises upon land (where there is more than one premises upon that land):
  - (i) the land upon which the premises are located is categorised as residential under section 516 of the *Local Government Act*, or
  - (ii) the dominant use of those premises is residential, as defined in section 516 of that Act and any regulations under it.

[Note: section 516 of the Local Government Act 1993 defines how land is categorised as residential. Under the Local Government Act 1993, hotels, motels, guesthouses, backpacker hostels or nursing homes or any other form of residential accommodation (not being a boarding house or a lodging house) prescribed by the regulations), are not included in this definition].

**strata title building** means a building that is subject to a strata scheme under the *Strata Schemes (Freehold Development) Act 1973*.

**strata title unit** means a lot as defined under the *Strata Schemes (Freehold Development) Act 1973*.

**Trade Waste Policy** means the Council's Trade Waste Policy (number S3.01 190.53.01) as amended from time to time.

**Tribunal** means the Independent Pricing and Regulatory Tribunal of New South Wales established under the IPART Act.

**vacant property** means a property that:

- (a) has no capital improvements, and
- (b) for the purposes of Schedule 1, is not connected to the Council's water supply system but is reasonably available for connection to the Council's water supply system, and
- (c) for the purposes of Schedule 2, is not connected to the Council's sewerage system but is reasonably available for connection to the Council's sewerage system.

## 1.2 Consumer Price Index

In this determination:

- (a) **CPI** means the consumer price index All Groups index number for the, weighted average of eight capital cities, published by the Australian Bureau of Statistics, or if the Australian Bureau of Statistics does not or ceases to publish the index, then CPI will mean an index determined by the Tribunal that is its best estimate of the index.

$$(b) \text{ DCPI} = \left( \frac{CPI_{Jun2003} + CPI_{Sep2003} + CPI_{Dec2003} + CPI_{Mar2004}}{CPI_{Jun2002} + CPI_{Sep2002} + CPI_{Dec2002} + CPI_{Mar2003}} \right) - 1$$

- (c) The subtext (for example <sub>June 2003</sub>) when used in relation to CPI means the CPI for the quarter and year indicated (in the example the June quarter for 2003).

## 2. Interpretation

### 2.1 Prices exclusive of GST

Prices or charges specified in this Determination do not include GST.

### 2.2 Billing cycle of Council

For the avoidance of doubt:

- (a) nothing in this Determination affects when the Council may issue a bill to a customer for prices or charges under this Determination; and
- (b) the maximum prices set out in this Determination apply in respect of the periods set out in this Determination, even if a bill traverses more than one period.

### 2.3 General provisions

- (a) A schedule means a schedule to this Determination.
- (b) A clause means a clause in this Determination and when used in a schedule means a clause in that schedule, unless otherwise indicated.
- (c) Words importing the singular include the plural and vice versa.
- (d) The explanatory notes do not form part of this Determination, but in the case of uncertainty may be relied on for interpretation purposes.