



## **NSW Government Submission**

This paper is the NSW Government's submission to the Independent Pricing and Regulatory Tribunal's (IPART's) Draft Reports on Sydney Water, Hunter Water and WaterNSW prices from 1 July 2020.

# **IPART Draft Reports on Sydney Water, Hunter Water and WaterNSW Prices 2020**

11 May 2020

# Government submission to IPART's Draft Reports on prices for Sydney Water Hunter Water and WaterNSW from 1 July 2020

## Summary of comments for all three reviews

1. The recent drought and analysis undertaken by the Government on a potential water conservation program has confirmed the Government's position that water conservation needs to be maintained over the long term, to achieve water savings, improve resilience to drought and delay the need for, or size of, new water augmentations. It is an integral part of the NSW Government's strategy for long-term planning and investment in the water sector to meet Sydney's future water needs.
2. The Government supports providing Sydney Water with an explicit allowance for water conservation and proposing a way of monitoring Sydney Water's expenditure and delivery of its water conservation activities. However, IPART should consider re-profiling the water conservation expenditure such that a greater proportion of the funds are provided within the base level of funding available outside of drought, and a smaller proportion is added during drought. Higher base level funding would allow for development of a broader suite of water conservation programs to achieve more long-term benefit for Sydney's residents.
3. IPART's proposed flexible pricing structure, that includes all drought related costs in the variable price for water, may create unintended impacts on low income households. The proposed flexible price has the potential to create inequity because it has a disproportionate impact on vulnerable members of society, who are least able to pay higher water bills during drought.
4. The Government asks IPART to reconsider two of its decisions regarding Sydney Water's capital expenditure allowance in light of the information provided by Government in this submission:
  - a. reducing Sydney Water's proposed capital expenditure required to meet its regulated environmental obligations, and
  - b. deferring the expenditure associated with the Prospect-Macarthur Pipeline Link. This is an important project to secure water supply for the Macarthur area, improving nodal resilience (providing multiple sources of supply) and addressing growth in that region.
5. The Government notes that IPART has extended asset lives for all new dams (from 100 to 200 years), pipelines (80 to 120 years) and ICT (6 to 10 years) resulting in a lower depreciation allowance. This change is a significant increase in previously approved asset lives. We note that these asset lives are well above design standards creating issues with financing and the business case justification for these investments. The Government asks IPART to review its assumed asset lives in line with recognised depreciation allowances for these types of assets.
6. The Government notes that Hunter Water proposed a modified Demand Volatility Adjustment Mechanism (DVAM) to help manage its exposure from drought related expenditure and revenue risks that it might face in the coming years. It proposed annual adjustments to service prices to recover lost revenue, to apply when water restrictions are in place and water sales are more than 5% lower than had been forecast for that year. The Government asks IPART to review its decision regarding Hunter Water's proposal for a 'modified DVAM' considering the best form of regulation for each utility based on its own circumstances.
7. The Government notes that IPART's draft decision provides lower operating and capital expenditure for Sydney Water and WaterNSW, than was requested by each organisation. The Government seeks additional clarity regarding the basis of these reductions. Specific details are outlined below.
8. The Government has begun work developing a Greater Sydney Water Strategy (GSWS) that, when approved by the Government, will replace the Metropolitan Water Plan. The GSWS is being developed to ensure that Sydney's future water needs for growth and drought can be met over the long-term and that water continues to contribute to the Government's vision for a productive, sustainable and liveable Sydney. Preliminary analysis to inform the GSWS has identified that additional water supply for Sydney will likely be required in the next 5 years, resulting in significant

expenditure on water infrastructure in Sydney beyond what is currently identified in the price submissions for Sydney Water and WaterNSW. The Government asks IPART to consider how to best cushion the potential impact on customer bills of these future investments as part of this current determination.

### **Sydney Water - Water conservation investment is a long-term activity that places a high value on water at all times**

The Government's long-term view of water conservation and demand management requires water to be valued highly regardless of dam levels – water conservation is valuable outside of drought as it adds to drought resilience, helps to delay the timing, or reduce the size of, major water augmentations.

The Government asks IPART to consider the following points in relation to water conservation funding when making its final determination for Sydney Water's prices (2020-24):

- Water conservation is a long-term activity requiring continuous and consistent planning and investment
- Water conservation requires behavioural change that recognises water is a finite resource and should be used efficiently, regardless of dam levels

While water conservation is important during drought, it needs to be recognised as a long-term activity requiring long-term planning and continuous and consistent investment. Water conservation programs take years to establish and generate benefits to society. Prior to the millennium drought it took Sydney Water a number of years to generate significant water conservation benefits and achieve a lasting change in customer behaviour.

To illustrate this, Sydney Water reported in 2000-01 during a non-drought period, that it spent \$16 million to save 8 gigalitres (GL). Through consistent investment of \$500m over 10 years (that includes the period of the millennium drought), Sydney Water was able to increase water savings each year so that it generated water savings of 116GL in 2009-10, the final year of the millennium drought.<sup>1,2</sup> At the end of the millennium drought, the yearly water saving was 14 times higher than it was at the beginning of that decade. This highlights that the concerted efforts over many years results in significantly higher levels of water savings as programs become more mature, behaviours change and economies of scale are achieved.

Between July 2017 and February 2020, Greater Sydney's water storages experienced one of the most severe drought sequences on record. Storages declined from approximately 90 per cent to 40 per cent during this time. This exceeded the depletion rate used in the 2017 Metropolitan Water Plan (MWP) which was based on the historical record. While restrictions and water conservation had a positive impact, the magnitude and pace of water savings would have been higher if greater water conservation efforts had been in place before the drought began.

The Government acknowledges that reframing the approach to water conservation in this way is a modification of the current approach used in the Economic Level of Water Conservation (ELWC) in Sydney Water's operating licence. The current interpretation of ELWC places a higher value on water as dam levels decline rather than valuing water highly regardless of dam level.

The Government acknowledges that water conservation activities must still be economic. However, when determining the value of water, greater emphasis needs to be placed on the long-term benefits of water conservation. This includes the extent to which it can assist in improving drought

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<sup>1</sup> Sydney Water Efficiency Report 2010-11, pp 37-39.

<sup>2</sup> Sydney Water Efficiency Report 2010-11, p 37.

resilience, deferring major augmentations or slowing dam depletion in dry periods. The government has previously indicated it will undertake a review of the ELWC methodology to better achieve these outcomes and will work with Sydney Water and IPART on scoping the terms of that review.

In relation to the level of funding, the Government supports IPART's draft decision to approve Sydney Water's requested \$40 million allowance for water conservation programs. This should allow Sydney Water to build capacity and implement programs before water restrictions are implemented. The Government also agrees with IPART's approach to monitor Sydney Water's water conservation activities and the proposal for regular reporting.

However, the Government suggests that IPART consider re-profiling the water conservation expenditure such that a greater proportion of the funds are provided within the base level of funding available outside of drought, and a smaller proportion is added during drought. As illustrated above, earlier expenditure is more likely to yield more significant water savings in drought and over a longer period of time. IPART should consider how this can be best achieved while avoiding additional pressure on customer bills.

The Government wants to ensure that funds allocated to Sydney Water for water conservation purposes are spent on that purpose and the government would like IPART to consider how this could be addressed in the final determination.

### **Sydney Water - The Government seeks clarification on IPART's proposed flexible pricing**

The Government has identified some potential risks due to the introduction of flexible pricing under IPART's proposed price structure. Specifically, this relates to including all drought related costs in the variable price when dam levels fall. The Government asks IPART to consider the following points when making its final determination:

1. Increases in water bills under drought prices (compared to average weather prices) will represent a higher proportion of the income of low-income households compared with higher income households. While bills can be reduced by decreasing usage, it will disproportionately force lower income households to reduce usage.
2. Increasing prices during drought may not have the intended outcome when combined with restrictions and conservation programs. Customers will not see a proportionate decrease in bills compared to their reduction in water use under restrictions. Customers are likely to expect a benefit proportional to the cost imposed.

Pensioners will be less able to mitigate the impact of increased water bills because Sydney Water's rebate for pensioners is only calculated based on the fixed service charge. The Government wants to ensure that pensioners' bills will not be generally higher as a result of the proposed flexible pricing structure. The Government will work with IPART to address the implications of the proposed flexible pricing on water rebates to ensure pensioners are not worse off, prior to IPART finalising its determination.

The Government requests that IPART consider these issues and any other impacts its decisions will have on customers when making its final determination.

## Sydney Water - The Government asks IPART to reconsider decisions on capital expenditure

### Deferring Prospect Macarthur Link capital expenditure

The recent drought highlighted that certain parts (nodes) of Sydney's water supply network are more vulnerable than others.

The Prospect to Macarthur link is a key project that Government will be considering in the upcoming determination period, for improving nodal resilience (by providing two sources of supply) and for servicing growth in that region. Water supply to the Macarthur region is predominantly from the southern coastal dams. During severe drought conditions, the ability to supply from these smaller dams may be constrained. The Prospect Macarthur link will allow this region to also be significantly supplied from Prospect Water Filtration Plant, which can source water from Warragamba dam. This makes it an important investment to service growth and increase resilience.

The Government views the Prospect to Macarthur link as a priority for the 2020-24 determination period and requests that IPART consider reinstating the funding for this in Sydney Water's cost base.

### Lowering Sydney Water's capex allowance to meet critical environmental requirements

The Government notes that IPART's draft decision on capital expenditure for assets such as critical sewers and wet weather overflow abatement was \$100m to \$150m lower than Sydney Water's proposal. This was despite Sydney Water having compliance challenges in these areas. It is unclear why Sydney Water has not been allowed its proposed level of expenditure given it needs significant expenditure to meet its regulatory requirements.

The Government requests that IPART review its decision concerning Sydney Water's capital expenditure to meet its environmental regulatory requirements.

## Sydney Water and WaterNSW - Reductions in operating expenditure

IPART's draft decision allowed operating expenditure for Sydney Water and WaterNSW that is less than the proposals by each organisation. The basis and rationale for these reductions is unclear.

The Government asks IPART to review its decision and if upheld provide clarification as to the appropriateness of reducing an operating expenditure allowance that is seen to be prudent.

## Hunter Water - Depreciation allowance

The Government notes that IPART has provided Hunter Water with a smaller increase in its depreciation allowance than it proposed. Hunter Water proposed disaggregating its regulatory asset base (RAB) and significantly reduce the assumed economic lives of the infrastructure it uses to deliver services. While IPART agreed that Hunter's depreciation allowance should increase, its draft decisions on the RAB and asset lives mean that the increase is lower than that proposed by Hunter Water. IPART's draft decision on the total depreciation allowance of \$269 million over the determination period is \$111 million (70%) higher than IPART used to set prices in 2016, it is \$20 million (or 7%) lower than that proposed by Hunter Water.

The Government asks IPART to review its decision regarding Hunter Water's asset lives and depreciation allowance included in its prices for the 2020-24 determination, rather than waiting for the 2024 determination to review.

## **Hunter Water - Demand volatility adjustment mechanism (DVAM)**

The Government notes that Hunter Water proposed a 'modified DVAM' to help manage its exposure from drought related expenditure and revenue risks that it might face in the coming years. It proposed annual adjustments to service prices to recover lost revenue, to apply when water restrictions are in place and water sales are more than 5 per cent lower than had been forecast for that year.

The Government asks IPART to review its decision regarding Hunter Water's proposal for a 'modified DVAM' considering the best form of regulation for each utility based on its own circumstances.

## **WaterNSW and Hunter Water - Asset lives**

The Government notes that IPART has extended asset lives for all new dams (from 100 to 200 years), pipelines (80 to 120 years) and ICT (6 to 10 years) resulting in a lower depreciation allowance. This change is a significant increase in previously approved asset lives. We note that these asset lives are well above design standards creating issues with financing and the business case justification for these investments.

The Government asks IPART to review its assumed asset lives in line with recognised depreciation allowances for these types of assets.

## **The Government is developing a Greater Sydney Water Strategy (GSWS)**

The Government is in the process of developing the GSWS to replace the Metropolitan Water Plan to ensure that the Government can meet Sydney's future water needs for growth and drought. The GSWS will be developed during the upcoming price period 2020-24 and will be an important component of the Government's strategic vision for Sydney as a productive, sustainable and liveable city. The GSWS will explore an integrated water cycle approach for managing water, wastewater and stormwater in Sydney and how we can improve the integration of water and land use planning. This strategy will provide high level direction for water planning for Sydney.

As part of developing the GSWS, the Government will make several decisions regarding water supply augmentation and demand management in Sydney. Preliminary analysis to inform the GSWS has identified that additional water supply for Sydney will likely be required in the next 5 years, resulting in significant expenditure on water infrastructure in Sydney beyond what is currently identified in the price submissions for Sydney Water and WaterNSW. The Government asks IPART to consider how to best ease the potential impact on customer bills of these future investments as part of this current determination.

The government will consult with IPART during the development of the GSWS about the potential impact of the government's decisions on water utility prices in the future.