Department of Planning, Industry and Environment – Water Group Submission

Review of the Sydney Water, Hunter and WaterNSW Prices 2020

11 November 2019

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Introduction

This paper is the Department of Planning, Industry and Environment's (DPIE) Water Group submission to the review of Sydney Water, Hunter Water and WaterNSW prices by the Independent Pricing and Regulatory Tribunal (IPART). The Premier of NSW, the Hon. Gladys Berejiklian MP has endorsed the submission.

DPIE submission on prices for Sydney Water and WaterNSW from 1 July 2020

Operating expenditure and water conservation

Sydney Water views

Sydney Water has stated that:
"Water conservation activities can defer or avoid the need for new water sources and provide a buffer to help respond to drought conditions or rising demand. Investing in water conservation is a key strategy in the NSW Government's 2017 Metropolitan Water Plan to ensure secure and affordable water supplies for Greater Sydney. Customers also identified ensuring a secure supply for the future as one of their top priorities for Sydney Water."[1]

"In 2016–17, the ELWC for our forward five-year water conservation program was 23.5ML/day. Despite dam levels falling, in 2017–18, the ELWC for the forward five-year program decreased to 10 ML/day. This is because of a reduction in predicted savings from some water efficiency and leak management projects across the five-year program. The ELWC is a measure of estimated water savings from currently available projects that have been assessed as economically efficient, not a target level of savings linked to dam levels.[2]

IPART Issues Paper

IPART has stated that:
"Sydney Water proposes an additional $10 million each year for water conservation. Sydney Water states that this is the baseline amount based on 'average weather' conditions. Under drought conditions and decreasing dam levels, Sydney Water anticipates to incur additional expenditure on water conservation. It did not outline what this expenditure would be in its proposal, because it proposed to absorb this additional expenditure in the case of drought."[3]

DPIE response

Q15. Is Sydney Water's proposed operating expenditure over the 2020 determination period efficient?

Q16. How should our review account for the risks of drought and support water conservation?

The NSW Government recognises that water conservation plays an important role in managing short term water security risk (drought) and responding to changes in long term demand and supply imbalance (future augmentation).[4] This was emphasised in the Government's submission to IPART's review of Sydney Water's Operating Licence.

The Government provides the following comments for IPART to consider as part of its 2020 determination of Sydney Water's prices:

- A broad range of water conservation projects should be considered,
- Investing in water conservation is increasingly important given the current drought.

Identification and assessment of water conservation options

Increasing investment in water conservation can come in the form of additional spending on existing programs or new programs. The Government supports Sydney Water investing in both as required for an efficient and effective response to the current drought.

[1] SWC Pricing Proposal Attachments 2019, p 17.
[2] SWC Pricing Proposal Attachments 2019, p 18.
[3] IPART SWC Issues Paper, p 66.
[4] SWC Pricing Proposal Attachments 2019, p 17.

As current water conservation programs mature, returns would be expected to diminish. As diminishing returns set in for mature projects, investment in new projects should become comparatively more efficient. The Government supports Sydney Water maintaining the capacity and capability to continually identify and assess new options (inside and outside of drought). This will ensure that the Economic Level of Water Conservation (ELWC) represents efficient investment in water conservation rather than the efficient level of investment in current projects.

Sydney Water revised its ELWC calculations down from 23.5ML/day in 2016-17 to 10ML/day in 2018-19. The stated reason for this is lower than expected savings from currently available projects. The Government supports transparent assessment of a broad range of potential projects.[5]

IPART may wish to consider Sydney Water's assessment of potential projects when determining the efficient level of expenditure on water conservation.

The consequence of underspending is greater than overspending

Sydney Water originally proposed spending $10 million a year on water conservation, assuming non-drought conditions, stating that it will absorb any additional expenditure due to drought.[6] The Government understands that Sydney Water is supplying updated forecasts for expenditure on conservation projects, which are significantly higher than originally forecast, to account for the current drought.

In recognition of the current and forecast conditions and the continuing steep rate of depletion, the Government supports more responsive expenditure on water conservation to water scarcity, accounting for the increased value of water as dam levels fall.

The Government considers that the potential impact of underspending on water conservation is more severe compared with overspending and supports Sydney Water engaging in water conservation initiatives that reflect the community's values and needs.

For example, according to Sydney Water's conservation reports, Sydney Water spent $500m (average of $55m per year) saving 352GL of water during the Millennium drought (2001-10).[7] This had a cumulative impact of saving 116GL in the final year of the drought (2010)[8] when dam storage fell to around 30%.

The Government considers that water conservation is a critical component of Sydney Water's operations and is a key licence requirement that Sydney Water must report against. Therefore, it would be more prudent and transparent to incorporate an explicit value for water conservation in Sydney Water's revenue requirement. This should account for current drought conditions and for the potential impact of under spending on water conservation. Transparent reporting on water conservation measures is also an important way to communicate the value of these projects to the community.

To give effect to the matters described above, and to improve transparency, IPART may consider providing Sydney water with an explicit allowance for water conservation, accounting for current drought conditions and the importance of long-term investment in water conservation and include a reporting mechanism for this expenditure.

[5] Sydney Water Pricing Proposal Attachments 2019, pp 18.
[6] IPART SWC Issues Paper, p 66.
[7] Sydney Water Efficiency Report 2010-11, pp 37-39.
[8] Sydney Water Efficiency Report 2010-11, p 37.

Capital expenditure and drought response

Sydney Water and WaterNSW views

Sydney Water has stated that:
"A significant increase in capital expenditure is required so that we can provide services to a projected 144,000 new properties by 2024, and to manage the risk of deteriorating performance from our asset portfolio."[9]

WaterNSW has stated that:
"WaterNSW is proposing to invest $682.4 million ($2019-20)27 of capital over the 2020-24 Determination period. The capital expenditure program underlying this forecast includes capital programs to help mitigate some of the risks associated with the extended dry conditions being experienced in NSW."[10]

IPART Issues Paper

IPART has stated that:
"We have not formed a preliminary view on Sydney Water's proposed capital expenditure for the 2020 period."[11]

"We have not formed a preliminary view on WaterNSW's proposed capital expenditure."[12]

DPIE response

Q9. Is **Sydney Water's** proposed capital expenditure including expenditure related to growth and existing mandatory standards over the 2020 determination period efficient?[13]

Q9. Is **WaterNSW's** proposed capital expenditure program for the 2020 determination period efficient, taking into account expenditure drivers and service outcomes to be achieved?[14]

The NSW Government has recently made improvements to the urban water policy and planning framework for Greater Sydney. DPIE is responsible for overseeing the new framework's implementation while Sydney Water is responsible for implementing several elements of the framework. This framework was outlined in our submission to IPART's review of Sydney Water's operating licence.

The Government is currently in the process of developing long term strategies for water across NSW which will provide guidance to Sydney Water and WaterNSW in preparing long and short-term capital plans. This includes the use of recycled water, where it is efficient to implement in conjunction with other sources of water supply. Much of this work will not be completed until the end of 2020. The Government will consult with IPART as these strategies are developed.

The Government supports investment in line with the 2017 Metropolitan Water Plan and the government's drought response strategy, subject to all the relevant Government approvals.

[9] SWC Pricing Proposal 2019, p 29.
[10] WaterNSW Pricing Proposal 2019, p 55.
[11] IPART SWC Issues Paper, p 55.
[12] IPART WaterNSW Issues Paper, p 39.
[13] IPART SWC Issues Paper, p 56.
[14] IPART WaterNSW Issues Paper, p 40.

DPIE submission on prices for Hunter Water from 1 July 2020

The proposal provided to IPART by Hunter Water from 1 July 2020 recognises the implementation of the 2014 Lower Hunter Water Plan and the ongoing review of the plan – anticipated for delivery in 2021. Cost recovery for the DPIE team is captured in Section 5.1.6 of Hunter Water's submission.

DPIE Water coordinates the inter-agency governance groups and Independent Water Advisory Panel that provide expert input and strategic oversight to the Lower Hunter Water Plan (LHWP). These groups have reviewed the work to date on the next iteration of the LHWP as well as the drought response.

DPIE has been working with Hunter Water to investigate options for the next LHWP and to deliver the deliberative forums conducted by Hunter Water to support this work. Preliminary options investigation and community engagement are guided by the decision support framework for the LHWP and DPIE supports Hunter Water's operating expenditure in these areas.

The following are DPIE's specific responses to issues for stakeholder comment as they relate to the implementation and development of the LHWP.

Demand and customer numbers for water, wastewater and stormwater

Q18. Is Hunter Water's demand forecasting model appropriate? Are the inputs used to estimate the model also appropriate?

Q19. Do you agree with Hunter Water's proposal to use a new climate correction methodology to generate a climate-corrected starting point?

DPIE engaged Jacobs Pty Ltd to review Hunter Water's revised demand forecast model. At the time of Hunter Water's IPART submission, a number of recommendations were already being implemented. A priority recommendation was to confirm and have reviewed the process for linking the SDP and DTM components of the model. It is expected that Hunter Water will implement the proposed urgent recommendations of the peer review and that the climate correction methodology will be applied in the modelling for the next iteration of the Lower Hunter Water Plan.

Prices for water, wastewater and stormwater services

DPIE is working closely with Hunter Water of the development of the LHWP. The planning process will aim to identify a set of supply and demand side measures, including the preferred next major supply augmentation. This will provide an estimate of LRMC to be developed for the next price review. LRMC provides a useful signal about the present and future costs of water security but other factors, such as sending appropriate price signals, price stability and customer preferences also play an important role in setting water usage charges. At this stage an estimate of LRMC would be uncertain because LHWP does not specify Hunter Water's next supply augmentation.

Form of regulation

Q46. Should we introduce a cost pass through mechanism for Hunter Water's proposed drought response costs?

DPIE supports consideration of cost pass through mechanisms for drought measures in the Lower Hunter Water Plan that are triggered by falling dam storage levels. Passing through the costs of drought measures may help reinforce their timely delivery according to the water plans and signal water scarcity to customers during drought events. Such a cost pass through mechanism should be applied according to a set of criteria to avoid eroding incentives for efficient investment by the water agencies. Key measures in the current Lower Hunter Water Plan to which a cost pass through mechanism could apply are:

- Water transfers with the Central Coast

- Temporary desalination in extreme droughts.

The drought response activities progressed by Hunter Water in the current determination period are generally consistent with the Lower Hunter Water Plan, including active leak detection and pressure management programs, water conservation initiatives, readiness for emergency desalination and infrastructure upgrades to enable transfers with the Central Coast.