

## **Sydney Water's response to WS Atkins' *IPART Capex, Asset Management and Opex Review - Overview Report***

### **Overview of Efficiencies**

On page 39, it is stated that 32% of Sydney Water's water related opex is controllable and that therefore one third of the efficiency target has been applied, whereas the efficiencies in Table 25 have been calculated on a different basis.

### **Asset Management**

On page 36, paragraph 6 the report comments on the fact that capital projects impact on operating costs and draws a linkage between capital cost / estimate variations and consequential operating costs. Sydney Water has developed its capex driven incremental opex costs by reference to established activity based cost data and not by reference to the capital project estimate (that is, a % of the capital estimate). As such variations in capital estimates will not have an impact on the consequential opex generated by that project so long as the project scope and timing remain the same.

Sydney Water in its Supplementary Submission to IPART increases the consequential opex from capex. This is a result of additional recycled capital arising from developer-undertaken work with some offsetting reductions in water and wastewater opex due to timing of capex. To this extent Sydney Water refutes the reduction in opex from capex made in the report.

### **New Mandatory Standards**

The statements regarding Department of Environment and Conservation requirements on page 9, paragraph 4 and again on page 42 paragraphs 4 and 5 are incorrect.

Expenditure that has been allocated to new mandatory standards relates to the Department of Environment and Conservation requirements for reducing dry and wet weather overflows in Sydney Water's wastewater catchments. This work would involve a combination of catchment rehabilitation of sewer pipes, building storages and amplification of sewers. Sydney Water has estimated the cost to be in excess of \$2.5 billion. Sydney Water considers that the least cost solution would include the rehabilitation of private sewers by sealing cracks and joints to minimise infiltration. However, the resolution of legal and social issues in relation to private sewers are likely to preclude this solution in the short term. The alternative, the use of additional storage systems and amplification would have considerable additional cost. .

Sydney Water has included approximately \$165M during the price period for specific capital works to reduce dry and wet weather overflows, including some allowance for works if the private sewer option is not available. Sydney Water agrees with WS Atkins/Cardno that it is likely that either set of options will cost more than the sum included in Sydney Water's submission."

## **Output Measures**

Sydney Water supports the introduction of output measures against intended capital investments as an indicator of efficiency. However, in line with IPART comments in their 2003 Price Determination care must be taken to ensure that these do not become the driver of investment in their own right.

## **Operational Projects**

Sydney Water disagrees with WS Atkins/Cardno proposal on page 39, paragraph 7 to re-phase the expenditure for water and wastewater operational projects. Sydney Water has identified a series of operational projects that address specific non-recurring business needs. Sydney Water's business model identifies these operational projects separately from direct operating expenses, but the nature of the work determines that this cost should be expensed (not capitalised)

These costs are identified in six categories:

- Major Periodic Maintenance (MPM)
- Decommissioning
- Future Asset Planning
- Operations
- Safety
- Program

A register has been developed of specific projects, from which the program for 2005/06 is drawn. This portfolio currently amounts to \$34M worth of projects, considerably more than that incorporated into our submission. Further, the forward plan has identified project types, categories and estimates for the next four years to 2009/10.

Projects in the register for 2005/06 have been identified for some time, and planning has already commenced. Further development to date has only been constrained by operational funding restrictions in the recent and current year.

In response to this report, a further review of projects nominated for 2005/06 and 2006/07 has been undertaken from the perspective of business risk and deliverability. This review confirmed the business need, project deliverability and unacceptable risk of not undertaking the work.

Sydney Water remains confident that the expenditure for operational projects indicated in the submission is appropriate and should not be re-phased.

## **Future Capital Expenditure**

Sydney Water endorses the comments made regarding the need to re-profile elements of the capital program to allow a longer period in which to prepare schemes. This issue is addressed in more detail in Sydney Water's Supplementary Submission.

Sydney Water disagrees with the statement, on page 41, that the high level of capital expenditure on growth still far exceeds the level of contributions within the

price control period. The developer charge methodology set by IPART provides for the recovery of growth related capital expenditure over a thirty year period. Therefore, because growth related capital expenditure is lumpy and up front, there will always be a lag between expenditure and recovery. This lag is allowed for in the IPART determination via the discounting of future developer charge revenue streams. Should IPART's DSP methodology be changed in the future, the financial implications on Sydney Water would need to be reviewed.

### **Capital Efficiencies**

Sydney Water accepts that its 'catch-up' efficiency target should be based on its process for managing capital expenditure. However, its continuing capital efficiency is overwhelmingly driven by the trends in Sydney's building and construction market, where it purchases over ninety percent of its capital works program. Sydney Water's annual capital expenditure represents only approximately 6% of the total market and the prices that it pays are entirely driven by market forces.

If construction costs grow in line with the historical average, then in real terms, continuing efficiency target proposed by WS Atkins/Cardno would effectively equate to well over 0.5%. On this basis, Sydney Water believes that a continuing capital efficiency target is not appropriate for Sydney Water for 2006 to 2009.