



SAWRD24: Draft Regulatory Determination

Following a detailed independent review and an opportunity for public submissions, the Essential Services Commission is consulting on a proposed revised regulatory framework, including consumer protections, service standards and revenue caps, to apply to SA Water for the period **1 July 2024 to 30 June 2028**.

The Commission welcomes comment and feedback on those proposals by **Wednesday, 6 March 2024**. A final regulatory determination will be published in **June 2024**.

Key Point	Description
Purpose of regulatory determinations	To reproduce the incentives for efficient outcomes that benefit SA Water customers in the absence of a competitive market.
Key objectives of the new regulatory determination	To protect South Australian consumers long-term interests with respect to the price, quality and reliability of SA Water's services, enhance protections for water users, and confirm the need for SA Water to provide regular, meaningful and transparent public information on its performance.
Key outcomes of the new regulatory determination	<ul style="list-style-type: none"> ▶ Generally maintaining the existing consumer protection framework, but providing enhanced protections for tenants (as consumers), customers experiencing payment difficulties and customers affected by family violence. ▶ An overall cap of \$5,335 million (\$Dec22) on the revenue that SA Water can recover from customers over the period July 2024 to June 2028, comprising: <ul style="list-style-type: none"> • \$3,550 million revenue cap for water retail services, which is 3 percent less than SA Water's proposal. • \$1,785 million revenue cap for sewerage retail services, which is 1 percent less than SA Water's proposal. <p>A pricing principles, price disclosure, monitoring and dispute resolution determination in relation to the recycled water and end-user specific retail services provided by SA Water.</p>
Key measures of the new regulatory determination	Performance and compliance by SA Water, reported publicly and to the Commission, in relation to consumer protection performance and delivery, revenue allowance compliance, and service, asset and delivery performance and outcomes
Purpose of regulatory determinations	To reproduce the incentives for efficient outcomes that benefit SA Water customers in the absence of a competitive market.

About SA Water Regulatory Determination 2024

People, businesses and communities in South Australia use water and sewerage services as an essential part of their everyday lives. The essential nature of these services means it is important for SA Water to deliver value for money, now and into the future.

The Essential Services Commission's (**Commission**) regulation of SA Water's water and sewerage retail services incentivises SA Water to deliver these services at the lowest sustainable price for the quality and reliability levels that customers value.

The draft regulatory determination sets out the consumer protection measures, revenue allowances and performance monitoring that are proposed to apply to SA Water over the four years from 1 July 2024. Further submissions, evidence and information will be considered by the Commission in preparing a final regulatory determination, to be released in June 2024. In that context, positions put forward in this report are draft and subject to change.

Under the statutory framework governing the economic regulation of SA Water, the Commission makes four-yearly economic regulatory determinations that set the maximum revenues that SA Water may earn and the service standards that it must provide to its customers.

The Commission will make a new regulatory determination to apply to SA Water for the period 1 July 2024 to 30 June 2028: SA Water Regulatory Determination 2024 (**SAWRD24**).

Consistent with its primary objective of protecting the long-term interests of consumers with respect to the price, quality and reliability of essential services, and with its past approach, SAWRD24 will challenge SA Water to continue to:

- ▶ provide water and sewerage services at the lowest sustainable price for the quality and reliability levels valued by customers, and
- ▶ have and deliver against sound long-term asset management, operating and financing strategies, which support the provision of those services for present and future customers.

Protecting consumers

The Water Retail Code – Major Retailers (**Code**) sets out the behavioural standards and minimum requirements that apply to SA Water for the sale and supply of retail services (water and sewerage) to customers and, in some instances, other consumers.

The Commission's draft decision is that the existing consumer protections contained in the Code continue to remain appropriate for SAWRD24, subject to some limited amendments to enhance protections for consumers, customers experiencing payment difficulties and customers affected by family violence.

The Commission has considered and reached draft decisions on two proposals for changes to the Code from SA Water, as explained below. As these are draft decisions, the Commission welcomes comment and feedback, as well as other further relevant information from stakeholders to inform its final decision.

- ▶ The Commission has accepted SA Water's proposal to remove the requirement for it to undertake an out of cycle meter read when a customer's self-read has not been accepted. To minimise the risk that customers will be over or under-charged SA Water will need to provide customers with the option of either resubmitting a compliant self-meter read or organise a time for a meter reader to have access to the meter before using an estimate of water use.
- ▶ The Commission has accepted SA Water's proposal that it have the discretion to charge customers for paper bills. Implementation approval will be subject to SA Water meeting minimum requirements including public consultation, provision of information to customers prior to the scheme taking effect and the establishment of an exemption scheme to remove the charge for certain customers (for example, those experiencing financial hardship or without access to the internet at home).

With regard to the service standards that SA Water must meet in the sale and supply of retail services to its customers, the Commission's draft decision is that the existing 22 service standards will continue to apply during SAWRD24, with one performance target lifted to reflect SA Water's historical performance.

The Commission has not accepted SA Water's proposals to adjust the performance metrics for regional response service standards and sewer overflow clean-up, as it considers doing so may result in service reductions.

Prudent and efficient revenue outcomes

The Commission's draft decision for revenue caps for water and sewerage retail services are approximately 3 percent and 1 percent lower than that proposed by SA Water in its regulatory business proposal (RBP), on a comparative basis.

Under the legislative framework governing SA Water regulatory determinations, the Commission will fix the maximum revenue that SA Water can recover from customers over the four-year period 1 July 2024 to 30 June 2028. While the Commission does not set prices, the legislative requirements mean SA Water must set its prices to recover no more than the revenue permitted, subject to ancillary revenue adjustment mechanisms included in the determination.

Though a six-week consultation on SA Water's RBP, the Commission heard that affordability is a key concern for South Australians. In reviewing SA Water's operations, the Commission has considered whether SA Water is operating prudently, efficiently and delivering value for money. The Commission sought to understand whether SA Water can deliver the projects it planned so that customers do not pay for projects before they commence.

The draft positions are consistent with stakeholders' submissions that some of the expenditure proposed by SA Water was neither justified nor consistent with customers' priority that prices should be kept as low as possible while delivering on the service levels valued by customers.

The draft revenue caps for SAWRD24 have been calculated as the forecast total efficient costs of providing water and sewerage retail services. The total efficient costs of providing water and sewerage retail services have been determined using the building blocks cost model. Efficient costs need not be the costs the regulated business is actually incurring, and it is for the regulated business to demonstrate that its actual costs represent an efficient cost base.

The draft decision is that the revenue caps for the four-year period commencing 1 July 2024, in present value terms, are:

- ▶ \$3,550 million (\$Dec22) for **water** retail services, and
- ▶ \$1,785 million (\$Dec22) for **sewerage** retail services.

The Commission's assessment is that the revenue caps will provide SA Water with sufficient revenue to fund prudent and efficient operations, finance prudent and efficient investments on a long-term basis, and meet SA Water's applicable health, safety, environmental and customer service standards and obligations over SAWRD24. In order to deliver value for money on an ongoing basis, SA Water should ensure it has in place sound long-term asset management, operating and financing strategies. These strategies should support the provision of retail services for current and future customers.

Following the release of the final regulatory determination in June 2024, SA Water has responsibility for setting prices for water and sewerage retail services. Prices for 2024-25 will apply from 1 July 2024. SA Water has the flexibility to set prices from year to year as it sees fit, but is only allowed to recover revenues over the SAWRD24 period in accordance with the final four-year maximum revenue caps and other regulatory requirements (including adjustment mechanisms).

While the revenue caps are set by the Commission in inflation-adjusted terms (that is, real, December 2022 prices), SA Water will set prices for water and sewerage retail services in nominal terms (that is, they will be set in current prices for customers). It is therefore worth noting that the percentage change in the revenue caps between regulatory periods (for example, the increase in the caps for SAWRD24 relative to those set out in SAWRD20) may not necessarily translate into the same percentage increase in the nominal prices that are set by SA Water.

Comparison against SA Water's regulatory business proposal

The Commission's draft decision is that the prudent and efficient **expenditure benchmark** amounts to be included in the calculation of the revenue caps are shown in Table 1.1.

Table 1.1: Prudent and efficient expenditure benchmarks for SAWRD24 compared with SA Water's proposal terms (\$Dec22)

	SA Water's proposal for SAWRD24 (\$m)	Draft Determination SAWRD24 (\$m)	Variance (\$m)	Variance (%)
Operating expenditure	2,386	2,272	-114 ↓	-5% ↓
Capital expenditure	2,831	2,529	-302 ↓	-11% ↓
Total	5,217	4,801	-416 ↓	-8% ↓

Of the \$2,831 million of capital expenditure proposed by SA Water for SAWRD24, approximately \$1,160 million (41 percent) is related to five major projects.

Under this draft determination, the **revenue caps** for SAWRD24 represent a:

- ▶ 3 percent decrease for water retail services compared with SA Water's proposal, and
- ▶ 1 percent decrease for sewerage retail services compared SA Water's proposal.

Table 1.2 compares the draft revenue caps for SAWRD24 with an adjusted version of SA Water's proposal.

Table 1.2: Draft revenue caps for SAWRD24 compared with an adjusted version of SA Water's proposal, in present value terms (\$Dec22)

	SA Water's proposal for SAWRD24 ¹ (\$m)	Draft Determination SAWRD24 (\$m)	Variance (\$m)	Variance (%)
Total Water	3,647	3,550	-97 ↓	-3% ↓
Total Sewerage	1,809	1,785	-23 ↓	-1% ↓

The Commission has, for the purposes of making a like-for-like comparison, adjusted SA Water's revenue proposal (including for the latest rate of return and the consumer price index (CPI) inflation roll-forward of the Regulated Asset Base (RAB)), in order to estimate a comparison between the Commission's draft determination and SA Water's proposal. Without making an adjustment, any comparisons of revenue caps may be, for example, significantly impacted by the timing of the assessments and the differing rate of return and other assumptions utilised.²

¹ For the purposes of comparison with the draft decision, this column has been adjusted to reflect the Commission's draft rate of return (calculated as of 14 November 2023) and uses December to December inflation to roll-forward assets in determining the opening RAB value. The Commission understands that SA Water's proposal stated expenditure in December 2022 dollars.

² SA Water's proposal used a rate of return of 3.23% that it calculated in March 2023, and so this would not be an appropriate comparison with the Commission's updated estimate derived as at November 2023.

Comparison against SAWRD20

The SAWRD24 determination is made in a different economic context to the previous regulatory determination, SAWRD20, which occurred in a low interest rate environment. That environment has changed materially, with material uplifts in interest rates which directly flow through into the determination of the regulatory rate of return (**rate of return**).

During the four-year SAWRD20 period, lower financing costs meant SA Water was able to deliver the same level of water and sewerage retail services for less than was the case in previous regulatory periods. The cost savings in SAWRD20 were passed on to customers through lower bills.

Current financing costs have increased operational costs compared to SAWRD20, returning to levels experienced previously. In addition, higher prices for energy and raw materials are adding to overall cost pressures.

The Commission's draft decision is that the prudent and efficient **expenditure benchmark** amounts to be included in the calculation of the revenue caps are shown in Table 1.3.

Table 1.3: Prudent and efficient expenditure benchmarks for SAWRD24 compared with SAWRD20 (\$Dec22)

	Final SAWRD20 (\$m)	Draft Determination SAWRD24 (\$m)	Variance (\$m)	Variance (%)
Operating expenditure	2,237	2,272	+35 ↑	+2% ↑
Capital expenditure	1,885	2,529	+644 ↑	+34% ↑
Total	4,122	4,801	+679 ↑	+16% ↑

The \$644 million (34 percent) increase in capital expenditure is driven by five major projects with total expenditure of approximately \$1,160 million for the SAWRD24 regulatory period (\$Dec22).

Under this draft determination, the **revenue caps** for SAWRD24 represent a:

- ▶ 22 percent increase for water retail services compared with those determined in SAWRD20, and
- ▶ 28 percent increase for sewerage retail services compared with those determined in SAWRD20.

While increased expenditure benchmarks have contributed to additional revenue requirements, the Commission's assessment is that the increases in the revenue caps, compared to SAWRD20, have been driven largely by the increase in the rate of return (refer Box 1.1).

Box 1.1 Key driver - Rate of return

Increased financing costs have resulted in a draft decision to set SA Water's allowed average rate of return at 3.99 percent (real, post-tax), calculated as of 14 November 2023. By way of comparison, the average regulatory rate of return (real, post-tax) adopted in previous determinations was:

- ▶ 4.5 percent in 2013-16
- ▶ 4.17 percent in 2016-20 and
- ▶ a low of 2.68 percent in 2020-24.

In its Regulatory Business Proposal, SA Water calculated revenue requirements using an average regulatory rate of return (real, post-tax) of 3.23%, calculated in March 2023.

To illustrate the impact of the revenue caps from the higher rate of return, holding all things equal, if the rate of return used in SAWRD20 (2.68 percent) was applied for the purposes of the SAWRD24 determination, it would lead to the following revenue outcomes (refer Table 1.4).

Table 1.4: Comparison of revenue caps for SAWRD24 using SAWRD20 rate of return (\$Dec22)

	Draft Determination SAWRD24 – 3.99% Rate of Return (\$m)	Draft Determination SAWRD24 - 2.68% Rate of Return (\$m)	Variance (\$m)	Variance (%)
Water	3,550	3,108	-441 ↓	-12% ↓
Sewerage	1,785	1,572	-213 ↓	-12% ↓

In this scenario, the revenue caps would be 7 per cent and 13 percent higher than in SAWRD20 (compared to 22 percent and 28 percent respectively). In both instances, this is 15 percentage points below the SAWRD24 draft decision (refer Table 1.5).

Table 1.5: Comparison of percentage change in revenue caps for SAWRD24 compared to SAWRD20, using SAWRD24 and SAWRD20 rate of return (\$Dec22)

	Draft Determination SAWRD24 – 3.99% Rate of Return (%)	Draft Determination SAWRD24 - 2.68% Rate of Return (%)	Variance (%)
Water	22%	7%	-15% ↓
Sewerage	28%	13%	-15% ↓

The conclusion may be drawn that the rate of return is the major contributing factor to the increase in the revenue caps.

Transparent performance reporting

In SAWRD20, the Commission established a new monitoring and evaluating performance framework that outlined the public reporting requirements and regulatory expectations that apply to SA Water. The framework requires SA Water to publicly account for the long-term commitments made to customers, including under its RBP, and for delivering the outcomes as required under the consumer protections established by the Code. The Commission's draft decision is to retain and strengthen this framework for SAWRD24.

Next steps

The Commission is consulting on this SAWRD24 draft regulatory determination, with written submissions due by Wednesday, 6 March 2024. It is requested that submissions are sent to reviews@escosa.sa.gov.au.

The Commission will consult directly with key stakeholders during the consultation period, providing opportunities for all interested parties to ask questions about the draft regulatory determination (and related matters) and provide further evidence and information to inform the final regulatory determination.

All relevant submissions, evidence and information will be considered by the Commission in preparing that final regulatory determination, to be released in June 2024.

Following the release of the final regulatory determination, SA Water will set water and sewerage prices in accordance with the final revenue caps and pricing requirements. Those prices will apply from 1 July 2024.

Timing	Milestone
January 2024	Commission releases draft regulatory determination for consultation
February 2024	Commission invites feedback on draft regulatory determination
June 2024	Commission releases final regulatory determination
June 2024	SA Water and SA Government develop prices
1 July 2024	SAWRD24 regulatory period commences

The Commission thanks those who made public and stakeholder submissions following publication of SA Water's proposal, all of which were carefully considered and have provided valuable information and insights for the draft regulatory determination.

For further information on SAWRD24, please refer to the Commission's website.³

The Essential Services Commission is an independent statutory authority with functions in a range of essential services including water, sewerage, electricity, gas, rail and maritime services, and also has a general advisory function on economic matters. For more information, visit www.escosa.sa.gov.au.

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³ Refer: www.escosa.sa.gov.au/industry/water/retail-pricing/sa-water-regulatory-determination-2024