

Final Revenue Determination - SA Water

MEDIA BRIEFING

27 May, 2013

The Essential Services Commission of South Australia is the independent economic regulator of the electricity, gas, ports, rail and water industries in South Australia. The Commission's primary objective is the protection of the long-term interests of South Australian consumers with respect to the price, quality and reliability of essential services.



Today's Agenda¹

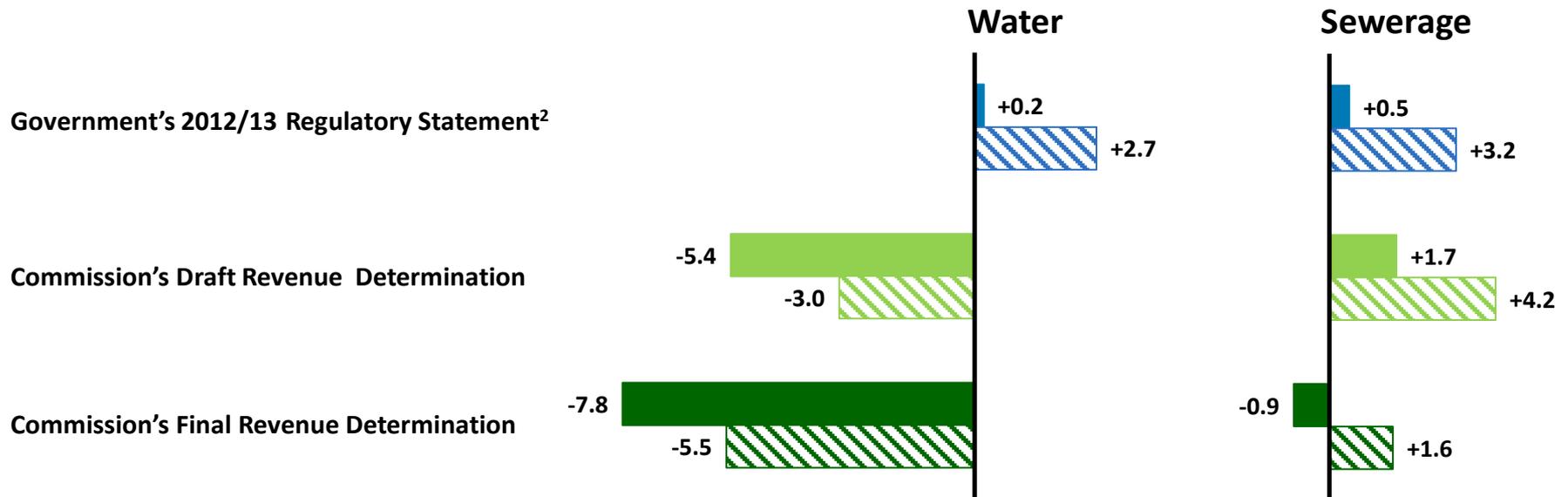
1. Preview
2. Background
3. Final Average Revenue Caps
4. Average Revenue Changes– Key Drivers
5. Next Steps
6. Questions

**All information provided today is embargoed
until this briefing session is formally closed**

The Final Revenue Determination's average revenue caps are lower than those flagged in the Draft Revenue Determination

Percentage change in average revenues on 1 July 2013

Real Nominal¹



As water accounts for about 70% of total regulated water and sewerage revenues, overall average water and sewerage average revenues will fall by 5.7% in real terms (3.4% nominal) from 1 July

¹ The Commission has adjusted real caps to nominal caps using an inflation rate of 2.5%, the actual change in the CPI in the year to March 31 2013. Nominal average revenue caps will be adjusted in each of the subsequent 2 years using the actual change in that index in the year to March 31

² In addition, the Regulatory Statement forecast further real increases in both 2014/15 and 2015/16. In contrast, all real average revenue reductions in the Draft and Final Revenue Determinations occur up-front and are then maintained for 3 years.

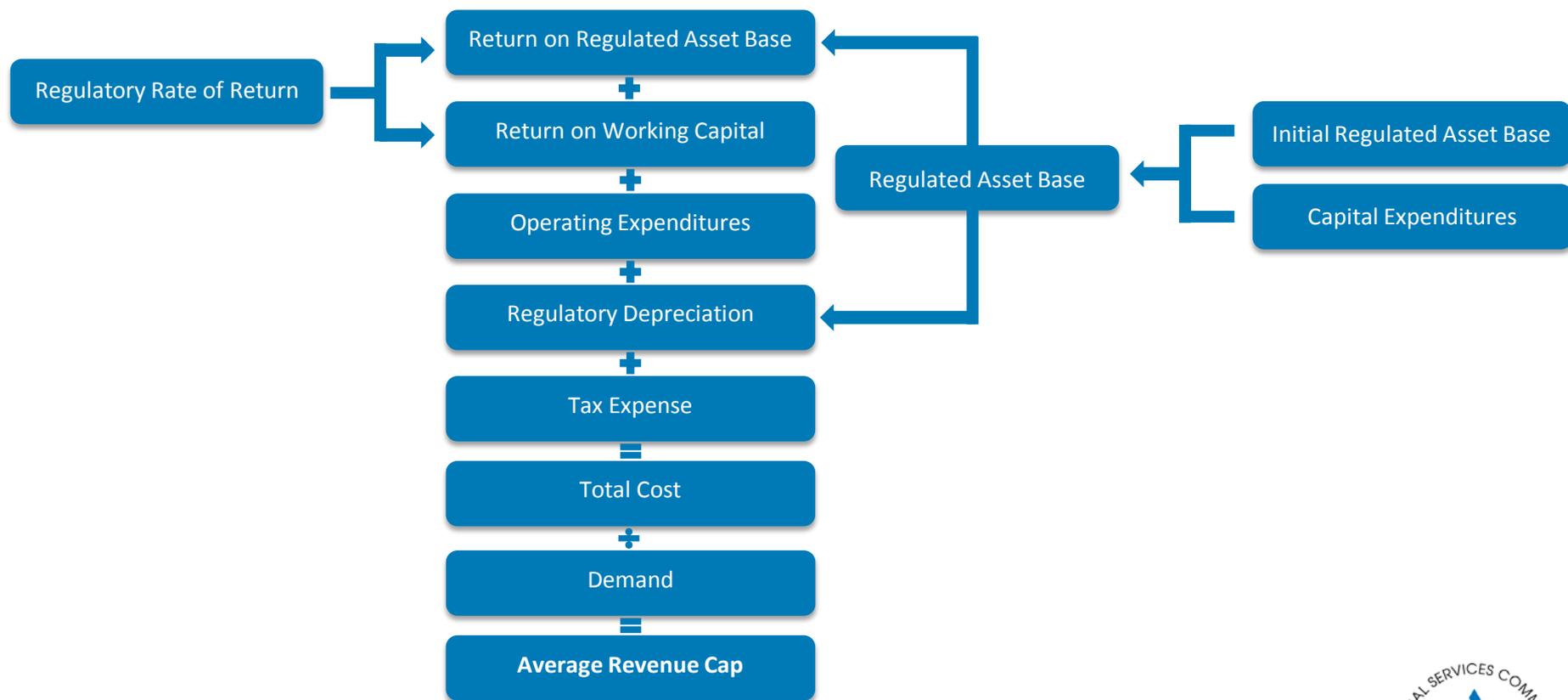
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Background

- ❑ Final Revenue Determination sets average revenue caps for SA Water's drinking water and sewerage retail services for the 3-year period 2013/14 – 2015/16
- ❑ Will be publicly released at 11am today
- ❑ Will apply from 1 July
- ❑ Builds on Commission's Draft Revenue Determination, which was released for public consultation on 7 February
- ❑ Made in accordance with the Commission's primary objective to protect the long-term interests of consumers, subject to significant constraints imposed by:
 - Treasurer's Initial Pricing Order of September 2012;
 - Treasurer's Second Pricing Order of May 2013; and
 - Directions to SA Water by the Minister for Water and the River Murray
- ❑ Delivers lower prices to consumers than those flagged in the Draft Revenue Determination

The Commission's Final Revenue Determination is based on the standard cost "building blocks" approach used by economic regulators



Treasurer's Initial Pricing Order

- ❑ Made in September 2012
- ❑ Required Commission to:
 - Set revenue caps only, not prices
 - Adopt the initial Regulated Asset Base (RAB) values to be set by the Treasurer in a subsequent Pricing Order
 - Pass through to consumers the net costs (net of any Government contributions) of non-commercial activities that the Government requires SA Water to perform
 - Establish a mechanism to adjust revenues for demand variations
- ❑ The Commission has complied with the Initial Pricing Order, as it must do

Treasurer's Second Pricing Order

- ❑ Made in May 2013
- ❑ Required the Commission to adopt:
 1. An initial water RAB value 5% (\$373 million¹) higher than the value that the Government's 2012/13 Regulatory Statement had forecast would apply as of 1 July 2013;
 2. An initial sewerage RAB value 10% (\$321 million¹) higher than the value that the Government's 2012/13 Regulatory Statement had forecast would apply as of 1 July 2013; and
 3. Annual water demand of 190GL for all elements of the Determination
- ❑ The Commission has complied with the Second Pricing Order , as it must do

Effects of the Treasurer's Second Pricing Order

- ❑ Increasing annual water demand¹ reduces average water revenue caps – all else being equal
- ❑ Increasing initial RAB values increases average revenue caps – all else being equal
- ❑ Taken together, the impacts of the annual demand requirement and the initial RAB increase partly offset each other, but do result in a net small increase in average water revenue caps over the next three years. Fortunately, this net impact is more than offset by the reduction in the regulatory rate of return
- ❑ However, the higher required demand and higher initial RAB will result in future water prices being higher than they otherwise would have been, as:
 - The requirement to adopt a higher demand will result in greater revenue adjustments² in the second three-year period; and
 - At the higher demand level specified, the initial water RAB value required to support the Final Revenue Determination's average revenue caps is higher than it otherwise would have been

Minister's Directions to SA Water

- ❑ The Minister for Water and the River Murray may issue Directions to SA Water which require it to undertake certain non-commercial activities
- ❑ The Treasurer's Initial Pricing Order required the Commission to pass through the net costs (net of any Government CSO¹ payments) of these activities to consumers
- ❑ The Minister's Direction to SA Water of January 2013 specified seven such activities, including statewide pricing, purchase of renewable energy for the Adelaide Desalination Plant and water planning and management. The Commission allowed the net costs of those activities in its Draft Revenue Determination, as it must do
- ❑ The Minister's Direction to SA Water of May 2013 added a further activity: payment of the Valuer-General's fees for the annual purchase of property valuation data:
 - The Commission's Draft Revenue Determination had decided that annual purchase was unnecessary and allowed only the cost of one purchase per three years (\$4.8 million²)
 - The cost of annual purchases is \$13.1 million over 3 years; the Government has provided no contribution towards these costs
 - The Commission's Final Revenue Determination has allowed this cost – an extra \$8.7 million over the cost allowed in its Draft Revenue Determination – as it must do
- ❑ The Commission believes that activities that the Government requires SA Water to perform should be fully and transparently funded directly by Government payments and not by consumers

¹ Community Service Obligation

² All costs stated on this page are in dollars of December 2012

Today's Agenda¹

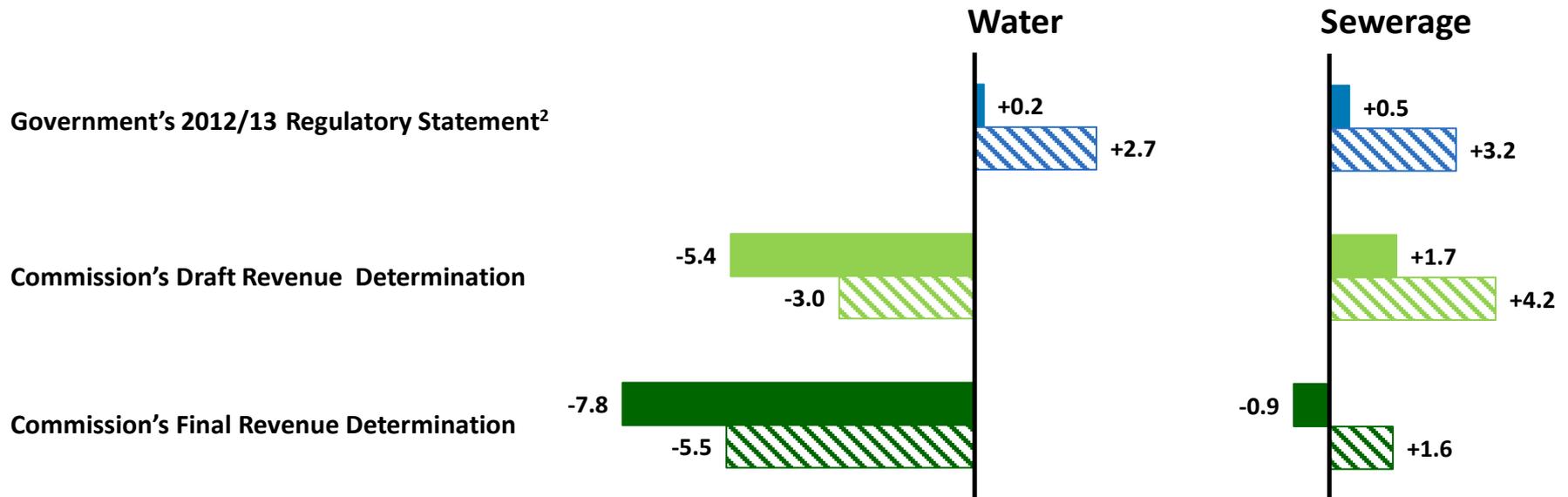
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Percentage change in average revenues on 1 July 2013

Real Nominal¹

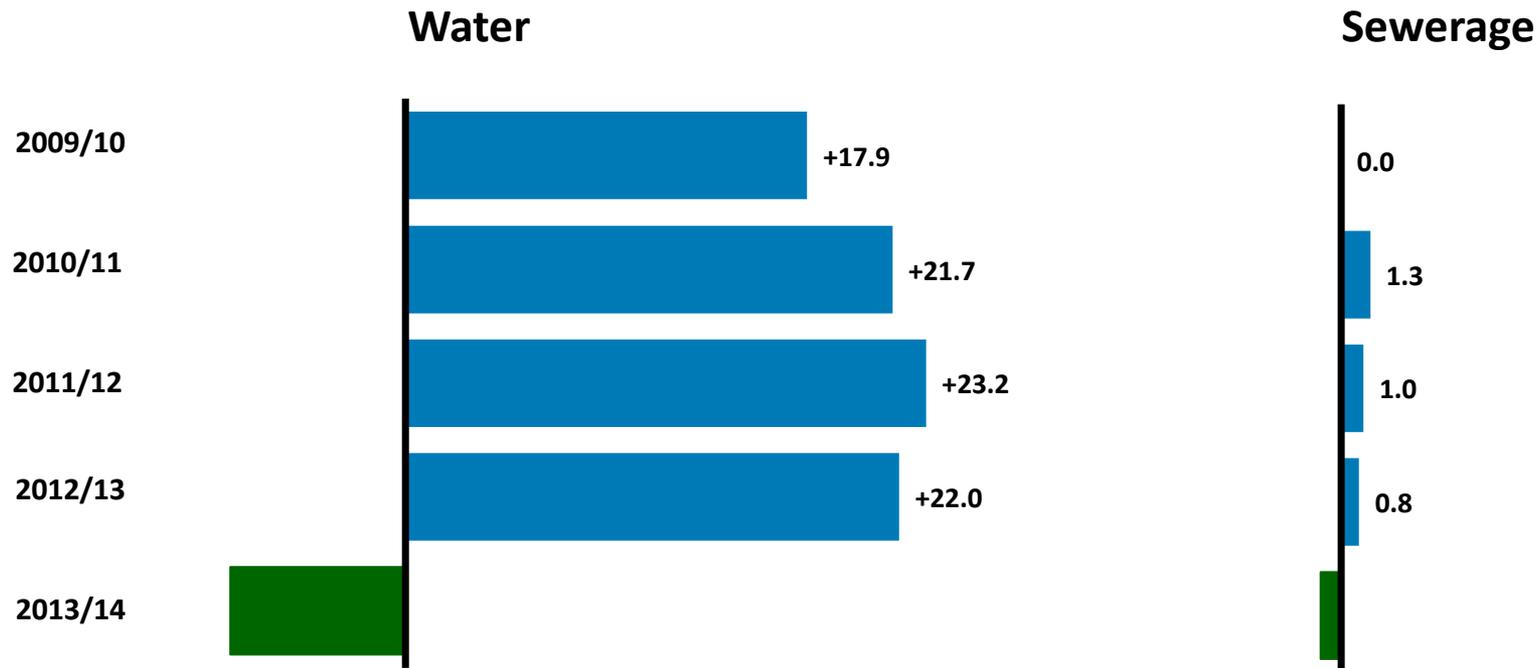


As water accounts for about 70% of total regulated water and sewerage revenues, overall average water and sewerage average revenues will fall by 5.7% in real terms (3.4% nominal) from 1 July

¹ The Commission has adjusted real caps to nominal caps using an inflation rate of 2.5%, the actual change in the CPI in the year to March 31 2013. Nominal average revenue caps will be adjusted in each of the subsequent 2 years using the actual change in that index in the year to March 31

² In addition, the Regulatory Statement forecast further real increases in both 2014/15 and 2015/16. In contrast, all real average revenue reductions in the Draft and Final Revenue Determinations occur up-front and are then maintained for 3 years.

Recent Average Real Percentage Price Changes



Average percentage price changes from July 1 to be announced by SA Water will be of a similar magnitude to the Commission's average revenue reductions; however, they may not be exactly the same¹

¹ For example, as the Treasurer's Second Pricing Order requires total annual water demand to be fixed at 190GL (as the Government assumed in its 2012/13 Regulatory Statement), growth in customer numbers would (by itself) require average price reductions to exceed average revenue reductions in order to meet the Commission's average revenue caps

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Two Main Overall Drivers of Average Revenue Reductions versus Government's 2012/13 Pricing Decision

1. Commission's operating expenditure savings

- ❑ \$143.6M (10.0%) operating expenditure savings versus Government's 2012/13 Regulatory Statement

2. Reductions in the regulatory rate of return

- ❑ 6.0% and 3.1%¹ in Governments 2012/13 Regulatory Statement
- ❑ 5.42%² in Commission's Draft Revenue Determination
- ❑ 5.06%² in Commission's Final Revenue Determination

¹ For water legacy assets

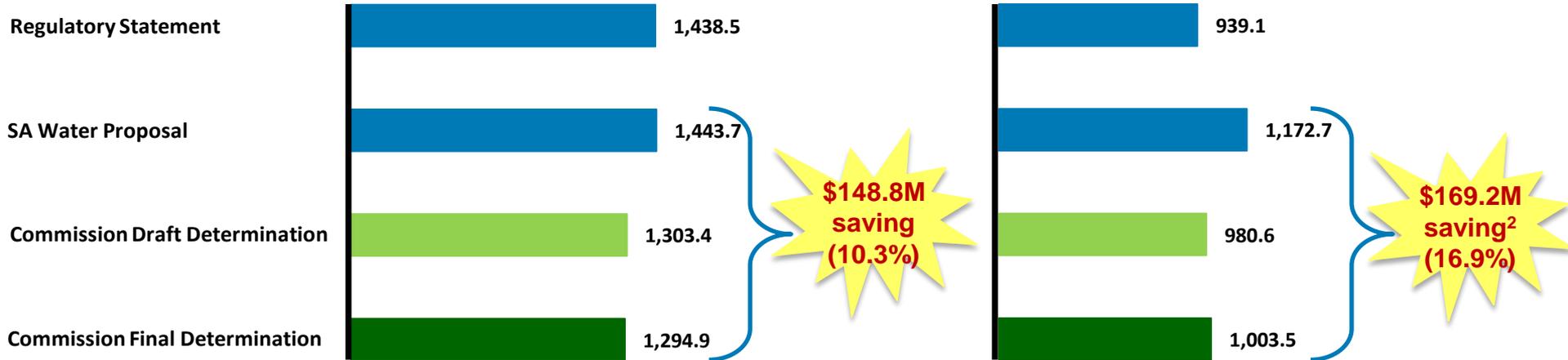
² While the Commission uses post-tax real rates of return, these returns are given on a pre-tax basis to provide an “apples with apples” comparison to the rates used in the 2012/13 Regulatory Statement

The Commission has made substantial overall savings versus SA Water's Proposal

3-Year Totals¹, \$M December 2012

Operating Expenditure

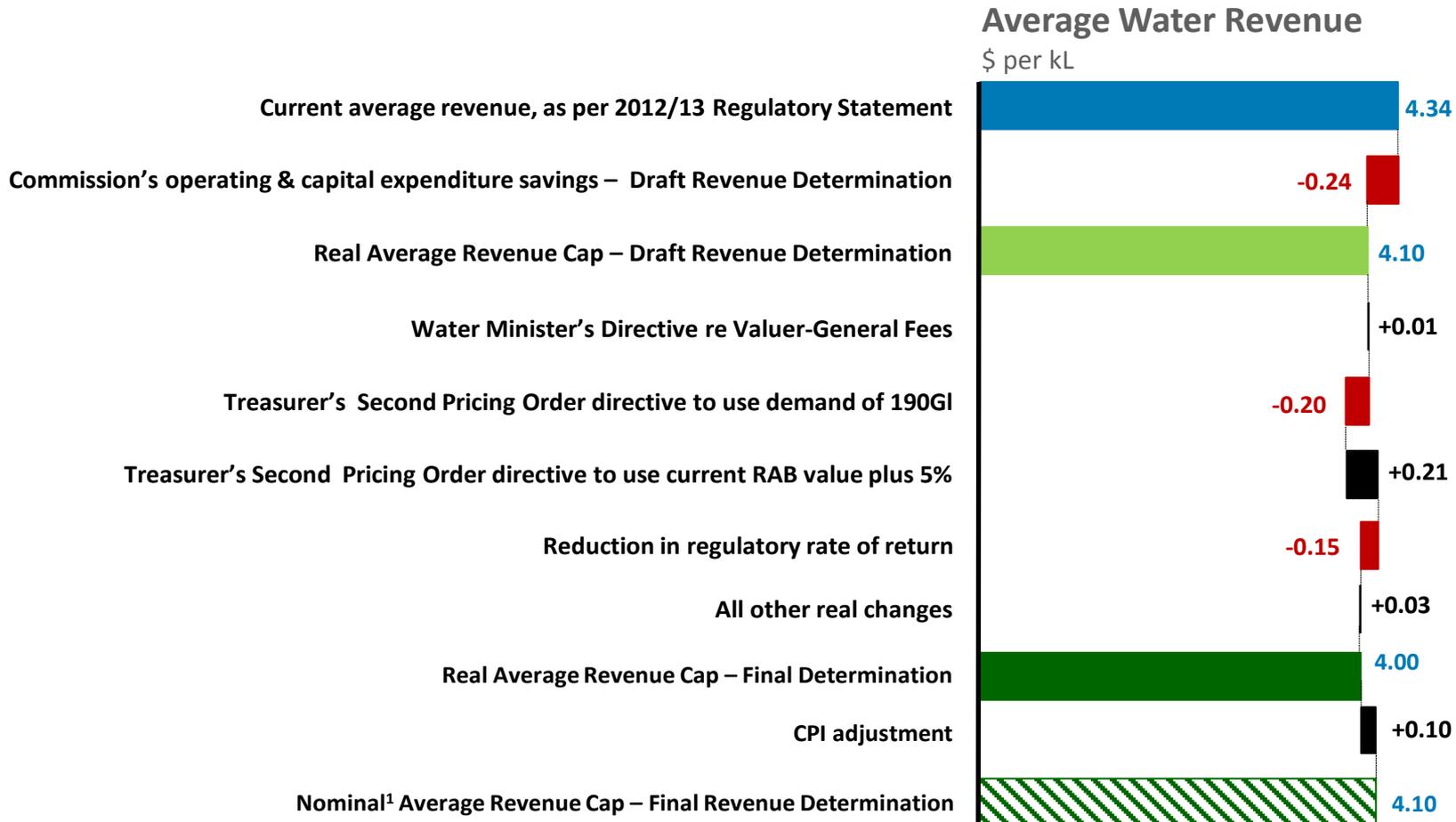
Capital Expenditure



¹ For water and sewerage combined. The biggest expenditure savings are summarised in Appendix A (pp. A-2 and A-3)

² Despite capitalisation of \$40.4M (Draft) and \$58.6M (Final) of desalination plant proving and membrane replacement costs

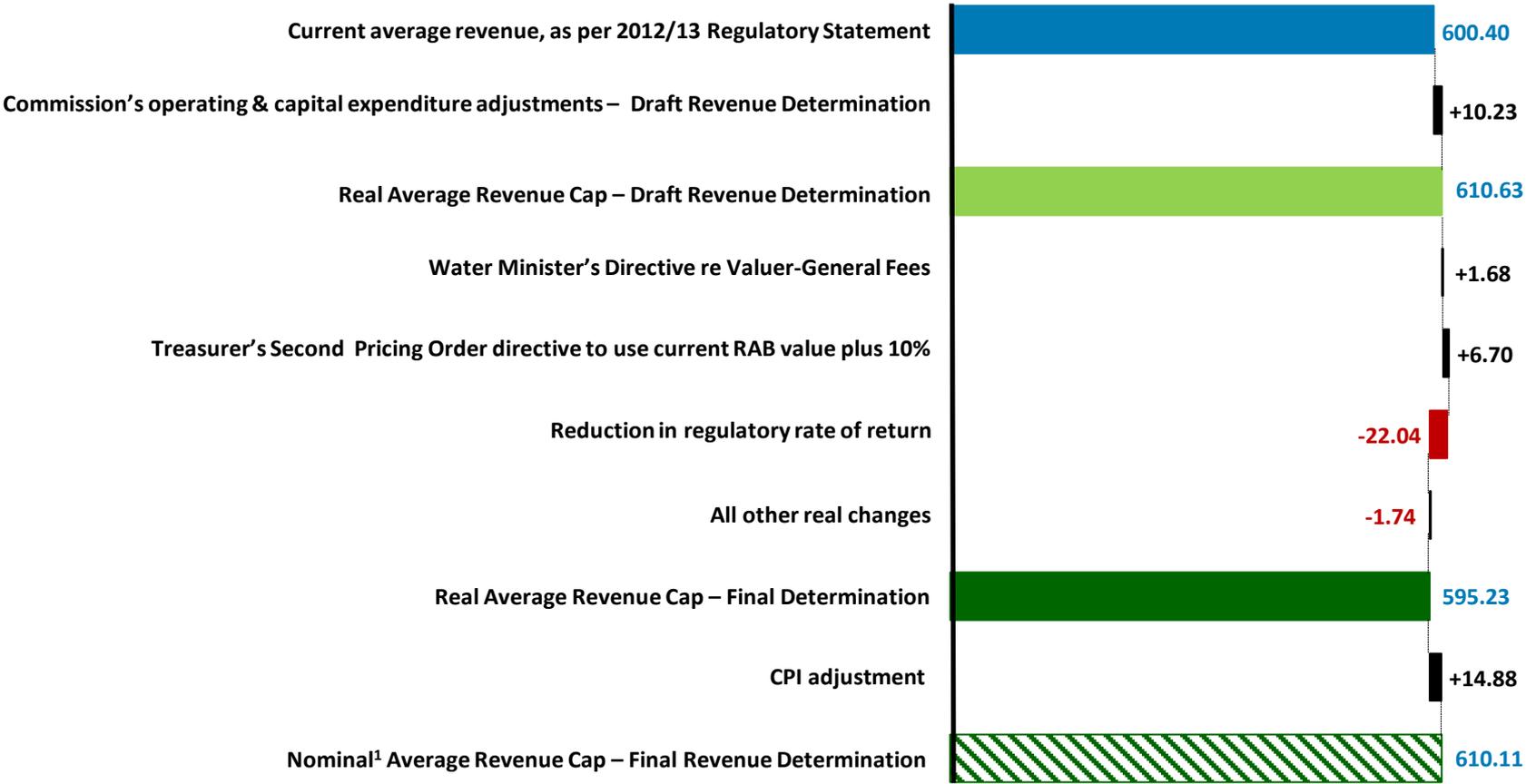
Key Drivers of Changes in Average Water Revenues



¹As of 1 July 2013. Nominal average revenue caps will be adjusted by CPI in each of the subsequent two years.

Key Drivers of Changes in Average Sewerage Revenues

Average Sewerage Revenue
\$ per connection



¹As of 1 July 2013. Nominal average revenue caps will be adjusted by CPI in each of the subsequent two years. The Commission's Draft Revenue Determination raised sewerage average revenues by more than the 2012/13 Regulatory Statement's forecast in 2013/14, but by the same percentage over the three years.



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Next Steps

- SA Water has proposed new prices
- Commission has checked that SA Water's proposed prices comply with the Final Revenue Determination's average revenue caps
- SA Water/Government to announce new prices
- New prices to apply from 1 July 2013

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Appendix A: Further Information

- Overview of the Commission
- Commission's biggest operating and capital expenditure savings
- Initial RAB values

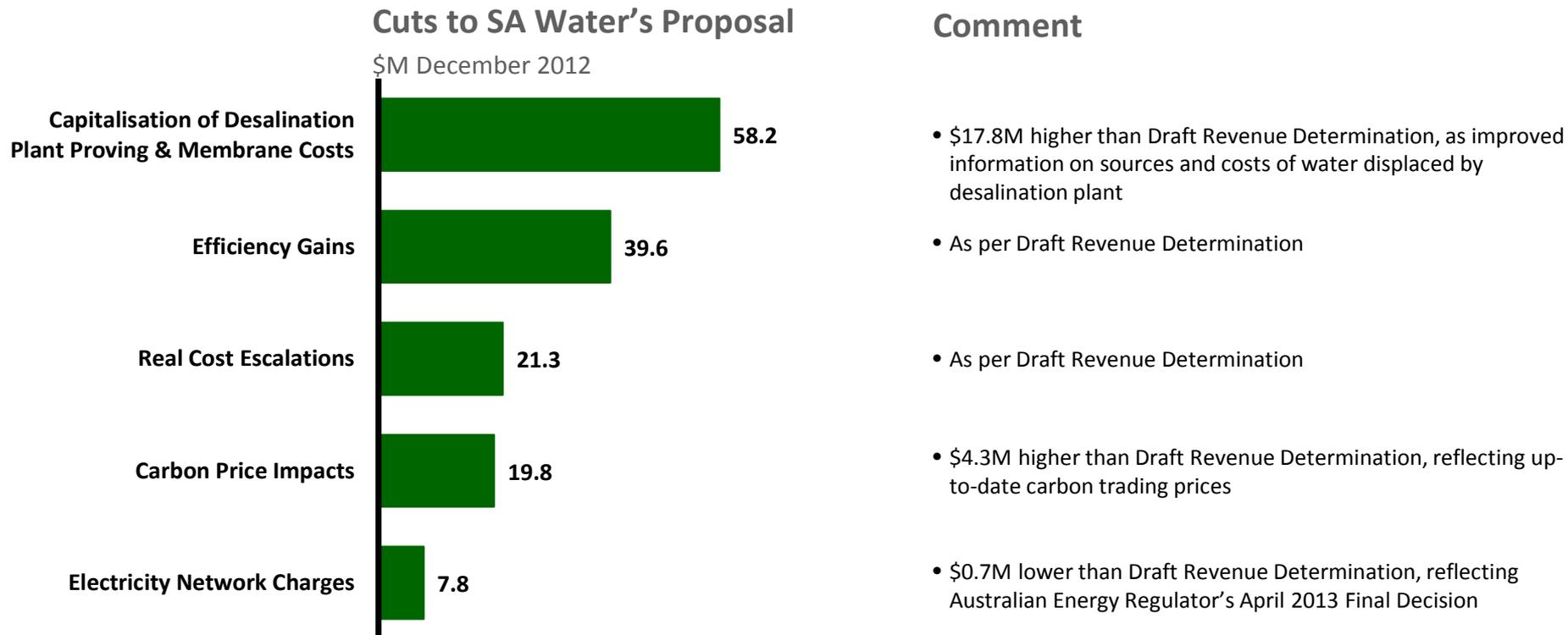
Overview of the Commission

- ❑ Independent economic regulator of 5 industries: water, electricity, gas, ports and rail.
- ❑ Legislated primary objective¹:
 - “protection of the long-term interests of South Australian consumers with respect to the price, quality and reliability of essential services”*
- ❑ Key functions:
 - Licencing
 - Consumer protection
 - Access regulation
 - Price/revenue regulation
 - Performance monitoring
 - Administration of Residential Energy Efficiency Scheme
- ❑ Strong focus on public consultation and transparency
- ❑ Became the economic regulator of the water industry following the passage of the Water Industry Act in 2012



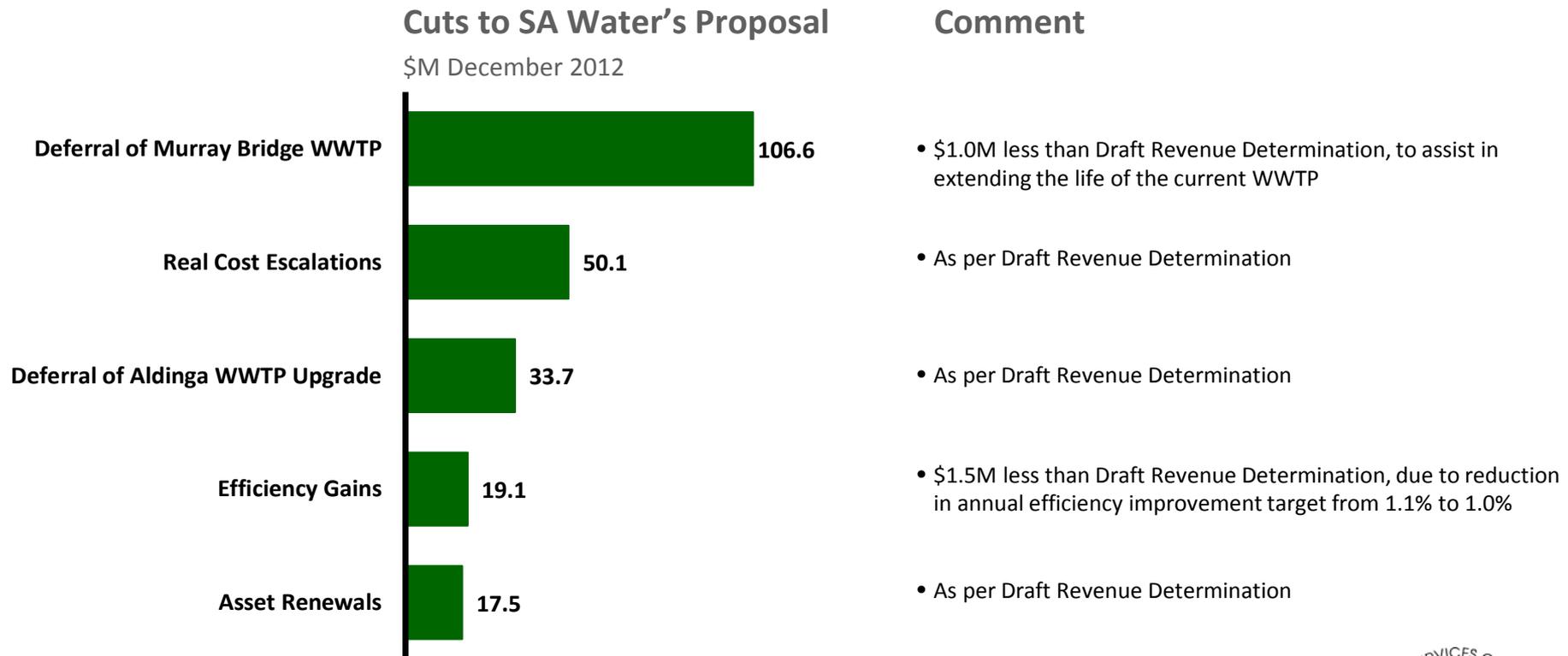
¹ Essential Services Commission Act 2002, Section 6 (a)

Biggest Operating Expenditure Savings – Final Revenue Determination



However, one of the biggest savings in the Draft Determination – reduced frequency of property valuation date purchases (\$8.5M) – has been excluded from the Final Revenue Determination, due to the Minister's Direction

Commission's Biggest Capital Expenditure Savings – Final Revenue Determination



Commission's Advice on Initial RAB Values

- ❑ In its Draft Revenue Determination, the Commission stated that:
 - It expected that an overall reduction in RAB values would be required to enable implementation of the Draft Revenue Determination's average revenue caps
 - A key reason for that expectation was the low rate of return earned on metropolitan water legacy assets
 - However, change in some factors (such as reductions in the regulatory rate of return) may require RAB increases
 - Therefore, the Commission stated that it would make recommendations regarding the setting of initial RAB values to the Treasurer in May 2013 and, in the interest of transparency would publish those recommendations in its Final Revenue Determination
- ❑ On 5 April 2013, the Commission advised the Treasurer to adopt three principles in setting initial RAB values

Commission's Advice to Treasurer on Principles for Setting Initial RAB Values¹

Principle	Comment
<p>Principle #1: The initial RAB values should be set to deliver the price paths that the Government forecast in its 2012/13 Drinking Water and Sewerage Prices Regulatory Statement</p> <p><i>plus/minus:</i></p> <p>Adjustments to pass through to consumers the full impact of changes in capital and operating expenditures that the Commission makes relative to those forecast in the 2012/13 Regulatory Statement.</p>	<ul style="list-style-type: none"> Initial sewerage RAB value does pass through to consumers the Commission's full operating and capital expenditure savings, as the effect of the RAB value increase is more than offset by the effect of a lower regulatory rate of return Initial water RAB value was set higher than if this principle was applied using the Commission's demand forecasts Nevertheless, as the small net impact of the combination of the higher initial water RAB value and the requirement to adopt a higher annual water demand (190Gl) is more than offset by the effect of a lower regulatory rate of return, the Commission's full operating and capital expenditure savings are passed through to consumers during the three-year period However, the higher water RAB value mean that consumers may not receive the full benefit of those operating and capital expenditure savings beyond the next three years
<p>Principle #2: The initial RAB values should be set consistent with the decisions of the Commission on key parameter values in its Final Revenue Determination, including those on the regulatory rate of return and demand forecasts.</p>	<ul style="list-style-type: none"> The Commission was required to adopt an annual water demand of 190Gl, rather than its own demand forecasts; this resulted in a higher initial RAB value being required to support any particular average revenue cap
<p>Principle #3: The initial RAB values should be set after considering the differences between water and sewerage prices in South Australia relative to other jurisdictions, as well as cost considerations. If South Australian prices remain higher than other comparable jurisdictions for reasons that cannot be explained by costs considerations, consideration should be given to setting lower initial RAB values to help bring SA water prices into line with those of other comparable Australian water utilities.</p>	<ul style="list-style-type: none"> Even after the Final Revenue Determination's average revenue reductions, South Australian households will continue to pay relatively high water prices

¹ Advice provided on 5 April 2013

Initial Water RAB Values Required to Support Commission's Average Revenue Caps

To support...

Initial Water RAB Value¹

Comment

\$ Million

Draft Revenue Determination's Caps
(at the time of its release)



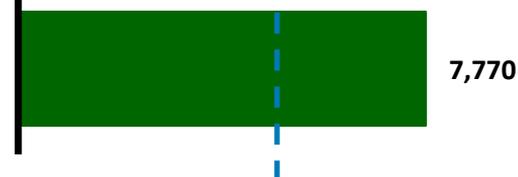
- \$297M write-down versus 2012/13 Regulatory Statement forecast
- Write-down then required was largely due to water legacy assets²

Final Determination Caps
without 190GL demand constraint



- \$59M write-up versus 2012/13 Regulatory Statement forecast
- \$356M increase since the Draft Revenue Determination is primarily due to a further reduction in the regulatory rate of return

Final Determination Caps
with 190GL demand constraint



- \$373M (5%) write-up versus 2012/13 Regulatory Statement
- This value is specified in the Treasurer's Second Pricing Order
- The requirement to adopt 190GL demand results in a \$314M increase in the initial RAB value required to support the Final Revenue Determination's average revenue cap

7,397

2012/13 Regulatory Statement

¹ As of 1 July 2013, in December 2012 dollars

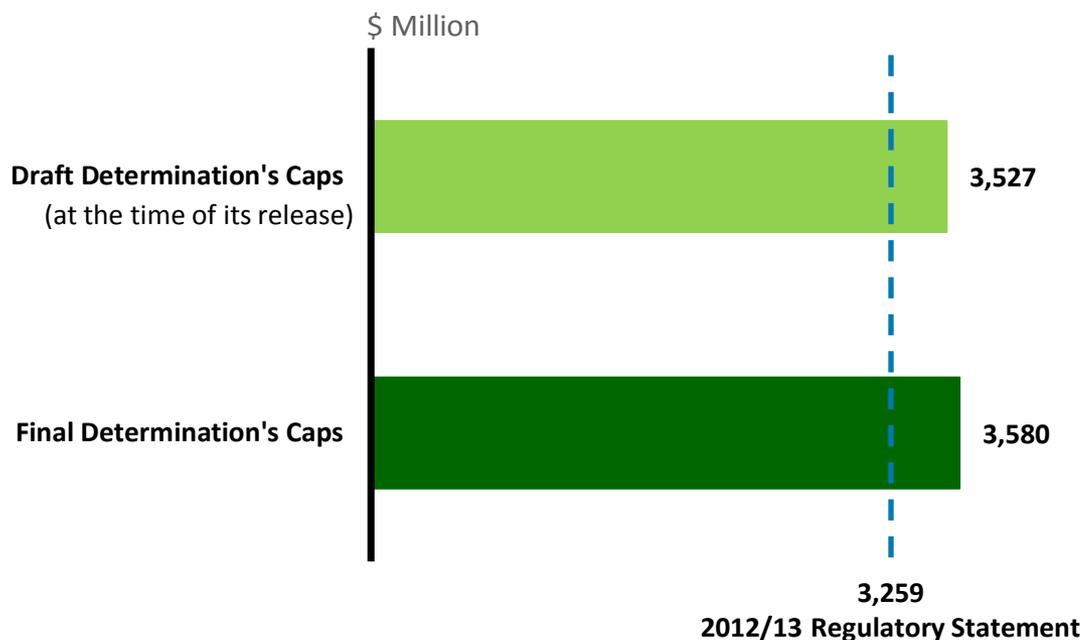
² While water legacy assets required a larger write-down, this was partly offset by other factors, including a reduction in the regulatory rate of return

Initial Sewerage RAB Values Required to Support Commission's Average Revenue Caps

To support...

Initial Sewerage RAB Value¹

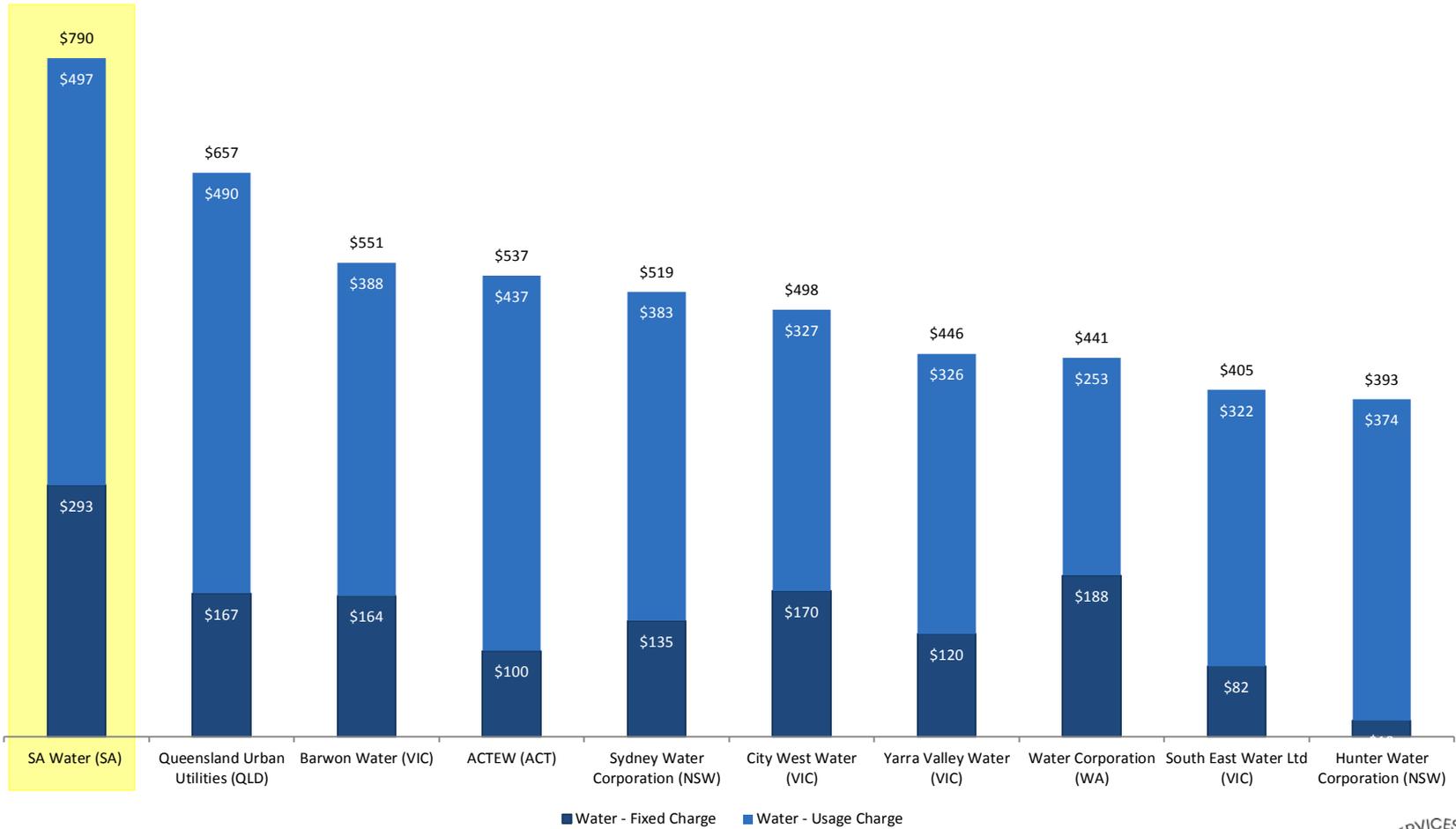
Comment



- \$268M write-up versus 2012/13 Regulatory Statement forecast, largely due to a reduction in the regulatory rate of return
- \$321 million (10%) write-up versus 2012/13 Regulatory Statement
- This value is specified in the Treasurer's Second Pricing Order
- Larger write-up required than in Draft Revenue Determination, primarily due to a further reduction in the regulatory rate of return

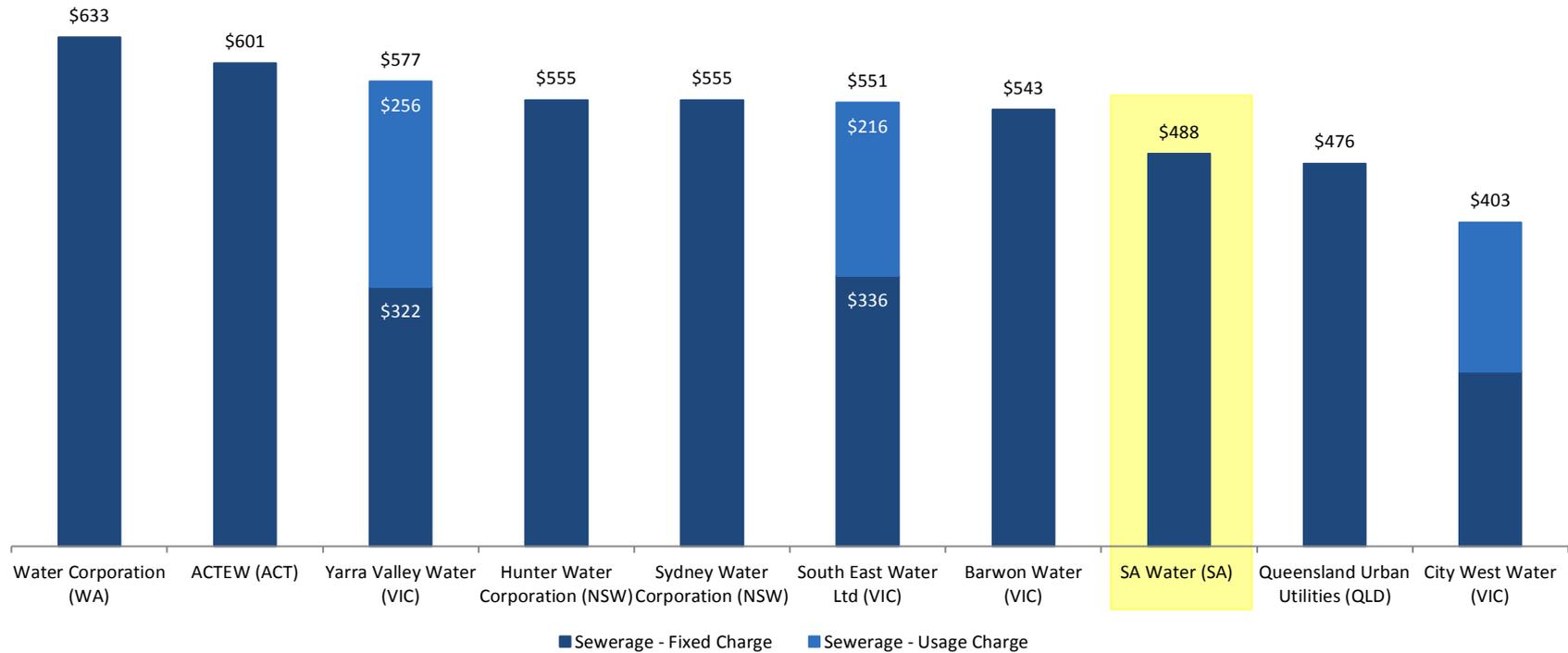
¹ As of 1 July 2013, in December 2012 dollars

Current Annual Residential Water Bill per Customer by Jurisdiction¹

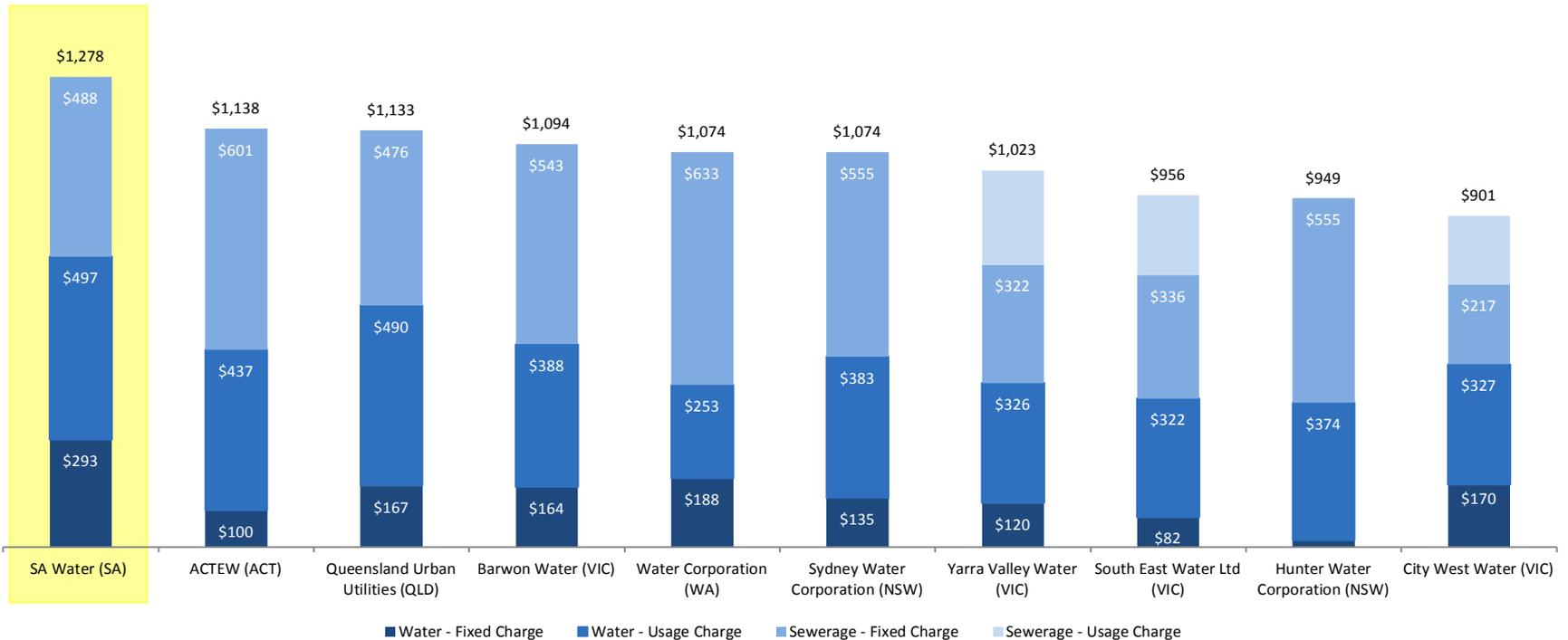


¹Based on 180kL consumption per annum.

Current Annual Residential Sewerage Bill per Customer by Jurisdiction



Current Annual Residential Combined Water and Sewerage Bills by Jurisdiction¹



¹This chart combines the water and sewerage numbers presented in the previous two charts