

# OVERVIEW OF IMPACT OF ECONOMIC REGULATOR'S PROPOSALS ON TASWATER'S MAXIMUM ALLOWED REGULATED REVENUE

TasWater's MARR for each year of the regulatory period is calculated as follows:

$$\begin{aligned} \text{MARR} &= \text{Return on Capital} \\ &+ \text{Depreciation} \\ &+ \text{Opex} \end{aligned}$$

In its proposed Price and Service Plan, TasWater calculated its MARR, as shown in Table 1, using the components and inputs outlined in Tables 2, 3 and 4 below. TasWater's calculation of its MARR would result in annual price increases of 7.9 per cent.

However, in its Proposed Price and Service Plan, TasWater proposed an annual price increase of 4.6 per cent. TasWater's forecast regulated revenue, based on an annual 4.6 per cent price increase, is also shown in Table 1.

Table 1 TasWater's maximum regulated revenue and forecast regulated revenue (\$'000s)

| Reference                                       | Description  | 2018-19 | 2019-20 | 2020-21 |
|---|--|---------|---------|---------|
| Proposed PSP, Section 8.8                       | TasWater's calculation of its MARR (7.9% price increase) | 395 085 | 410 378 | 419 722 |
| Proposed PSP, Chapter 9                         | TasWater's proposed price increase                       | 4.6%    | 4.6%    | 4.6%    |
| TasWater's Draft Pricing Model                  | TasWater's forecast regulated revenue                    | 338 317 | 356 123 | 374 857 |
| Economic Regulator's Draft Report, Section 11.3 | Economic Regulator's calculation of TasWater's MARR      | 339 878 | 352 143 | 368 228 |
| Economic Regulator's Draft Report, Section 13.1 | Economic Regulator's proposed price increase             | 4.16%   | 4.16%   | 4.16%   |

Based on the components and inputs outlined in Tables 2, 3 and 4 below the Economic Regulator calculated TasWater's MARR, as shown in Table 1 to be lower than TasWater's forecast regulated revenue, and would result in an annual price increase of 4.16 per cent.

The Economic Regulator's calculation of TasWater's maximum regulated revenue, the variations between TasWater's proposed values and those proposed by the Economic Regulator and the reasons for those variations are outlined in Tables 2 to 4 inclusive for 2018-19 (1 July 2018 to 30 June 2021 for WACC components and WACCs in Table 4).

Table 2 Building block components - 2018-19

| Draft Report reference   | Building block component | TasWater's proposed value | Economic Regulator's proposed value | Impact of difference in values on revenue <sup>1</sup> | Comments/reason for change  |
|--------------------------|--------------------------|---------------------------|-------------------------------------|--|---|
| Section 7.10             | Opex                     | 174 781                   | 169 862                             | -4 919   | Arup recommendations; Economic Regulator's productivity adjustment                                    |
| Sections 8.7.1 and 8.7.2 | Regulatory depreciation  | 109 967                   | 86 705                              | -23 262  | Maintain weighted average approach for existing assets and apply line by line approach for new assets |
| Section 11.2.1           | Inflationary gain        | -71 178                   | -71 354                             | -176   | Correct calculation error   |
| Section 11.2.3           | Working capital          | 1 585                     | 0                                   | -1 585   | TasWater has not justified the need for this allowance  |
| Section 11.2.2           | Tax allowance            | 22 021                    | 10 781                              | -11 240  | Correct calculation error   |

Table 3 Key inputs to maximum regulated revenue - 2018-19

| Draft Report reference | Key inputs   | TasWater's proposed value | Economic Regulator's proposed value | Impact of difference in values on revenue | Comments/reason for change   |
|------------------------|--|---------------------------|-------------------------------------|---|--|
| Section 6.5            | Capex  | 143 362                   | 131 675                             | -11 687                                   | Arup recommendations; Economic Regulator's proposed adjustment for gifted assets |
| Section 10.2           | Return on capital<br>$[(RAB_{EXISTING} \times WACC_{EXISTING}) + (RAB_{NEW} \times WACC_{NEW})]$ | 157 908                   | 143 884                             | -14 024                                   | Reflects impact of the Economic Regulator's lower WACCs and different RABs       |

<sup>1</sup> Revenue impacts shown for each adjustment.

Table 4 WACC components, WACC<sub>NEW</sub> and WACC<sub>EXISTING</sub> - 1 July 2018 to 30 June 2021

| Draft Report reference     | WACC component  | TasWater's proposed value | Economic Regulator's proposed value | Impact of difference in values on revenue | Comments/reason for change  |
|----------------------------|---|---------------------------|-------------------------------------|---|---|
| Section 9.4.1              | Gearing   | 60%                       | 60%                                 | n/a                                       | No change   |
| Sections 9.4.2 and 9.4.4   | Risk free rate  | 3.50%                     | 2.90%                               | -0.60%                                    | Different methodology used  |
| Sections 9.4.3.1 and 9.4.4 | Debt risk premium                                       | 2.49%                     | 2.03%                               | -0.46%                                    | Different methodology used  |
| Section 9.4.3.2            | Debt issuance   | 0.10%                     | 0.10%                               | n/a                                       | No change   |
| Section 9.5                | Cost of debt (pre-tax)                                  | 6.09%                     | 5.02%                               | -1.07%                                    | Different methodology used  |
| Section 9.4.5              | Market risk premium                                     | 6.50%                     | 6.50%                               | n/a                                       | No change   |
| Section 9.4.6              | Equity beta   | 0.70                      | 0.65                                | -0.05                                     | Maintaining approach from the second regulatory period noting results from an international benchmarking study  |
| Section 68(1A) of the WSIA | Statutory return on equity (Existing) (pre-tax nominal) | 3.00%                     | 3.00%                               | n/a                                       | No change - set by legislation  |
| Section 9.4.7              | Gamma   | 0                         | 0.40                                | 0.40                                      | Maintaining approach from the second regulatory period; public ownership of TasWater is not taken into account as the objective is to determine revenue for a benchmark, efficiently managed, <i>privately owned</i> business |
| Section 9.5                | Cost of equity <sub>(New)</sub> (post-tax)              | 8.05%                     | 7.12%                               | -0.93%                                    | Calculated based on the Economic Regulator's proposed WACC components   |
| Section 9.5                | WACC <sub>EXISTING</sub>                                | 4.49%                     | 4.00%                               | -0.49%                                    | Calculated based on the Economic Regulator's proposed WACC components   |
| Section 9.5                | WACC <sub>NEW</sub>                                     | 6.87%                     | 5.86%                               | -1.01%                                    | Calculated based on the Economic Regulator's proposed WACC components   |