Allconnex Water Price Monitoring Submission 2010-2011

Submission to the Queensland Competition Authority
Review of Prices for Allconnex Water

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Allconnex Water Price Monitoring Submission 2010-11

1 Executive summary

1.1 Overview of Allconnex Water's pricing strategy from 1 July 2010

Gold Coast City Council, Logan City Council and Redland City Council have collaborated in the establishment of Allconnex Water as a new 'distributor-retailer' water business. Allconnex Water is responsible for the delivery of water, wastewater and recycled water services to households and businesses across the three local government areas.

Pursuant to section 23A of the *Queensland Competition Authority Act 1997*, the Premier and Treasurer of Queensland have referred Allconnex Water to the Queensland Competition Authority (QCA) for a price monitoring investigation from 1 July 2010 to 30 June 2013 (Ministers' Direction Notice, July 2010). The QCA also is assessing the pricing policies of Queensland Urban Utilities and Unity Water, the other two distributor-retailer authorities covering the rest of south east Queensland.

Allconnex Water has prepared this submission to accompany the regulatory Information Template requested by the QCA. The QCA's Information Template includes detailed revenue, cost, customer and other data intended to support the QCA's interim prices monitoring role for the south east Queensland distributor-retailer authorities.

This submission provides an overview of Allconnex Water's business, its customer base, cost structure and pricing strategy as adopted from 1 July 2010. The submission also outlines Allconnex Water's medium-term strategies and plans, as these are relevant to the QCA's prices monitoring role.

Historically, each of Allconnex Water's three Participating Councils has administered a 'postage-stamp' charging framework for water and wastewater services within their supply area. Charges may have been differentiated by customer-type or service (e.g., different fixed charges for customers with differently sized water meters), but were uniform across Council supply areas. The application of pricing policies and billing frequency also varied between Councils.

While the three Councils have been moving towards full cost recovery, as provided for under the *Local Government Act*, each was at a different stage of this progression. Collectively, water and wastewater charges in 2009-10, across the three Councils, did not deliver revenue sufficient to generate a commercial rate of return on the Councils' investment in water and wastewater facilities.

Allconnex Water believes that increasing prices in 2010-11 to achieve full cost recovery - or a 'maximum allowable revenue' (MAR), as defined by the QCA - would result in undue customer impacts, and is inconsistent with the State's request to the businesses to avoid price shocks. However, some level of price increase is required. Even if the business collectively had been earning revenue equivalent to MAR in 2009-10, prices would still need to increase significantly to hold this level of cost recovery in 2010-11. Key cost pressures for Allconnex Water include:

- significant external cost movements, including increasing State bulk water charges and above-CPI growth in energy costs;

- the business' large water and wastewater capital program, to meet the demands of the region's growing population, to renew and maintain the business' existing asset base, and to continue to deliver high-quality service levels to customers.

Acknowledging these factors, Allconnex Water has adopted a transitional approach to pricing which, for 2010-11, incorporates price increases which are significantly less than required to achieve MAR. Over the medium term, this strategy translates into a revenue *glide path* which is longer than the QCA's interim price monitoring period.

Allconnex Water has finalised its interim pricing strategy for 2010-11 and prices have been published on Allconnex Water's website. Allconnex Water's pricing strategy for 2010-11 has been informed by both the apparent level of cost recovery for each Council area (or 'district'), and a consolidated perspective of the business' level of cost recovery for each of its major product lines (water and wastewater).

The immediate pricing strategy incorporates a simple percentage adjustment to all tariff components (fixed and variable). This strategy has been established with regard to the following factors:

- In most instances, prices which recover MAR would be significantly higher than current prices and therefore a transitional approach is preferred, which seeks to ameliorate customer impacts and is sensitive to the State's preference for avoiding price shocks; and
- Each district has different legacy tariff structures and these structures have been retained until appropriate consideration is given to:

    a. Price harmonisation/rationalisation across the three districts, including due consideration of customer-level impacts from any significant changes in tariff structure; and

    b. Billing/customer system implementation, to ensure that any new tariff structures are properly incorporated into Allconnex Water's systems.

Broadly, pricing arrangements for 2010-11 for core water and wastewater services have been set at a district and product level such that a *consistent* percentage increase is applied to all charges within a particular district/product category. The level of the percentage increase reflects the percentage required to achieve MAR up to a maximum of 20%. Practically, this results in a lower percentage increase for Redland customers, with higher increases for Logan and Gold Coast customers, since Redland's charges for 2009-10 were already near its (district-level) MAR.

Allconnex Water has not yet determined a pricing strategy for 2011-12. Significant further work is required to inform this strategy – including more detailed revenue and cost projections and customer-base analysis – as well as direction from the State Government in terms of future bulk water price paths and overall regulatory pricing 'principles' for the urban water sector in south east Queensland.

1.2 Response to the QCA's information requirements

As part of its light-handed price monitoring role, Allconnex Water understands the QCA will monitor Allconnex Waters' revenues from water and wastewater activities against an estimate of the business' MAR. For this purpose, as well as meeting its other responsibilities set out by the Ministers' Direction Notice, the QCA requires Allconnex Water to provide comprehensive cost, revenue and other data in the form of an excel-based Information Template ('Template').

Allconnex Water's current forecasts are based on its own Enterprise Financial Model (EFM), which is a Microsoft Excel model designed to forecast key financial outcomes at an enterprise level. This model was built by the WB3 Project Team prior to the release of the QCA Information Templates and corresponding (draft) QCA calculation models. Where possible, Allconnex Water has completed the Information Templates in a way which allows reconciliation of input data back to the Allconnex Water EFM.

The current 2010-11 Template represents the Allconnex Water's first regulatory submission, and coincides with the business' first two months of operation. As such, Allconnex Water notes that it is currently dealing with the challenging task of integrating the legacy Council businesses, information systems, corporate policies and processes. This includes formulating more integrated pricing, costing and revenue policies, which will have a material impact on key elements of the QCA's price monitoring framework. Many of these policies have not yet been finalised, and will continue to be developed throughout 2010-11.

Practically, this means that Allconnex Water has been unable to provide all of the information requested by the QCA, or in some instances has provided data but in a different format from that specified. Allconnex Water has sought to clearly identify where there are variances in the data provided from that requested, and during 2011-11 will work to develop its information systems and processes to inform future regulatory submissions.

That said, Allconnex Water believes there is sufficient information, in coverage and quality, for the QCA to inform its prices monitoring role for 2010-11 and for the regulator to provide guidance and direction on its reporting requirements for 2011-12 and 2012-13.

The QCA should not consider that data as provided in Allconnex Water's current Template 'signals' its ongoing approach to particular issues for the remainder of the price monitoring period. For instance, key issues such as whether geographically-differentiated pricing should continue, and in what form, have not yet been determined by Allconnex Water. The provision of cost, revenue and pricing information at a Council, or 'district' level, does not presuppose that future pricing policies will continue to be linked to Council boundaries.

2 Context to Allconnex Water's regulatory submission

2.1 Structure and history

With a rapidly expanding regional population, estimated to reach 4.3 million by 2031, coupled with a growing concern over climate change, Queensland acted to safeguard water security and sustainability through a program of major structural and regulatory reform for the urban water sector. The reforms seek to efficiently deliver water supply security and sustainability for south east Queensland, by taking a coordinated and regionally-focused approach to water and wastewater activities.

Specifically, the reforms seek to achieve:

- asset aggregation and consolidation across the full water supply stream
- structural arrangements which can support the effective delivery of needed capital investment and efficient asset management across the sector.
- clear allocation of responsibilities and accountabilities for water supply and wastewater services; and
- improvements in the economic performance in the delivery of water – including through the introduction of independent economic regulation.

Under the ongoing reform program, the State Government has coordinated a process for the transfer of bulk assets from Councils to newly-created State statutory bulk authorities and a non-asset owning Water Grid Manager. The second phase of the reform program is the aggregation of remaining Council water and wastewater distribution and retail functions to three new Council-owned entities – one of which is Allconnex Water.

Gold Coast City Council, Logan City Council and Redland City Council have collaborated in the establishment of Allconnex Water as a new 'distributor-retailer' water business. Allconnex Water is responsible for the delivery of water, wastewater and recycled water services across the three local government areas.

The coming year will be challenging for Allconnex Water. The business needs to bed down a range of interrelated business reform projects, with the ultimate objective of ensuring the continued provision of high quality water and wastewater services to around 850,000 people.

2.2 Purpose and objectives

Allconnex Water has prepared this submission to accompany the regulatory Information Template requested by the Queensland Competition Authority (QCA). The QCA's Information Template includes detailed revenue, cost, customer and other data intended to support the QCA's interim prices monitoring role for the south east Queensland distributor-retailer authorities.

This submission provides an overview of Allconnex Water's business, its customer base, cost structure and pricing strategy as adopted from 1 July 2010. The submission also outlines Allconnex Water's medium-term strategies and plans, as these are relevant to the QCA's prices monitoring role.

Allconnex Water supports the transparency offered by the Authority's regulatory review process, and commits to participate fully and constructively in the new regulatory environment. In return, Allconnex Water seeks from the QCA acknowledgement of the transitional and challenging environment the business is operating in.

This submission seeks to provide context to the raw data provided in the QCA's Information Template. It also identifies where Allconnex Water has been unable to provide data in exactly the format requested by the QCA. In most instances this is because the data was not previously captured by Allconnex Water's three Participating Councils – Gold Coast City Council, Logan City Council and Redland City Council. Where data gaps have been identified, Allconnex Water intends to develop processes and systems to allow for this data to be captured and reported in subsequent reporting periods.

2.3 QCA price monitoring / price regulation (current and future)

Pursuant to section 23A of the Queensland Competition Authority Act 1997, the Premier and Treasurer of Queensland have referred Allconnex Water to the QCA for a price monitoring investigation from 1 July 2010 to 30 June 2013 (Ministers' Direction Notice, July 2010).

As part of its light-handed price monitoring role, the QCA is expected to monitor Allconnex Waters' revenues from water and wastewater activities against a Maximum Allowable Revenue (MAR). For this purpose, as well as meeting its other responsibilities set out by the Minister's Direction Notice, the QCA requires Allconnex Water to provide comprehensive cost, revenue and other data in the form of an excel-based QCA Information Template ('Template'), consistent with the QCA Information Requirements for 2010-11.

The current 2010-11 Template represents the entities first regulatory submission, and coincides with the new entities' first year of operation. As such, Allconnex Water notes that it is currently dealing with the challenging task of integrating the legacy Council businesses, information systems, corporate policies and processes. This includes formulating more integrated pricing, costing and revenue policies, which will have a material impact on key elements of the price monitoring framework. Many of these policies have not yet been finalised, and will continue to be developed throughout 2010-11.

Allconnex Water will be in a stronger position to respond to the QCA's information requirements from 2011-12. The QCA should not consider that Allconnex Water's current Template 'signals' its ongoing approach to these and other issues for the remainder of the price monitoring period. For instance, key issues such as whether geographically-differentiated pricing should continue, and in what form, have not yet been determined by Allconnex Water. The provision of cost, revenue and pricing information at a Council, or 'district' level, does not presuppose that future pricing policies will continue to be linked to Council boundaries.

2.4 Explanation of template returns

Allconnex Water's current forecasts are based on its own Enterprise Financial Model (EFM), which is a Microsoft Excel model designed to forecast key financial outcomes at an enterprise level. This model was built by the WB3 Project Team prior to the release of the QCA Information Templates and corresponding (draft) QCA calculation models. Allconnex Water has identified a number of differences between the Information Templates, QCA draft models, and the EFM, in terms of the level of data disaggregation, use of data categories, and elements of the methodology for calculating the RAB and MAR.

Where possible, Allconnex Water has completed the Information Templates in a way which allows reconciliation of input data back to the Allconnex Water EFM.

At the current time, Allconnex Water cannot provide the level of data that is required by the Information Template. As the business moves forward during 2010-11, further work will be undertaken to verify, test and develop more robust data.

A description of how Allconnex Water has used the Template categories is provided in Table 2.1 below:

Table 2.1: Summary of categories

Summary of service categories	Revenue	Volume	Costs / Assets
Drinking Water	Water	Water	All water costs and assets
Other core water services	Not used	Not used	Not used
Aggregate non-core water services	Other services relating to water	Not used	Not used
Wastewater via sewer	Wastewater	Wastewater	All wastewater/recycled water costs and assets, except trade waste
Trade waste	Trade waste	Trade waste	Trade waste
Other core wastewater services**	Recycled water	Not used	Not used
Aggregate non-core wastewater services	Other services relating to wastewater	Not used	Not used

** NB. Refer to data limitations section.

2.5 Data limitations

Information systems from the three Councils are presently not able to separate all the costs associated with service categories, revenue, volume and assets to fully populate the Information Template.

To respond to the regulatory data requirements, Allconnex Water has had to make certain assumptions regarding the allocation of costs between certain activities/products.

For instance, Allconnex Water's EFM separates capital and operating costs only by the broad water/wastewater categorisation. The model includes recycled water costs within the total wastewater asset base, such that all costs and revenues for recycled water have been reported to the QCA as either wastewater via sewer (costs) or other core wastewater services (revenues). Volumes were not available for recycled water, and costs were unable to be adequately 'unbundled' from general wastewater costs to allow separate reporting. Revenue details for recycled water have been provided under 'other core wastewater services' to allow comparison against costs, which as noted above are included in overall wastewater costs. Similarly, data for other unused categories was either not available or not sufficiently disaggregated to allow separate reporting.

In the case of certain forecasts, such as the business' forward capital program, Allconnex Water has reported data as provided by Councils, though emphasises that

much of this information is presently being reviewed as the business continues to develop its business integration strategies.

The table below summarises the key departures from the SEQ Interim Price Monitoring Information Requirements for 2010-11 (July 2010) which are reflected in Allconnex Water's template return. Where relevant, additional workpapers have been provided where information is unavailable in the format of the Information Template.

Table 2.2: Data limitations

Ref	Requirement	Compliance	Comment
5.1	Statutory Accounts and budget, including details of profit and loss, balance sheet and cashflow.	Partially compliant	Statutory accounts are currently unavailable for 2009-10 and will be provided prior to 30 September 2010. Allconnex Water does not presently have regulatory accounts.
5.2	Revenue from prices and other sources	Substantially compliant	Revenue from core water/wastewater charges has been provided on a price times quantity basis as set out in the Template, however revenue from non-core and unregulated services has been provided only at an aggregate level. Separately, a full schedule of charges has been provided as an attachment to this submission.
5.3	Service standards	Substantially compliant	Service standards have been provided separately to the Information Template, rather than by individual metric within the Template.
5.4	Demand	Substantially compliant	Demand details have been provided, however not all categories have been used.
5.5	Regulatory asset base	Substantially compliant	Details on the RAB have been provided in the Template, however the allocation of Allconnex Water's opening RAB at 1 July 2008 is based on the ratio of the Minister's advised asset value to accounting WDV, as determined by the fixed asset registers (FAR) provided to Allconnex Water. In some cases there are (immaterial) discrepancies between the FAR and final audited total WDV. Details have been provided at an asset class/product level, rather than by individual assets. Corresponding weighted average useful lives have also been provided.
5.6	Capital expenditure	Partially compliant	Capital expenditure has been provided (and allocated to categories), based on the year that the expenditure was/will be incurred rather than the year of commissioning. A complete list of capital expenditure items and corresponding values is provided separately to the

			Information Template, but in some cases the level of detail required in the Information Requirements is unavailable.
5.7	Contributed, donated and gifted assets	Substantially compliant	Details of contributed, donated and gifted assets are provided, however a full schedule of infrastructure charges is provided separately.
5.8	Depreciation	Compliant	-
5.9	Indexation	Compliant	-
5.10	Return on capital	Partially compliant	Allconnex Water has adopted a mid-point within a range as advised by an independent expert, therefore has not provided specific parameters. Separately, a report on WACC which discusses the input parameters has been provided as an Appendix to this report.
5.11	Operating costs	Substantially compliant	Operating costs have been provided, however the categories reflect the categories in Allconnex Water's own EFM (not every category is used and therefore some categories may represent the aggregation of a number of categories).
5.12	Third party transactions	Compliant	-
5.13	Related party transaction	Substantially compliant	Details of related party transactions have been provided (principally, these are Service Level Agreements between Allconnex Water and the Participating Councils).
5.14	Non-regulated services	Substantially compliant	Supporting documentation has been provided, however the level of detail required in the Information Requirements is not available.
5.15	Tax	Partially compliant	Tax written-down asset values and remaining useful lives have been provided based on regulatory values (as a conservative interim assumption). While Allconnex Water understands that the State Government has sought advice on appropriate tax transition arrangements, this advice is yet to be formally communicated to Allconnex Water.
n/a	Board members' responsibility statement	Substantially compliant	Allconnex Water has amended the 'pro forma' QCA Board members' Responsibility Statement to reflect that the results at the period end date (30 June 2010), to which the Board members are required to attest, are the expected results for 2019-10 and the state of affairs at 30 June 2013 are projected. Further minor amendments have been made to reflect that information on third and related party transactions are

			included in Allconnex Water's Template Returns, and to acknowledge the data limitations described in this table.

2.6 Structure of this submission

The remainder of this submission is structured as follows:

- **Chapter 3** provides an overview of the regulatory asset base (RAB) roll-forward approach applied by Allconnex Water. The RAB is obviously a critical reference point for any regulatory prices review process, and understanding the RAB is important to understanding Allconnex Water's overall cost-recovery profile and pricing strategy;
- **Chapter 4** describes the outcomes from 2009-2010**;**
- **Chapter 5** describes the businesses planning approach and service standards – which inform the forecasts as provided over the 2010/11 to 2013/13 period;
- **Chapter 6** provides an overview of the business demand forecasts, both in terms of customer growth and water consumption;
- **Chapter 7** summarises the business capital program, providing an overview of Allconnex Water's main capital projects for the coming financial year, and **Chapter 8** presents the business operating cost profile;
- **Chapter 9** details the business' target rate of return and financing arrangements, linking to **Chapter 10** which brings the total cost profile together to describe the overall regulatory 'Maximum Allowable Revenue', or MAR, for Allconnex Water.
- **Chapter 11** details Allconnex Water's pricing strategy for the current financial year, including the expected level of cost recovery as compared to the MAR; and
- **Chapters 12** and **13** provide a summary of, respectively, the business projected financial outcomes and its forward work program for the balance of the three-year interim prices monitoring period.

3 RAB roll-forward

3.1 Overview of methodology

The Ministers' Direction Notice provides guidance to the businesses and the QCA on the methodology that the QCA is to apply in rolling-forward the RAB. To the extent that there is a clear methodology which can be inferred from the Direction Notice, Allconnex Water's RAB roll-forward modelling reflects this methodology. Where there is no clear methodology, Allconnex Water has sought to interpret the Direction Notice consistent with established regulatory practice and with the underlying intent of the transition from the Participating Councils to the new Distributer-Retailer.

3.1.1 Opening RAB

As advised by the Minister for Natural Resources, Mines and Energy and Minister for Trade, the total (residual) asset valuation for Allconnex Water at 1 July 2008 is $3,557.537m. The allocation of this opening RAB to each district, as advised by the Minister, is as follows ($'000):

- Gold Coast - $2,131,160
- Logan - $1,005,432
- Redland - $420,945

Allconnex Water's regulatory modelling allocates this total opening RAB to each major product type, based on the relative proportions of accounting written down values as at 30 June 2008. The accounting WDV for each product type was determined in accordance with the information provided in the asset registers by each of the Councils as part of the former WRP due diligence.

The table below sets out the result of this allocation process, including the exclusion of $0.260m from the opening RAB (for non-regulated services).

Table 3.1: Opening RAB at 1 July 2008 ($'000)

Opening RAB	Water	Wastewater	Non-regulated	Total valuation	Total RAB	% of total RAB at 30 June 2008
Gold Coast	849,721	1,281,178	260	2,131,160	2,130,900	59.91%
Logan	435,148	570,284	-	1,005,432	1,005,432	28.26%
Redland	172,081	248,864	-	420,945	420,945	11.83%
TOTAL	**1,456,950**	**2,100,326**	**260**	**3,557,537**	**3,557,277**	**100%***

Note. Wastewater includes recycled water and trade waste assets

* This figure is rounded

3.1.2 Additions

The Direction Notice clearly establishes parameters for the QCA's review of capital expenditure, including that actual capital expenditure 'as included in Council financial accounts' up to 30 June 2010 must be accepted by the QCA as prudent and efficient and included in the RAB.

During the RAB roll-forward period to 30 June 2010, a 'revenue-offset' approach was adopted by all districts and therefore donated assets and cash contributions are

included in the RAB in the same way as other Council-funded capital expenditure. This is consistent with the Ministers' Direction Notice to the Authority which directs the QCA to apply a revenue-offset methodology during the two year transition period to 30 June 2010, in which all capital expenditure, whether in the form of developer cash contributions or gifted assets, or Council-funded works, are to be included in the RAB.

A corresponding revenue amount is also deducted from the MAR in the year in which it is received, rather than when the asset is physically in service. Although this is internally consistent (in that an appropriate/consistent timing assumption is adopted for the off-set amount), it creates a potential disconnect between the physical asset base and the RAB, since cash amounts may have been received for future assets which do not yet exist (at least in terms of a commissioned and capitalised asset in a fixed asset register).

A key issue is the treatment of work-in-progress (WIP) capital expenditure which spans an end-of-year reporting date. Commissioning dates were not originally collected as part of the WB3 data book and as an interim assumption, all capital expenditure is capitalised into the RAB in the same financial year as the expenditure. Although the Direction Notice does not provide any guidance on the treatment of WIP projects which span a reporting date, Allconnex Water believes that this assumption is consistent with the Direction Notice for the treatment of WIP projects which span 1 July 2010, which requires that the QCA include in the RAB *actual* capital expenditure as included in Council financial accounts up to 30 June 2010.

As at 30 June 2010, Participating Councils reported WIP carrying values of $109 million for Gold Coast, $79.4 million for Logan and $7.9 million for Redland.

There are also a number of practical issues with the consolidation of the three Council systems/processes, with the districts applying different treatment of WIP project expenditure for financial reporting purposes. Allconnex Water will need to work through this issue in 2010-11 and in future intends to collect more comprehensive data in relation to commissioning dates for new capital expenditure.

Table 3.2: Overview of capital expenditure (2008-10)

	2008-09 ('000)	2009-10 ('000)	Total ('000)
Gold Coast	221,567	185,617	407,184
Logan	34,356	76,592	110,948
Redland	5,044	17,363	22,408
TOTAL	**260,968**	**279,572**	**540,540**

3.1.3 Disposals

The Direction Notice provides no detailed guidance in relation to disposals, other than they are to be deducted in the RAB roll-forward.

There is some regulatory precedent to support an approach which values disposals at an approximate RAB value. For example, in NSW, IPART[1] takes the accounting value of a disposal and applies the relative proportion of total RAB to total accounting WDV,

[1] IPART (2009), *Gosford City Council, Wyong Shire Council Prices for water, sewerage and stormwater drainage services from 1 July 2009 to 30 June 2013*, May

deducting this adjusted disposals amount from the RAB roll-forward. In effect this adjustment seeks to recognise that the book value of a disposal may not accurately reflect the contribution of that asset to the RAB, and thus in recalculating the RAB an adjustment to the value of reported disposals is required. Where the disposal was effected for cash consideration, then IPART[2] regards this as a proxy market value for those assets and the total value of the disposal amount is used to adjust the RAB.

Consistent with this approach, Allconnex Water has adjusted the book value of disposals, as provided by the districts, by the proportion of the district-level RAB to the district-level WDV.

Disposals are generally not a significant component of water businesses, and for Allconnex Water typically only accounts for approximately 0.2% – 0.3% of the RAB in any year.

3.1.4 Indexation

For 2008-09 and 2009-10, indexation rates have been adopted which reflect the Australian Bureau of Statistics Consumer Price Index for June (all groups, Brisbane, Series ID A2325817T). The reported CPI rate was 2% for 2008-09 and 3.2% for 2009-10.

3.1.5 Depreciation

Consistent with the Minister's Direction Notice, regulatory depreciation is calculated based on a straight line methodology and using the apportionment of the original asset valuation to Council assets and the existing useful lives attached to those assets.

For the purposes of Allconnex Water's modelling, a weighted average approach has been used to calculate the 'roll-forward' remaining useful lives.

3.1.6 RAB roll-forward summary

A summary of the RAB roll-forward to 30 June 2010, using the parameters described above, is provided in the table. For the purposes of calculating the RAB roll-forward, a mid-year assumption has been adopted for capital expenditure, the receipt of donated assets, and asset disposals.

As at 1 July 2010, Allconnex Water's opening RAB is $4,079.952m, as shown in table 3.3, below.

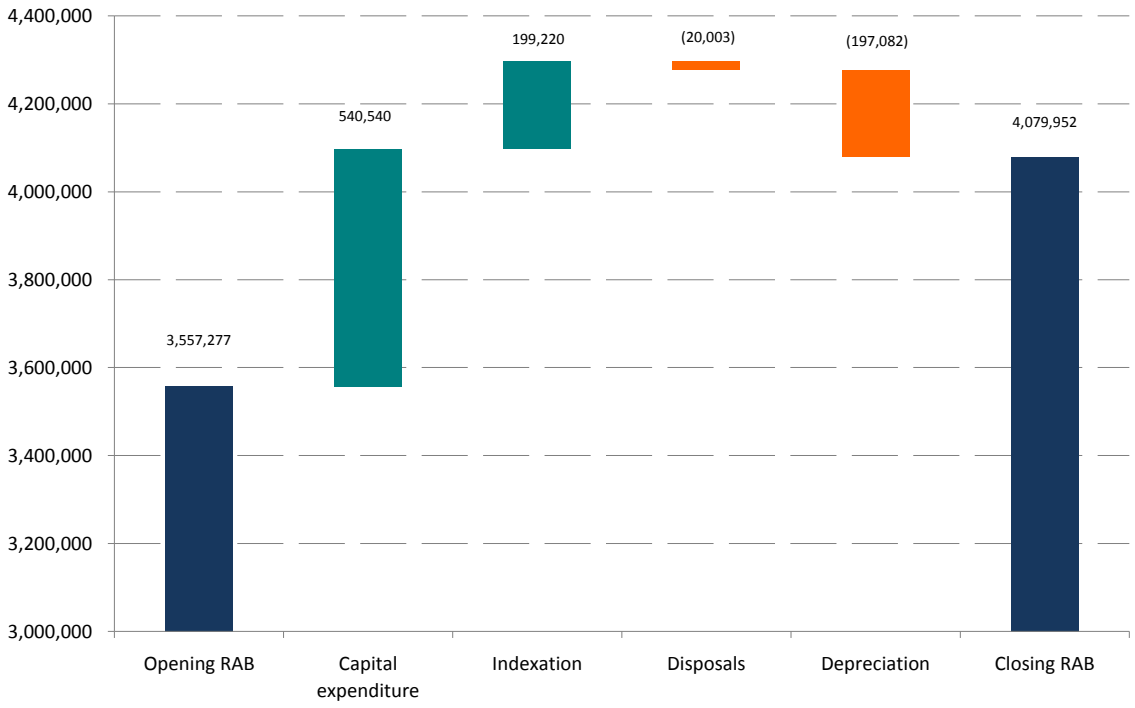
[2] IPART (2008), *Review of prices for Sydney Water Corporation's water, sewerage, stormwater and other services from 1 July 2008, Water — Determination and Final Report*, June

Table 3.3: RAB Roll-forward (2008-10)

	2008-09 ('000)	2009-10 ('000)
Opening RAB	3,557,277	3,789,209
Capital Expenditure	260,968	279,572
Disposals	(9,420)	(10,583)
Indexation	73,661	125,559
Depreciation	(93,277)	(103,805)
TOTAL	**3,789,209**	**4,079,952**

Figure 3.1 details the combined adjustments from the Ministers' originally determined regulatory asset base as at 1 July 2008, to the 'rolled forward' capital base for 1 July 2010. It shows the respective contributions of capital expenditures, asset indexation, disposals and depreciation.

Figure 3.1: RAB roll-forward (2008-10)



4 Business outcomes for 2009-10

The QCA's *Retail Price Monitoring in SEQ Urban Water Sector* reports from October 2009 observed that "total revenues are below those necessary to achieve full cost reflectivity"[3], for all three Council water businesses.

Early modelling by the WB3 project team identified significant cost-recovery shortfalls for both water and wastewater services, at a consolidated Allconnex Water level, although at a Council or district level, the level of cost recovery was varied.

Modelling indicated that Redland was quite close to full cost recovery in 2009-10, especially for water services, while Gold Coast and Logan had a significant cost recovery gap against MAR for both water and wastewater.

However, while all three districts were assessed to be under recovering according to full cost pricing principles, they are not under any financial pressure, and the Council business' transferred across to Allconnex Water with a sound fiscal position and low levels of debt. Each business has been able to fund vital operations, business initiatives, and water and wastewater infrastructure, and has provided its Council with dividends and tax equivalent payments.

Nevertheless, Allconnex Water does have a challenge in the years ahead to maintain (and improve) the return to Council's past investment in water and wastewater assets, absorb significant increases in operating costs, including increasing bulk water charges, and other input prices such as electricity and construction materials, and fund a large capital expenditure program to cater for the considerable growth in the region.

4.1 Financial position 2009-10

Audited financial statements for each of the districts are not available for 2009-10. These will be provided separately to the Authority by the supplementary reporting date (30 September 2010).

Overall, the water businesses of Allconnex Water's Participating Councils finished 2009-10 in a sound financial position, with approximately $126m in dividends distributed to Councils. The table below summarises the aggregate (forecast) closing income statement for 2009-10.

Table 4.1: Summary of financial position 2009-10 ($million)

Income statement	2009-10
Operating revenue	598
Operating expenditure	295
EBIT	177
Interest expense	18
Tax equivalents	15
Profit after tax	145

[3] *Retail Price Monitoring in SEQ Urban Water Sector*, Queensland Competition Authority 2009

4.2 Pricing policies

The structure and magnitude of water and wastewater tariffs varied between Gold Coast City Council, Logan City Council and Redland City Council. The table below provides a summary of the tariff structures administered in 2009-10 by each Council.

Table 4.2: Summary of 2009-10 pricing policies by Council

Charge	Type	Gold Coast	Logan	Redland
Water Service Charge (Fixed Charge)	Residential	Single standard service charge	Base charge X capacity factor (based on diameter of service), with discounting arrangements.	Multiple service categories – domestic, (base rate) caravan parks (per unit charge), units/flats/multiple dwellings (meter size)
	Non-residential / commercial	Base charge X capacity factor, based on deemed service diameter from flow factor table)	Multiple categories, based on old v new GCCC / LCC charges.	Based on meter size and categories above)
Water Consumption (Volumetric Charge)	Residential	Basic per kilolitre charge (no distinction between charges for residential v non-residential)	Basic per kilolitre charge (no distinction between charges for residential v non-residential)	Multi-tiered charge, based on volume of consumption (measured per day)
	Non-residential / commercial			Basic charge per kilolitre (based on highest of residential charges)
Wastewater Service Charge	Residential	Single standard service charge.	Multiple category, per-pedestal charge based on type of dwelling, with discounting arrangements.	Single standard service charge, with discounting arrangements.
	Non-residential / commercial	Single standard service charge	Per pedestal with base access charge for first pedestal and further charges for additional pedestals (based on multiple categories)	Per pedestal with base access charge for first pedestal and further charges for additional pedestals (based on multiple categories)
Wastewater consumption charge	Residential	N/A (service charge only)	N/A (service charge only)	N/A (service charge only)
	Non-residential / commercial	Charge based on water consumption and industry discharge factor, minus domestic allowance.	New GC LCC has same arrangements as for Gold Coast	N/A (service charge only)

Water tariff structures are similar between the three Councils, although differ in the level of fixed charge, the basis on which fixed charges for non-residential customers are levied, and in the level of volumetric charge applied. Wastewater charges, particularly for non-residential customers, are more variable – one Council applied a volumetric wastewater charging structure for non-residential customers, the others a form of pedestal-based charge. Tradewaste charging policies also are significantly different across the three participating Councils, and may include some aspects similar to the wastewater volumetric charge.

Allconnex Water's pricing strategy for 2010-11 has had to consider whether and how the three different Council charging structures are brought into alignment, as well as issues such as the level of any future spatial or customer-based charging differentiation. These issues are explored further at Chapter 11.

4.3 Key projects

The three Council water and wastewater businesses of Allconnex Water have achieved much during the last two years since the transfer of bulk water assets to the State. They have continued to provide high quality water and wastewater services to their customers, and have taken the opportunity to invest in Allconnex Water's future with a range of key projects:

- Completion of infrastructure associated with the Pimpama Coomera Waterfuture Masterplan area which included new Recycled Water and Wastewater Treatment Plants, and Class A+ recycled water delivered to over 4,000 residents and businesses in the area via a third pipe;
- Preliminary works on the new Stapylton WWTP to cater for population growth within the catchment and reduce the load on nearby treatment plants;
- Completion of the Merrimac East wastewater program, including the new SP68 pump station, reducing greenhouse emissions, odour and potential for wastewater overflows;
- Upgrades of the Loganholme, Coombabah and Elanora WWTPs to facilitate growth

and licence requirements and improve the quality of recycled water released to waterways;

- Pressure and Leakage Management Programs throughout the Logan and Gold Coast districts;
- The Round Mountain Reservoir and associated earthworks to improve water distribution to customers;
- Significant Water trunk and reticulation works on North Stradbroke Island; and
- City wide fire flow augmentations program in Redland district to ensure compliance with legislative guidelines.

5 Planning and Service Standards

5.1 Introduction

The projections reported by Allconnex Water have been informed by the three Council's planning frameworks, forecasts and corporate strategies. Key source documents include Council planning schemes, growth sequencing, demand conversion rates, historical demand and future demand projections. The Councils have used this information to develop capital renewal plans, growth infrastructure plans and operational expenditure forecasts, much of which is reflected now in Allconnex Water's regulatory information template.

Councils have been required to undertake robust planning which is reviewed by various regulators. Councils have been required to produce strategic asset management plans and priority infrastructure plans to ensure that the Council areas are delivery the appropriate levels of service and infrastructure to the community.

The Councils' strategic business plans have been developed taking into consideration the Council's vision, strategic priorities and obligations to the customer and the environment. These documents detail strategic initiatives that the Councils have regarded as key elements to be delivered to the community.

The priority infrastructure plan (PIP) is an integrated infrastructure plan and considers future infrastructure requirements for Council areas which will ultimately result in the provision of well serviced communities and a higher standard of living for its residents and visitors. The PIP defines the scale, type, timing and location of the growth in the city in order to plan future water supply and wastewater trunk infrastructure and to determine the charges required to fund it. Councils have put considerable time and effort into the development of their PIPs and the infrastructure identified in the PIP has been used build the growth component of Allconnex Water's capital works program.

5.2 Service standards

Allconnex Water's planning projections currently assume no change to the pre-existing planning and customer service standards for each of the districts. The districts have incorporated the new requirements around fire fighting articulated in chapter 6 of the Department of Environment and Resource Management Planning Guidelines for Water Supply and Sewerage. The service standards were reviewed for currency and applicability as part of the total management plans (TMPs) and strategic asset management plans (SAMPs) reviews.

Information on service standards is provided at Section 5.3.1 of the Information Template.

5.3 Strategic asset management plans

The strategic asset management plans (SAMPs) for the three districts were developed to meet the requirements of section 71 of the *Water Supply (Safety and Reliability) Act 2008*. SAMPs must be prepared in accordance with the guidelines made by the regulator. The SAMPs include the following:

- the registered services to which the plan applies
- the infrastructure for providing the services
- an operations, maintenance and renewals strategy
- the methodology used for developing standards
- arrangements for financing the implementation of the Plan

- have regard for industry best practice, and
- demonstrate the service provided will comply with any system operating plan.

The SAMPs have been structured so that they not only meet the regulator's requirements but are also an intrinsic component of the districts strategic, tactical and operational activities. The SAMPs outline the districts approach to asset management and the key elements of this approach are:

- provision of services at the lowest whole of lifecycle cost;
- maintaining compliance with legislation;
- meeting defined standards of service, and
- appropriate level of risk.

The three districts SAMPs were developed between 2008 and 2009 and have been approved by the regulator. Gold Coast district's SAMP was approved in April 2009, Logan' was approved in April 2009 and Redland's in January 2010.

Copies of the district SAMPs have been provided separately to the QCA. Allconnex Water notes that there are variances between the forecasts as outlined in the SAMPs and those presented in the current Information Template. Broadly, these variances reflect the passage of time since the SAMPs were prepared; with some of the planning and forecasts in the SAMPs now more than 2 years old.

5.4 Customer service standards and desired standards of service

Allconnex Water's commitment to its customers is articulated in its corporate vision and values.

Allconnex Water's Customer Service Standards have brought together the districts' existing standards. This includes, but is not limited to, details of the services provided and the water, wastewater and recycled water service areas, details of response and repair completion times, and other objectives.

The service standards are consistent with each district's previously established corporate vision, and obligations to its customers and the environment.

The service standards detail key service commitments, performance indicators and customer service targets. The service standards are used to continuously monitor the district's performance against a suite of key performance indicators (KPIs), these indicators and targets are monitored and reported on monthly. Performance is tracked and graphed for the year to date with comments provided where performance has deviated from expected targets.

Performance against the service standards was also reported to the regulator each year.

The Desired Standards of Service (DSS) provide standards for the following criteria, which therefore has an impact on scale and timing of the capital program:

- Average Day Demand
- Demand Distribution
- Peaking Factors
- Non-Revenue / Unaccounted for Water

- Periods for System Planning
- Pressure Parameters
- Fire Fighting Parameters
- Reservoir Storage
- Pump Design
- Pipeline Design
- Water, Wastewater, Trade Waste, Biosolids, Release and Recycled Water quality
- Wastewater Flows
- Gravity Sewer Design
- Odour
- Noise, and
- Infiltration.

Desired Standards of Service (DSS) define requirements used for planning and design of water, wastewater and recycled water infrastructure. The DSS form the basis for infrastructure planning, forms part of the standards for design and construction of infrastructure.

The development of the demand-based DSS (water demands, sewage loads, peaking factors and diurnal patterns) include:

- comparison to the Planning Guidelines for Water Supply and Sewerage
- real data, system performance, historical records and a consideration of projected demand pattern changes
- analysis of water consumption, water and wastewater flows, recycled water production and usage
- analysis and consideration of water consumption and current end use data, and
- comparison to other water utilities and Queensland Water Commission targets.

The development of non-demand-based DSS (technical design criteria) incorporated consideration of technical design criteria used by councils and developers in planning and designing water and wastewater infrastructure. This includes:

- Benchmarking the existing DSS for water, wastewater (conventional and RIGS), and recycled water systems
- Undertaking a review of current standards, codes of practice and state and national guidelines, primarily:
    - Water Services Association of Australia Codes (WSA 02, WSA 03, WSA 04) and supplements
    - Department of Environment and Resource Management Planning Guidelines for Water Supply and Sewerage, (March 2005 incorporating Chapter 6 dated June 2007)
- Benchmarking the existing DSS against the standards of service used by other South East Queensland authorities
- Reviewing recent papers and studies relating to relevant standards of service

5.5 Value to customer

Previous research undertaken by Allconnex Water's Participating Councils suggests that customers consider issues of water security, water quality, and wastewater management and treatment as critically important.

All three districts have historically had a high regard for the above issues and these continue to be priorities for Allconnex Water. They are also reflected in the existing service standards, ensuring that customers are satisfied with Allconnex Water's performance.

Historically, customers have been involved in shaping the way the three Council water businesses operated. Whether through Product and Pricing reviews, advisory committees or industry referral groups, they have involved key representatives of business, industry and the community, whom have provided valuable insight into the future direction of the water businesses.

The three districts also receive feedback from their customers in a variety of ways. The most common of these is customer feedback, usually directed to the customer contact centers. Previous research suggests that nearly half of residential customer contact is to provide the business with a complaint regarding service levels or other matters. Complaints are dealt with seriously by the business.

Surveys have also been undertaken by the districts covering customer satisfaction of water and wastewater operations, satisfaction with customer contact experience, and willingness to pay for recycled water.

To responsibly manage the water and wastewater needs of our customers will continue to be a core focus of Allconnex Water, as it was previously under the three districts.

5.6 Planning processes

The general process followed by the three districts to prepare and validate the capital (CAPEX) and operational (OPEX) budgets comprised of a number of elements:

- Development – the process used to identify projects, build, approve and review a program;
- Justification – the process used to justify individual projects in terms of meeting corporate goals, identifying service levels, defining the timing of the project in terms of meeting demands, regulatory requirements, maintenance or expected failure;
- Evaluation and analysis – the process used to define the scope, cost estimates, impacts on CAPEX and OPEX budgets, options evaluation and consequence of failure to make the investment;
- Procurement – assessment of procurement options;
- Prioritisation – the process used to prioritise projects on an annual basis, taking into consideration the ability to deliver the program; and
- Delivery – the process used to plan and deliver the program, including concept and detailed design, construction, asset acceptance and handover, monitoring and reporting on the program, process review, improvement and integration into further phases of planning or the business.

5.6.1 Capital forecasts

Capital forecasts were developed taking into consideration growth, renewals/replacement/enhancements and regulatory requirements.

- Growth CAPEX is dependent on the variables of population growth (residential and commercial/industrial development) and the changes in unit demand. Growth CAPEX is derived from a long term growth infrastructure plan (Priority infrastructure plan or planning scheme policies and associated planning reports). The 3/5 year program is evaluated to confirm the timing requirement, validating growth patterns, existing

infrastructure and demand.

- Replacement/renewals/enhancements are generally forecast on an end of economic life basis, using notional asset lives. The program reviews whether the life of the assets can be extended through maintenance and rehabilitation which will allow for the deferral of full replacement.
- Regulatory is driven by regulatory time constraints and the need to meet a regulatory or legislative requirement. The expenditure often arises from changes in legislation to improve issues such as service provision, safety and security. Forecasts are limited to the 3/5 year program.

5.6.2 Operating forecasts

Operating forecasts were developed taking into consideration labour and labour growth requirements, business establishment costs, known electricity increases, increases in the volume of water and wastewater, sludge disposal, chemicals and programs that requires investigations to guide network improvements, asset/data knowledge, regulatory requirements and non infrastructure solutions.

Chapter 8 provides further detail on the development of operating forecasts.

6 Demand

6.1 Introduction

Demand forecasts are a key business driver for Allconnex Water. Projections of future customer numbers and water consumption are used to inform capital planning and operating budgets, which in turn are critical inputs to the business' revenue and pricing strategy.

In this chapter Allconnex Water outlines its approach to forecasting demand for water and wastewater services, and presents both historic customer demand data and forecasts for the period 2010-11 to 2012-13.

The nature of Allconnex Water's customer base, including in terms of its growth profile and consumption characteristics, differs between the three districts. Forecasts and customer composition are therefore presented at both an aggregate and district-level.

6.2 Allconnex Water's customer base

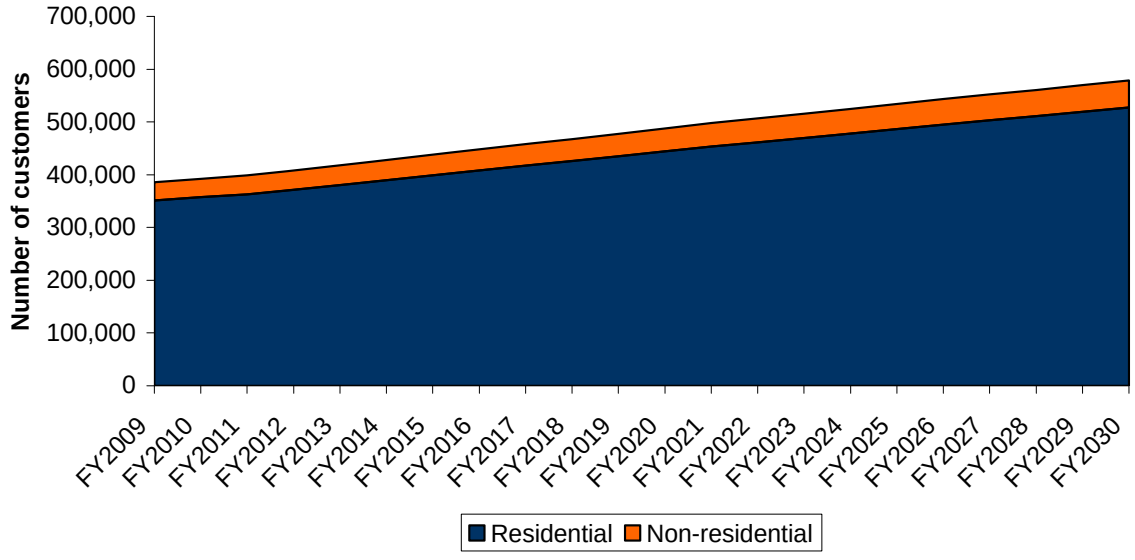
Allconnex Water services a population of 850,000 with water and wastewater services provided to nearly 400,000 properties. Allconnex Water also services a large number of tourists and visitors to the region.

Across the three districts, more than 90% of water customers (measured in terms of properties) are residential. However the customer composition between each district is quite diverse. This includes detached residential dwellings, tourist accommodation, high-density dwellings, semi-rural properties, and island living.

While just less than 10% of water customers in the area are non-residential, there are some large businesses which require high reliable water services, including a large brewery, meat processing plant, and theme parks.

The area Allconnex Water services is also expected to see sustained levels of high population growth, being at the centre of the SEQ growth corridor. Growth in customer connections across the business is expected to be approximately 2.4% per annum on average.

Figure 6.1: Projected growth in residential and non-residential customers

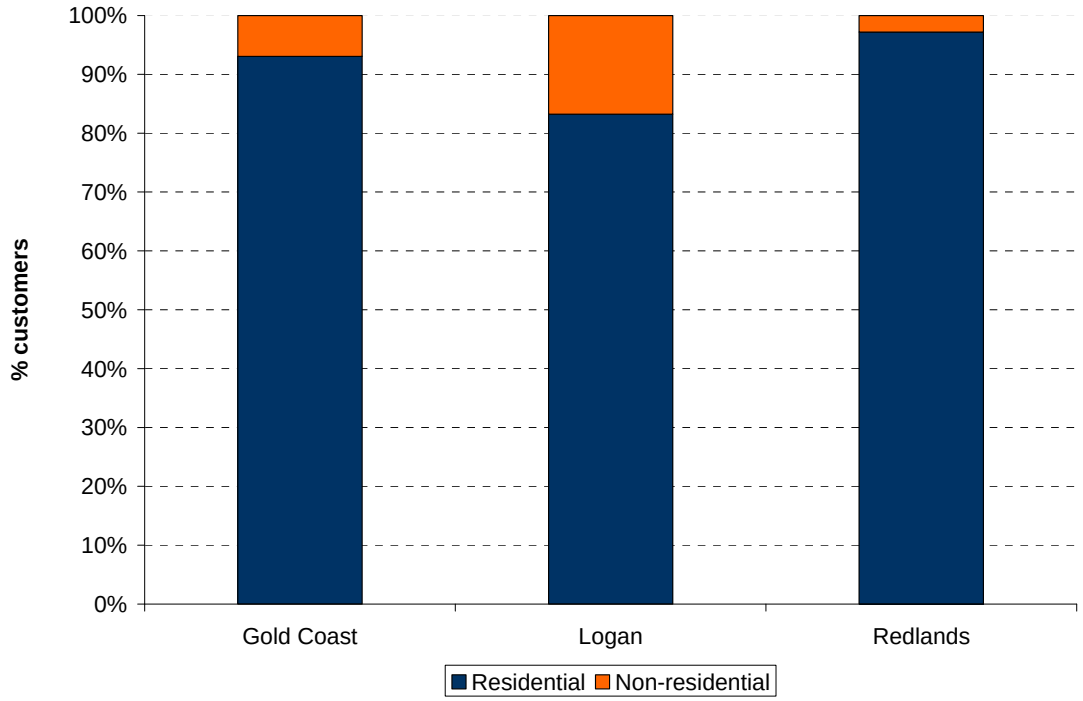


Over the period to 2030, Allconnex Water is expecting its total customer base to grow

from just under 400,000 now, to nearly 600,000, an increase or nearly 50%. Over this period the composition of the customer base – in terms of the relative proportions of residential and non-residential customers – is expected to remain relatively stable.

Figure 6.2 below, shows how the customer base composition differs between Allconnex Water's districts. Logan City Council, in particular, has a significantly higher proportion of non-residential customers than does either Gold Coast or Redland.

Figure 6.2: Comparison of customer composition by region



6.2.1 Gold Coast District

The Gold Coast is now the 6th largest city in Australia (ABS, 2007). It has a unique customer composition, from long-established residential areas, to areas of high population growth and development, to the large mix of high rise apartments across the coast. There is also an increase in the number of non-residential and industrial properties in the area.

Based on 2010-11 forecasts included in the information templates, the Gold Coast district currently has 214,189 residential and 16,020 non-residential water customers. These are based on forecasts of expected water service charges, determined from customers charged previously for water services, combined with extracts from property and billing systems, and growth. The same methodology is used for wastewater forecasts.

Forecast growth rates are consistent with the Planning and Information Forecasting Unit (PIFU) *Medium Series* data released in March 2009.

The Gold Coast district is renowned for the high number of visitors and tourists which arrive for a holiday or a day trip. For example, in 2009 the Gold Coast district had 54,270 overnight visitors per day, plus an additional 13,454 daytrip visitors per day. This causes an increase in the district's water consumption levels and distorts per capita consumption data.

While proportions of consumption between customer groups does vary year to year, based on factors such as weather and water restrictions, the forecasts that have been used for 2010-11 are considered to be close to normal levels. These are:

- Residential 69%
- Non-Residential 21%, and
- Unaccounted / Non-Revenue 10%.

The top five customers by volume in the Gold Coast District are:

- mixed industry
- shopping centre
- hotels
- unit/flat, and
- breweries.

6.2.2 Logan District

The Logan district comprises of 90,928 residential properties and 18,309 non-residential properties in 2010-11 for water services, and for wastewater services 78,548 residential properties and 5,089 non-residential properties. The district was impacted by local government boundary reforms in 2008 whereby the area north of the Albert River was transferred to Logan from the Gold Coast and an area of Beaudesert Shire also was transferred to the district.

Approximately 90% of the water connections in the transferred Beaudesert Area are supplied through a constant flow system. The remainder of connections have an on-demand water supply. There are potentially up to 5,840 properties that would ultimately be serviced through a constant flow system.

Approximately 300 connections in Logan Village are serviced through a Common Effluent Drainage (CED) scheme. The remainder of the City is served through

conventional wastewater collection systems.

The Woodlands development in north-west Beenleigh has dual reticulation infrastructure provided with recycled water planned to be provided from the Stapylton WWTP around 2011-12.

Forecast growth rates are consistent with the Planning and Information Forecasting Unit (PIFU) growth targets for the area and consideration has been given to two growth areas (Flagstone and Yarrabilba) declared under the Urban Land Development Act.

While proportions of consumption between customer groups does vary year to year based on factors such as weather and water restrictions, the following forecasts that have been used for 2010-11 are considered to be close to normal levels. These are:

- Residential 75.7%
- Non-Residential 15.3%, and
- Unaccounted / Non-Revenue 9%.

Major customer groups in the Logan district include:

- Meat processing
- Laundry
- Food manufacturing
- Retailing
- Medical
- Nursery, and
- Retirement village.

6.2.3 Redland District

The Redland district customer composition is unique when compared to the other two districts. The customer composition is almost entirely residential with 97% of the district's customers being residential.

The many islands in the Redland district results in significant difference between the numbers of customers connected to water supply and wastewater services. Based on 2010-11 forecasts included in the information templates, the Redland district currently has 57,556 residential and 1,662 non-residential water customers, and 49,067 residential and 1,843 non-residential wastewater customers.

Forecast growth rates considered the Planning and Information Forecasting Unit (PIFU) growth targets for the area however these were reduced to 1 per cent per annum based on Council's current development policies.

While proportions of consumption between customer groups does vary year to year based on factors such as weather and water restrictions, the following forecasts that have been used for 2010-11 are considered to be close to normal levels. These are:

- Residential 78.9%
- Non-Residential 14.1%, and
- Unaccounted / Non-Revenue 7%.

The major water supply customers in the Redland district include:

- unit and apartment complexes
- chicken abattoirs
- retirement villages
- schools and colleges
- hospitals
- caravan parks, and
- shopping centres.

6.3 Historical demand and basis for forecast

The main impacts historically on water demand across the districts have been climatic weather conditions and rainfall, water restrictions and water-use awareness campaigns, and other compliance initiatives such as the WEMPs program for non-residential customers.

In forecasting future water sales Allconnex Water has considered:

- historical metered water sales
- metered water production
- current water restrictions
- QWC water consumption targets
- average day demand from desired standards of service
- demand management initiatives, potable water replacement, Queensland building code requirements
- demand analysis modelling
- water usage behaviour
- customer composition
- system losses, and
- growth patterns.

Forecast consumption is essentially based on previous years' water consumption, and inferred per capita consumption levels. Separate consumption proportion estimates for residential and non-residential consumption have been applied. Long periods of water-use restrictions and variable climatic conditions and rainfall have been key determinants of changing water consumption patterns over time. Of course, the timing, level and duration of any future water restrictions are unknown and these factors generally have been ignored in Allconnex Water's forecasts.

The forecasts for each district are a yearly average, though do account for the seasonality of consumption patterns.

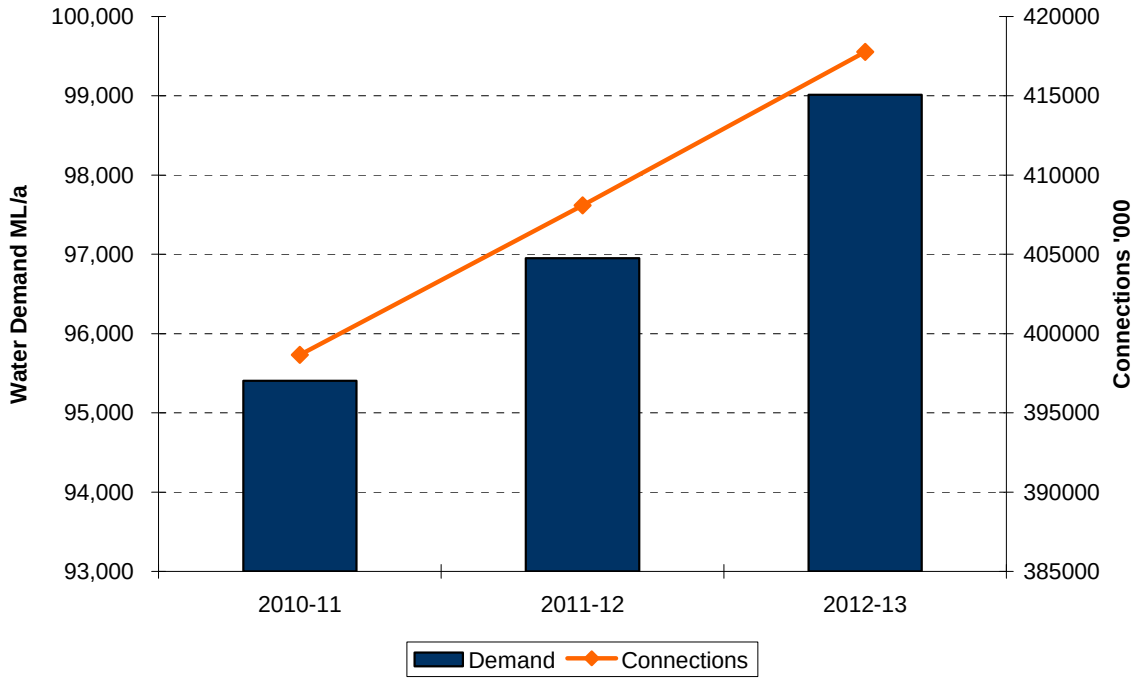
While prices have increased significantly in the last three years due to bulk water purchase cost increases, and will continue to do so in the future for a variety of reasons, price elasticity has not been considered in Allconnex Water's demand forecasts. Allconnex Water believes further research is required to reliably estimate a price-elasticity coefficient and protocols for the application of this adjustment, in the face of significant non-price influencers on water consumption behaviours.

Due to the introduction of compliance and education programmes such as WEMPs and continued customer liaison with key customers, non-residential consumption appears to have stabilised somewhat, and are now less affected by the introduction of restrictions. There is an emerging view that in periods of water restrictions or prolonged wet

weather, the residential proportion of consumption may decrease, and non-residential proportion increase, but the actual volumetric level of non-residential consumption remain relatively stable.

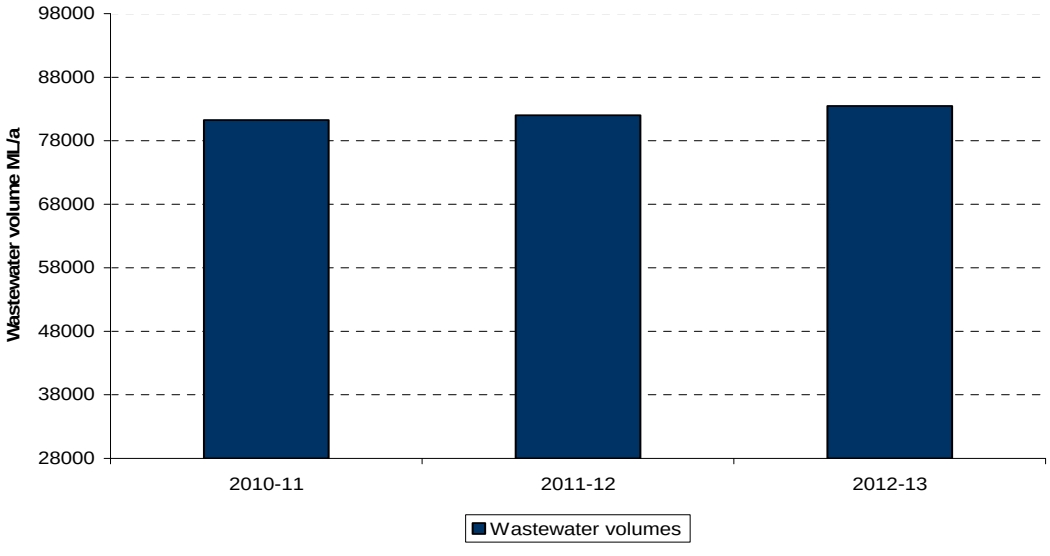
Growth in demands has been based on district forecasts prepared by the Councils. Key forecast assumptions for Allconnex Water includes growth in customer connections of 2.4% per annum, water volumes increase by an average of 2.1% per annum and wastewater volumes average annual increase of 1.7% over the period to 2015.

Figure 6.3: Water consumption and connections growth



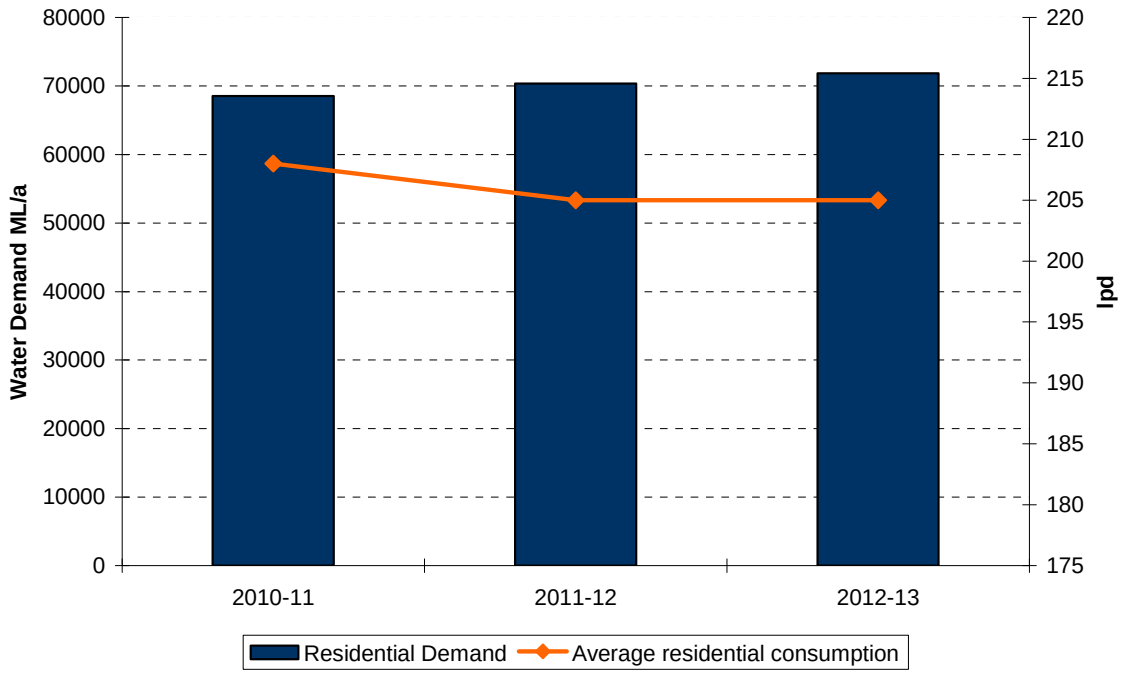
Wastewater volumes increase at a lower rate as outdoor water use is expected to increase over the forecast period due bounce back from the relaxation of water restrictions which will result in a lower proportion of water used being return to the wastewater system.

Figure 6.4 Growth in wastewater volumes



The weighted average residential consumption is forecast to change from 208 litres per person per day (lpd) in 2010-11 to 206lpd in 2011-12 to 2014-15. The average annual increase in total residential water demand Allconnex Water from 2010-11 to 2014-15 is 4.1%.

Figure 6.5 Residential water demand and average residential consumption



6.3.1 Gold Coast District

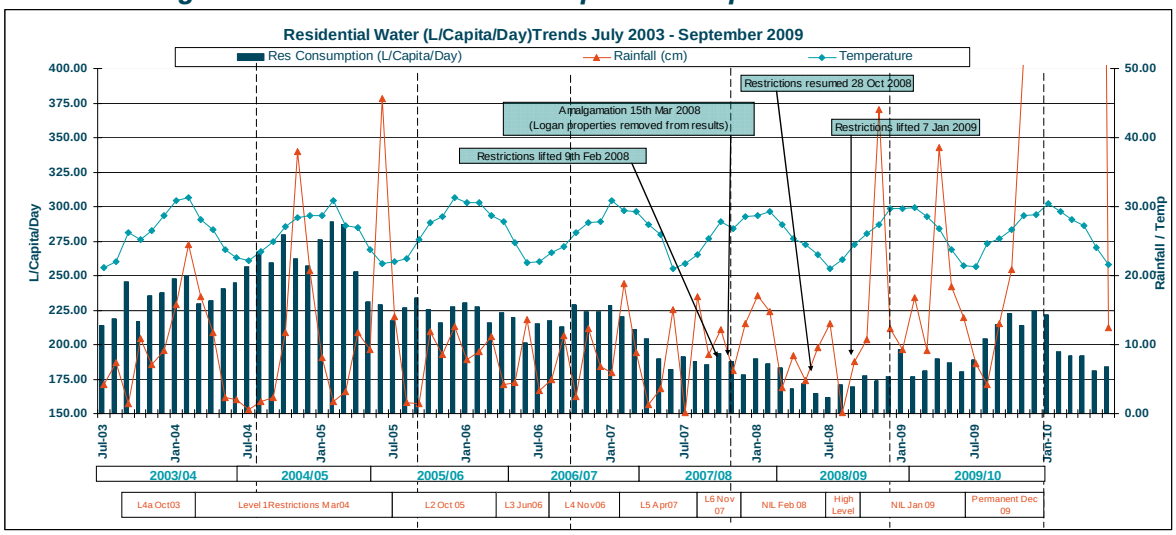
Historical Demand

Historical metered water sales in the Gold Coast district declined from an average of 200 ML/d (peak 299 ML/d) in 2001-02 to an average of 132 ML/d (peak 206 ML/d) in 2008-09. This was a direct consequence of the introduction of water restrictions and extensive communications programs in 2001, itself a response to the severe drought then affecting the Gold Coast district. This continued throughout the SEQ regional water restriction campaign when SEQ dams approached crisis levels.

Water restrictions for the Gold Coast district were lifted in February 2008 and were not reintroduced until after the Gold Coast was connected to the SEQ Water Grid and the Hinze Dam dropped below 95% capacity. While restrictions per se have been lifted by the QWC, the “Target 200” campaign is in place to manage population growth and provision of new bulk water assets. With the relaxation of water restrictions the Gold Coast district has experienced some “bounce back” to near-to pre-water restrictions usage. This was also exacerbated by hot, dry and dusty weather conditions in late 2009.

However, average water usage is not expected to reach the full pre-restriction levels due to a number of factors including the Queensland Building Code, Gold Coast districts rainwater tank policy which pre-dated the Queensland Building Code and the retrofit program. Prolonged periods of rainfall in February and March 2010 also saw residential consumption reduce significantly.

Figure 6.6 Historical consumption compared to restrictions



Basis for Forecasts

The Gold Coast district has used 215lpd for 2010-2011 water sales and 210lpd for future years. These are below the QWC long term permanent water restrictions target of 230lpdand are due in part to the implementation over many years of community awareness campaigns which seem to have altered water use behaviours.

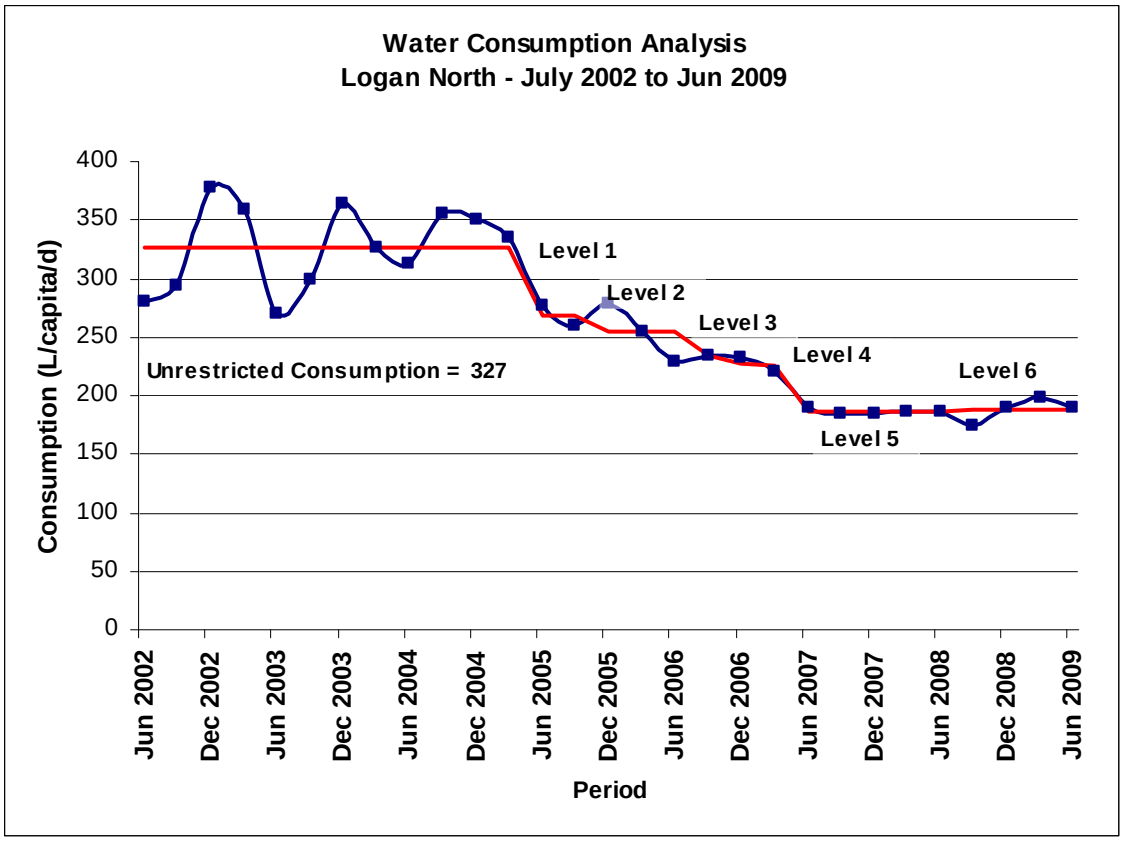
6.3.2 Logan District

Historical Demand

Historical metered water sales in the Logan district declined from an average of 55.4 ML/d (peak 73.8 ML/d) in 2002-03 to an average of 34.3 ML/d (peak 36 ML/d) in 2008-09. The decline has been predominately as a consequence of SEQ regional water restrictions when SEQ dams approached crisis levels which have been in place since 2005. While restrictions per se have been lifted by the QWC, the target 200 campaign is in place to manage population growth and provision of new bulk water assets.

However, average water usage is not expected to reach the full pre-restriction levels due to a number of factors including the Queensland Building Code and the retrofit program.

Figure 6.7 Historical consumption compared to restrictions



Basis for Forecasts

The Logan district utilised 190lpd for 2010-2011 water sales and 200lpd for future years. These are below the QWC long term permanent water restrictions target of 230lpd and are due in part to the implementation over many years of community awareness campaigns which seem to have altered water use behaviours.

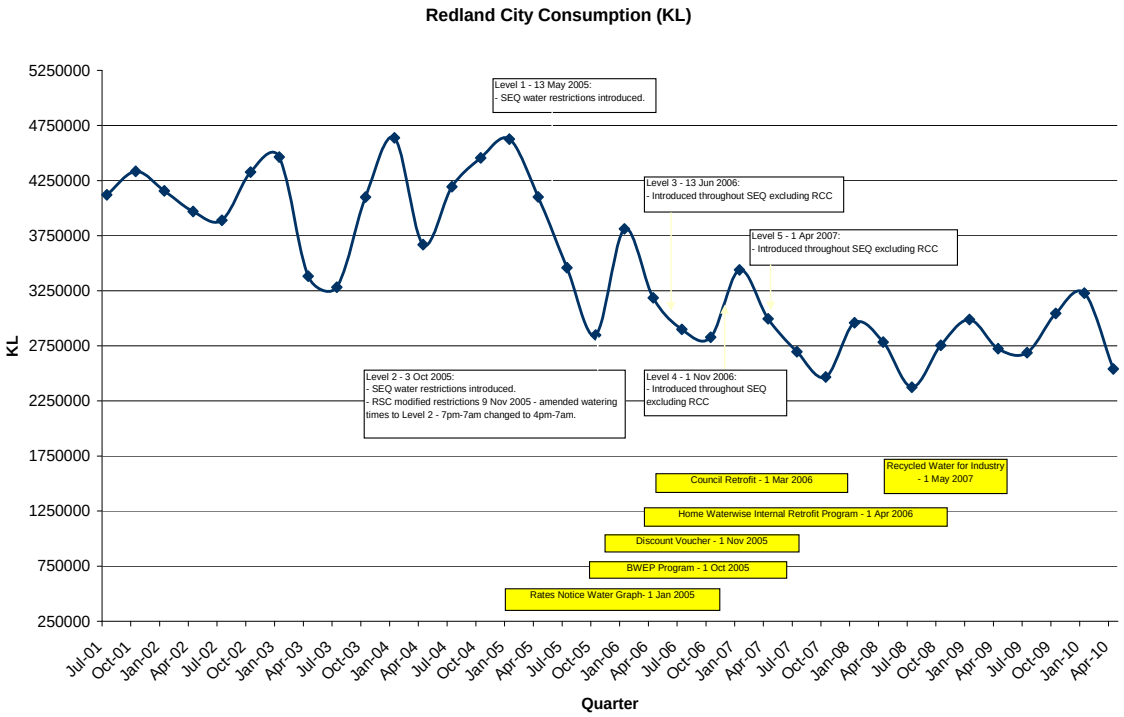
6.3.3 Redland District

Historical Demand

Historical metered water sales in the Redland district declined from an average of 46.5 ML/d (peak 50.4 ML/d) in 2004-05 to an average of 29.1 ML/d (peak 32.1 ML/d) in 2007-08. The decline has been predominately as a consequence of SEQ regional water restrictions when SEQ dams approached crisis levels which have been in place since 2005. While restrictions per se have been lifted by the QWC, the target 200 campaign is in place to manage population growth and provision of new bulk water assets.

However, average water usage is not expected to reach the full pre-restriction levels due to a number of factors including the Queensland Building Code and the retrofit program.

Figure 6.8 Historical consumption compared to restrictions



Basis for Forecasts

The Redlands district utilised 200lpd for 2010-2011 and future water sales. These are below the QWC long term permanent water restrictions target of 230lpd and are due in part to the implementation over many years of community awareness campaigns which seem to have altered water use behaviours.

6.4 Demand Management and Leakage reduction

6.4.1 Demand Management

Allconnex Water's demand management programs targets both the residential and non-residential sectors. The demand management programs include:

- Home watersaver program
- Garden watersaver program
- Sustainable gardening workshops
- School education program – make your water mark, water for life, water in Redlands, class room presentations and online resources, and
- Water efficiency management plans (WEMPs)

Further details on these initiatives are provided in Appendix 1.

6.4.2 Pressure and leakage management

Allconnex Water's Pressure and Leakage Management Project (PLMP) helps conserve drinking water by:

- detecting and repairing leaks in the network
- decreasing potential pipe bursts by reducing excess water pressure, and

- reducing the amount of water used in homes by reducing excess water pressure.

In the Gold Coast district all infrastructure components have been completed, which includes 60 District-Metered Areas (DMA) installed across the city. These DMAs can be more closely monitored to detect leaks, adjust pressure and minimise water wastage. Currently 35 of these areas are pressure managed with the remainder due to be fully pressure managed by February 2011. The Gold Coast district program has been undertaken for the last 7 years.

In the Logan district the project is at the commissioning stage and covers the Kimberley Park, Springwood, Marsden and Greenbank water supply zones.

In the Redland district the PLMP has been completed in three DMAs.

Project aims

The Pressure and Leakage Management Project's primary objectives are to:

- minimise the leakage water loss component by systematically detecting and repairing leaks in the network, and
- reduce excess water pressure to minimise leakage and pipe bursts.

The annual cost to purify the water lost due to leakage and to repair burst pipes is estimated at $4.5 million.

A secondary objective is to prolong the lifespan of the water supply network thereby reducing the overall cost of water supply. Excessive water pressure causes fatigue in pipe materials requiring their replacement.

Advantages of reduced water pressure

Reducing excess water pressure in the supply network has the following advantages:

- pipe materials have reduced fatigue and a longer lifespan
- pipe bursts are reduced resulting in lower repair costs and water lost
- reduction in leakage from pipe joints, valves, hydrants and fittings
- dripping taps, dripping showers, running toilets and washer replacements are reduced
- hot water cylinder lifespan is increased, and
- water hammer is the term used for the sound the water system makes when water suddenly stops or starts in the pipeline. This sound is significantly reduced when taps and valves are closed.

Lower water pressure also means reduced water consumption. Trials conducted on the Gold Coast generated water savings of more than 10 per cent and reduced pipe breaks and leaks by approximately 80 per cent.

7 Capital expenditure

7.1 Overall capital program

Water and wastewater services are inherently capital intensive. Allconnex Water's capital program is intended to meet customer, regulatory and environmental requirements, and deliver key outcomes required under the South East Queensland Regional Plan and Council planning schemes. A significant driver of Allconnex Water's capital program is the investment required to establish services in growth areas. Investment also is needed to efficiently maintain the existing systems and service levels.

Allconnex Water's capital works program totals more than $1.3 billion over the forecast period 2010-11 to 2012-13. The program is lumpy in nature with a peak spend of $528 million in 2011-12. The CAPEX spend for the forecast period per district ranges from $797 million for the Gold Coast district to $80 million for the Redland district (including apportionments of corporate costs). Significant investment in wastewater infrastructure is occurring in all three districts.

Figure 7.1 Total CAPEX program

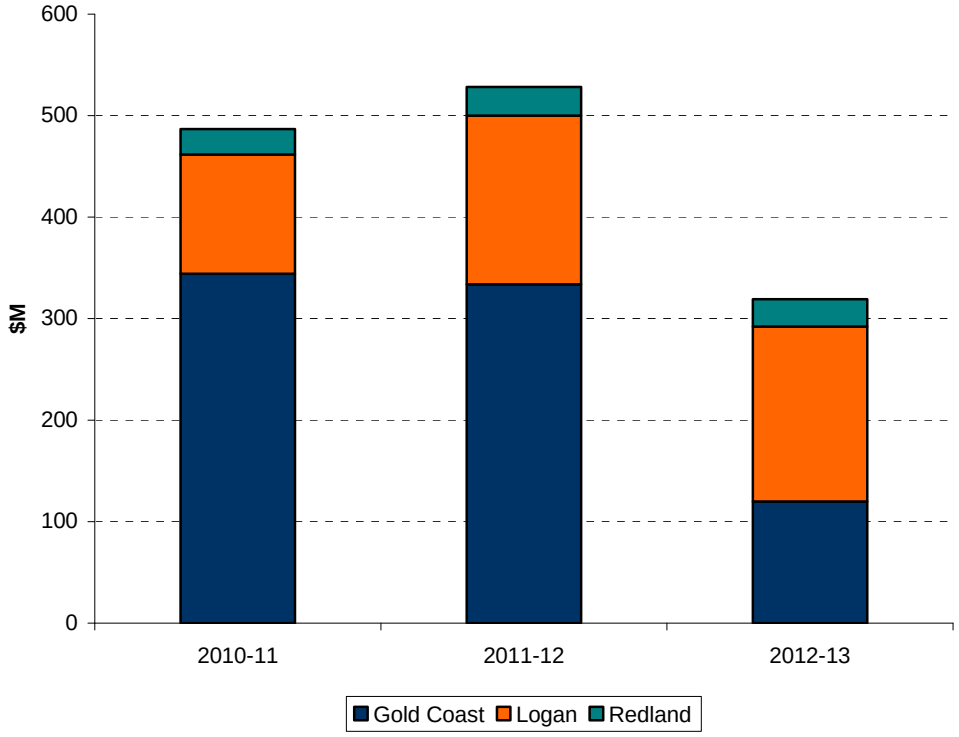


Figure 7.2 Water CAPEX program

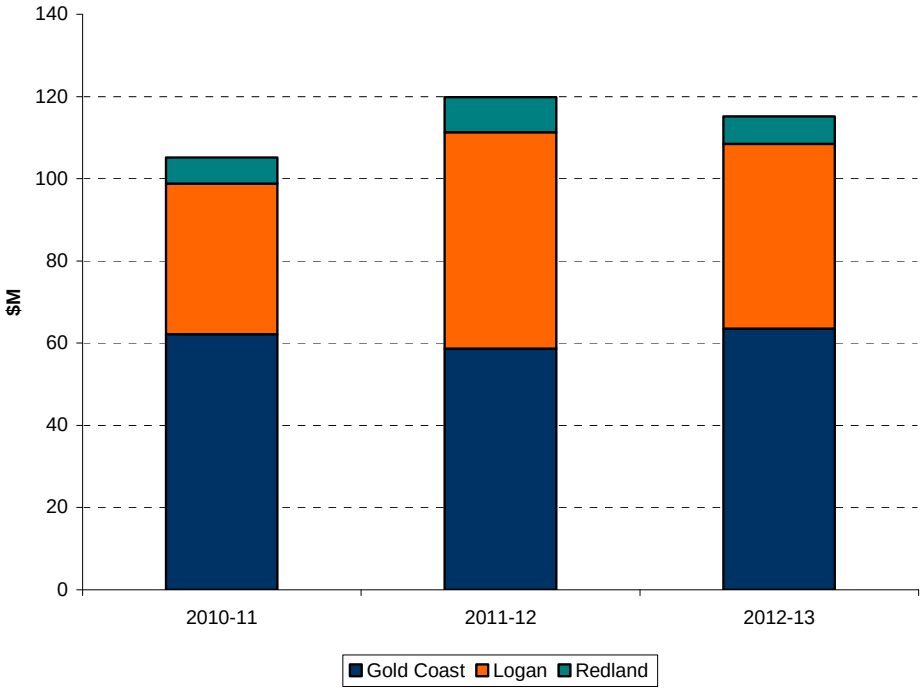
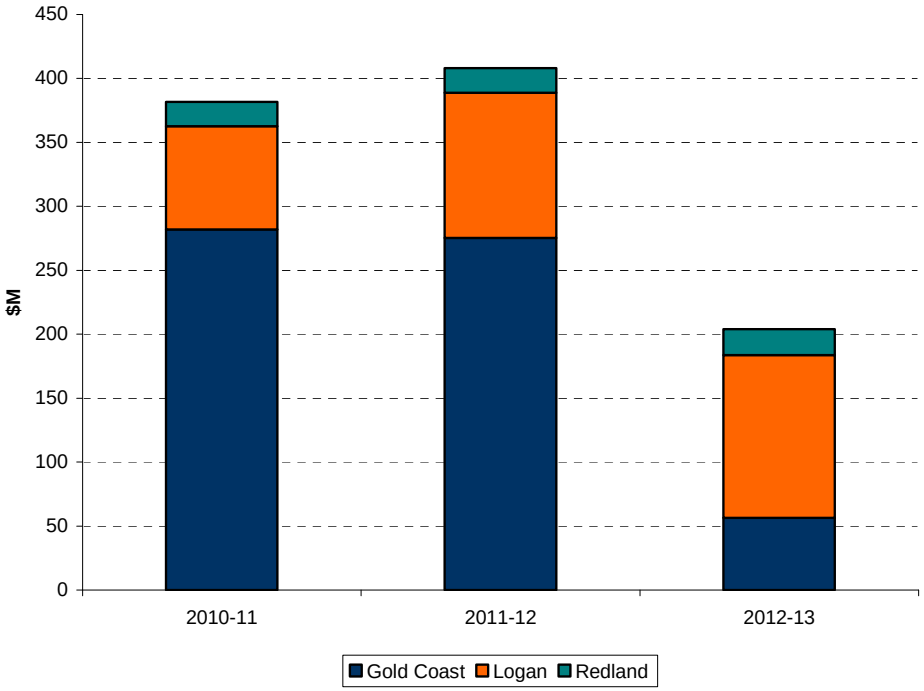


Figure 7.3 Wastewater CAPEX program



The major component of the program is infrastructure required to meet the growth in the districts, as identified in each Council's planning schemes, the SEQ Regional Plan or new urban areas identified by the *Urban Land Development Act*. Growth capital expenditure for the three districts is $869 million. Key projects are detailed in section 7.2.

Corporate costs of $101 million include the purchase of new systems such as ERP, GIS and billing systems so that Allconnex Water is in a position to take over functions currently handled by Service Level Agreements (SLAs) with Councils.

Table 7.1 Capital program

TOTAL CAPITAL EXPENDITURE $000's	2010/11	2011/12	2012/13
Water Distribution			
Growth	41,344	45.674	29,515
Replacement	35,359	42,413	39,870
Regulator Required	2,451	77	899
Donated Asset	18,404	19,387	20,374
Total Water Distribution	**97,558**	**107,552**	**90,659**
Waste Water			
Growth	285,592	341,568	125,728
Replacement	51,254	36,443	31,299
Regulator Required	23,678	3,330	3,348
Donated Asset	10,074	10,648	11,203
Total Waste Water	**370,597**	**391,988**	**171,699**
Non-Regulated Services			
Growth	5	0	6
Replacement	1,289	554	829
Regulator Required	0	0	0
Donated Asset	0	0	0
Total Non-Regulated Services	**1,294**	**554**	**835**
Districts' Capital Expenditures			
Growth	326,941	387,242	155,249
Replacement	187,903	79,411	71,998
Regulator Required	26,128	3,407	4,337
Donated Asset	28,478	30,035	31,578
Total Districts' Capital Expenditures	**469,450**	**500,095**	**263,162**
Corporate Office			
Computer Software	14,354	27,976	56,000
Computer Hardware	2,100	0	0
Fixtures & Fittings	0	0	0
Buildings	840	0	0
Total Corporate Office	**17,294**	**27,976**	**56,000**
TOTAL ALL CAPITAL EXPENDITURES	**486,744**	**528,071**	**319,162**

*Note numbers have been rounded

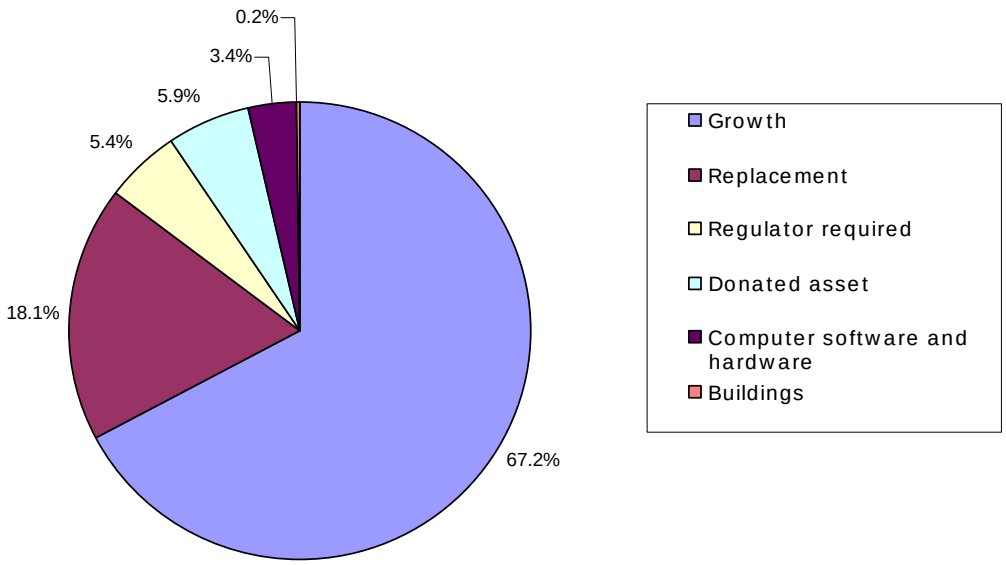
7.2 Key drivers and major projects

The key drivers of the capital program include:

- growth
- replacement
- regulator required
- donated assets
- computer hardware and software, and
- buildings.

Figure 7.2 depicts the breakdown of the drivers as a percentage of the capital expenditure

Figure 7.2 Key CAPEX drivers



The following major programs target renewal or rehabilitation of existing assets, protection of the environment, new or upgraded infrastructure for growth areas:

- Merrimac west stage 2 – augmentation of the existing wastewater system from Nerang pump station to Merrimac wastewater treatment plant (WWTP) to cater for population growth, environment protection and decrease system operations and maintenance costs ($220 million).
- Stapylton WWTP stage 1 – a new WWTP to cater for population growth within the catchment ($50 million).
- Coombabah WWTP Stage 5 – augmentation of the existing WWTP to increase capacity in order meet growth in the catchment and ensure ongoing compliance with licence conditions ($48 million).
- Elanora WWTP renewals – ensure assets within the Elanora WWTP are replaced, rehabilitated or renewed to maintain service levels, meet statutory requirements and comply with licence conditions ($26 million).

- Wastewater network developed areas – design and construction of wastewater services to existing developed areas of Jacobs Well, Cabbage Tree Point and Coomera Shores as required under the Pimpama Coomera Master Plan and to meet customer and environmental requirements ($25 million).
- Logan north and east southern relief sewer stage 1 – design and construction of a new pump station at Bethania and new gravity sewer to the Loganholme WWTP and diversion of a rising main from existing pump station at Beenleigh. This pipeline is required for the stage 1 development of the Park Ridge area ($25 million).
- Loganholme lift station upgrade Chetwyn St – design and construction of a new deep lift station and new shallow lift station and odour control unit. This upgrade forms part of the network to service the growth in the Park Ridge area ($25 million).
- Lower Logan wastewater centre – preliminary planning of a WWTP in Logan South area. The WWTP is required due to growth in a new urbanised area identified in the SEQ Regional Plan ($20 million).
- Logan north and east southern relief sewer stage 2 – design and construction of a new pump station and rising main at Beutel Street and gravity main to link to stage 1 of the sewer relief system. This pipeline construction finalises the network required to cater for the growth in Park Ridge ($13 million).
- Point Lookout WWTP (2011-F2017) – The existing Pt Lookout WWTP consists of three small package plants that have reached the end of their serviceable lives and flow handling capability. A new WWTP has been planned to be built on a more suitable site to the south-east of the existing site. The construction of the new plant is to avoid imminent environmental failures of the existing plant ($20 million).
- Meter replacement program Redland district (2011-2030) – this program is a rolling annual program designed to reduce the age of the meter fleet and to improve the level of meter accuracy. The replacement schedules are based on meter age in excess of12 years and kilolitre reading in excess of 4700 kL. These parameters were set to provide achievable replacement schedules and target those meters with the highest potential for failure or inaccuracy (age and volume of record) ($9 million total program).
- Cleveland WWTP (2012-2016) – Pump Station 6 has been identified as requiring a capacity upgrade to ensure it meets the expected future sewage loads associated with the Cleveland catchment. The scope of the upgrade includes an additional 450mm diameter rising main (currently being constructed) and a modified dry well, switchboard and new pumps ($8 million).

7.3 Capital cost escalation

Construction costs in general have continued to rise faster than consumer price index (CPI). This trend is expected to continue, with construction costs/unit rates expected to increase even where Allconnex Water's capital program is outsourced to the private sector through competitive tender or delivered through alliances with costs confirmed by independent verification.

Since ABS has collected data on construction indices, the average annual increase from March 1999 to March 2010 was 5.0%[4] compared with 3.3% for CPI.

The QCA in its Assessment of Gold Coast City Council's Infrastructure charges

[4] The roads and bridges index has been utilised for this comparison due to changes in ANZIC classification occurring in September 2009. ABS reclassified Division E Construction in accordance with the new ANZIC codes which resulted in subdivision 41 has become subdivision 31. However, with the aligning to the new sub-classifications, the non-building general classification has been removed and the division contains data only on the roads and bridges classification.

Schedules for Water and Wastewater acknowledged that construction costs had risen more than CPI from when the plan was formulated. The Authority also noted that future rates at which construction costs might escalate were uncertain.

Capital costs in Allconnex Water's forecasts have been escalated at 5% per annum.

8 Operating expenditure

8.1 Forecast operating costs

Allconnex Water's operating expenditure (OPEX) is expected to be over $366 million in 2010-11. This consists of approximately $202 million for water, $99 million for wastewater (including recycled water, trade waste and non-regulated) and the remainder in Council SLAs and corporate head office costs.

The figures below illustrate the growth of OPEX over the forecast period. The sections below discuss the assumptions used to project the OPEX costs.

Figure 8.1 Total and district OPEX cost

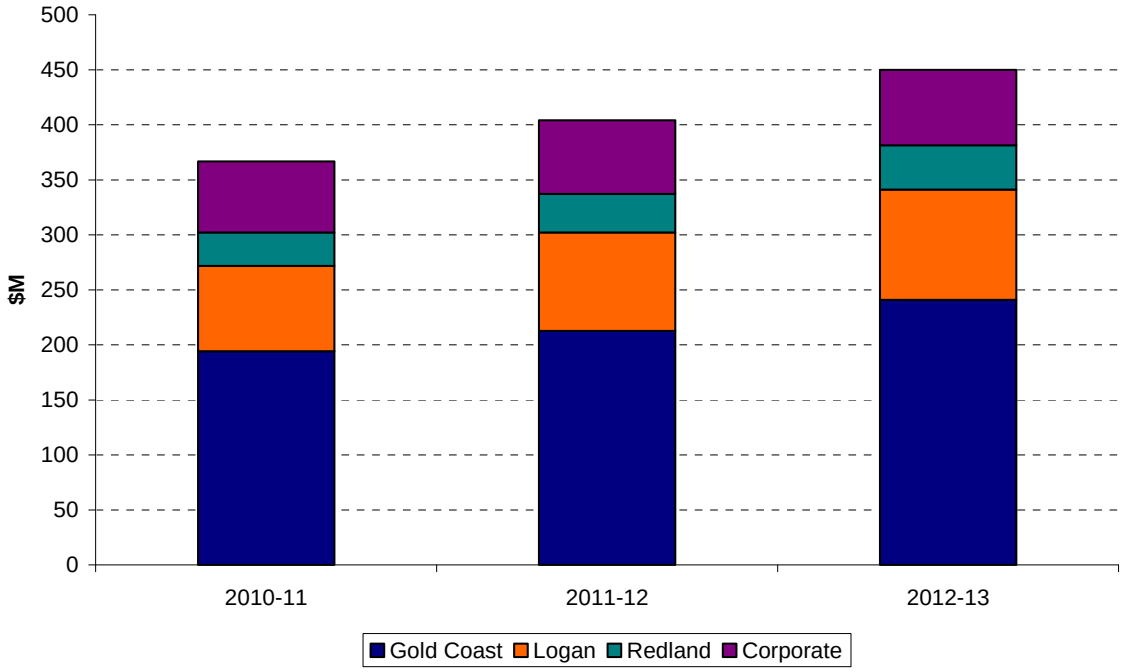


Figure 8.2 Total and district water OPEX costs

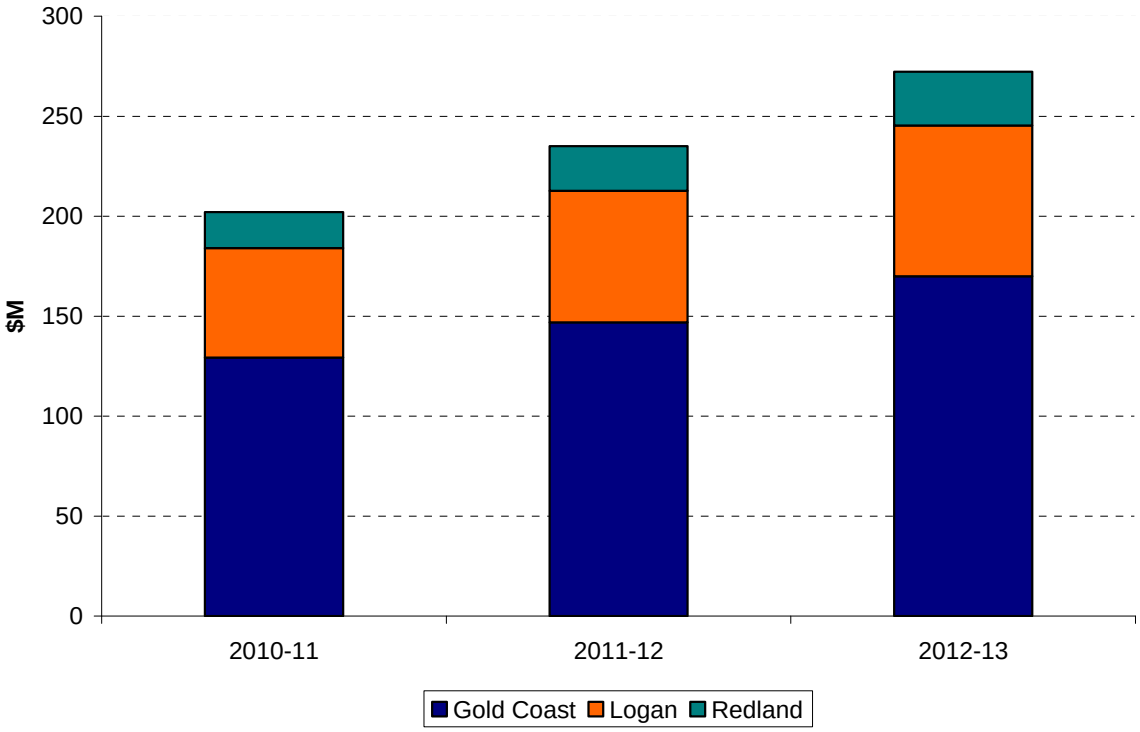
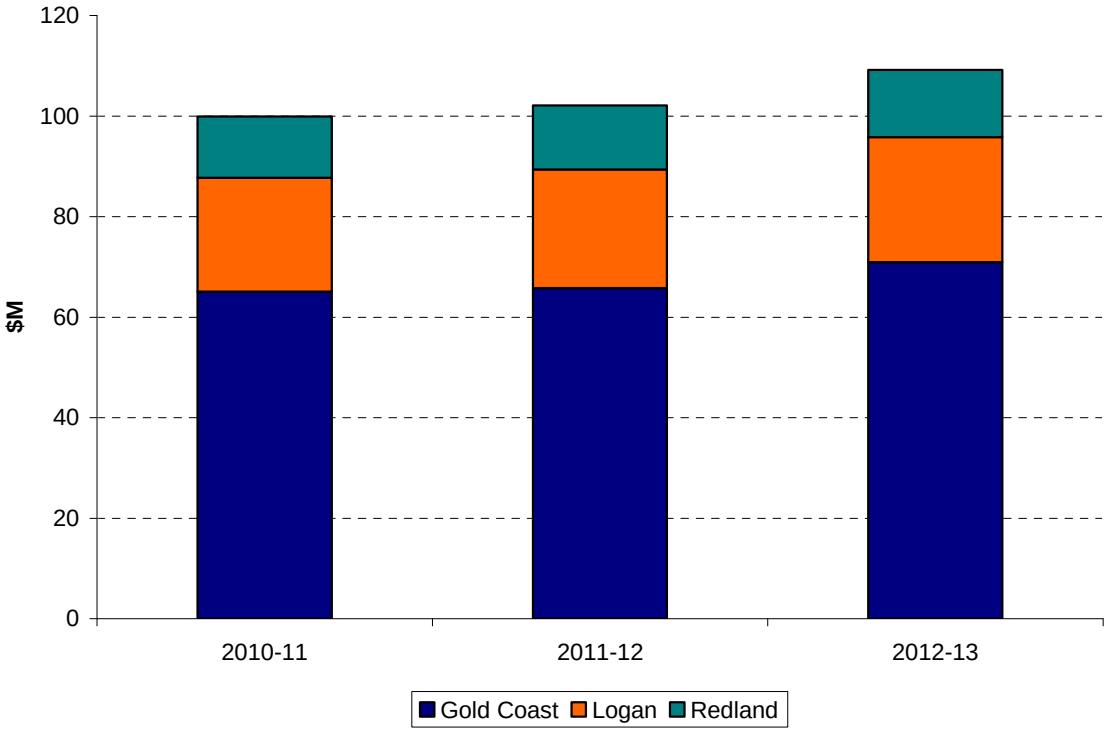


Figure 8.3 Total and district wastewater OPEX costs



Operating costs have been forecast based on 2009-10 operating costs from each Council, assumptions regarding cost escalation, volume related costs, population growth-related costs, Council SLAs, electricity costs, labour costs, bulk water charges and services/materials.

Key cost drivers can be divided into two categories: controllable and non-controllable costs. Controllable operating costs generally include labour, services, materials and

other expenditures, and represent cost categories over which Allconnex Water has some reasonable degree of management discretion. Non-controllable costs include bulk water costs, electricity, sludge disposal and Council SLAs – all of which are largely external to Allconnex Water.

Figure 8.4 Key OPEX drivers 2010-11

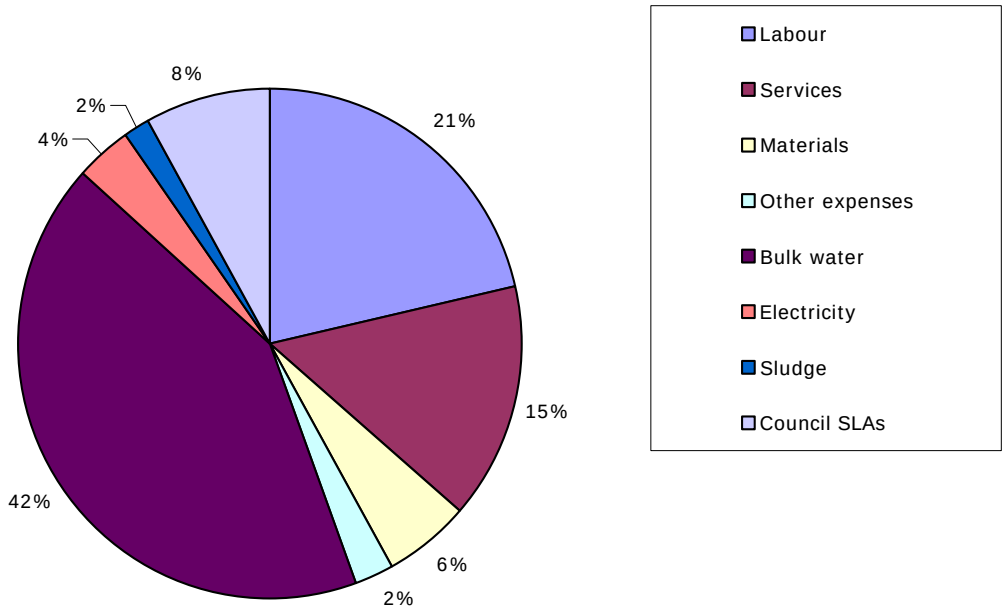
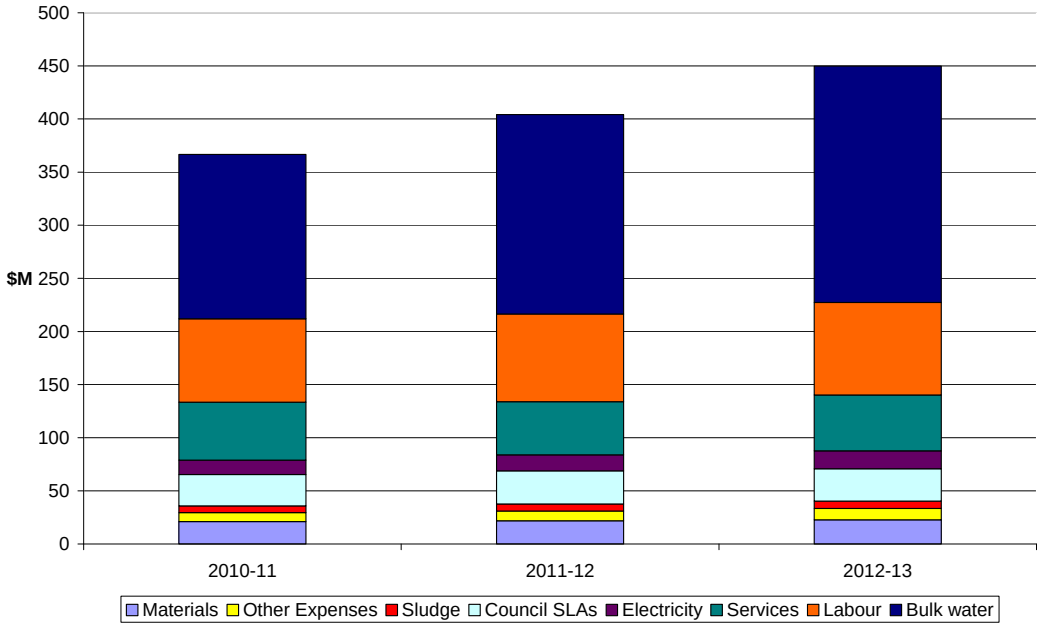


Figure 8.5 illustrates growth in the major operating cost components over the forecast period. It demonstrates that bulk water costs are both the largest single operating cost component, and the fastest growing over the forecast period. Operating costs that are a result of customer/volume growth include bulk water costs, electricity costs, sludge handling and materials (chemicals). However bulk water costs and electricity have an increasing price path, compounding the effect of growth in customers/volume. Other operating costs are escalated using the appropriate escalation indices, as discussed below.

Figure 8.5 Forecast OPEX costs



8.2 Key operating cost assumptions

Where possible common cost-escalation assumptions have been applied across the three districts. Between 2010-11 and 2014-15 Allconnex Water has forecast:

- total operating costs to increase by an annual average of around 13%, reflecting both underlying cost inflation and an increasing quantity of services being provided
- total controllable costs to increase by an annual average of around 4%, and
- total non-controllable costs to increase by an annual average of around 17%.

Increases in non-controllable costs represent 86% of the total operating cost increase over the forecast period.

8.2.1 Corporate office assumptions

Corporate office costs are based on estimates capturing human resources needs as well as information systems and establishment costs. Allconnex Water is continuing to develop estimates for corporate information systems to replace existing Council SLAs.

8.2.2 Workforce framework

Under the SEQ distribution and retail reform Workforce framework 2009 the entitlements and benefits of transferring employees are protected for the first three years. Transferring employees are covered by the Enterprise Bargaining Agreements (EBAs) in place at their respective local Councils until 1 July 2011. Broadly, these provide for wage adjustments in 2010-11 of approximately 4%.

Allconnex Water will negotiate a new EBA with its employees for the period 1 July 2011 onwards. From 2011-12 onwards a 4.0% annual rise in employee costs has been used.

8.2.3 Economic indices

Consistent with Allconnex Water's EFM, a CPI forecast of 3% per annum has been used from 2010-11 to 2012-13 (except for the purposes of asset indexation, where the Authority's methodology has been used).

8.2.4 Demand forecasts

Demand forecasts detailed in Chapter 6 have been used to inform operating cost forecasts.

Increases in water demand have a direct impact on volume-dependent operating costs. These costs include electricity, which is used for pumping and treatment plant operations, bulk water purchases, and materials (chemicals) used in water[5] and wastewater treatment processes.

[5] Although water treatment is now managed by State-owned bulk authorities, namely Seqwater and WaterSecure, Allconnex Water still manages a number of dosing facilities which are critical to managing water quality across its distribution network.

8.2.5 Bulk water costs

Bulk water costs are determined by the Queensland Water Commission (QWC) which has set a ten year price path commencing 1 July 2008. A firm commitment to these prices has been provided for the first five years with prices expected to be subject to review by the QWC from 2013-14 onwards.

Allconnex Water's forecasts assume that bulk water costs will increase in line with the QWC's published price path. The bulk water costs are forecast to increase on average 17.9% from 2010-11 to 2014-15. For the reporting year 2010-11, bulk water costs comprise approximately 68% of Allconnex Water's operating cost budget for water services (and 42% of total OPEX), increasing to more than 70% by 2014-15.

Figure 8.6: District Bulk water costs (columns) and price path (line)

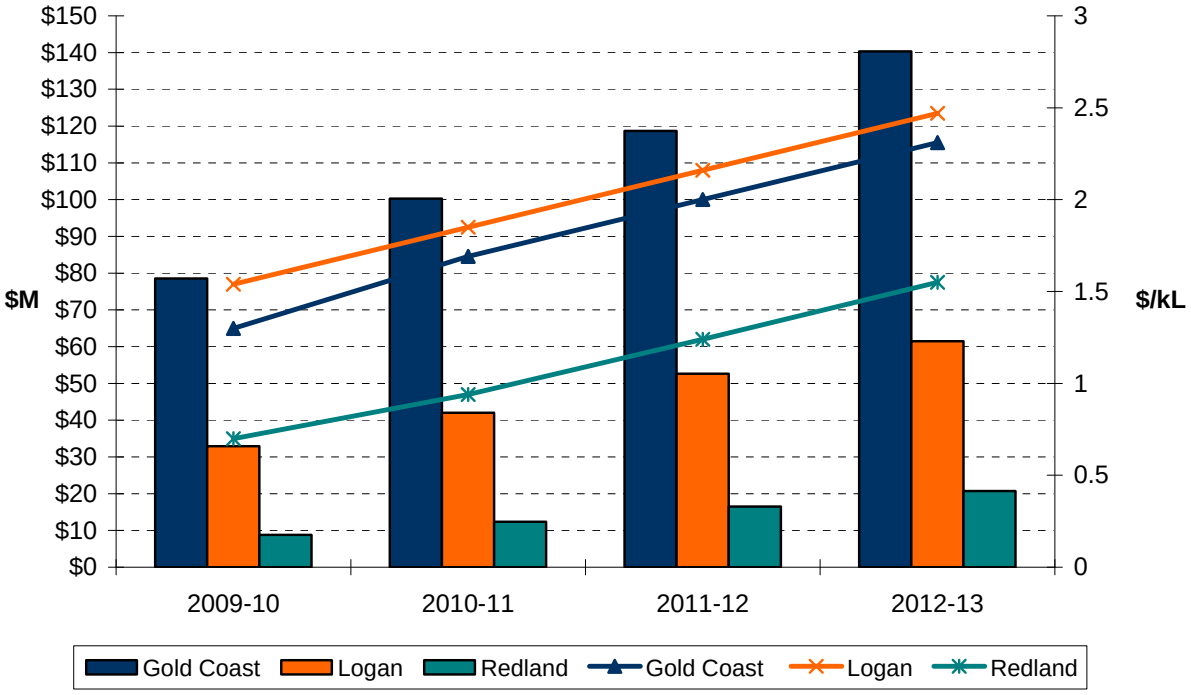
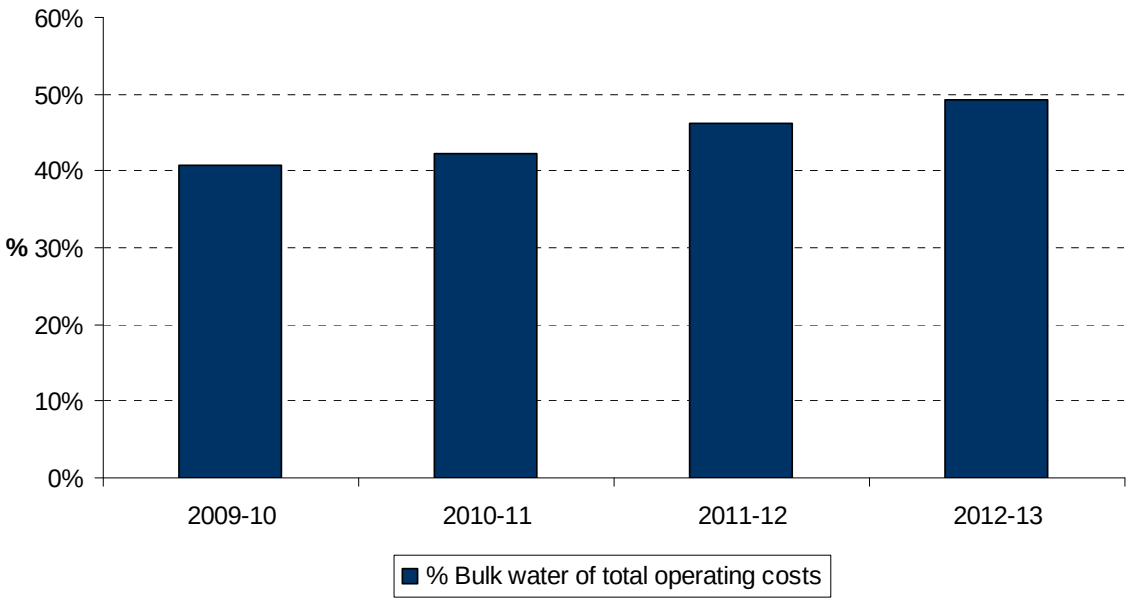


Figure 8.7: Bulk water compared to total operating costs



8.2.6 SLA costs

Allconnex Water will purchase certain services from Councils under service level agreements (SLAs) from 1 July 2010 onwards. Estimates of the 2010-11 SLA costs were provided by Councils and have been escalated annually by 3%. The SLAs are forecast to progressively reduce to zero by 2014-15, as Allconnex Water develops its own internal capacity to deliver services currently being provided by Councils.

The broad categories of services provided in the SLAs include:

- Finance and accounts
- Information technology and communication
- Human resources
- Property and facilities management
- Fleet management
- Procurement
- Customer services and management
- Asset maintenance, construction and design materials and services, and
- Finance system.

The three districts and head office utilise variations of the above categories from their respective councils.

8.2.7 Electricity

Electricity costs were determined from existing contracts with unit rates forecast to increase by an electricity index of 10% per annum.

8.2.8 Growth in employees

Full time equivalent employee growth was determined as a percentage of the population growth in each district and an allowance for the establishment of corporate positions from 69 employees in 2011 to 92 employees in 2017.

8.2.9 Return to Participating Councils

Returns to the Participating Councils include a number of items:

- Interest payments on shareholder loans
- Tax payments made under the Local Government Tax Equivalents Regime, and
- Dividends.

The dividend ratio is assumed to be 75% of distributable profits, defined as net profit after tax less capital contributions.

This pay-out ratio is applied for modelling purposes only. Allconnex Water has developed a policy for profit distributions for Participating Councils, and the actual dividend/distribution amount paid may vary depending on a range of factors.

8.3 Efficiencies and cost synergies

Efficiency savings will be achieved through work programs to achieve improvements in processes, harmonisation of processes and management structures. The programs are expected to include:

- procurement efficiencies – renegotiation with vendors and market testing of prices when existing contracts expire for bulk purchasing power of chemicals, materials, sludge disposal and electricity
- IT improvements to automate tasks and enhance data quality and reporting
- harmonisation of the 3 district processes into one process, and
- progressive reduction of tasks undertaken by Councils.

Other efficiency savings have been incorporated after the expiry of the 3 year workforce framework. The forecast efficiency savings is set at a target of 3.1% of the controllable costs which include:

- labour
- services
- materials, and
- other expenses.

This equates to a 1.2% efficiency saving in 2013-14 and 1.1% in 2014-15 of the *total* operating costs.

9 Return on investment

9.1 Introduction

Gold Coast, Logan and Redland Councils have over many years invested significant funds into their water and wastewater businesses. Allconnex Water believes it is appropriate that its water and wastewater pricing strategy delivers a revenue outcome sufficient to provide a return on Council's past investment in water and wastewater assets, and on its own future capital investment program.

Pricing to achieve a commercial return is not a new concept, and indeed has been a feature of the Council's past water pricing strategies. Allconnex Water's approach builds from the pricing and revenue policies of its Participating Councils, and has been informed also by precedents established by the QCA and by the Ministers' Direction Notice to the Authority.

9.2 Weighted average cost of capital

Allconnex Water has sought to determine a target rate of return based on regulatory and commercial benchmarks. To inform this, the three south east Queensland distribution-retail authorities (Allconnex Water, Queensland Urban Utilities and Unity Water) jointly commissioned a report on an appropriate cost of capital for regulatory pricing purposes for the SEQ Distributer-Retailers. A report by Competition Economists Group (CEG) is provided as a supporting document to this Submission.

CEG recommended a weighted average cost of capital (nominal 'vanilla' WACC) in the range of 9.62% to 10.14%. This range was calculated by CEG having regard to:

- An estimated benchmark capital structure for the Queensland Distributer-Retailers based on 60% gearing level and the issuance of 10 year debt with a credit rating of BBB+ (at a yield equal to the (annualised) average of CBASpectrum BBB+ 10 year fair value and Bloomberg BBB 10 year fair value;
- A cost of debt of 8.79%, which reflects an equal weighting given to the average cost of debt over the last five years and the average prevailing cost of debt (during the period 24 May 2010 to 3 June 2010 – the period leading up to the CEG's final report). This gives rise to a lower cost of debt than if the prevailing cost of debt (9.28%) alone was used to set the cost of debt; and
- A cost of equity in the range of 10.85% to 12.15%, calculated using the Sharpe CAPM formula, and using an equity beta of 0.8-1.0, a market risk premium of 6.5% and a risk-free rate of 5.65% based on the 5-year average for 10-year government bonds.

Allconnex Water's EFM projections originally included a (slightly lower) WACC, derived using a range of different assumptions and parameters. As an interim assumption for this price monitoring period, Allconnex Water has adopted a post-tax vanilla WACC of 9.88%, which represents the mid-point the CEG range, noting that the Board has not yet formally developed its position on WACC and the QCA is expect to release guidance on a WACC range for the Distributer-Retailers prior to next year's price monitoring review.

Table 9.1: WACC parameters

Parameter	CEG
Risk free rate	5.65%
Equity Beta	0.8-1.0
Market risk premium	6.5%
Capital structure D/(D+E)	60%
Nominal return on equity	10.85% - 12.153%
Cost of Debt	8.79%
Nominal vanilla WACC	9.62% - 10.14%
Provisionally adopted WACC	9.88%

9.3 Financing capital investment

Allconnex Water's capital structure has been framed to provide the business with sufficient flexibility to fund future its future capital investment program, whilst managing cash returns to its Participating Councils.

Broadly, the business' opening capital structure on 1 July 2010 comprises 55% Council 'equity', in the form of Participation Rights, and debt of 45%. Borrowings are primarily shareholder loans, including both senior and subordinated facilities, with a small working capital facility provided by QTC.

The shareholder loans provide for stability of cash returns to Councils, whilst giving the business a more commercial capital structure without requiring the drawdown of large external loans and notional refinancing of Council's equity interests in the business. The shareholder loans nominally have a three year term, to 30 June 2013, and are divided between the three Participating Councils roughly in line with each Council's RAB proportion. Terms for the shareholder loans have been set having regard to rates and conditions as advised by QTC.

Generally, replacement capital works are intended to be funded by free cash flows, with growth capital also cash-flow funded (including through developer cash contributions), with additional QTC borrowings as required.

QTC has advised Allconnex Water of target credit metrics for a BBB+ equivalent credit rating, including interest cost, internal financing and gearing and return ratios. Allconnex Water's revenue glide path has been structured to achieve (or exceed) these benchmarks by the end of 2012-13.

10 Revenue requirement

10.1 MAR calculation methodology

Allconnex Water has calculated its revenue requirement, or maximum allowable revenue (MAR) using a 'building block' framework, informed by the QCA's draft MAR Building Block model and other regulatory guidance materials. Separate MARs have been calculated for three broad products – water, wastewater and tradewaste services – and at the district level.

Key elements of Allconnex Water's approach include:

- The annual RAB roll-forward has been calculated as described in Section 4, with capital expenditure over the period 2010-11 to 2012-13 included in the RAB when the cash expenditure is incurred. Allconnex Water notes that typical regulatory practice is to include in the RAB capital expenditure only when the relevant asset is commissioned and brought into service. In practice, this results in an NPV-neutral revenue outcome to the regulated services provider, since a WACC return on expenditure is 'capitalised' in a WIP account prior to commissioning (and the asset is brought into the RAB at a higher starting value at the commissioning date). For Allconnex Water specifically, and because of the use of a glide path approach to pricing determined using an NPV-neutral methodology, the timing of WIP capitalisation to the future RAB does not impact on customer prices;
- Wastewater and tradewaste MARs have been calculated based on a percentage allocation of initial assets, net additions, and operating costs. Council-level allocation percentages were based broadly on estimated wastewater/tradewaste discharge volumes - Allconnex Water recognises that this allocation does not directly consider other non-volumetric cost drivers, such as the wastewater composition and potential impacts on treatment costs, and will continue to work on refining this cost allocation for future regulatory periods;
- A mid-year assumption has been adopted for new capital expenditure, the receipt of donated assets, and asset contributions. The allowable asset base for calculating a return on assets is therefore the sum of existing assets and 50% of net additions (i.e. capital expenditure plus donated assets minus disposals). The timing of indexation and depreciation also follow the same mid-year assumption (current year depreciation is added to the MAR and current year indexation is deducted from the MAR);
- The indexation rate for the forecast period (2.56%) has been calculated consistent with the methodology set out in the QCA's *Information Requirements for 2010/11* – i.e. based on the "difference between the RBA return on the market rate for five year bonds and five year capital indexed bonds". Allconnex Water has used the Fisher Equation to derive the implied inflation rate using RBA bond issues TB119 (fixed coupon bond with maturity 15 April 2015) and TI405 (capital indexed bonds with maturity 20 August 2015). Allconnex Water has not sought to interpolate between bond issue dates to capture variances between the exact maturity date of these bonds and the term of the prices monitoring framework; and
- A post-tax framework has been applied, including a nominal post-tax vanilla WACC (9.88%) and forecast tax cash flows.

10.1.1 Taxation

At the time Allconnex Water was formulating its pricing strategy for the financial year 2010-11, the State Government had provided no guidance on the tax transition arrangement to apply under the Local Government Tax Equivalents Regime (LGTER). A key issue outstanding was the basis on which Allconnex Water's opening tax cost base would be determined.

Allconnex Water therefore adopted, as a conservative assumption, a tax cost base aligned to its then estimate of its RAB. This assumption was conservative in that the RAB represented the highest possible valuation for the tax cost base, thereby giving the highest possible tax depreciation estimate and lowest tax cost estimate. This approach may not represent Allconnex Water's preferred or proposed approach to the determination of a tax cost base.

Subsequently, Allconnex Water understands that the State Government has sought advice on appropriate tax transition arrangements to apply, and on related matters such as the tax treatment of developer cash contributions and gifted assets. This advice is yet to be formally communicated to Allconnex Water, though Allconnex Water understands that the most likely outcome is that the tax cost base will be determined based on the closing tax written down values for each of the three Participating Councils as at 30 June 2010.

Allconnex Water intends to provide updated information to the QCA once formal advice has been received from the State Government on these matters.

Allconnex Water has as an interim approach calculated a tax cost based using regulatory depreciation as a proxy for tax depreciation, a notional interest expense, and adjustments for the (expected) non-assessable treatment of developer gifted assets.

10.2 Water, wastewater and tradewaste MAR

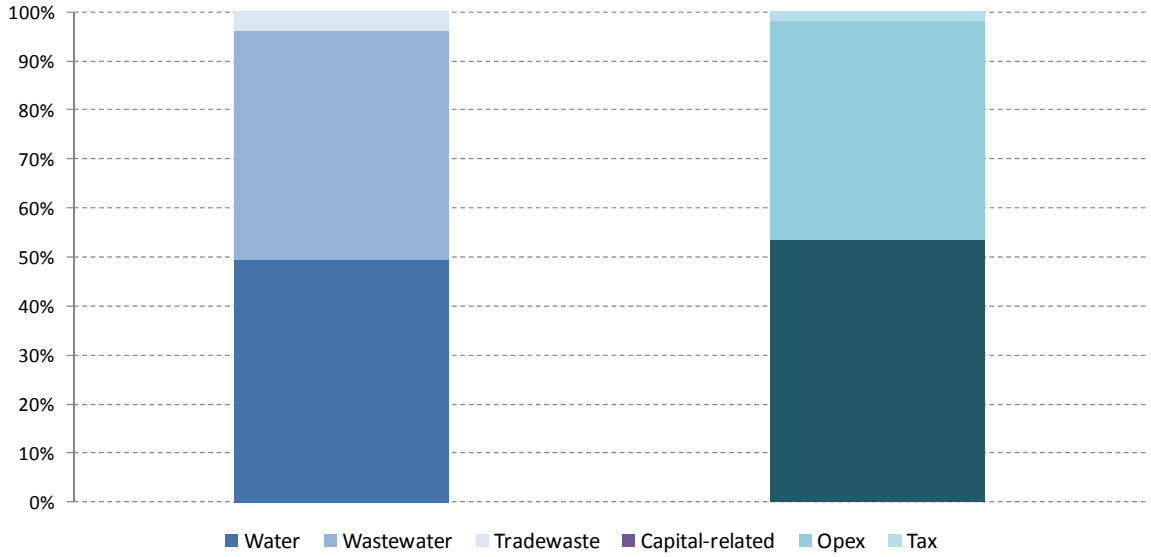
Allconnex Water's total MAR (for all regulated services) for 2010-11 is **$806m**. Of this amount, approximately 49.5% relates to water services, 46.7% to wastewater services and 3.8% for tradewaste services.

The 2010-11 MAR represents a significant increase (approximately 50%) on the (hypothetical) total MAR for 2009-10, driven by factors such as higher bulk water costs, a large capital program, and the switch to an asset offset approach to setting the MAR (which will be offset by future lower prices as contributed assets are excluded from the RAB and therefore this cost is not recovered from customers over time).

Capital-related components account for approximately 53.5% of the MAR (return on assets, depreciation and an offset for indexation), 44.6% for operating expenditure (including bulk water costs) and 1.9% for tax expenses.

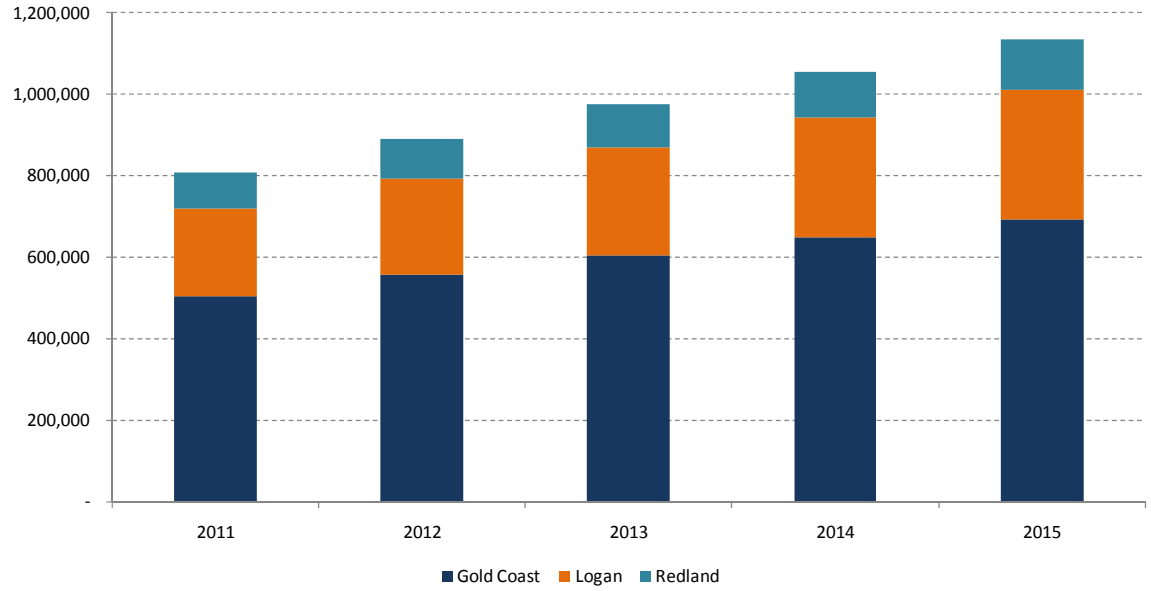
The graph below provides a summary of the total MAR by each major product (water, wastewater and tradewaste), and by component type (capital, operating and tax).

Figure 10.1: Composition of Allconnex Water MAR



Over the period to 2012-13 MAR is forecast to increase by around 21% (from 2010-11 levels), largely due to the continued upward trend in the bulk water price path, and the business' significant investment in capital projects. The graph below shows the annual (forecast MAR) to 2015.

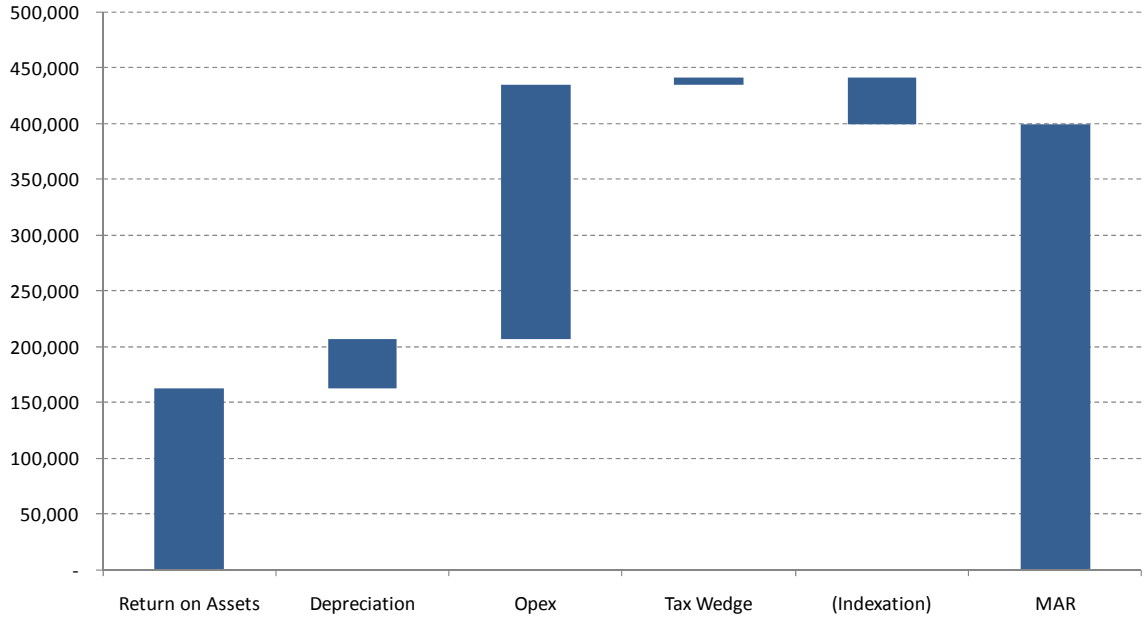
Figure 10.2: Composition of Allconnex Water MAR



The figures below set out the key building block components of the MAR calculations for each major product for 2010-11.

For water, operating expenditure is the largest single component, accounting for approximately $228m (or ~57%) of the total water MAR. Of this $228m, approximately 65% is directly attributable to bulk water costs.

Figure 10.3: Water MAR



For wastewater and tradewaste, the composition of MAR is virtually identical in percentage terms (since the allocation of costs between wastewater and tradewaste based on a district-level percentage allocation applied to all cost components. For 2010-11, collectively across the districts the percentage allocation for wastewater is around 92.5%, compared to ~7.5% for tradewaste. This percentage varies slightly during the forecast years, reflecting the weighting of MAR across the districts and the corresponding individual percentage allocations.

Figure 10.4: Wastewater MAR

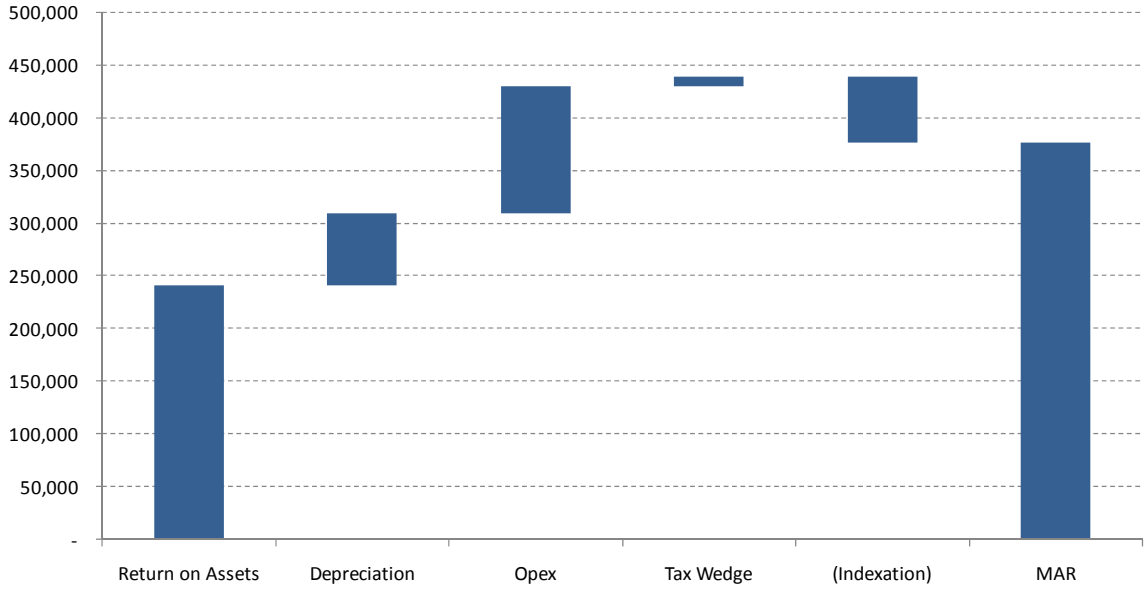
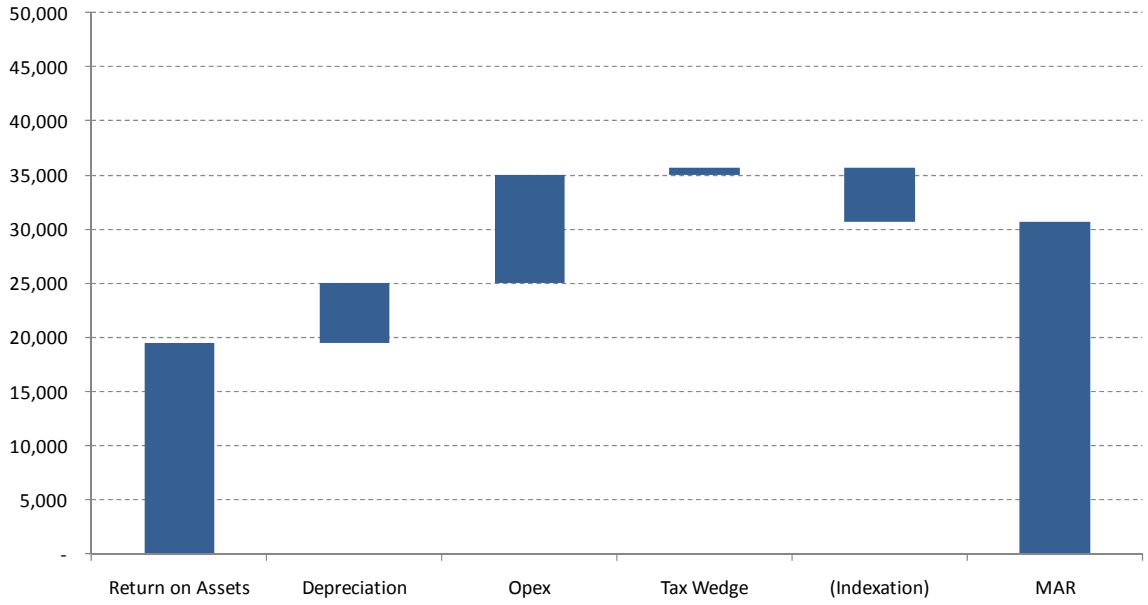


Figure 10.5: Tradewaste MAR



11 Allconnex Water's water and wastewater prices

11.1 Interim pricing strategy for 2010-11

Allconnex Water has finalised its interim pricing strategy for 2010-11 and prices have been published on Allconnex Water's website. Allconnex Water's pricing strategy for 2010-11 has been informed by both the apparent level of cost recovery for each district, and a consolidated perspective of the business' level of cost recovery for each of its major product lines (water and wastewater).

Allconnex Water's immediate pricing strategy incorporates a simple percentage adjustment to all tariff components (fixed and variable). This strategy has had regard to the following factors:

- In most instances, prices which recover MAR would be significantly higher than current prices and therefore a transitional approach is preferred, which seeks to ameliorate customer impacts and is sensitive to the State's preference for avoiding price shocks – i.e. a longer-term glide path should be adopted where possible; and
- Each district has different legacy tariff structures and these structures have been retained until appropriate consideration is given to:
    - Price harmonisation/rationalisation across the three districts, including due consideration of customer-level impacts from any significant changes in tariff structure; and
    - Billing/customer system implementation, to ensure that any new tariff structures are properly incorporated into Allconnex Water's systems.

Broadly, pricing arrangements for 2010-11 for core water and wastewater services have been set at a district and product level such that a *consistent* percentage increase is applied to all charges within a particular district/product category. The level of the percentage increase reflects the percentage required to achieve MAR up to a maximum of 20%. That is, where a >20% increase would be required to achieve a district/product MAR, the percentage increase for all charges within that district/product category are increased by 20% only.

Practically, this results in a lower percentage increase for Redland customers, with higher increases for Logan and Gold Coast customers, since Redland's charges for 2009-10 are already near its (district-level) MAR.

Table 11.1: Summary of interim pricing structure (2010-11)

	Charge type	Percentage increase	Basis of price increase
Gold Coast	Water charges	20.00%	Transition-based pricing
	Wastewater charges	20.00%	Transition-based pricing
	Tradewaste	20.00%	Transition-based pricing
	Non-core charges	3.00%	CPI-based escalation
Logan	Water charges	20.00%	Transition-based pricing
	Wastewater charges	20.00%	Transition-based pricing
	Tradewaste	20.00%	Transition-based pricing
	Non-core charges	3.00%	CPI-based escalation
Redland	Water charges	2.95%	MAR-based pricing
	Wastewater charges	7.14%	MAR-based pricing
	Tradewaste	20.00%	Transition-based pricing
	Non-core charges	3.00%	CPI-based escalation

Note: percentage increases are applied consistently to all fixed and variable charges, whether residential or non-residential.

* The CPI estimate of CPI (3%) reflected Allconnex Water's forecasts at around May 2009, when its pricing policies were formulated. For the purposes of asset indexation, the inflation estimate has been updated using the Authority's methodology.

A full schedule of prices for 2010-11, including percentage increases from 2009-10 prices, is provided as an Appendix to this submission (*Appendix 3: 2010-11 Price Schedule, 1 July 2010*).

Other fees and charges

Other fees and charges, excluding developer charges, have been increased by a CPI forecast of 3% for 2010-11 across all three districts.

Developer charges

Infrastructure and planning policy charges have been adjusted by a CPI forecast of 3% across all of the districts. Since Allconnex Water will retain existing escalation policies across each of the districts for 2010-11, the application of the CPI adjustment differs across the districts. Charges for Gold Coast and Logan are updated quarterly, whereas Redland's charges are adjusted for CPI annually.

11.2 Recovery of MAR

Allconnex Water believes that increasing prices in 2010-11 to achieve MAR would result in undue customer impacts, and is inconsistent with the State's request to avoid 'price shocks'. However, some level of price increase is required - even if the business was earning revenue equivalent to MAR in 2009-10, prices would still need to increase significantly to hold this level of cost recovery in 2010-11. Key pricing pressures include:

- significant external cost pressures (e.g. increasing bulk water charges);
- forecast growth in operating and capital costs for both water and wastewater; and
- the magnitude of historical under-recovery against MAR.

Allconnex Water has adopted a transition approach to pricing which, for 2010-11, incorporates price increases which are significantly less than required to achieve MAR. Over the medium term, this strategy translates into a revenue *glide path* which is longer than the price monitoring period.

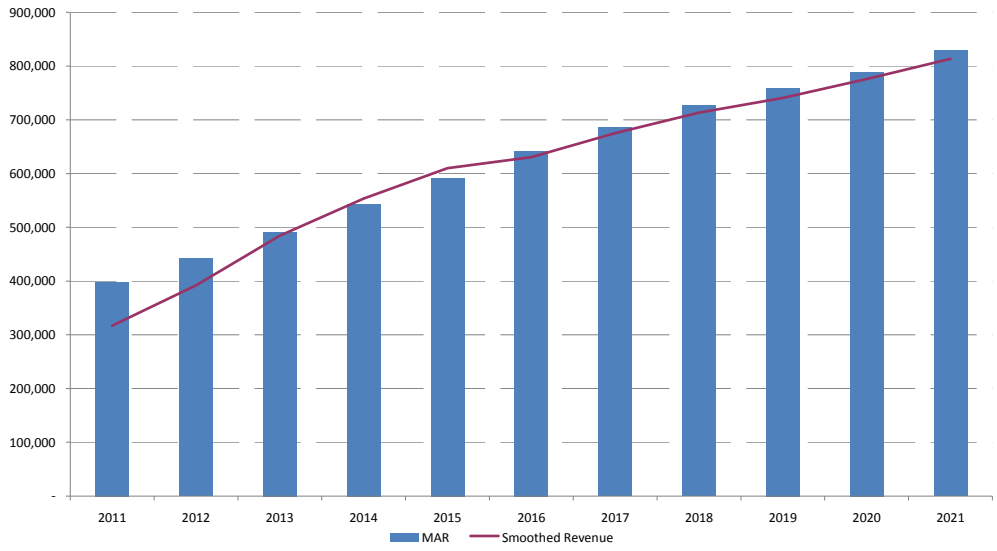
Currently, Allconnex Water has adopted an assumption that it will have separate glide paths for each major product (water, wastewater, and tradewaste) and for each district, although this is subject to the outcome of pricing/revenue policies which are to be formulated during 2010-11.

Various glide path configurations were considered by Allconnex Water, with the (current) glide paths seeking to balance the following:

- first year price increases of no greater than 20%, based on representations from Councils and Allconnex Water's own research as to an acceptable level of price increases from a customer's viewpoint, and acknowledging the State's concern regarding customer price shocks;
- price increases thereafter sufficient to meet BBB+ benchmark financial ratios by the end of 2013-14, either in line or in advance of QTC requirements;
- a glide path profile which achieves an NPV-neutral cost-recovery outcome for Allconnex Water – any shortfall in cost-recovery initially is recouped in latter years through prices/revenues which are, on a single year basis alone, above MAR;
- a glide path term determined from the scale of revenue increase needed to achieve MAR, with longer glide path terms where revenue larger revenue increases are required; and
- profiling of the glide path to ensure there is no "drop off" in revenues/prices in the last year, before aligning with MAR thereafter. A price decrease would present a confusing signal to customers, after multiple years of significantly above-CPI price increases.

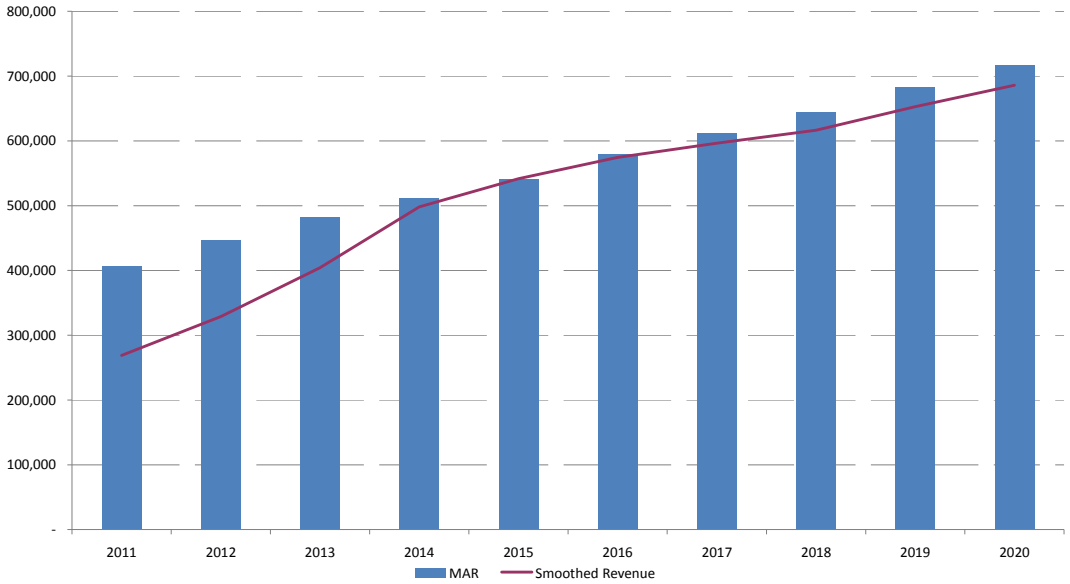
The graphs below summarise the glide paths incorporated into Allconnex Water's initial modelling.

Figure 11.1: Summary of revenue glide paths - water



Note: Revenues and other data in Graphs 11.1, 11.2 and 11.3 were produced using a previous version of Allconnex Water's EFM (at the time that pricing was determined for 2010-11), therefore do not reconcile precisely to the data provided in the QCA Information Template.

Figure 11.2: Summary of revenue glide paths – waste water



Allconnex Water notes that while the Ministers' Direction Notice requires the QCA to take into account any revenue glide path submitted by the entity for the purpose of avoiding price shocks over the interim period, there is no formal guidance as to the recoverability of a glide path which extends beyond the interim price monitoring period. Given that Allconnex Water customers face significant 'catch up' price increases to reach MAR, Allconnex Water believes strongly that it would be appropriate for the QCA to recognise glide paths beyond this period such that undue customer impacts are minimised in the near term.

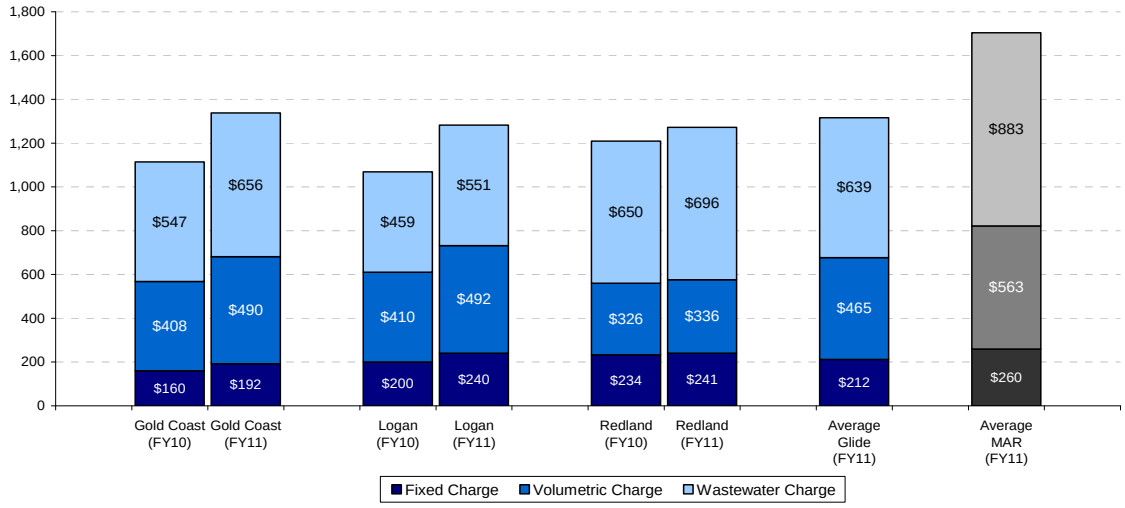
11.3 Customer impacts and future pricing policies

Detailed customer-level analysis is expected to be undertaken in 2010-11 as part of an overall review of pricing/revenue policies.

To inform its interim pricing strategy, Allconnex Water has undertaken initial customer analysis to isolate potential impacts on customers across the districts. While this analysis has focused on 'average' customers, particularly residential customers, it demonstrates that if Allconnex Water were to adopt a harmonised pricing approach there would be a re-distribution of costs between customers of the three districts. This is largely because Redland's existing RAB is lower (on a per customer basis) compared to Gold Coast and Logan and also has higher historic charges.

The graph below shows an 'average' residential customer bill for 2009-10 (including water and wastewater services) for each of the districts compared to a harmonised 'average' 2010-11 customer bill, based on the hypothetical prices that would be required for Allconnex Water to achieve a 'harmonised' MAR. The required price increase would vary between ~40% and ~60%, depending on the location of the customer.

Figure 11.3: Average customer bill by location for 2009-10 and 2010-11 ($)



Policies that look after our community

Concessions for water consumption due to renal dialysis

The objective of this policy is to provide a concession for water consumption charges to properties where renal dialysis patients have been provided with facilities for dialysing at home.

This policy includes domestic properties in the Allconnex Water area serviced by a water meter.

Relief from Water and Wastewater charges due to genuine fire emergencies

The objective of this policy is to provide relief from water consumption charges and wastewater volumetric charges in cases of proven use of water, drawn from Allconnex Water's water supply system, for a genuine fire emergency.

All applications received must meet the following eligibility criteria:

- That the water used for fighting the fire was drawn from Allconnex Water's water supply system
- A copy of the fire brigade's confirmation and/or Statutory Declaration is received, and
- The application is received within a period of two years of the fire occurring.

The quantity of water used in a genuine fire emergency is determined by:

- the actual quantity of water used, in cases where it is possible to monitor the metered water usage, or
- an estimate of the quantity of water used, in cases where the actual quantity of water used is unknown, either by adjusting the bill to similar usage from previous periods, or by using a flow rate calculation.

Water and Wastewater Leakage Policy

Allconnex Water will provide relief from water consumption charges and wastewater volumetric charges due to undetected leakage. The policy includes both residential and non-residential properties in the Allconnex Water area serviced by a water meter.

11.4 Future pricing policies

Currently, each of the three Councils administers a postage-stamp charging framework for water and wastewater services within their supply area (excluding the 'hybrid' charges administered by Logan relating to areas transferred as part of the local government boundary realignment, where transferred areas are still charged under the former Council charging arrangements). Charges may be differentiated by customer-type or service (eg, on meter-size), but are uniform across supply areas. The application of pricing policies and billing frequency varies between the districts.

Arguments for some type of nodal or geographically-differentiated charging framework are usually that prices should reflect variances in supply costs. Although the cost-bases of the three Council water businesses were different, it does not immediately follow that under a consolidated operating model future costs will follow historic cost trends. Moreover, even within any legacy Council area, there are higher (and lower) cost supply areas.

Prior to implementing any tariff/price harmonisation, it will be critical for Allconnex Water to understand the potential range of customer impacts of such strategies. Key issues will include:

- Understanding the customer-level impacts of tariff-level harmonization – for example, a given percentage adjustment to one tariff component within a non-linear charging structure will impact differently on different customers, depending on their particular consumption or other characteristics;
- Bulk water charges currently are wholly-variable however the Water Grid Manager has signalled that it may seek to revise the structure of bulk water charges, potentially introducing some form of fixed charge. A change in the structure of bulk water charges would impact on Allconnex Water's exposure to consumption volume risk; and
- Structurally, there are more differences between existing Council non-residential wastewater charges than for other services. Included in this are the significant structural and policy differences between the Councils in respect to trade waste charging, which need further investigation and analysis. A fixed and variable charging structure for wastewater introduces a number of complex issues, such as determining appropriate discharge factors, consistent customer definitions, the transition path for Councils without volumetric wastewater charges, and how to address alternative water supplies (such as non-reticulated water supplied from rainwater tanks, but which is still discharged into the sewer network).

Allconnex Water will continue to assess the appropriateness of a consolidated MAR and/or harmonised tariff structures through 2010-11, noting that the QWC is expected to release pricing principles later this calendar year.

11.5 Non-core charges

Each district administers a series of Non-regulated or Regulatory Fees and Charges, which includes charges for work such as meter installations, document sales, and meter testing. Under the QCA Information Requirements, these activities could be deemed as non-core activities.

Each district currently has different charges for what could be considered in many cases the same service. In the future, it may also be determined that these charges need to be consolidated and harmonised across the three districts. In some cases however, these charges are "built up" under the principles of full cost pricing.

The increase on non-core charges for 2010-11 has generally been a 3% increase on

2009-10 charges. Many charges however are still “Price on Application” and are determined when a customer enquiries about a particular service.

11.6 Non-regulated services

Under the definition provided in the QCA Information Requirements, a Non-Regulated service is *a service provided by an entity that is not required to satisfy any specified legal obligation or is provided by other service providers in a competitive market.*

There are two types of non-regulated services: work provided by Allconnex Water for another entity under a service level agreement (SLA); and the business’ Scientific Services laboratories.

Allconnex Water currently provides services for entities such as the state owned Bulk Water Supply Authority (Seqwater) for maintenance of water treatment plants. Allconnex Water also undertakes a small amount of recoverable works as part of the Gold Coast Rapid Transit Project.

Allconnex Water receives revenue from these entities to recover the costs incurred in performing the work under SLA. This is detailed in template 5.14.1.

Allconnex Water’s three districts also have laboratories which undertake scientific testing for both external customers (including Councils) and internally.

The laboratory service area is operated as a business unit within Allconnex Water. Its costs are recovered from its customers, including work it undertakes internally for Allconnex Water.

12 Projected financial outcomes

Allconnex Water has applied a revenue glide path assumption which seeks to balance transitional customer impacts against QTC and other financial requirements. Overall, Allconnex Water expects to achieve BBB+ benchmark financial ratios by the end of 013-14 in accordance with QTC requirements.

An indicative forecast of Allconnex Water's financial position and key indicators (e.g. water sales, return on assets/equity, gearing etc) over the period to 2012-13 is provided below, which reflects the forecast (glide path) revenue, cost and other data provided in the Information Template.

Table 12.1: Forecast financial position

	2010-11 (000's)	2011-12 (000's)	2012-13 (000's)
Income statement			
Revenue	698,551	822,418	993,739
Expenses	366,715	404,164	449,802
Earnings before interest & tax & depreciation	331,837	418,254	543,936
Profit after tax	**62,823**	**82,592**	**144,936**
Balance Sheet			
Current Assets	155,926	167,770	195,735
Property, plant & equipment	4,432,328	4,855,693	5,056,221
Total assets	4,588,254	5,023,533	5,251,956
Debt	2,235,764	2,579,747	2,643,797
Other liabilities	119,068	145,975	222,731
Net assets	**2,233,422**	**2,297,811**	**2,385,427**
Cash Flow			
Operating cash flow	158,753	311,023	432,316
Interest and Taxes	137,096	180,477	226,298
Dividends	-	25,758	39,418
Net Payments for property, plant & equipment	396,537	445,122	233,050
Closing cash	**24,751**	**28,399**	**25,000**

* Note: Forecast financial position may vary when audited 2009-10 financial statements become available

Over the three-year interim prices monitoring period, Allconnex Water's forecasts imply:

- Dividend payment commencing in 2011-12, reflecting the distribution of the forecast 2011 profit
- Strong growth in operating cash flows, driven by operating revenues increasing

ahead of operating costs

- EBIT increases from $332 million in 2010-11 to over $500 million by 2012-13, and
- Notwithstanding improvements in profitability, Allconnex Water's aggregate return on its RAB is still significantly below comparable regulatory and commercial benchmarks.

13 Forward work program

As expected with a "merger" of three large businesses, there are a multitude of tasks and consolidation that will need to be completed over the coming years. This may include, but is not limited to: Integrated Standards; Financial Practices; Systems; Infrastructure Planning; Regulation and Pricing; Procedures and Policies; and, Enterprise Bargaining. The focus will be on consistency and efficiency that will take Allconnex Water forward.

13.1 Integrated standards

Each district of Allconnex Water has its own service standards and policies. A review of standards is already taking place which will ensure that there is consistency across the business. There should also be consideration to SEQ design requirements and construction manuals.

13.2 Financial practices

Currently the three districts have different policies and methods around the way they budget, their financial reporting, and their treatment of revenue and expenditure.

Future work in this area will include a new chart of accounts, consistent budgeting and financial reporting and policies, and a set of audited financial statements.

13.3 Systems

Allconnex Water is currently receiving system and IT support from its Councils under SLAs. This includes billing and financial systems, and computer networks and support.

Allconnex Water will be looking to procure shortly its own billing system, and work will commence on developing an Enterprise Resource Planning (ERP) system. Both will be crucial in meeting Allconnex Water's future regulatory and legislative obligations.

13.4 Infrastructure planning

There will need to be a coordinated approach to the planning issues that face the business. This may require a link between the infrastructure planning strategies of the three districts which should take into account the requirements of growth, renewals and legislative and regulatory obligations.

In addition to coordinated planning, a "NetServ Plan" will also be developed for the three districts to guide future growth planning for the region.

13.5 Regulation and pricing

As the regulatory environment in the SEQ region is changing, Allconnex Water will ensure that it is well equipped to meet the challenges this poses by expanding its regulatory team. This team will help guide and drive the business during the regulatory period and ensure it meets its future obligations.

Allconnex Water will also be looking at its future price structures and tariffs for 2010-11 and onwards later this year. Any decisions on harmonisation will be guided by regulatory pricing principles and thorough customer impact analyses.

13.6 Procedures and policies

There are a number of policies and procedures throughout the three districts that may need review and consolidating. Many policies have already been endorsed, and it is expected that this work will continue throughout 2010-11.

13.7 Enterprise bargaining

Employees that transferred from the Council water businesses will be covered by the Enterprise Bargaining Agreements (EBAs) in place at their respective councils until 1 July 2011. Allconnex Water therefore will have a new EBA in place by this time. Allconnex Water human resources will commence negotiations with employees and their representatives later this year.

Appendix 1 Demand management programs

School education programs

Make Your Water Mark

Make your water mark is extensive early childhood, primary school, middle school and secondary school program specifically tailored for Gold Coast schools and linked to Education Queensland Learning outcomes. To ensure students get the most from the curriculum material, teachers receive support via:

- Online access to educational resources including lesson plans, worksheets and activities
- Professional development seminars
- Professional development via teacher workshops, and
- Access to facilities for excursions.

Water for Life

The Waterwise program offers some local information on where water comes from, how it is treated in the urban water cycle and responsible water use of a limited resource. The program involves school visits with topics for discussion targeted at the early childhood and primary school level. All classes receive teacher and class packs with Waterwise items and follow-on material. Sessions are tailor-made to suit the class unit of work and take on various formats. Additional activities provided to ensure students get the most out of the program include:

- Water for life resource CD
- Waterwise schools competitions
- Teacher workshops
- Access to facilities for excursions, and
- The character Whizzy is available to deliver the top ten water and energy saving tips.

Class room presentations

Complimentary class room presentations are offered to raise awareness of water issues in a fun and innovative environment. An experience presenter will visit the school to deliver a tailored presentation.

Water in Redlands

This program contains curriculum based teaching resources for primary schools. It aims to enhance awareness of the importance of fresh water and hoe to conserve it. The program contains 15 lesson plans which includes 3 lessons for grades 3-7. Each of the lessons address the specific Department of Education requirement.

Sustainable gardening workshops

In partnership with Gold Coast City Council free workshops are held monthly throughout the community to provide advice on composting, worm farming and water efficiency to create a sustainable garden.

Home watersaver

Allconnex Water has created a brochure with practical tips to make water conservation in your home easy to achieve.

Garden watersaver

The program provides training in garden water conservation practices to people who have a significant influence over water use. These include members of the nursery, landscaping and irrigation industries as well as local residents who are keen to learn more about water efficient gardening, especially in times of water restrictions. The Garden Watersaver guide was produced as part of a long term water efficient management plan.

WEMPS

Water Efficiency Management Plans (WEMPs) are a long-term demand management strategy requiring businesses to achieve water use efficiency. While the development and implementation of a WEMP enables businesses to assess their activities and identify and implement water savings, the overall aim is for businesses to make the efficient use of water a part of normal day to day business operations.

WEMPs assist businesses to:

- Account for water use in a business or non-residential premise
- Identify water saving measures that can be readily applied to a business or other non-residential premises, and
- Prepare a plan for implementing the identified measures, including the identified savings, program priority and implementation timelines.

All WEMPs must:

- Be prepared in accordance with the QWC Guideline
- Be submitted for approval to Allconnex Water
- Be capable of third party certification, and
- Contain details (including dates) of how the business is achieving or plans to achieve a 25 per cent reduction of water use or best practice.

Best practice can be demonstrated by documenting and justifying why such measures are considered to be best practice. For example, businesses can assess and benchmark their activities and processes against industry accepted key performance indicators or relevant business or industry standards.

Allconnex Water manages the implementation and management of WEMPS in its area of operation for the QWC.

Appendix 2 2010-11 price schedule, 1 July 2010

Document Status

Rev No.	Author	Reviewer	Approved for Issue	Date
0	Kathy Baker	Craig Fenton		
1	Hettie Farrell	Kathy Baker		
2	Kathy Baker	Kathy Baker	Andrew Foley	30/8/10
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