

Irrigation price review 2025-29

**Stakeholder workshops
on draft report –
Burdekin-Haughton**

July/August 2024

Today's session

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Purpose of this workshop

The purpose of today's session is to:

- provide an overview of the QCA's draft report
- provide information to help stakeholders with their submissions
- answer questions about the draft report.

QCA's role

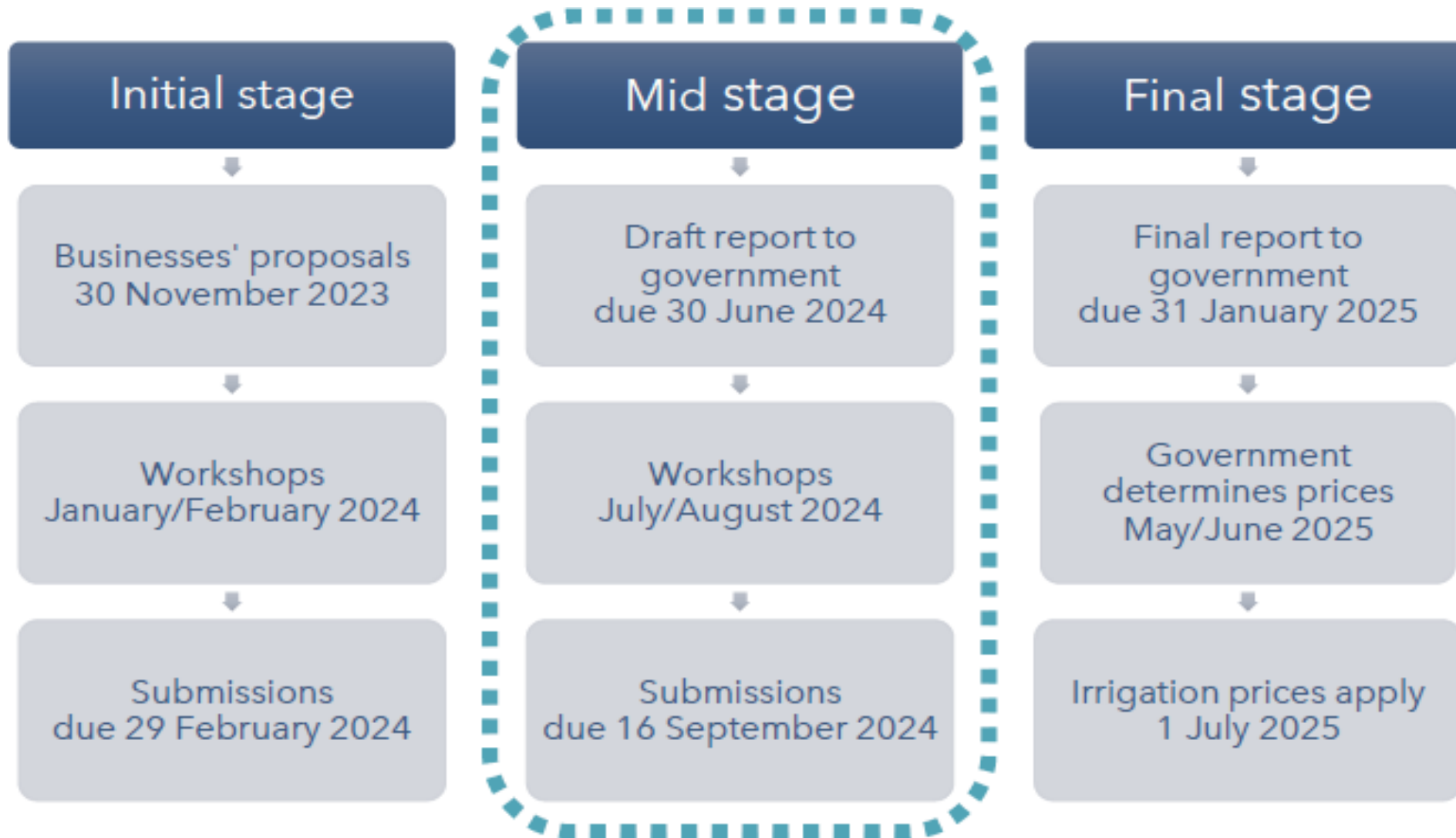
- The QCA is the independent economic regulator for Queensland.
- The Queensland Government can direct the QCA to review and make recommendations about irrigation prices.
- The QCA does not:
 - make water policy
 - determine irrigation prices.
- This review is separate to other reviews undertaken by the QCA (e.g. setting retail electricity prices under the Electricity Act).

Burning issues or questions?

Please tell us your burning issues or questions that you would like us to cover in this session:

- can be general / high level
- can be specific / detailed.

Timeline for the review



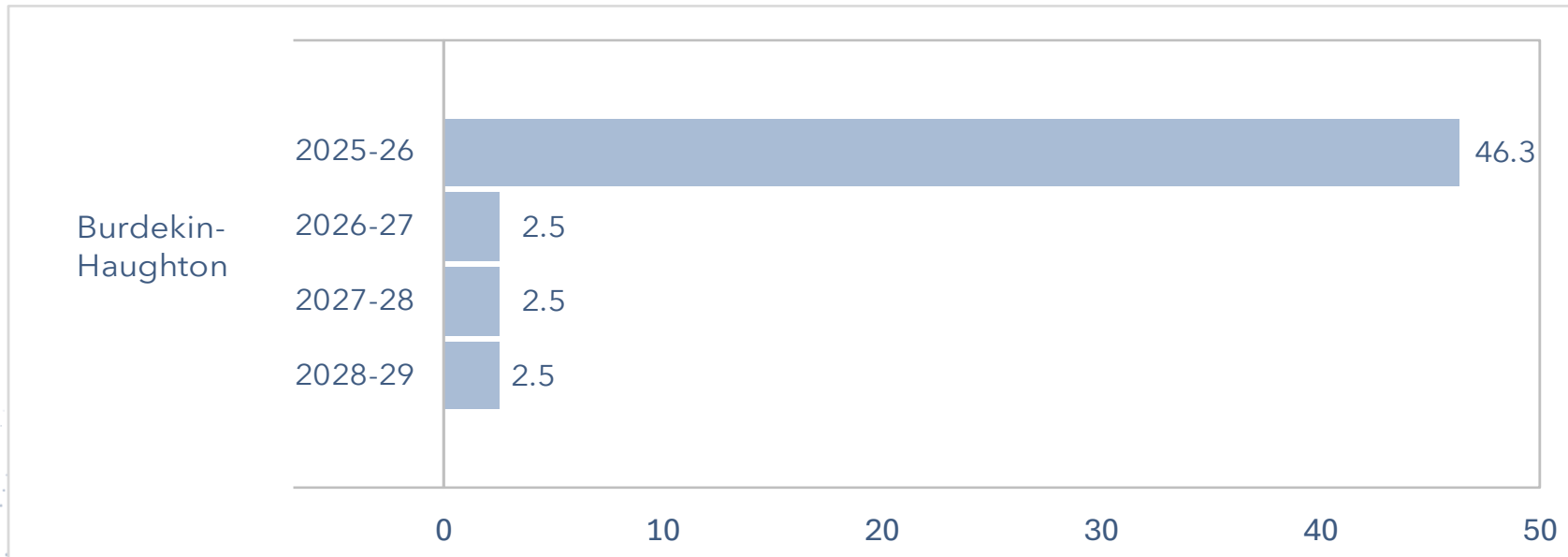
Overview of our draft price recommendations

- Consistent with the requirement in the referral, we applied the government's pricing principles to reach our draft price recommendations.
- The pricing principles constrain the increases required each year to reach the price target for each tariff group.
- The price target reflects the prudent and efficient costs allocated to each tariff group, but excludes allowances for pre-2000 capex and dam safety upgrade capex.
- If prices reach the price target during the price path period, the price target applies for the rest of the period.

Draft price recommendations - Burdekin-Haughton

- Based on our draft price recommendations, we estimated the average change in prices for each year of the price path period from 2025-26 to 2028-29.
- Price changes for individual customers will vary if their water usage differs from the assumed scheme usage (53.1% of WAE for bulk customers).

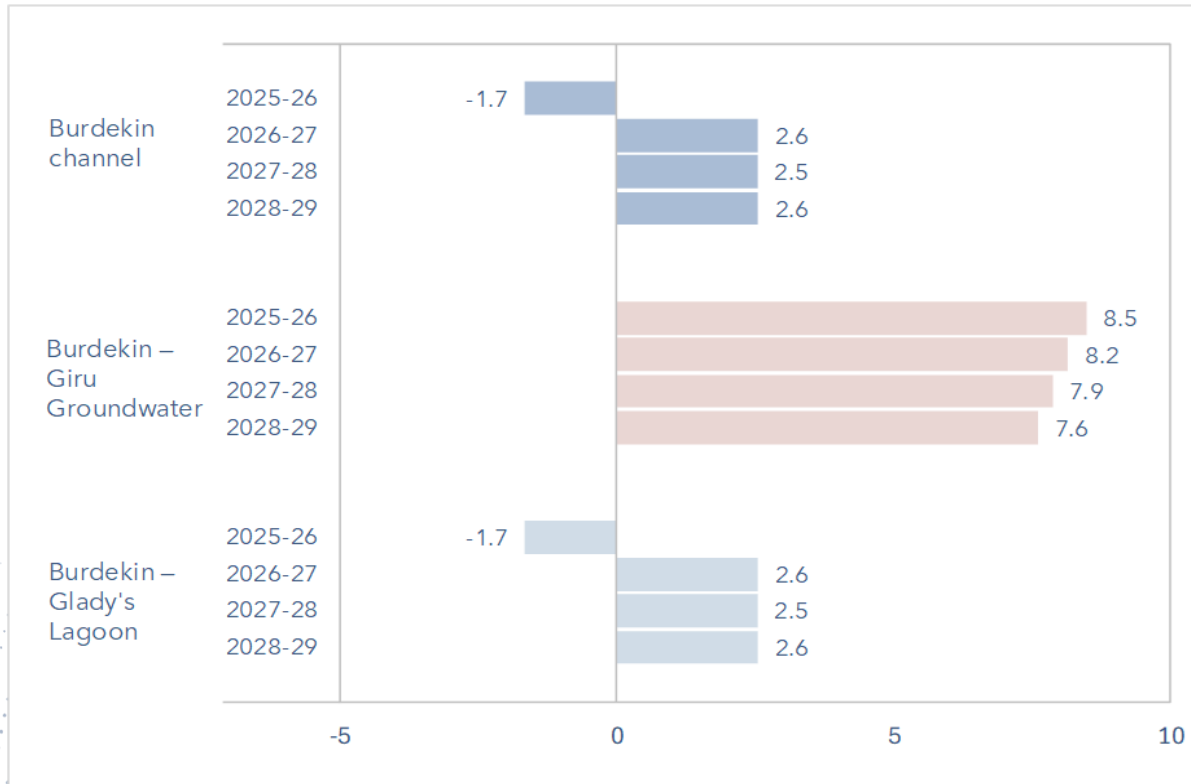
Annual changes in draft irrigation prices, from 2025-26 to 2028-29 (% change)



Draft price recommendations - Burdekin-Haughton

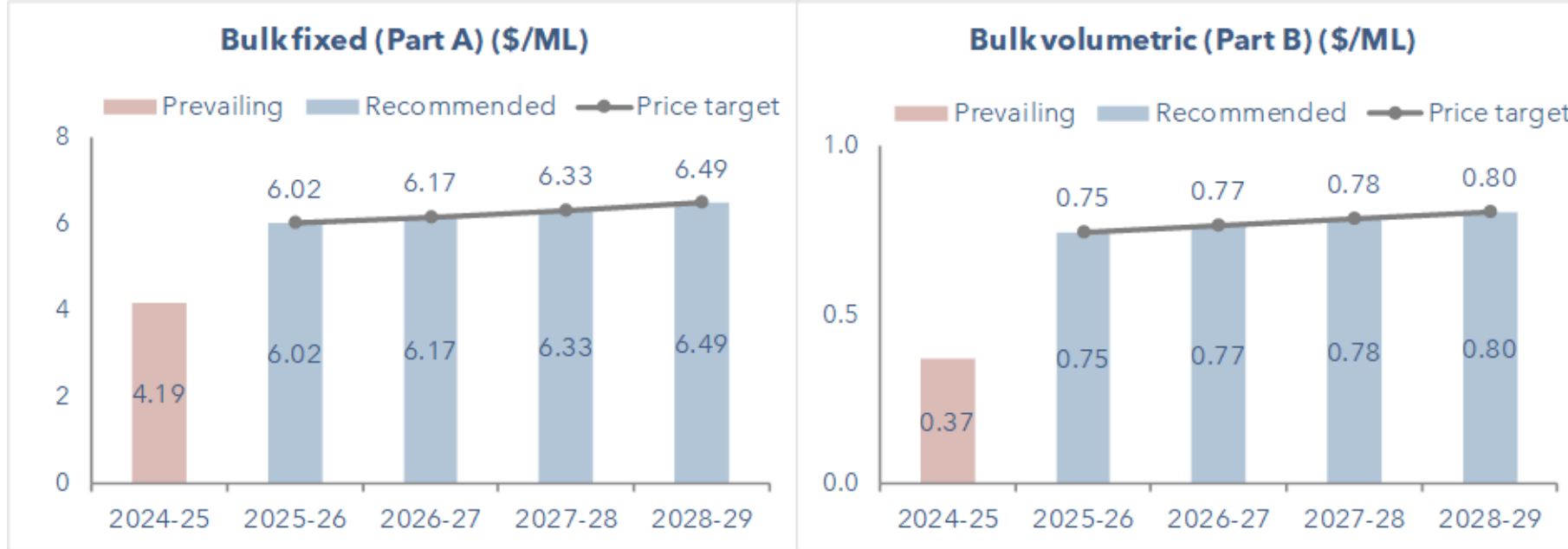
- Based on our draft price recommendations, we estimated the average change in prices for each year of the price path period from 2025-26 to 2028-29.
- Price changes for individual customers will vary if their water usage differs from the assumed scheme usage (62.2% of WAE for distribution customers).

Annual changes in draft irrigation prices, from 2025-26 to 2028-29 (% change)



Draft price recommendations - Burdekin-Haughton

Draft recommended prices – Burdekin-Haughton

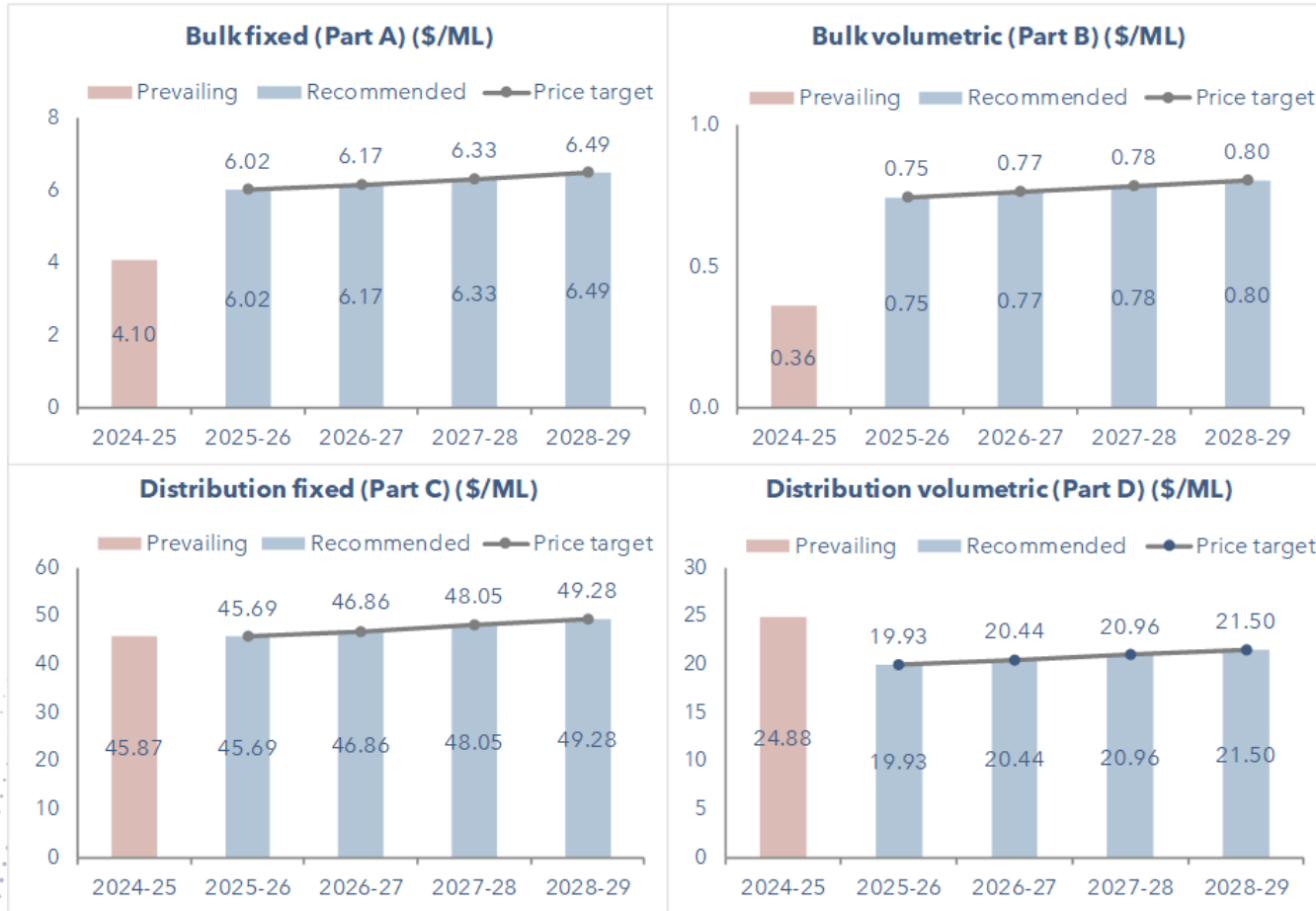


Note: The 2024-25 price is before the 15% discount that Sunwater was directed to apply.

- For the tariff group in this scheme, our draft prices cover allowable costs over each year of the price path period.

Draft price recommendations - Burdekin-Haughton

Draft recommended prices – Burdekin Channel

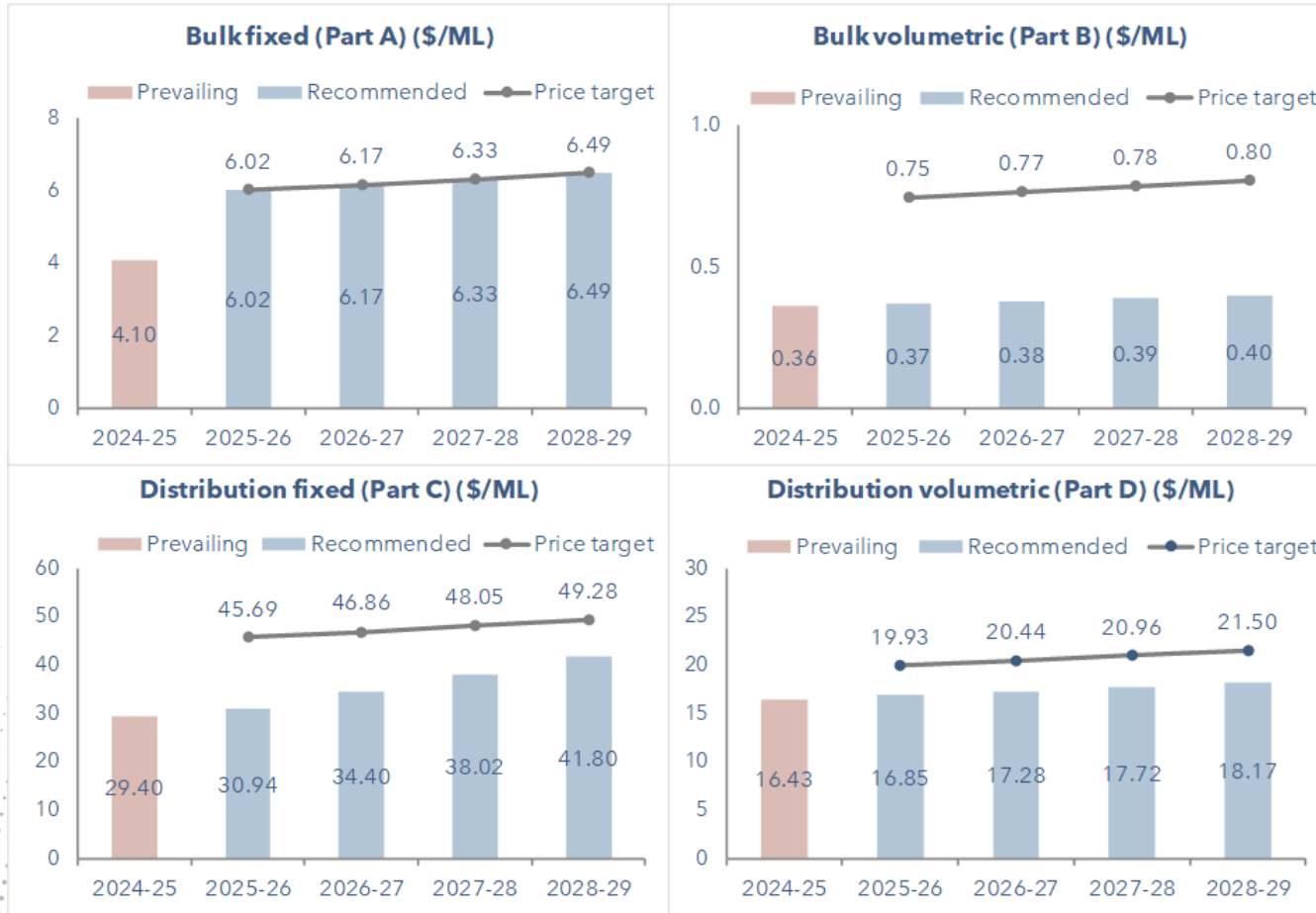


Note: The 2024-25 price is before the 15% discount that Sunwater was directed to apply.

For the tariff group in this scheme, our draft prices cover allowable costs over each year of the price path period.

Draft price recommendations - Burdekin-Haughton

Draft recommended prices – Giru Groundwater

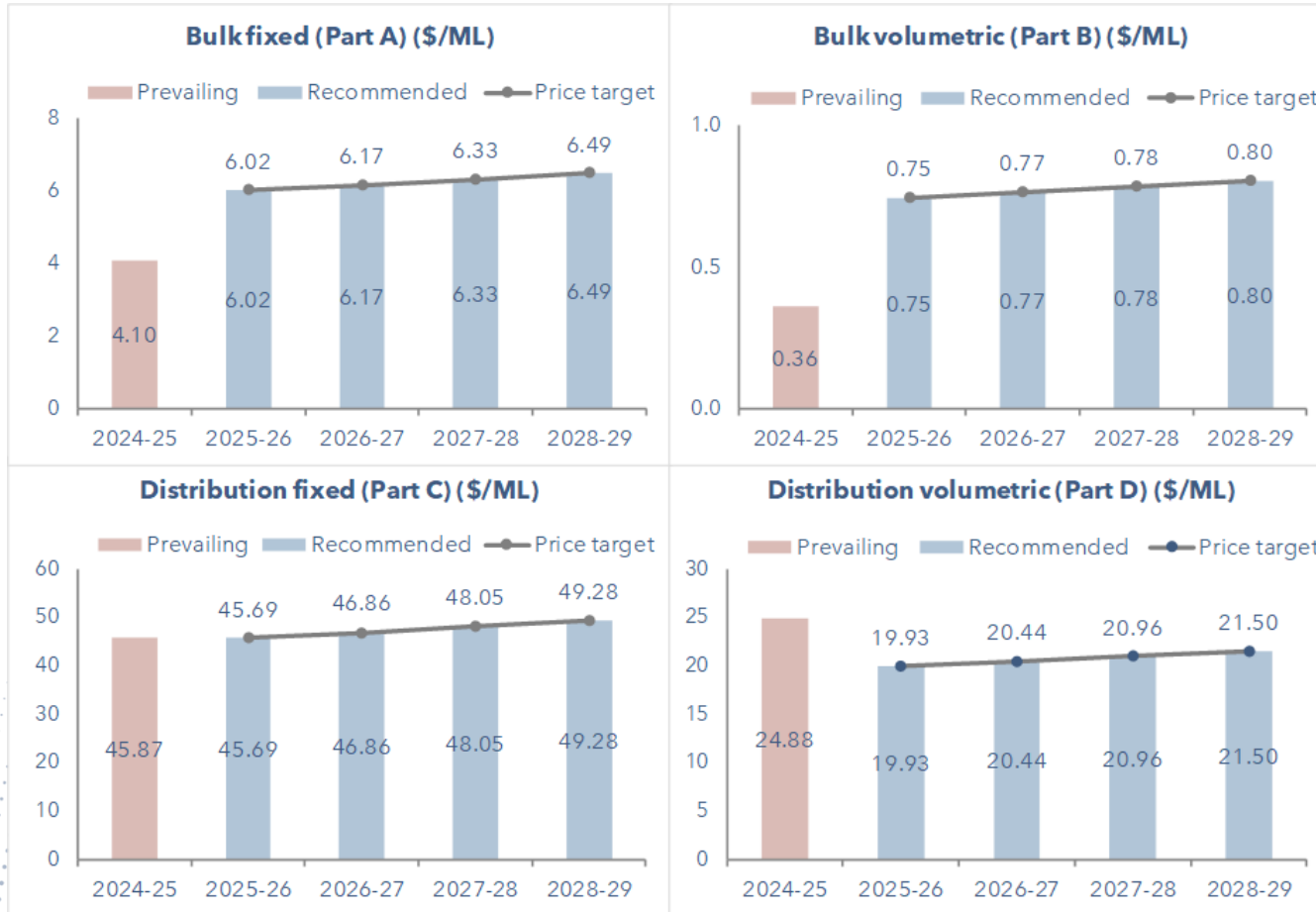


Note: The 2024-25 price is before the 15% discount that Sunwater was directed to apply.

Recovery of allowable costs for this tariff group will increase from 74% in 2025-26 to 86% by 2028-29.

Draft price recommendations - Burdekin-Haughton

Draft recommended prices – Gladys Lagoon (other than Natural Yield)

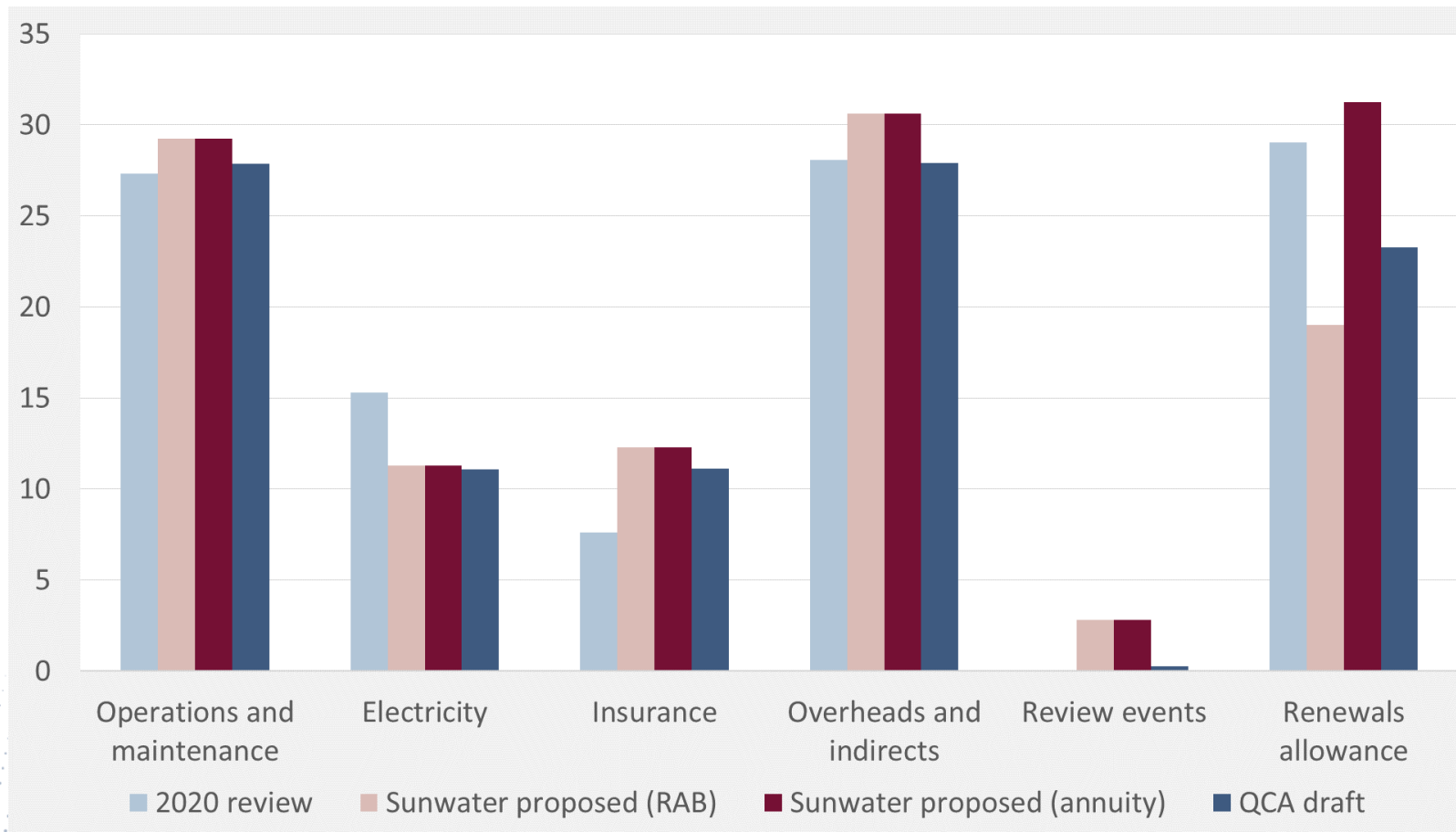


Note: The 2024-25 price is before the 15% discount that Sunwater was directed to apply.

For the tariff group in this scheme, our draft prices cover allowable costs over each year of the price path period.

We propose to reduce Sunwater's proposed costs

Average allowable costs by cost category (\$ million, 2025-26)



Draft position on key cost drivers over the price path period:

- our draft opex allowance is 9.0% lower than Sunwater's proposal
- our draft renewals allowance is 25.4% lower than Sunwater's proposal

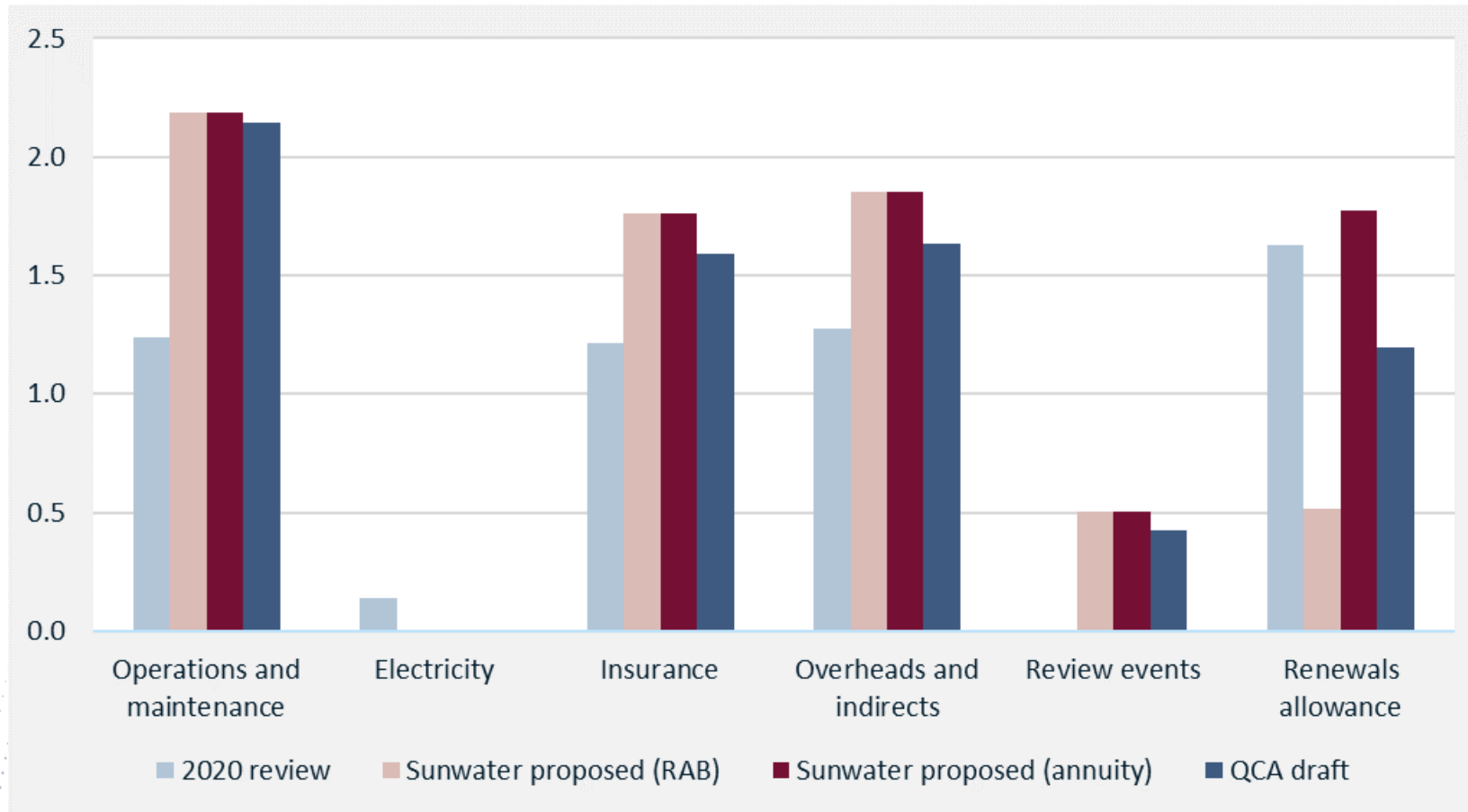
Draft costs - Burdekin-Haughton WSS

Total allowable costs, Burdekin Haughton (\$'000, nominal)

Cost	2025-26	2026-27	2027-28	2028-29
Operations - direct	1,574.7	1,614.6	1,647.0	1,679.9
Operations - non-direct	1,300.9	1,333.8	1,360.7	1,387.8
Maintenance - direct	577.2	591.6	603.5	615.5
Maintenance - non-direct	341.2	349.8	356.9	364.0
Insurance	1,598.4	1,636.3	1,673.1	1,706.5
Electricity	7.2	7.3	7.5	7.6
Review events	425.9	436.9	447.9	459.1
Renewals allowance	1,201.5	1,232.8	1,260.1	1,285.5
Revenue offsets	(6.5)	(6.6)	(6.8)	(7.0)
QCA fee	369.0	378.4	388.0	397.9
Total allowable costs	7,389.4	7,574.8	7,737.9	7,896.9

Draft costs - Burdekin Houghton WSS

Average allowable costs by cost category (\$ million, 2025-26)



Draft position on key cost drivers over the price path period:

- our draft opex allowance is 8.0% lower than Sunwater's proposal
- our draft renewals allowance is 32.3% lower than Sunwater's proposal

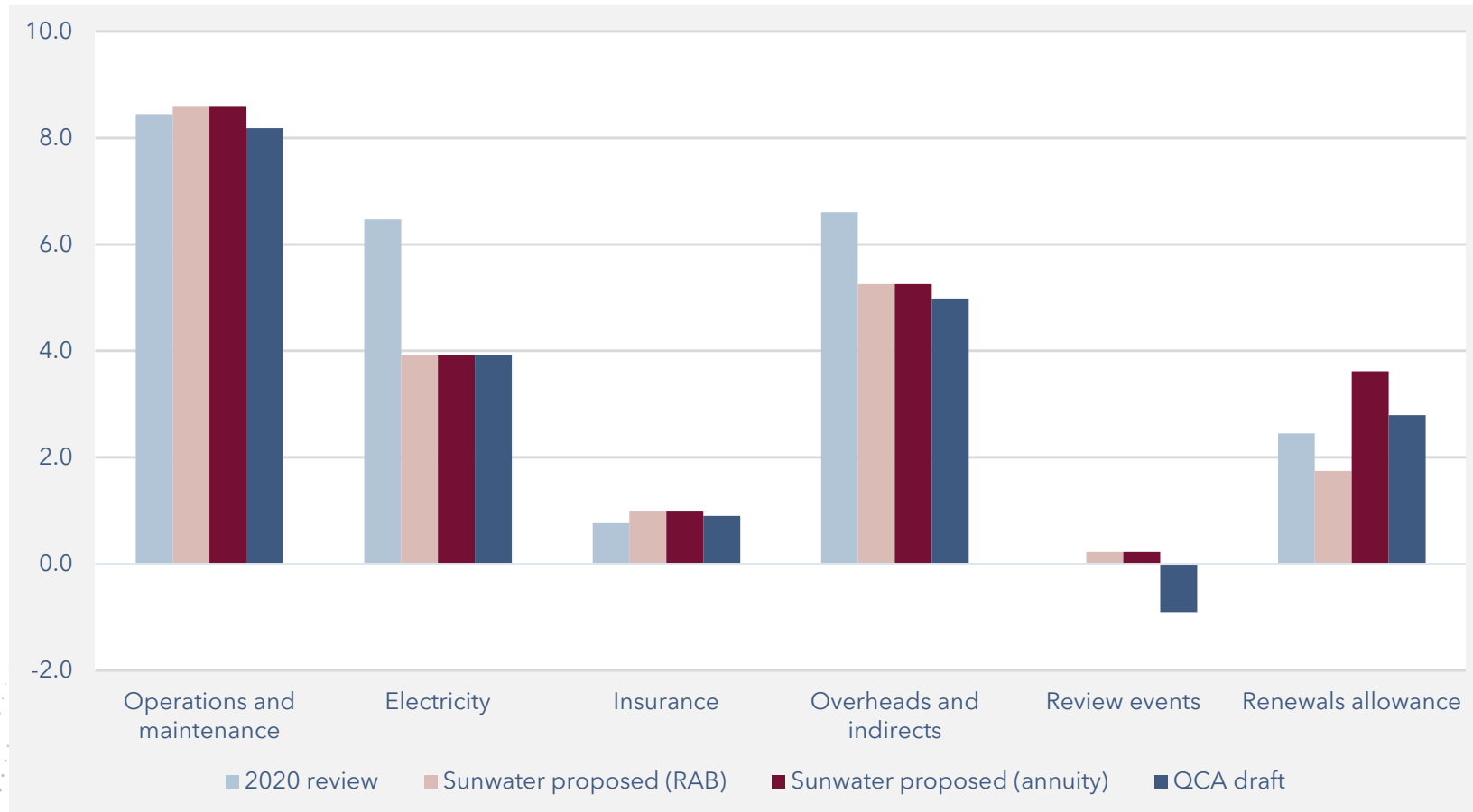
Draft costs - Burdekin-Haughton distribution

Total allowable costs, Burdekin-Haughton distribution (\$'000, nominal)

Cost	2025-26	2026-27	2027-28	2028-29
Operations - direct	2,198.5	2,254.2	2,299.5	2,345.4
Operations - non-direct	2,819.2	2,890.6	2,948.7	3,007.6
Maintenance - direct	1,873.3	1,917.9	1,956.6	1,995.7
Maintenance - non-direct	1,766.9	1,811.7	1,848.1	1,885.0
Insurance	1,525.1	1,561.3	1,596.4	1,628.3
Electricity	5,171.0	5,253.2	5,348.8	5,455.8
Review events	(407.5)	(417.9)	(428.5)	(439.2)
Renewals allowance	2,837.6	2,900.7	2,985.3	3,088.1
Revenue offsets	(3.9)	(4.0)	(4.1)	(4.2)
QCA fee	-	-	-	-
Total allowable costs	17,780.1	18,167.5	18,550.8	18,962.3
Costs transferred to bulk scheme	(59.4)	(60.6)	(61.8)	(63.1)
Total allowable costs allocated to tariff groups	17,720.7	18,106.9	18,489.0	18,899.3

Draft costs - Burdekin Houghton distribution

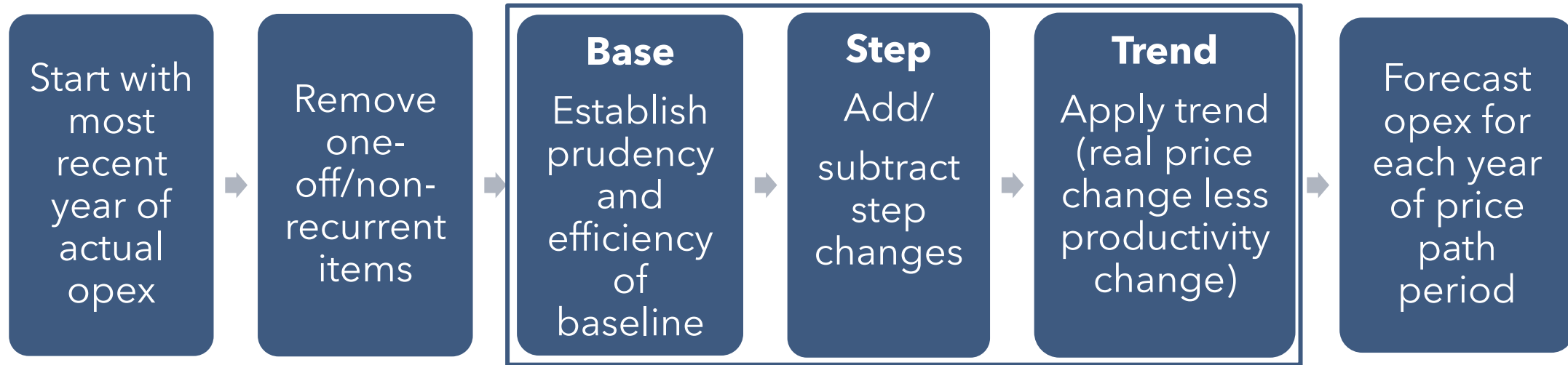
Average allowable costs by cost category (\$ million, 2025-26)



Draft position on key cost drivers over the price path period:

- our draft opex allowance is 10.0% lower than Sunwater's proposal
- our draft renewals allowance is 22.8% lower than Sunwater's proposal

Operating expenditure - assessment approach



- Our approach involved:
 - determining an appropriate baseline level of prudent and efficient recurrent expenditure
 - reviewing material step changes in the efficient baseline
 - ensuring appropriate adjustments for trend growth

Operating expenditure - baseline

- To establish an appropriate baseline (excluding electricity), we:
 - ensure appropriate adjustments are made for one-off or non-recurrent items
 - compare the adjusted baseline with our recommended 2020 review expenditure
 - assess the reasons provided by Sunwater for why the adjusted baseline is higher
 - establish an alternative baseline where Sunwater has not provided sufficient justification.
- Key opex categories that have increased since the 2020 review are:
 - direct labour: we consider there is not sufficient justification for the increase (except for some safety related expenditure)
 - other direct opex: accepted as Sunwater has no control over local government rates
 - overhead and indirect costs:
 - o we consider there is not sufficient justification for the increase in local overheads
 - o direct labour may not be an appropriate allocator of overhead and indirect costs
 - o Sunwater should undertake a comprehensive review of its cost allocation approach.

Review event – insurance and electricity

- Our review of insurance costs indicated that Sunwater has managed insurance costs prudently and efficiently.
- Given this, and as Sunwater’s proposed insurance review event meets the required definition, we accepted Sunwater’s proposed insurance review event.
- However, given significant electricity cost savings in some schemes (Bundaberg distribution, Burdekin distribution and Eton), we also assessed an electricity review event in these schemes.

New billing system

- Sunwater proposed to treat the ongoing costs of the new billing system as a step change to baseline opex but to treat the build cost as capex to be recovered through the renewals allowance.
- We have concerns with Sunwater's proposed treatment of the build cost as it:
 - is inconsistent with Sunwater's classification and allocation of other non-infrastructure (including ICT) capex
 - would require using the headworks utilisation factor to allocate the expenditure between high and medium priority customers which is not appropriate for non-infrastructure costs
- We assessed the build cost and ongoing opex together as a potential step change in corporate overheads.

New billing system - build cost

- We assessed the new billing system to be prudent as the:
 - old system was at the end of its useful life and was being discontinued by the vendor
 - new system would address a range of technical, cyber and regulatory compliance risks.
- However, we found the build cost was inefficient given weaknesses in the management of the project (around options assessment, budgeting, procurement and governance).
- We found a build cost of \$18.5 million (as opposed to Sunwater's proposal of \$38.6 million) to be appropriate.
- This estimate removes costs that could have been avoided with better scoping and reflects the costs of similar implementations for water businesses with the size and customer base of Sunwater.
- We have amortised the build cost over 15 years to be recovered as overheads, consistent with other ICT capex and the approach for the old billing system.

New billing system - net change

- We have adjusted the ongoing costs for operational savings from the retirement of the old system.
- The net annual impact of our adjustments to the build cost and ongoing costs is as below

	\$ million, 2022-23 dollars
Sunwater proposed step change (ongoing opex)	1.4
Reduction for labour efficiencies and other system savings	(0.7)
Net annual impact - ongoing opex (a)	0.7
Build cost (annual annuitised amount)	1.7
Annual savings (in depreciation) from retirement of old system	(2.0)
Net annual impact - build costs (b)	(0.3)
Total net incremental cost across all schemes/contracts (a + b)	0.4
Share allocated to regulated schemes	0.1

- Given this is not a material change, we have treated it as an adjustment to baseline opex

Renewals expenditure - assessment approach

Review governance frameworks and processes to determine whether they:

- (1) are consistent with good practice
- (2) provide appropriate controls
- (3) mitigate potential risks



Review a sample of material projects to:

- (1) test prudence and efficiency
- (2) assess the application of governance frameworks and processes in practice



Review key aspects of the proposal, such as the approach to replacement timing and approach to allocating overhead and indirect costs

Renewals expenditure - governance arrangements

- We consider Sunwater could find efficiencies in asset planning and management by:
 - improving its understanding of asset condition and risk (including by developing an asset health reporting system)
 - developing evidence-based asset lives
 - improving its cost estimation and control processes
 - improving its procurement processes.
- We have asked Sunwater to respond to the draft report with a plan for realising efficiencies in the renewals program.
- We will consider applying an efficiency target to the renewals program if Sunwater does not present a workable and quantified plan.
- We have proposed information reporting requirements to improve the ex post review process for historical renewals.

Renewals expenditure - historical program

- We reviewed a sample of historical projects (25% of the historical program) covering:
 - key asset categories (dams, switchboards, pump stations)
 - a varied geographical area in terms of schemes selected
- Our review confirmed issues with Sunwater's asset planning and management, which have informed our view of efficiencies that Sunwater could achieve in the renewals program.
- We adjusted Sunwater's proposed expenditure to incorporate insurance proceeds in 2019-20 and to reduce overhead and indirect costs allocated to renewals expenditure in 2024-25.

Renewals expenditure - forecast program

- We reviewed a sample of forecast programs covering:
 - programs with significant spend expected
 - key asset categories (dams, metering, switchboards, channels)
- The sample represents 41% of program spend expected over the price path period and 20% of program spend expected over the 30-year planning period.
- We reduced forecast renewals over price path period (20.5%) and planning period (22.4%):
 - From our sample assessment, we removed duplication in the dam safety program and adjusted the replacement timing for metering renewals.
 - We adjusted the appropriate timing of asset replacement in the wider program (we extended the asset life of projects with an assumed life of 20 years by 6 years).
 - We adjusted the level of overhead and indirect costs (reflecting our assessment of the appropriate direct labour component of pre-overhead renewals).

Approach to recovering renewals expenditure

- We assessed Sunwater's proposed regulatory asset base (RAB) approach against the existing renewals annuity approach.
- We support an appropriately designed RAB approach, but the approach should not be adopted alongside Sunwater's current capitalisation policy which expenses a large proportion of renewals expenditure.
- This policy results in large, irregular expenditure being recovered in the year it is incurred, rather than over the multi-year period it provides benefits to customers, resulting in significant price target variability between price path periods.
- In the 2020 review, the QCA recommended that Sunwater undertake a comprehensive review of its renewals expenditure profile that identified appropriate opex and capex treatments under a RAB approach.
- Our draft price recommendations reflect the renewals annuity approach, but we also calculated prices under Sunwater's proposed RAB approach.

Approach to recovering renewals expenditure

- We consider that the RAB approach would generally lead to improved efficiency from:
 - better investment incentives (as Sunwater's revenue would be more closely linked to prudent and efficient capex)
 - more cost reflective pricing (since costs would be recovered over the useful life of the relevant assets)
 - better allocation of risk (since renewals opex would be recovered through the opex allowance and not be eligible for ex post review).
- The RAB approach would also generally lead to improved transparency.

Approach to recovering renewals expenditure

- However, in the form proposed by Sunwater, the RAB approach could:
 - lead to greater price target variability (due to a capitalisation approach that expensed more renewals expenditure than is appropriate for regulatory purposes)
- We encourage Sunwater to undertake a comprehensive review of the opex and capex treatment of renewals to reflect an appropriate capitalisation policy
- An appropriate capitalisation policy would require appropriate adjustments to address short-term transitional impacts on cash flows and price targets
- We expect Sunwater to consult with customers to ensure its approach to managing transitional impacts is informed by outcomes sought by customers

Allocating costs to tariff groups

- We allocated costs between fixed and volumetric tariff components
 - 20% of direct opex assigned to variable
 - electricity cost allocation scheme-specific
- We allocated costs between WAE priority groups using updated headworks utilisation factors (HUFs).

Giru Groundwater: Overview

- Sunwater considered current cost allocation and pricing approach remains appropriate
 - no basis to justify a change in approach
 - unable to provide cost data at the sub-scheme level
 - potential for unintended consequences of different price target for Giru Groundwater tariff group
- divergent views held by stakeholders in Burdekin-Haughton scheme on appropriate pricing approach
- Based on available information, our preliminary view is that:
 - there is no basis in the current water planning and regulatory framework for a discount for Giru Groundwater tariff group to reflect 'unsupplemented yield'
 - price differentiation for Giru Groundwater tariff group not warranted, when all relevant costs are considered
 - Haughton Zone A (including GBGA) remains materially supplemented by water delivered by channel infrastructure

Giru Groundwater: Regulatory framework

- No current government agreement, legislation or policy that provides a basis for us to recognise an amount of unsupplemented yield as 'free' water for Giru Groundwater tariff group
- Under current water plan and ROL, no separate recognition of 'unsupplemented yield' in Houghton Zone A or Giru Benefited Groundwater Area (GBGA):
 - groundwater in GBGA declared to be surface water, and managed as a single resource reflecting hydrological connectivity
 - each allocation is supplemented water
 - same water allocation security objectives for WAEs across the scheme and between zones
- Referral does not specify free water allocations or direct a different pricing approach for these customers

Giru Groundwater: Differential pricing

- Constraints in referral on establishing new tariff groups means we cannot separately define a price for GBGA customers
 - Giru Groundwater tariff group comprises all supplemented WAE in Haughton Zone A - it includes customers in GBGA as well as a small number of customer located upstream along Haughton River
 - referral requires us, in considering new tariff groups, to avoid shifting costs from one customer or group of customer to another within a WSS, in absence of business having significant commercial interest in change and agreement from customers
- We considered whether a different price target should apply for the Giru Groundwater tariff group
 - divergent views among stakeholders on whether price differentiation justified
 - o GBGA stakeholders submitted differences in cost and service levels justify a discount
 - o BRIA said discount for GBGA customers should not be recovered from other channel customers
 - o Sunwater said it cannot provide breakdown of channel costs between sub-schemes, and GBGA likely one of higher cost sub-schemes
- Our preliminary view is that price differentiation for Giru Groundwater tariff group is not warranted, when all relevant costs are considered

Giru Groundwater: Differential pricing

- True estimate of cost to serve Giru Groundwater tariff group customers must include:
 - bulk costs
 - Giru Groundwater tariff group's share of costs of operating and maintaining shared Burdekin channel infrastructure (Tom Fenwick pump station, HMC and HBS)
 - full cost of operating and maintaining infrastructure required specifically for supply of Giru Groundwater tariff group customers (Healey's Lagoon pump station, Reed Beds relift pump station and pipeline, Val Bird Weir, Giru Weir)
 - associated overhead and indirect costs

Giru Groundwater: Differential pricing

- Our initial view - while likely to be some difference in cost and service levels given different nature of operational systems, unlikely to be sufficiently material to justify price discount
 - PFE for channel customers potentially reflects a service difference
 - o Sunwater information indicates no impact on security of supply to Giru Groundwater tariff group customers
 - our assessment of available data suggests that costs for this tariff group (ML of entitlement basis) comparable to other sub-schemes that use HMC system infrastructure (ie. Barratta and Haughton sub-schemes)
- Stakeholder concern pricing approach reflects treatment as part of distribution system
 - prudent and efficient cost of providing service to Giru Groundwater tariff group customers key factor, not the classification of assets

Giru Groundwater: Extent of supplementation by channel system

- We considered whether a cost offset for Giru Groundwater tariff group was warranted on the basis that materially less than 100% of water supplied is sourced from the channel system
- Extent of supplementation of Haughton Zone A by channel system:
 - 2020 review: 95-100% supplemented
 - this review: 97% supplemented
- Haughton Zone A (including GBGA) remains materially supplemented by water delivered by channel infrastructure

Stakeholder concerns about affordability

- We acknowledge customer's concerns about the affordability of irrigation prices.
- We have limited scope to consider or address those concerns, because we are required to recommend prices that are consistent with the government's pricing principles.
- However, our price recommendations may indirectly affect affordability:
 - we ensure that only prudent and efficient costs are recovered through the price target
 - when setting the price target, we have some scope to consider customer preferences.
- It is a matter for the government to provide additional support to address affordability concerns or to meet other policy objectives.

Electricity cost pass-through mechanism

- Stakeholders did not support Sunwater's proposed ECPT mechanism due to concerns about losing the subsidy and complicated tariffs/billing.
- Some stakeholders appear to support an alternative mechanism, such as the one that applied during the ECPT trial.
- Our draft report discusses potential issues with the introduction of an ECPT mechanism, including:
 - compatibility with the pricing principles and the government's aim of keeping prices simple and transparent
 - the rationale for introducing a mechanism with a subsidised price
 - consistency with efficient price signals.
- We did not make any draft recommendations, but we will consider feedback or alternative proposals in response to the draft report.

Review events

- We were directed to make a recommendation about mechanisms to manage material changes in allowable costs outside Sunwater's control.
- In relation to opex risk, our draft recommendation is to:
 - maintain the review event mechanism to address uncontrollable opex risk
 - maintain the current list of review events (electricity, insurance, government policy)
 - clarify the definitions and the criteria for assessing review event applications.
- In relation to renewals and other capex risk, our draft recommendation is to maintain the current approach of undertaking an end-of-period true-up for prudent and efficient costs.

Next steps

- Submissions are due by **16 September 2024**.
- Information about how to make a submission is available on our website: www.qca.org.au/submissions.
- All submissions received by the due date will be considered in preparing our final report.
- The final report is due to the government by 31 January 2025 and will be published in early February 2025.

Questions?

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