



# **Annexure 9 – Regulatory Settings and Revenue Requirements**

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QCA Price Monitoring Investigation – Part 2 Submission

*Public Release*

This Annexure is a key component, and forms part of, the overall Urban Utilities' Part 2 Submission to the Queensland Competition Authority's (QCA) price monitoring investigation for the period 1 July 2026 to 30 June 2030. The Urban Utilities' Part 2 Submission should be read as a whole and, because of the interrelated nature of the subject matter, no part should be read in isolation or taken out of context.

The Executive Narrative provides a summary of the entire Urban Utilities' Part 2 Submission, and this Annexure should be read in conjunction with that narrative.

Amongst other items, the Executive Narrative outlines how this technical Annexure, along with the other Annexures provided with the Part 2 Submission, specifically addresses different elements of the Part 2 Stated Matters of the QCA investigation covering the period FY28–30 (1 July 2027 to 30 June 2030).

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# 1 Introduction

The regulatory framework ensures that Urban Utilities delivers water and wastewater services to an appropriate standard while charging prices that reflect the efficient cost of those services. The framework allows Urban Utilities to recover its efficient costs and earn an appropriate return on its investments.

This annexure sets out our regulatory settings for the FY28-FY30 price monitoring period. These settings provide the framework to establish and adjust revenue requirements and prices for water and wastewater services over the period. The annexure also covers the mechanisms for managing and allocating demand, expenditure and unforeseen-event risks between Urban Utilities and our customers, and the associated adjustments to revenue requirements where these risks eventuate. We look to appropriately balance our expenditure with customer interests and the need to invest to sustain service performance outcomes for customers into the longer-term.

## 1.1 Referral Notice

The referral notice requires the Queensland Competition Authority (QCA) to consider the forecast Maximum Allowable Revenue (MAR). MAR is defined as the prudent and efficient costs of providing water and wastewater services, including:

- a. operating and capital expenditure assessed using Normal Operating Conditions and Forecast Demand
- b. a return on assets (calculated using the Rate of Return x RAB<sup>1</sup>)
- c. a return of assets (Depreciation)
- d. a return on working capital
- e. tax

That effectively assumes a building blocks approach to calculating the MAR.

The referral notice guiding the QCA's review of our revenue settings distinguishes between bulk and distribution/retail costs, where bulk water costs are treated as a 'cost pass-through' item.

## 1.2 Our Approach

Section 2 of this Annexure outlines our regulatory settings including the form of price control we will apply to set and adjust the revenue requirement for water and wastewater services over the FY28-30 price monitoring period.

Section 3 of this Annexure applies the regulatory settings to determine the forecast MAR for the FY28-30 price monitoring period that recovers only the efficient costs of providing our water and wastewater services.

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<sup>1</sup> Regulatory Asset Base

Table 1-1 presents the forecast unsmoothed total MAR for water and wastewater services including bulk water sales and sundry revenue from non-utility services. Table 1-2 presents the forecast smoothed total MAR.

Revenue smoothing has been applied only to water and wastewater services to moderate year-on-year changes in customers' total bills over the price monitoring period. The approach involved a one-off adjustment at the commencement of the regulatory period, to recalibrate the FY28 MAR to manage changes in customers' total bills relative to FY27 accounting for the effect of lower bill increases in FY27 in support of the government's cost-of-living initiative. The smoothing mechanism does not recover the FY27 under-recovery as we have elected not to passthrough in setting the FY28-FY30 revenue requirements. Thereafter, a smoothing factor is used to determine the annual rate of change in the FY29 and FY30 MARs, to ensure a steady movement in customers' total bills over the period. The smoothed revenue recovers the same efficient costs, in net present value terms, as the unsmoothed revenue would. Smoothing changes the timing of cost recovery for customers within the period without changing the total amount recovered. Bulk water sales and sundry revenues are excluded from the smoothing calculation. Smoothed water and wastewater services revenue has been used for calculating forecast water and wastewater prices for FY28-30.

**Table 1-1** Forecast Total MAR with unsmoothed water and wastewater MARs (\$ million, **nominal**)

|                                               | FY28      | FY29      | FY30      |
|-----------------------------------------------|-----------|-----------|-----------|
| <b>Wastewater MAR</b>                         | \$723.6   | \$765.3   | \$825.0   |
| <b>Water MAR (excluding bulk water sales)</b> | \$451.7   | \$477.1   | \$508.8   |
| <b>Bulk water sales</b>                       | \$516.9   | \$537.8   | \$559.6   |
| <b>Sundry revenue</b>                         | \$36.1    | \$37.0    | \$38.0    |
| <b>Total MAR</b>                              | \$1,728.2 | \$1,817.3 | \$1,931.3 |

Source: Urban Utilities

**Table 1-2** Forecast Total MAR with smoothed water and wastewater MARs (\$ million, **nominal**)

|                                               | FY28      | FY29      | FY30      |
|-----------------------------------------------|-----------|-----------|-----------|
| <b>Wastewater MAR</b>                         | \$722.8   | \$770.2   | \$820.7   |
| <b>Water MAR (excluding bulk water sales)</b> | \$434.2   | \$478.5   | \$527.4   |
| <b>Bulk water sales</b>                       | \$516.9   | \$537.8   | \$559.6   |
| <b>Sundry revenue</b>                         | \$36.1    | \$37.0    | \$38.0    |
| <b>Total MAR</b>                              | \$1,710.0 | \$1,823.5 | \$1,945.5 |

Source: Urban Utilities

## 2 Regulatory Settings

This section outlines the regulatory settings that we will apply to set and adjust MAR and prices for water and wastewater services over the FY28-30 price monitoring period. These include:

- the form of price control;
- the revenue and price adjustment process; and
- arrangements to manage unforeseen costs, when they arise during the period.

### Key points

- Consistent with established regulatory practice, the MAR for the FY28-30 price monitoring period will be determined using a building block approach, ensuring that only prudent and efficient costs associated with providing water and wastewater services are recovered. Under this methodology, each building block is assessed and estimated separately.
- The revenue settings outline the discipline that Urban Utilities will apply to constrain our costs within the forecast expenditure requirements. With a few exceptions for uncontrollable costs and external cost inputs, Urban Utilities is focused on fiscal discipline and controlled, efficient expenditure in providing essential services to our customers.
- We will continue our current practice to apply a revenue cap form of control, with separate caps for water and wastewater services. We will continue to apply a demand volatility adjustment mechanism that will operate where actual volumetric water sales revenue varies by more than  $\pm 1\%$  from the expected revenue from volumetric water sales in any year. Any over- or under-recovery beyond this threshold will be recorded and subsequently returned to or recovered from customers through an overs-and-unders mechanism.
- Forecast MAR for water and wastewater services will be smoothed across the price monitoring period to limit volatility in customer bills. We will annually update the forecast MARs to reflect changes in Brisbane CPI and updates to the regulatory cost of debt.
- We will continue our current practice where variations between actual and forecast non-revenue water (NRW) costs in any year will be shared between Urban Utilities and customers on a 25:75 basis. The customer share of any over- or under-recovery will be managed through the overs-and-unders account. This proposed share helps to ensure that we continue to focus on managing NRW as efficiently as possible.
- We will continue our current practice to true-up variance in the regulatory tax allowance where actual capital (cash) contributions deemed as tax assessable income differ from forecast levels. The true-up will be managed through the overs-and-unders account. Separately, the regulatory asset base (RAB) will also be updated at the commencement of the next regulatory period (that is, FY31) to reflect actual contributions and incurred capital expenditure.
- We will continue our current practice to implement cost pass-through provisions to address the financial impacts of unforeseen and uncontrollable events, including regulatory or legislative changes, service standard events, tax events, natural or human-caused disasters, and insurance-coverage events. The pass-through of prudent and efficient additional costs, or avoided forecast costs, will be managed through the overs-and-unders account.

- An overs-and-unders account will be maintained to manage revenue adjustments arising from demand volatility, NRW cost differences, regulatory tax allowance true-ups, and pass-through events. Due to the two-year lag to reconcile actuals, revenue adjustments for FY26 will be trued-up in setting the forecast MAR and prices for FY28-30. Revenue adjustments from FY27 will be considered in the annual update of the forecast MAR through the overs-and-unders account. To minimise bill impacts and avoid delays, revenue adjustment balance from the overs-and-unders account will be incorporated into prices subject to an annual up to  $\pm 2.5\%$  side constraint to limit the incremental effect of revenue adjustments on customer total bills. Any remaining balance at the end of the price monitoring period will be reconciled in the next regulatory period (from FY2031).
- We will continue our current practice to retain the risk associated with controllable expenditure and any input cost escalation that exceeds the forecasts underpinning the forecast revenue allowance. The costs arising from unforeseen events that are within the control of Urban Utilities will not be passed to customers.
- If funding for Olympics-related capital expenditure is secured during FY28-30, the RAB will be adjusted (reduced) to recognise the contribution and the associated impact (reduction) on MAR will be passed through to customers in the following price-setting year. A true-up mechanism will also address any timing differences between funding commitments and expenditure. The resulting impact on prices will not be subject to the side constraint.
- Any variance between actual and forecast bulk water prices reflected in customers' bills in a year will be passed through to customers, without mark-up, either in the next billing cycle (subject to administrative processes) or in the subsequent price-setting year. The resulting impact on prices will not be subject to the side constraint.

## 2.1 Legislative and Regulatory Context

Urban Utilities' water and wastewater services are declared monopoly business activities under the *Queensland Competition Authority Regulation 2018*, pursuant to section 20 of the *Queensland Competition Authority Act 1997* (QCA Act). As a declared monopoly business, Urban Utilities is required to operate consistently with the consumer protection principles that underpin the QCA Act.

Under section 23A of the Act, the Minister referred Urban Utilities to the Queensland Competition Authority (QCA) for a price monitoring investigation. In accordance with section 24(1)(b), the Minister directed the QCA to have regard to a number of Stated Matters, to the extent relevant, in undertaking the investigation. These matters are set out in the referral notice.<sup>2</sup>

In conducting its investigation, the QCA must also consider the matters specified in section 26 of the Act, including the efficient cost of providing services, an appropriate rate of return on assets, the effects of inflation, and relevant social welfare and equity considerations.

Collectively, these legislative requirements are directed toward promoting economic efficiency while recognising broader public interest objectives and the need for regulatory

<sup>2</sup> Queensland Competition Authority. (2025, September). Referral notice. <https://www.qca.org.au/wp-content/uploads/2025/09/referral-notice.pdf>

flexibility. In practice, this means prices should enable recovery of the efficient costs of service provision, including an appropriate return on and return of capital. Prices should also provide efficient signals to customers and service providers regarding water use, investment, and the timing and scale of future network augmentation. In addition, the pricing framework should appropriately allocate risk between customers and the business, supporting both revenue adequacy and incentives for ongoing efficiency.

Regulatory pricing frameworks are inherently limited in their ability to simultaneously achieve multiple, and at times competing, objectives. For example, recovering the full efficient cost of services within a short period may lead to significant bill impacts for customers, whereas extending the recovery period may reduce affordability pressures but defer cost recovery and potentially compromise efficient service delivery. As a result, regulatory pricing decisions require the exercise of judgement to balance these competing considerations. Urban Utilities has applied this judgement with a focus on promoting the long-term interests of customers in submitting the regulatory settings outlined in this section.

Urban Utilities is committed to working with government and other stakeholders to identify funding and cost recovery options (such as loss capitalisation and alternative funding sources for growth expenditure) to further ease bill impacts without undermining the long-term investment our services need. These options will be explored in the coming months with further details to be provided in response to the QCA's draft report in early 2027.

## 2.2 Price control mechanisms

The remainder of this section discusses the following control mechanisms Urban Utilities will apply over the FY28-30 price monitoring period:

- A post-tax building block framework to determine MAR (section 2.3)
- Revenue cap form of price control with separate caps for water and wastewater services and a demand volatility adjustment mechanism to manage water volume demand risk (section 2.4).
- Revenue smoothing to manage bill volatility with annual adjustment of smoothed revenue to account for changes to Brisbane CPI and updates to the regulatory cost of debt (section 2.5)
- Mechanisms to manage the risk of forecasting uncertainty and unforeseen uncontrollable pass-through events accompanied by an 'overs and unders' mechanism (section 2.6).
- Mechanism to manage specific pass-through events associated with Olympics funding and variation in bulk water price (section 2.7).

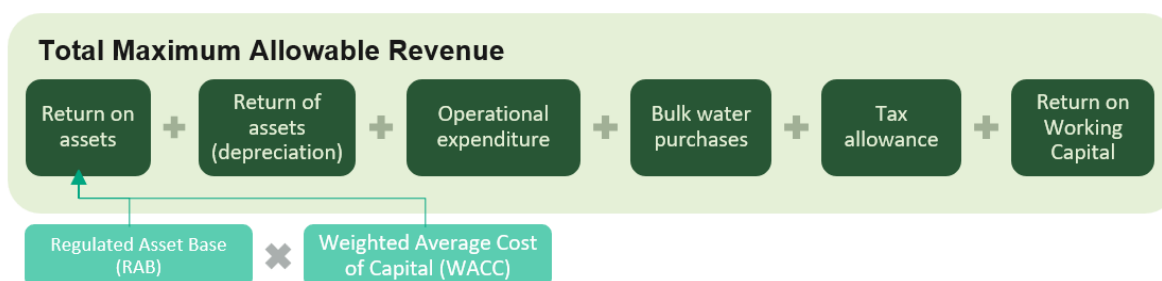
## 2.3 Regulatory building blocks to establish revenue requirement

Consistent with standard regulatory practice, we use a conventional 'building block' methodology to set revenue that recovers only the efficient costs of providing our water and wastewater services. This involves separately estimating the prudent and efficient amount of each underlying 'building block'. Our building blocks, which follow standard regulatory practice, are comprised of:

- **Return on assets**, being the return generated by applying a benchmark rate of return (the weighted average cost of capital – WACC) to the value of the regulatory asset base (RAB). This provides a benchmark allowance for the cost of capital invested in the business.
- **Indexation**, being a deduction that removes the inflationary component embedded in the nominal RAB and nominal WACC. This prevents double counting inflation within the return on assets building block.
- **Return of assets (depreciation)**, being the recovery of capital invested in the RAB over the remaining life of the asset base. This returns the initial capital outlay to investors over time.
- **Operating expenditure**, being our forecast efficient cost for the provision of essential water and wastewater services to our customers.
- **Bulk water purchases**, being the direct pass-through of our cost of purchasing bulk water from Seqwater without mark-up.
- **Tax allowance**, being an allowance for the corporate income tax liability attributable to our water and wastewater services.
- **Return on working capital**, being an amount to compensate for the timing difference between the cash outlays and the receipt of customer revenue.
- **Revenue adjustments**, being adjustments that reconcile actual to forecast revenue from the previous period (correcting for under- or over-recovery) and remove sundry or non-regulated revenue from the building block calculation.

The total MAR is calculated as the sum of these building blocks set, as shown in Figure 2-1.

*Figure 2-1 Setting our maximum allowable revenue through the building block methodology*



Those building blocks reflect the referral notice.

## 2.4 Revenue cap with a deadband to manage demand risk

Economic regulators use a range of price control mechanisms to balance efficient cost recovery, customer price stability, and the allocation of risk between service providers and customers.

A **pure price cap** places limits on the prices a regulated business can charge over a regulatory period. Under this approach, revenue recovery varies directly with customer demand, meaning the business bears most demand risk. This can be particularly challenging for businesses with predominantly fixed costs, where revenues may fluctuate despite little change in underlying expenditure.

A **pure revenue cap** establishes the maximum revenue that a business is permitted to recover. Prices are adjusted periodically to ensure actual revenues align with allowed revenues regardless of demand outcomes. This approach provides greater revenue certainty and reduces demand risk for the business, but transfers that risk to customers through price adjustments.

Recognising the strengths and limitations of both approaches, regulators increasingly adopt **hybrid price control mechanisms** that combine elements of price caps and revenue caps. These hybrid mechanisms retain incentives for efficient forecasting and demand management while providing protection against material demand variations that are outside the business's control. A common example is a revenue cap or a price cap with a **demand volatility adjustment mechanism (DVAM)**, under which price adjustments are only made when demand outcomes differ materially from forecasts.

### 2.4.1 Urban Utilities applies a hybrid control mechanism

We will continue our current practice to apply a revenue cap with a demand volatility adjustment mechanism over the FY28-FY30 price monitoring period.

The revenue cap form of regulation is better suited to Urban Utilities than a price cap because of the nature of our business and cost structure. Our costs of providing water and wastewater services are predominantly fixed and do not vary materially with short-term changes in customer consumption. We must maintain and operate infrastructure assets regardless of whether short-term demand is above or below forecast. Consequently, a price cap would expose us to demand risks that are largely outside our control and unrelated to our cost structure.

Revenue certainty is particularly important as we undertake a significant long-term capital investment program to support population growth, maintain service reliability, and meet regulatory requirements. A revenue cap provides greater confidence that efficient costs can be recovered, supporting financial sustainability and reducing financing risk, while enabling continued investment in essential water and wastewater infrastructure.

A revenue cap is also better aligned with Urban Utilities' objective of managing total customer bill outcomes. Urban Utilities' pricing strategy focuses on affordability, bill stability and minimising impacts on small and vulnerable customers.

In jurisdictions with a vertically separated industry structure (e.g. New South Wales and Victoria), bulk water costs are included in the regulatory cost base used to set prices to achieve total bill outcomes. In those jurisdictions, total bill outcomes can be achieved through a price cap or a revenue cap. However, in South East Queensland the bulk water price is passed directly to customers in bills (without mark-up) and is outside Urban Utilities' control. A price cap on our prices will significantly constrain our ability to manage the total bill outcomes for customers. In contrast, a revenue cap will provide us with important flexibility to rebalance our prices to manage total bill outcome for our customers and set prices to recover no more than our efficient maximum allowable revenue to ensure customers only pay for efficient costs.

## 2.4.2 Demand volatility adjustment mechanism

We will continue to apply a demand volatility adjustment mechanism for the FY28-30 price monitoring period to balance revenue stability, customer price certainty and a reasonable allocation of demand risk.

Under this approach, we set prices annually based on forecast demand. Where actual revenue from the volumetric component of water charges differs from the revenue requirement within any year due to difference between forecast and actual water consumption, the variance in each year is assessed against a deadband threshold. Any over- or under-recovery beyond the deadband is returned to or recovered from customers.

For instance, a 0.5% deadband threshold was implemented in FY25 to account for over- and under-recovery in the absence of regulatory intervention. This resulted in approximately \$0.3 million being returned to customers through pricing adjustments in FY27, with a two-year lag.

From FY26, we will apply a 1% annual deadband threshold to manage revenue over- and under-recovery. Revenue over- or under-recoveries of up to 1% will be retained by or absorbed by Urban Utilities. Where actual volumetric water sales revenue differs from forecast revenue by more than  $\pm 1\%$  within a year, the associated over- or under-recovery will be returned to, or recovered from, customers through future revenue adjustments. That is, Urban Utilities will absorb/retain the first 1% of the variation and only the amount outside the 1% deadband will be recorded in the overs-and-unders account for a true-up. Any FY26 over- or under-recovery will be reconciled when forecast MAR and prices are finalised for FY28-30 (see section 3.1.7 of this Annexure). For FY27 onwards, over- and under-recoveries will be managed annually through the overs-and-unders account.

Urban Utilities considers a 1% deadband to be an appropriate balance between demand forecast risk and customer protection. Water demand in South East Queensland is inherently difficult to predict because it is heavily influenced by factors outside Urban Utilities' control, particularly rainfall patterns, drought conditions and periods of extreme heat (see *Annexure 3 Demand Forecast*). Some level of deadband is therefore necessary to avoid frequent price adjustments resulting from normal and immaterial demand fluctuations.

A 1% threshold ensures customers receive the benefit of timely corrections where revenue outcomes differ materially from those allowed, while still requiring Urban Utilities to bear a reasonable level of normal demand risk and maintain incentives for demand forecasting.

The mechanism is also symmetrical, applying equally to over-recoveries and under-recoveries beyond the deadband threshold. This means customers benefit when revenues materially exceed allowed levels, while Urban Utilities can recover material shortfalls arising from demand outcomes outside its control.

For FY27 onwards, where revenue over- or under-recoveries exceeds 1% within a year, the amount above the deadband will be recorded in an overs-and-unders account. The overs-and-unders account will also be used to manage other revenue adjustments described later in this section. To support bill stability and not delay the true-up, revenue adjustments from the overs-and-unders account will be incorporated into prices subject to an annual up to  $\pm 2.5\%$  side constraint to limit the incremental impact on customers' bills. Any remaining balance in overs-and-unders account at the end of the price monitoring period will be carried

forward and reconciled in the next regulatory period (that is, from FY31). Urban Utilities will provide relevant information on the status of the overs-and-unders account in the annual price monitoring report.

Table 2-1 outlines the application of the deadband mechanism.

*Table 2-1 Revenue adjustment deadband for water volume revenues*

| Under (over) recovery quantum                                 | Proposed adjustment mechanism                                                                                                                                                       |
|---------------------------------------------------------------|-------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| Within +/-1% of allowed volumetric water sales in any year    | <ul style="list-style-type: none"> <li>No adjustment made to MAR</li> </ul>                                                                                                         |
| More than +/-1% of allowed volumetric water sales in any year | <ul style="list-style-type: none"> <li>Over (under) recovery is recorded in the overs-and-unders account for a true-up subject to an annual bill impact side constraint.</li> </ul> |

## 2.5 Revenue smoothing to manage bill volatility

It is common for the MAR derived from the building block approach to vary across a regulatory period, particularly where capital expenditure occurs unevenly over time. While these revenue profiles are designed to recover efficient costs, they can result in volatility in customer bills, which is generally undesirable.

To moderate changes in customers' total bills, we will smooth revenue over the price monitoring period by constraining the MAR to a CPI-X trajectory. Revenue smoothing has been implemented through a **P0 factor** and an **X factor**, which has been determined to achieve the desired revenue profile.

The **P0 factor** provides a one-off adjustment at the commencement of the regulatory period, allowing the first year MAR to be adjusted to manage the change in customers' total bills relative to the previous year's MAR. The **X factor** then governs the annual rate of change in revenue over the remainder of the period, with forecast revenue adjusted each year by forecast CPI and the X factor. By selecting the P0 and X factors, Urban Utilities has sought to manage the timing and profile of revenue recovery to moderate total bill impacts while ensuring that the net present value (NPV) of the smoothed MAR is equal to the NPV of the unsmoothed MAR.

Revenue smoothing affects only the timing of cost recovery and does not alter the total amount recovered in present value terms. This approach provides customers with a more gradual and predictable transition in bills over the regulatory period.

Revenue smoothing is applied only to the Target MAR for water and wastewater services, ensuring that it affects only those revenue components that directly influence customer bills and are within Urban Utilities' control.

The X factor is used solely as a revenue-smoothing mechanism and does not represent expected productivity improvements. Any productivity gains are incorporated directly into the underlying operating and capital expenditure forecasts (refer to *Annexure 4 – Operating Expenditure* and *Annexure 5 – Capital Expenditure* for relevant efficiency details).

During annual updates, forecast CPI will be replaced with actual Brisbane CPI (March quarter-to-March quarter) to maintain the real value of the smoothed revenue allowance. The X factor will be recalculated annually to reflect updates to the trailing average cost of debt, while preserving the intended smoothed revenue profile.

## **2.6 Mechanism to manage uncertainties and unanticipated events**

Urban Utilities bears the consequences of changes in costs it can control. This provides Urban Utilities with incentives to carefully manage its costs and spending.

However, it needs to be recognised that unexpected changes in costs may arise during the regulatory period that are outside the control of Urban Utilities. These are costs Urban Utilities must incur but cannot reasonably influence or avoid through management actions, operational efficiencies, or investment decisions. These costs arise from external factors such as changes in government policies, statutory requirements, global events, market conditions, or other factors outside business direct operational control (e.g. customer behaviour).

This creates an inherent risk that actual outcomes will diverge from forecasts or assumptions used to determine the forecast revenue requirement. For example, Urban Utilities' may incur additional costs or avoid incurring certain forecast costs due to unexpected events beyond Urban Utilities' control (for example, flood related uninsured and unrecoverable costs, additional or reduced costs arising from a change in regulatory or legislative obligation). Given these unavoidable uncertainties, it is common for regulated businesses to incorporate mechanisms to true-up and pass-through costs (or cost savings) in a limited number of circumstances to customers.

Urban Utilities will retain the current practice of managing revenue adjustments through two mechanisms: true-ups and cost pass-throughs.

### **2.6.1 True-ups**

True-ups are used to reconcile differences between the forecasts used in setting revenue requirements and the actual outcomes observed during the regulatory period. We consider true-ups in three circumstances:

- Demand volatility adjustment mechanism discussed above
- Variation between actual and forecast non-revenue water (NRW) costs
- Variation in the regulatory tax allowance where actual capital (cash) contributions deemed as tax assessable income differ from forecast levels.

#### **2.6.1.1 Non-revenue water**

Urban Utilities purchases additional bulk water to allow for NRW which arises due to network leakage, water theft, authorised unbilled consumption (e.g. firefighting) and unmetered sales. NRW is therefore part of our bulk water purchases. At the start of a year, NRW cost is forecast based on forecast NRW volume and bulk water price. The forecast NRW cost is socialised across customers and recovered through Urban Utilities water prices. However, differences between the forecast NRW volume at the start of a year and the actual NRW volume during the year can create a difference between the NRW cost recovered from customers and the actual cost paid to Seqwater (for additional bulk water purchases). The

difference between forecast and actual NRW volumes can arise due to uncontrollable factors (e.g. weather conditions) and controllable factors (e.g. due to efficiency improvements in network operations).

The NRW cost recovered from customers can be greater (or less) than the NRW cost paid to Seqwater resulting in an over-recovery (or under-recovery). Because an over/under-recovery in NRW can arise due to both uncontrollable and controllable factors, Urban Utilities applies a true up with a sharing arrangement to provide incentives for the business to pursue efficiency improvements in network operations to manage NRW efficiently. Typically, regulators allow businesses to retain (or absorb) 20-30% of the benefits (or costs). Consistent with this regulatory approach and practice to balance risks weighted to the party able to control the outcomes, Urban Utilities practice is to share efficiency benefits and costs with customers on a 25:75 basis between Urban Utilities and customers.

For instance, in the absence of regulatory intervention, we returned approximately \$7.9 million to customers through pricing adjustments in FY27 for NRW over-recovery in FY25 (with a two-year lag).

Any FY26 NRW over- or under-recovery will be reconciled when forecast MAR and prices are finalised for FY28-30 (see section 3.1.7 of this Annexure). For FY27 onwards, over- and under-recoveries will be managed annually through the overs-and-unders account.

#### **2.6.1.2 Regulatory tax allowance impacted by variation in capital (cash) contributions**

There can be a material difference between the forecast capital (cash) contributions used in the tax building block and the actual contributions Urban Utilities receives. Urban Utilities is unable to control the level or timing of capital (cash) contributions. This difference in forecast and actual cash contributions can result in a material over or under-estimation of the tax allowance in MAR building blocks (based on forecast contributions) and the tax allowance recoverable from customers (based on actual contributions). Given the difficulty in accurately forecasting contributions due to factors beyond Urban Utilities control, Urban Utilities practice is to true-up the full difference.

For example, approximately \$4.7 million was returned to customers through FY27 pricing adjustments to reconcile an overestimation of the FY25 tax allowance, with a two-year lag. Conversely, approximately \$1.6 million is expected to be recovered from customers through FY28-30 prices in respect of FY26 (see Section 3.1.7.2 of this Annexure). From FY27 onwards, over- and under-recoveries will be addressed annually through the overs-and-unders account.

#### **2.6.2 Cost passthroughs for unknown uncontrollable events**

Urban Utilities applies a cost pass-through mechanism to deal with positive and negative changes in uncontrollable costs (for example, taxes, externally determined service standards and regulatory requirements) that may arise during the price monitoring period.

To establish and assess a cost passthrough, Urban Utilities will demonstrate the following:

- The extent to which the cost trigger arises from:
  - an event that was not reasonably foreseeable at the time of developing expenditure forecasts; or

- a change in circumstances and/or costs that could not have been predicted at the time of developing expenditure forecasts.
- That Urban Utilities has taken reasonable actions to mitigate the risk of the event and/or the impacts of the event on the business.
- The costs are sufficiently material that the costs could not reasonably be met within business-as-usual budget constraints, through prudent prioritisation of expenditures, or be otherwise mitigated.
- The costs have been prudently and efficiently incurred.

Urban Utilities has identified five circumstances where a cost pass-through would apply that are discussed in the sections below.

### **2.6.2.1 Regulatory and legislative events**

Urban Utilities will allow costs arising from new or changed regulatory or legislative requirements to be passed through to customers. These include new reporting obligations, environmental requirements, or safety standards that are imposed externally on the business. Consistent with this approach, approximately \$5 million of regulatory costs incurred in FY26-27 in relation to the QCA price monitoring investigation, which were not included in the FY27 revenue requirement, will be recovered through FY28-30 prices (see Section 3.1.7.1).

### **2.6.2.2 Service standard events**

Urban Utilities will pass through costs associated with externally mandated changes to service standards that increases or decreases the costs to Urban Utilities. This includes:

- varying the way Urban Utilities is required to provide a water or wastewater service;
- imposing, removing or varying minimum service standards applicable to water and wastewater services; and
- altering the nature or scope of the water or wastewater services provided by Urban Utilities.

### **2.6.2.3 Tax events**

Urban Utilities will pass through changes in statutory taxes, levies, or government charges that affect its costs. These include:

- a change in the way, or rate, at which a relevant tax is calculated (including a change in the application or official interpretation of a relevant tax), or
- the removal of a relevant tax or imposition of a new relevant tax

### **2.6.2.4 Natural and other disaster events**

Urban Utilities will treat costs arising from both natural and other disasters as eligible for pass-through recovery. These events include, but are not limited to, droughts, floods, bushfires, terrorist acts, cyber security incident, pandemic or public health event, and other significant disruptions. Such events create extraordinary, unpredictable, and uncontrollable costs that cannot be reasonably forecast or prevented during the pricing process. Only prudent and efficient costs related to such events will be passed through to customers, following an assessment of Urban Utilities' ability to reasonably manage the impact of such costs.

### **2.6.2.5 Insurance coverage event**

Urban Utilities will seek to passthrough costs that are not covered by insurance or are incurred above our insurance policy limit.

### **2.6.3 'Overs and unders' mechanism**

Revenue adjustments arising from true-ups and cost pass-throughs in FY26 will be returned to, or recovered from, customers through the setting of FY28-30 prices, reflecting a two-year lag. This is reflective of typical regulatory practice given that it is only in the year after the over and under-recovery when the extent of the required true-up becomes known.

Revenue adjustments arising between FY27 and FY29 will be recorded annually in an overs-and-unders account and returned to, or recovered from, customers through the annual revenue and price update process during the FY28-30 price monitoring period, subject to a side constraint.

To minimise bill impacts and avoid delays, revenue adjustment balance from the overs-and-unders account will be incorporated into prices subject to an annual side constraint of up to  $\pm 2.5\%$  on the incremental impact of revenue adjustments on customers' total bills. Any remaining balance at the end of the price monitoring period will be reconciled in the next regulatory period (i.e. from FY31 onwards).

Urban Utilities will account for the time value of money (using the nominal weighted average cost of capital) in calculating the revenue adjustment to reflect the opportunity cost associated with the timing difference between when the cost/revenue variance occurred and when it is incorporated in prices.

## **2.7 Specific passthrough events**

Urban Utilities has identified the following two specific passthrough events unique to its circumstances that are beyond its control and need to be passed through to customers without delay and without being subject to the annual side constraint.

### **2.7.1 2032 Brisbane Olympics and Paralympic Games funding**

Urban Utilities' forecast capital expenditure over the FY28-30 price monitoring period includes capital expenditure driven by the 2032 Brisbane Olympics and Paralympic Games (the Games). The Games will need new and upgraded water and wastewater infrastructure to support venues, athlete accommodation and the visitor footprint.

We are responsible for delivering a substantial share of this infrastructure to a non-negotiable deadline. There is currently uncertainty related to Urban Utilities receiving contributions (i.e. government funding and subsidies) towards funding for the Games-related capital expenditure.

We have included a specific passthrough event to account for the Games funding. If funding for the Games-related capital expenditure is secured during FY28-30, the RAB will be adjusted (reduced) to recognise the contribution and the associated impact (reduction) on MAR will be passed through to customers in the following price-setting year. A true-up mechanism will also address any timing differences between funding commitments and

expenditure. The resulting impact on prices will not be subject to the side constraint to ensure the revenue and price impacts are passed through to customers without delay.

For illustrative purposes, we have also modelled an alternative indicative MAR forecast under the assumption that Urban Utilities receives a tax-free government funding to fully fund the Games-related capital expenditure (see Section 3.2.3).

### **2.7.2 Bulk water price**

Bulk water prices are set externally by Seqwater and are therefore not controllable by Urban Utilities.

Any variance between the actual bulk water price and the forecast bulk water price passed directly to customers in bills will be passed through to customers, without mark-up, either in the next billing cycle (subject to administrative processes) or in the subsequent price-setting year. The resulting impact on prices will not be subject to the side constraint to ensure the price impacts are passed through to customers without delay. The impact on NRW due to a variance between actual and forecast bulk water price will be managed through the true-up mechanism for NRW as discussed in section 2.6.1.1 of this Annexure.

### 3 Revenue Requirements

This section applies the regulatory settings to determine the forecast maximum allowable revenue (MAR) for the FY28-30 price monitoring period that recovers only the efficient costs of providing our water and wastewater services.

#### Key points

- Consistent with standard regulatory practice, we use a 'building block' methodology to calculate separate MARs for water and wastewater services for each year of the FY28–30 price monitoring period. This involves separately calculating, for each service, the 'building blocks', described in this section. This approach aligns with the definition of MAR in the Referral Notice.
- For each of water and wastewater services, the relevant building block components are summed to calculate the **Total MAR**.
- Revenue earned from non-utility services, known as the **Sundry Revenue Offset**, is then deducted from the relevant Total MAR to calculate the **Target Water MAR and Target Wastewater MAR** used to set prices. This offset includes revenue from services such as developer application fees, recycled water sales, and special meter readings which are not paid for by our broader customer base. This deduction ensures that customers pay only the net efficient cost of providing water and wastewater services.
- As Seqwater bulk water costs are passed directly through to customers, forecast bulk water sales revenue is excluded from the Target Water MAR to determine the Urban Utilities component of the Target Water MAR (**Target UU Water MAR**), which is used to set Urban Utilities' water prices.
- The unsmoothed Target Wastewater MAR and Target UU Water MAR can create bill volatility for customers, which is undesirable. To address this, we have smoothed the recovery of the revenue stream so that our smoothed revenue recovers the same efficient costs, in net present value terms, as our unsmoothed revenue over the FY28-FY30 period. Smoothing delivers a more predictable bill path for customers over the price monitoring period.
- The smoothed Target Wastewater MAR and Target UU Water MAR are then used to calculate prices to apply for the FY28-30 period, which is discussed in *Annexure 10 - 2028-30 Prices and Bill Impacts*.
- The forecast Total MAR for water and wastewater services for FY28-30 is \$5,479 million (nominal \$) comprising:
  - \$1,440 million for Target UU Water MAR (smoothed)
  - \$2,314 million for Target Wastewater MAR (smoothed)
  - \$111 million for Sundry Revenue Offset
  - \$1,614 million for Bulk water sales
- The forecast MAR includes Olympics-related expenditure. For illustrative purpose, we have shown an alternative forecast MAR if Urban Utilities receives tax-free government funding to directly recover the forecast the capital expenditure. We will adjust the MAR to account for any funding committed for Olympics-related expenditure and pass through the resulting impact (reduction) on revenue to customers.
- The forecast MAR will be updated closer to the start of the FY28-30 price monitoring period to account for, among other things, updated external input forecasts (e.g. inflation, input cost escalators and WACC), changes in bulk water

forecast price, updated demand forecasts, and revenue adjustment events for FY26 and FY27.

Each of the building blocks that make up the MAR are presented in Table 3-1 for water and Table 3-2 for wastewater.

**Table 3-1 Forecast MAR – water services (\$ million, nominal)**

|                                        | FY28       | FY29         | FY30         |
|----------------------------------------|------------|--------------|--------------|
| Return on assets                       | 196        | 208          | 224          |
| Indexation adjustment                  | -71        | -74          | -79          |
| Return of assets (Depreciation)        | 108        | 117          | 129          |
| Operating expenditure                  | 152        | 158          | 164          |
| Return on working capital              | 9          | 9            | 10           |
| Bulk water costs                       |            |              |              |
| - Bulk water sales                     | 517        | 538          | 560          |
| - Non-revenue water                    | 48         | 50           | 52           |
| Tax (net of imputation credit)         | 22         | 23           | 24           |
| Revenue adjustment                     | 2          | -            | -            |
| <b>Total Water MAR</b>                 | <b>982</b> | <b>1,029</b> | <b>1,082</b> |
| Less: bulk water sales                 | 517        | 538          | 560          |
| Less: sundry revenue offset            | 13         | 14           | 14           |
| <b>Target UU Water MAR: unsmoothed</b> | <b>452</b> | <b>477</b>   | <b>509</b>   |
| <b>Target UU Water MAR: smoothed</b>   | <b>434</b> | <b>478</b>   | <b>527</b>   |

Source: Urban Utilities

Note: Totals may not add due to rounding.

**Table 3-2 Forecast MAR – wastewater services (\$ million, nominal)**

|                                          | FY28       | FY29       | FY30       |
|------------------------------------------|------------|------------|------------|
| Return on assets                         | 275        | 294        | 324        |
| Indexation adjustment                    | -99        | -105       | -115       |
| Return of assets (Depreciation)          | 211        | 230        | 254        |
| Operating expenditure                    | 308        | 320        | 333        |
| Return on working capital                | 9          | 10         | 11         |
| Tax (net of imputation credit)           | 38         | 39         | 41         |
| Revenue adjustment                       | 5          | -          | -          |
| <b>Total Wastewater MAR</b>              | <b>746</b> | <b>789</b> | <b>849</b> |
| Less: sundry revenue offset              | 23         | 23         | 24         |
| <b>Target Wastewater MAR: unsmoothed</b> | <b>724</b> | <b>765</b> | <b>825</b> |
| <b>Target Wastewater MAR: smoothed</b>   | <b>723</b> | <b>770</b> | <b>821</b> |

Source: Urban Utilities

Note: Totals may not add due to rounding.

## 3.1 Building-blocks

This section describes each building block that make up the Total MAR for water and wastewater services.

### 3.1.1 Return on assets including indexation adjustment

Urban Utilities requires an appropriate return on investments made in assets used to deliver services. This return is determined using benchmark financing parameters that reflect the costs faced by an efficient service provider. By benchmarking the rate of return to prevailing market conditions, the allowance provides a transparent and stable basis for remunerating investors and supporting ongoing infrastructure investment. At the same time, this approach protects customers by ensuring returns are no higher than those required to efficiently finance the business, balancing stable and affordable prices with sustainable service delivery.

We calculate the return on assets by multiplying the regulated asset base (RAB) by the weighted average cost of capital (WACC). See *Annexure 7 - Regulatory Asset Base* for details on RAB roll forward and *Annexure 8 - Rate of Return* for WACC. As outlined in the RAB annexure, Urban Utilities applies a mid-year convention for recognising new capital expenditure in the RAB. Consistent with this approach, the return on assets calculation includes a half-year return on the net commissioned capital expenditure in the year it is recognised in RAB.

Urban Utilities maintains the RAB in nominal terms and applies a nominal (post-tax) vanilla WACC to estimate the return on assets. To avoid double counting the inflationary gain, we deduct the annual RAB indexation component from the return on assets. This is a standard regulatory practice where a nominal (post-tax) vanilla WACC is used to calculate the return on capital.<sup>3</sup>

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<sup>3</sup> For example, the ICRC and AER both apply a nominal regulatory framework in which the RAB is indexed for inflation and the business earns a nominal return on capital. However, they differ in how they remove the inflationary gain from the building blocks to avoid double counting. The ICRC's approach for Icon Water deducts the annual RAB indexation amount from the return on capital allowance, whereas the AER's approach for electricity distribution businesses deducts inflation from the depreciation allowance by calculating depreciation net of RAB indexation. While the allocation between building blocks differs, the two approaches yield the same outcome on the total building blocks.

**Table 3-3 Return on assets (\$ million, nominal)**

|                                          | FY28         | FY29         | FY30         |
|------------------------------------------|--------------|--------------|--------------|
| Return on assets - water                 | \$196        | \$208        | \$224        |
| Indexation adjustment - water            | -\$71        | -\$74        | -\$79        |
| <b>Net return on assets - water</b>      | <b>\$125</b> | <b>\$134</b> | <b>\$145</b> |
| Return on assets - wastewater            | \$275        | \$294        | \$324        |
| Indexation adjustment – wastewater       | -\$99        | -\$105       | -\$115       |
| <b>Net return on assets – wastewater</b> | <b>\$176</b> | <b>\$189</b> | <b>\$209</b> |
| <b>Total net return on assets</b>        | <b>\$301</b> | <b>\$323</b> | <b>\$354</b> |

Source: Urban Utilities

Note: Totals may not add due to rounding.

### 3.1.2 Return of assets (depreciation)

Regulatory depreciation returns the value of invested capital to Urban Utilities over the economic life of its assets. This ensures that efficient costs are recovered in the periods when customers receive the associated services. Depreciation is calculated on a straight line basis. Further detail is provided in the *Annexure 7 - Regulatory Asset Base*.

**Table 3-4 Return of assets (depreciation) (\$ million, nominal)**

|                           | FY28         | FY29         | FY30         |
|---------------------------|--------------|--------------|--------------|
| Depreciation - water      | \$108        | \$117        | \$129        |
| Depreciation - wastewater | \$211        | \$230        | \$254        |
| <b>Total depreciation</b> | <b>\$319</b> | <b>\$347</b> | <b>\$383</b> |

Source: Urban Utilities

Note: Totals may not add due to rounding.

### 3.1.3 Operating expenditure

Operating expenditure comprises the ongoing costs of planning, operating and maintaining our network to provide water and wastewater services. In contrast to capital expenditure, which is recovered from customers over the economic life of the assets, operating expenditure is recovered in the same year that the costs are incurred. As a result, adequate revenue recovery is required to offset these costs and support the continued provision of essential water and wastewater services.

We have forecast our prudent and efficient operating expenditure requirement (excluding bulk water costs) for the price monitoring period using the Base–Step–Trend (BST) approach. *Annexure 4 – Operating Expenditure* provides a detailed description of the BST approach, the underlying assumptions and the total operating expenditure estimates for FY28-30. The total operating expenditure has been split into water (33%) and wastewater (67%) components using an allocator based on historical and forecast expenditure trends (see *Annexure 4 – Operating Expenditure*).

Table 3-5 presents the operating expenditure requirement for the price monitoring period.

**Table 3-5 Urban Utilities BST operating expenditure (excluding bulk water costs) (\$ million, nominal)**

|                                    | FY28         | FY29         | FY30         |
|------------------------------------|--------------|--------------|--------------|
| Operating expenditure - water      | \$152        | \$158        | \$164        |
| Operating expenditure - wastewater | \$308        | \$320        | \$333        |
| <b>Total operating expenditure</b> | <b>\$459</b> | <b>\$478</b> | <b>\$497</b> |

Source: Urban Utilities

Note: Totals may not add due to rounding.

### 3.1.4 Return on working capital

Working capital represents the short-term funding required to support the day-to-day operations of the business. It reflects the timing differences between when Urban Utilities incurs costs, such as operating expenditure and bulk water purchases, and when it receives revenue from customers.

The return on working capital is calculated by applying the WACC to the working capital balance.

There are two approaches to estimating the working capital balance that have previously been accepted by the QCA:

- **Days-based approach:** This method estimates the working capital balance using assumptions about payment and receipt timings, expressed in days, and applies these to MAR and operating expenditure. This approach is adopted by Seqwater.
- **Working capital facility approach:** This method is based on the balance of the working capital facility that Urban Utilities maintains with the Queensland Treasury Corporation (QTC). This approach is adopted by Gladstone Area Water Board (GAWB).

We have adopted the days-based approach to estimate working capital for FY28-30 period. This is because it produces the lower of the two estimates we considered and therefore is consistent with the regulatory practice to adopt the least cost option to provide an efficient allowance.

#### Days-based approach

The days-based approach reflects the specific billing and payment arrangements Urban Utilities has with its suppliers and customers. It uses inputs of Total MAR, operating expenditure, and bulk water purchases to estimate the working capital balance. The calculation applies assumptions about the number of days between when costs are incurred and when revenues are received reflecting accounts receivable, plus inventory, minus accounts payable, where:

- accounts receivable = total MAR x days receivable (77.5) / days in a year (365)
- inventory = operating expenditure (excluding bulk water) x days in inventory (3) / days in a year (365)

- accounts payable (bulk water) = bulk water costs x days payable (45) / days in a year (365).
- accounts payable (other) = operating expenditure (excluding bulk water) x days payable (30) / days in a year (365).

Under the days-based approach the return on working capital is approximately 1% of Total MAR over the FY28-30 period. In contrast, Seqwater's allowance in the 2022-26 bulk water price review was about 0.6% of Seqwater's total building block costs. The difference primarily reflects Urban Utilities' longer quarterly billing cycle and the additional 30-day customer payment period, both of which increase the time between incurring costs and receiving revenue.

### Working capital facility

An alternative method is to adopt the balance of Urban Utilities' working capital facility funded through the Queensland Treasury Corporation (QTC), which is higher than the working capital balance estimated under the days-based approach. The two approaches converge over time, with both producing similar estimates of working capital balance by 2029–30.

We will continue to monitor both approaches in future regulatory periods and may adopt the working capital facility approach if it results in a lower estimate than the days-based method.

Table 3-6 provides the return on working capital estimate.

**Table 3-6** Return on working capital (\$ million, *nominal*)

|                                                 | FY28 | FY29 | FY30 |
|-------------------------------------------------|------|------|------|
| Return on working capital – days based approach |      |      |      |
| Water                                           | 9    | 9    | 10   |
| Wastewater                                      | 9    | 10   | 11   |

Source: Urban Utilities

### 3.1.5 Bulk water costs

Urban Utilities sources bulk water from Seqwater at prices set by the Queensland Government. Urban Utilities passes on bulk water prices from Seqwater without mark-up and displays this separately on customer bills. As these prices are externally determined, Urban Utilities' focus is on forecasting water demand to estimate total bulk water costs. *Annexure 3 – Demand Forecast* provides detailed description of the demand forecast methodology and the forecasts developed for FY28-30 price monitoring period.

Total bulk water costs are split into two components:

- **Bulk water sales:** Bulk water sales represent the forecast bulk water demand multiplied by the applicable bulk water price. Given that bulk water costs are directly passed through to customers, the primary purpose of forecasting bulk water sales for regulatory settings is to estimate working capital impacts resulting from the timing

difference between the payment of bulk water costs to Seqwater and the recovery of those costs through customer revenues.

- **Non-Revenue Water (NRW)** represents water that is supplied by Seqwater but not billed to customers. This includes network leakage, water theft, authorised but unbilled consumption, such as firefighting, and unmetered usage.

To account for NRW, Urban Utilities purchases additional bulk water. At the beginning of each year, the cost of NRW is forecast based on the expected NRW volume and the applicable bulk water price. The forecast NRW cost is then recovered from customers through Urban Utilities component of water prices. A true-up mechanism is applied to account for the variation between forecast and actual NRW volume (see Section 2.6.1.1).

**Table 3-7 Bulk water costs estimate (\$ million, nominal)**

|                   | FY28  | FY29  | FY30  |
|-------------------|-------|-------|-------|
| Bulk water costs  |       |       |       |
| Bulk water sales  | \$517 | \$538 | \$560 |
| Non-revenue water | \$48  | \$50  | \$52  |

Source: Urban Utilities

### 3.1.6 Tax (net of imputation credits)

Urban Utilities includes a tax allowance in its Maximum Allowable Revenue (MAR) to reflect the notional corporate income tax liability of an efficient commercial business. Consistent with the QCA's post-tax regulatory framework applied to Seqwater and Gladstone Area Water Board (GAWB), the allowance is calculated on a post-tax basis.

The tax allowance is calculated by estimating taxable income, which is equal to assessable revenue less allowable tax deductions. Assessable revenue consists of the total MAR and capital (cash) contributions. Capital contributions are included to ensure that the revenue base used in the tax calculation appropriately reflects income that is assessable for tax purposes.

Allowable deductions comprise tax depreciation, interest expenses, operating expenditure, bulk water costs, and any tax losses carried forward from previous periods. Taxable income is then multiplied by the corporate tax rate of 30% to determine the gross tax liability.

The tax allowance also takes account of the benefits of Australia's dividend imputation system through the application of the gamma parameter. Gamma represents the proportion of imputation credits expected to be realised by investors. Urban Utilities adopts a gamma value of 0.484, consistent with its WACC methodology (refer to *Annexure 8 - Rate of Return*). The value of imputation credits is calculated by applying gamma to the estimated tax liability, and this value is deducted from the gross tax liability in determining the tax building block.

Urban Utilities maintains a Tax Asset Base (TAB) to calculate tax depreciation. The TAB is established using the same underlying capital expenditure, asset disposal, and straight-line depreciation methodology as the Regulatory Asset Base (RAB), ensuring a consistent representation of asset values and their consumption over time.

However, there are two key differences between the TAB and the RAB. First, capital (cash) contributions are deducted from the capital expenditure rolled into the RAB but are not deducted from the capital expenditure included in the TAB. Second, while the RAB is indexed for inflation, the TAB is not subject to inflation indexation.

The opening TAB balance as at 1 July 2014 is based on that submitted during the 2013–15 price monitoring investigation. From this opening position, the TAB is rolled forward annually using the same asset life assumptions adopted in the previous price monitoring investigation, ensuring consistency in the calculation of tax depreciation over time.

Table 3-8 presents the forecast tax allowance for the FY28-30 period.

**Table 3-8 Tax (net of imputation credits) (\$ million, nominal)**

|                            | FY28        | FY29        | FY30        |
|----------------------------|-------------|-------------|-------------|
| Tax - water                | \$22        | \$23        | \$24        |
| Tax - wastewater           | \$38        | \$39        | \$41        |
| <b>Total tax allowance</b> | <b>\$60</b> | <b>\$62</b> | <b>\$65</b> |

Source: Urban Utilities

Note: Totals may not add due to rounding.

### 3.1.7 Revenue adjustments

The revenue allowance for FY28-30 period has been adjusted to incorporate pass-throughs and true-up events that were not included in the prior years' revenue allowance, so are being reconciled in the FY28-30 price monitoring period (see section 2.6 for a discussion on pass-throughs and true-up events).

The revenue adjustment:

- Includes \$5 million (nominal) to pass through regulatory costs incurred in FY26-27 associated with the QCA price monitoring investigation, including both Urban Utilities and QCA costs.
- Includes \$1.6 million (nominal) to true-up the impact of the difference between forecast and actual capital contributions on the tax allowance in FY26.
- Does not yet true-up the difference between forecast and actual NRW for FY26, and the water volume demand adjustment as this actual data are not yet available. We will account for them closer to the start of the FY28-30 price monitoring period.
- Does not pass through the \$50 million (nominal) expected revenue under-recovery in FY27 due to our decision to under-recover revenue in FY27 to support cost of living. However, Urban Utilities cannot continue to bear such under-recoveries into the future and continue to invest sustainably due to the scale of investment forecast over the FY28-FY30 period and beyond.

#### 3.1.7.1 QCA cost of regulation passthrough

Urban Utilities will pass through regulatory costs for FY26-27 associated with the QCA price monitoring investigation, comprising of:

- incremental costs incurred by us to participate in the pricing investigation, over and above our usual practice of budgeting and price setting expenditure. This cost has been exacerbated by the truncated timeline imposed through the referral notice and requirement to submit two Submissions to QCA within a 10-month period.
- QCA's costs for the investigation that will be a passthrough directly to customers in our bills.

The pass through is currently estimated at \$5 million based on our actual and estimated costs for FY26 and FY27, and QCA's forecast costs as advised by the QCA. We have split the cost to water and wastewater services applying the same allocator that has been used to split total operating expenditure between water and wastewater (see *Annexure 4 Operating Expenditure*).

Separately, from FY28, we have included an ongoing forecast step change of \$1m in the operating expenditure allowance to reflect the expected ongoing regulatory requirements for the QCA price monitoring period (see *Annexure 4 Operating Expenditure* for the details on this step change).

### **3.1.7.2 Capital (cash) contributions related true-up**

There can be a material difference between the forecast capital cash contributions used in tax building block and the actual contributions Urban Utilities receives. Urban Utilities is unable to control the level or timing of capital cash contributions. We seek to true-up the impact on tax allowance due to a difference between forecast and actual cash contributions.

The actual FY26 cash contributions of \$126 million is about \$9 million more than what we had forecast in FY26, resulting in a true-up of \$1.6m being the impact on tax allowance of this difference that will be recovered from customers in setting FY28-30 prices.

Separately, the higher contributions in FY26 have also reduced the FY26 capital expenditure that is rolled into the RAB (see *Annexure 7 Regulatory Asset Base*).

### **3.1.7.3 Not passing through FY27 expected under-recovery**

The forecast MAR for FY27 (excluding bulk water sales but including revenue from non-utility services) embedded in our Part 1 submission was \$1,100 million.<sup>4</sup>

Urban Utilities had advised the QCA that our forecasts would be revised to update certain inputs (e.g. inflation, the rate of return and consumption closer to the start of the FY27 pricing period).

The updated resulting forecast MAR for FY27 was higher at \$1,137 million primarily due to movements in the rate of return and CPI inflation that are beyond our control.

However, Urban Utilities subsequently made the decision to under-recover revenue in FY27 to support the government's cost of living initiative with a forecast expected under-recovery of \$50 million.

We are not seeking to pass through this under-recovery to customers. This under-recovery is excluded from the FY28–30 revenue requirement and is not recovered through revenue

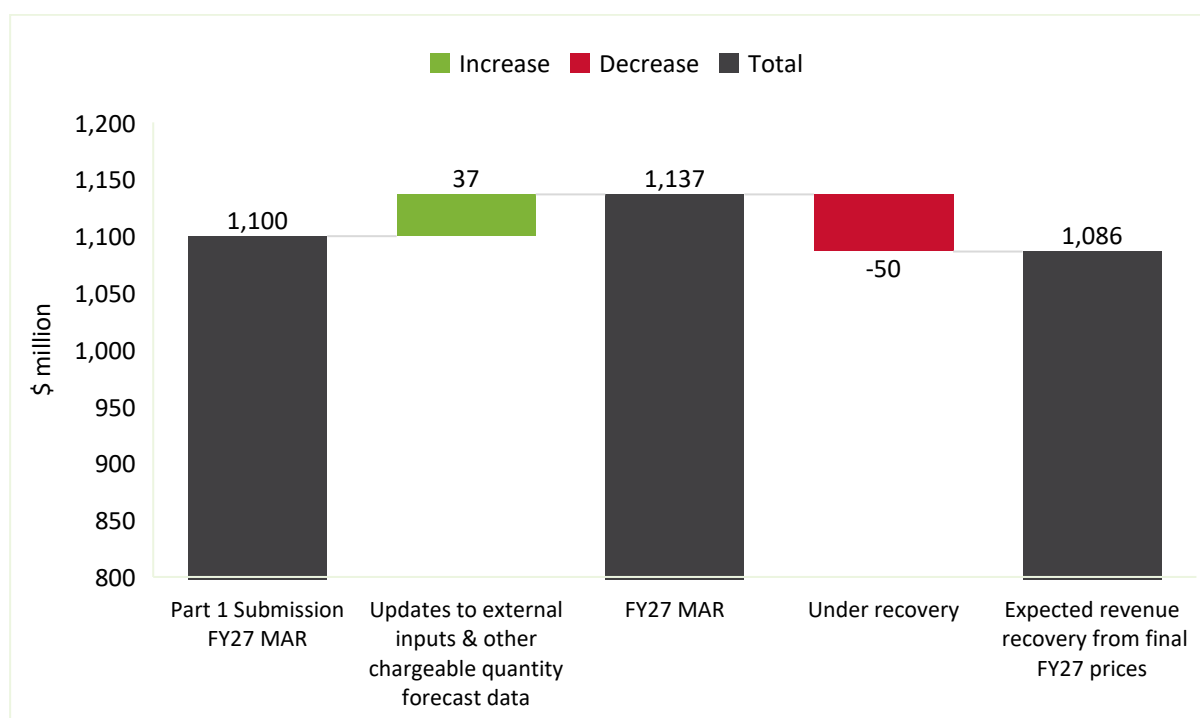
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<sup>4</sup> QCA, Price monitoring review 2026-27: Urban Utilities Interim report, p.26

smoothing. However, we cannot continue to bear such under-recoveries and continue to invest sustainably.

Figure 3-1 shows the updated forecast revenue requirement and the expected revenue recovery. Further detail will be provided in our annual price monitoring periodic report for FY27 as required to be provided under the QCA referral.

*Figure 3-1 Movement in FY27 MAR (excl. bulk water sales) from Part 1 Submission (\$million, nominal)*



Source: Urban Utilities

## 3.2 Forecast MAR

### 3.2.1 Total MAR for water and wastewater

The sum of each of the building blocks gives the Total MAR for water and wastewater services which is presented in Table 3-9.

**Table 3-9 Total MAR (including bulk water sales) (\$ million, nominal)**

|                                                | FY28           | FY29           | FY30           |
|------------------------------------------------|----------------|----------------|----------------|
| Total MAR – water (including bulk water sales) | \$982          | \$1,029        | \$1,082        |
| Total MAR - wastewater                         | \$746          | \$789          | \$849          |
| <b>Total MAR - combined</b>                    | <b>\$1,728</b> | <b>\$1,817</b> | <b>\$1,931</b> |

Source: Urban Utilities

Note: Totals may not add due to rounding.

### 3.2.2 Target MAR for water and wastewater

Revenue earned from non-utility services, known as the Sundry Revenue Offset, is deducted from the Total MAR to calculate the Target Water and Wastewater MARs used to set utility prices.

We provide a range of services known collectively as 'non-utility services' to customers which are separate to 'utility services' (that is, water and wastewater, noting wastewater includes trade waste services).

We set prices for utility and non-utility services annually such that the forecast annual revenue to be recovered from the combination of these services does not exceed the total MAR for the year.

We deduct (offset) forecast non-utility revenues from the Total MAR to determine the Target MAR used in setting utility prices. This revenue offset is known as the Sundry Revenue Offset.

The sundry revenue offset includes but is not limited to developer services water approval application fees and auxiliary services, recycled water sales, other contracts with customers (such as food waste co-digestion, wastewater access charges), special meter reading services and other low-value administrative revenues. While the broader community benefits from Urban Utilities providing these services we deduct the revenue generated through the provision of these services to avoid double counting and ensure our broader customer base does not subsidise these non-utility' services through their bills.

Deducting these revenues from the MAR ensures that only the net revenue requirement attributable to regulated water and wastewater services is recovered from customers through regulated prices.

We forecast sundry revenues using several different methods including bottom-up revenue forecasting based on forecast quantities and prices where feasible, and top-down annual indexation of revenues where detailed revenue forecasting is either impractical or the revenues are immaterial.

Revenue forecasting beyond the one-year pricing period is performed on an indexation basis using the RBA twelve-month June-to-June forecast and is interpolated across a three-year glide path returning to the mid-point of the RBA target band in the fourth year of the forecast period.

We allocate most sundry revenue to water and wastewater by the underlying water or wastewater component (e.g. recycled water revenue is allocated to wastewater). Only a small amount is apportioned on a pro-rata basis.

For water services, we also exclude forecast bulk water sales revenue from the Target Water MAR to determine the Urban Utilities component of the Target Water MAR (Target UU Water MAR), which is used to set Urban Utilities' water prices.

Table 3-10 presents the Target water MAR (Urban Utilities component) and the Target wastewater MAR.

**Table 3-10 Target MAR: unsmoothed (\$ million, nominal)**

|                                                    | FY28           | FY29           | FY30           | NPV            |
|----------------------------------------------------|----------------|----------------|----------------|----------------|
| Target UU MAR – water (excluding bulk water sales) | \$452          | \$477          | \$509          | \$1,254        |
| Target MAR – wastewater                            | \$724          | \$765          | \$825          | \$2,018        |
| <b>Target MAR - combined</b>                       | <b>\$1,175</b> | <b>\$1,242</b> | <b>\$1,334</b> | <b>\$3,273</b> |

Source: Urban Utilities

Note: Totals may not add due to rounding.

### 3.2.2.1 Smoothed MAR (water and wastewater)

We have applied revenue smoothing only to the Target MAR for water and wastewater services. This ensures that smoothing affects only those revenue components that influence customer bills and are within Urban Utilities' control. Bulk water sales and sundry revenues are excluded from the smoothing calculation.

We have smoothed the revenue recovery over the price monitoring period to follow a forecast CPI-X trajectory, with the objective of moderating changes in customers' total bills. Revenue smoothing has been implemented through a **P0 factor** and an **X factor**, which have been determined to manage change in customers' total bills in the first year through to the last year.

The **P0 factor** provides a one-off adjustment at the commencement of the regulatory period and is set to recalibrate the FY28 MAR to manage changes in customers' total bills relative to FY27 accounting for the effect of lower bill increases in FY27 in support of the government's cost-of-living initiative. The **X factor** is used to determine the annual rate of change in the FY29 and FY30 MARs, to ensure a steady movement in customers' total bills over the period. By selecting the P0 and X factors, Urban Utilities is seeking to manage the timing and profile of revenue recovery within the period to moderate total bill impacts while ensuring that the net present value (NPV) of the smoothed MAR is equal to the NPV of the unsmoothed MAR.

Table 3-11 presents the smoothed MARs outputs for water and wastewater services for the price monitoring period.

**Table 3-11 Target MAR: smoothed (\$ million, nominal)**

|                                                    | FY28           | FY29           | FY30           | NPV            |
|----------------------------------------------------|----------------|----------------|----------------|----------------|
| Target UU MAR – water (excluding bulk water sales) | \$434          | \$478          | \$527          | \$1,254        |
| Target MAR – wastewater                            | \$723          | \$770          | \$821          | \$2,018        |
| <b>Target MAR – combined</b>                       | <b>\$1,157</b> | <b>\$1,249</b> | <b>\$1,348</b> | <b>\$3,273</b> |

Source: Urban Utilities

Note: Totals may not add due to rounding.

### 3.2.3 MAR assuming funding for the Games

The forecast MAR includes capital expenditure associated with the Games. We are currently assessing any potential step change in operating expenditure resulting from the Games-related activities, which will be submitted separately (refer to *Annexure 4 Operating Expenditure* and *Annexure 7 Regulatory Asset Base*).

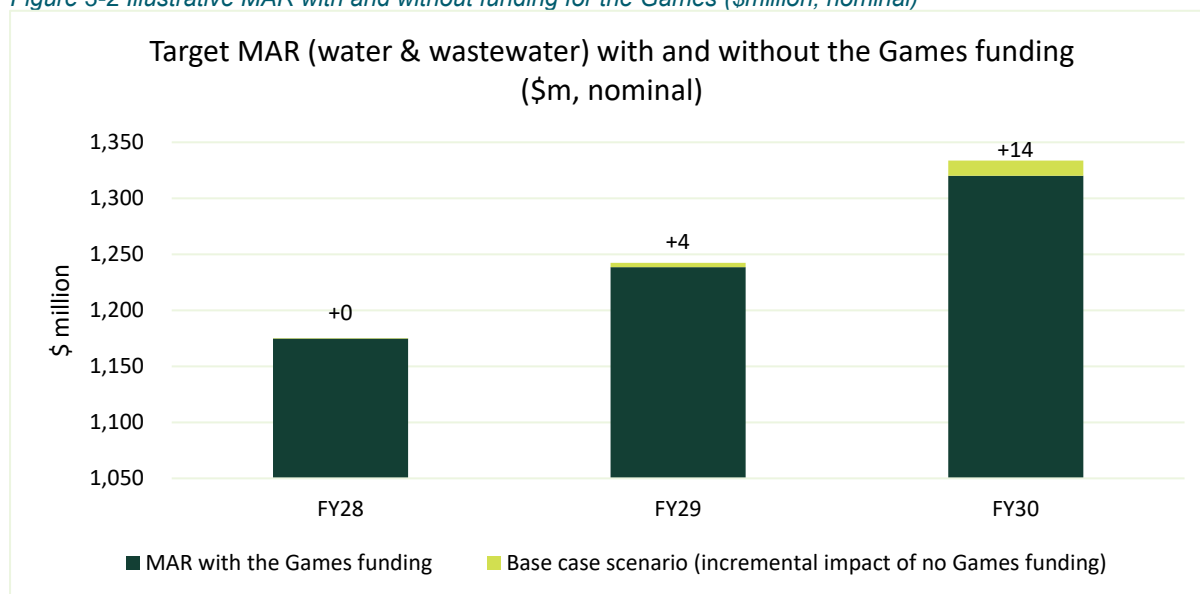
For illustrative purposes, we have also modelled an alternative MAR forecast under the assumption that Urban Utilities receives tax-free government funding to fully fund the Games-related capital expenditure. This funding is assumed to be received progressively and applied to offset the Games-related capital expenditure incurred between FY27 and FY30 that would otherwise be rolled into the RAB.

As capital expenditure is recovered over the useful life of the asset and is typically incorporated into the RAB with a one-year lag, the MAR impact of not receiving such funding increases progressively from FY30 onwards.

As illustrated in Figure 3-2, customers are expected to contribute approximately \$18 million in total over the FY28-30 period in the absence of the funding being received. This contribution is projected to increase to around \$27 million per annum from FY32 onwards.

Should funding for the Games-related capital expenditure be secured during FY28-30, the RAB will be adjusted (reduced) to recognise the funding contribution, and the resulting impact on MAR will be reflected in customer prices in the subsequent price-setting year. A true-up mechanism will also be implemented to address the timing mismatch between funding commitments and expenditure.

Figure 3-2 Illustrative MAR with and without funding for the Games (\$million, nominal)



Source: Urban Utilities

Note: The Target MARs shown in the figure are unsmoothed MARs.

### 3.2.4 Updating MAR before the start of the price monitoring period

The forecast MAR will be updated closer to the start of the FY28-30 price monitoring period considering QCA's view on our Part 2 submission and reflecting updated building blocks to account for:

- updated external inputs (e.g. inflation, input cost escalators and WACC)
- changes in bulk water forecast price
- updated demand forecasts
- updated revenue adjustment events for FY26 and FY27
- updated capital expenditure and capital (cash) contributions forecasts.

## 3.3 Revenue adjustments in the price monitoring period

Potential revenue adjustments that may apply for the FY28-30 price monitoring period are summarised in Table 3-12 arising from annual inflation and cost of debt update to the smoothed revenue, true-ups, cost passthroughs and the specific passthrough events.

*Table 3-12 Potential revenue adjustments for the FY28-30 period*

| Adjustment                                                             | Description                                                                                                                                                                                                                                                                                                                    | Timing of update                                                                                                                                                                                               |
|------------------------------------------------------------------------|--------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| <b>CPI escalation</b>                                                  | Smoothed water and wastewater MARs in FY29 and FY30 escalated by actual Brisbane (March to March) inflation                                                                                                                                                                                                                    | Annual                                                                                                                                                                                                         |
| <b>Cost of debt update</b>                                             | Trailing average cost of debt updated annually and incorporated to update X-factor                                                                                                                                                                                                                                             | Annual                                                                                                                                                                                                         |
| <b>Olympics funding passthrough</b>                                    | If funding for Olympics-related capital expenditure secured during FY28-30, RAB will be adjusted to recognise the funding contribution, and resulting impact on MAR will be reflected in customer prices. A true-up mechanism will also be implemented to address timing mismatch between funding commitments and expenditure. | Subsequent price setting year                                                                                                                                                                                  |
| <b>Bulk water charge passthrough</b>                                   | If actual bulk water price differs from the forecast price passed to customers in bills, the difference will be true-up and passed through to customers.                                                                                                                                                                       | Next billing cycle (subject to administrative processes) or in the subsequent price-setting year                                                                                                               |
| <b>Water demand volume true-up</b>                                     | When actual volumetric water revenue differs from allowable volumetric water revenue by more than the 1% deadband threshold on a yearly basis.                                                                                                                                                                                 | Annual adjustment subject to a side constraint of up to $\pm 2.5\%$ to limit typical bill volatility; maintain unders/overs account with any balance at end of period reconciled in the next regulatory period |
| <b>Non-revenue water true-up</b>                                       | When actual NRW cost differs from the forecast NRW cost recovered from customers, the difference is shared 25:75 between UU and customers.                                                                                                                                                                                     |                                                                                                                                                                                                                |
| <b>Tax allowance true-up</b>                                           | When actual contributions differ from forecast, resulting in an over (under) estimation of regulatory tax allowance.                                                                                                                                                                                                           |                                                                                                                                                                                                                |
| <b>Cost passthroughs for unforeseen events beyond business control</b> | Cost pass-through mechanism to deal with positive and negative changes in uncontrollable costs in the period due to regulatory and legislative events, service standard events, tax events, natural and human-caused disaster events and insurance coverage event.                                                             |                                                                                                                                                                                                                |