

7 August 2024

Chair
Queensland Competition Authority
GPO BOX 2257
Brisbane QLD 4001

Dear Chair,

Gladstone Area Water Board – Price Monitoring 1 July 2025 to 30 June 2030

I refer to your recent notice with respect to the receipt of the proposal by Gladstone Area Water Board (GAWB) for pricing for 2025-2030 and formally submit below Gladstone Regional Council's comments for consideration.

It is noted that this pricing process specifically excludes the Gladstone Fitzroy Pipeline (GFP) project but for clarity and in alignment with Council's long held position, the costs associated with the GFP should not be borne by Council's residential base. It is not residential demand that is triggering the augmentation and its associated costs and these should not be borne by the 23,500 residential connections, whom already pay the highest water consumption costs outside of South East Queensland, prior to any consideration of the forthcoming price monitoring assessment.

Background

Gladstone Regional Council (GRC) purchases bulk water from Gladstone Area Water Board (GAWB) at prices which are monitored (not set) by the Queensland Competition Authority (QCA).

On 14 December 2023, the Treasurer and Minister for Trade and Investment (Minister) directed the QCA to conduct a price monitoring investigation relating to the monopoly business activities of GAWB for the period from 1 July 2025 to 30 June 2030. Subsequently, on 23 May 2024, the Minister amended its direction to exclude the allowable costs associated with the Fitzroy to Gladstone Pipeline from the price monitoring investigation which will instead be considered as part of a separate pricing assessment closer to the date of project commissioning.

Council acknowledges that as an essential service provider, GAWB is obliged to ensure that it delivers bulk water services that are safe, secure, reliable and appropriately priced for the 54,000 residents to whom GAWB is the bulk water provider. Currently Gladstone residents bear the highest cost of bulk treated water in Regional Queensland, following a 52% increase in per kilolitre costs to residents over the recent five year regulatory period to \$2.79 per kilolitre in 2024/2025. Any additional imposts projected within the 2025-2030 regulatory period need to be managed appropriately to ensure that the impact on residential consumers is minimised, particularly within a cost of living crisis that is part of the national and local economic landscape.

The response below has been grouped into applicable sub-headings and has focussed on specific areas of interest and concern rather than undertaking an in-depth assessment of the appropriateness of each and every assumption within the submission and directing the QCA as regulator to areas of concern.

Extent of Price Increases

Council has been advised that the "step change" increase provided for within the GAWB submission is 35%. This directly relates to residential consumers whom under such a scenario would see the cost per kilolitre increase to

\$3.77 per kilolitre (kl). Council's average residential consumption is 308kl per annum, should the submitted prices remain, this would see additional costs of \$301.84 per residential connection on average. This would mean that the per kilolitre rate and associated costs referred by GAWB would have more than doubled from 30 June 2020 to 1 July 2025, with the price moving from \$1.83 per kilolitre to \$3.77 per kilolitre. These significant step changes place additional financial pressures on our residents.

The annual nominal revenue requirement outlined in GAWB's submission (p.112) begins at \$113.43 million in 2025/26 and increases to \$168.17 million by 2029/30. With the step-change in operational expenditure in 2025/26, the indicative average price increase for treated water in 2025/26 versus what would otherwise be charged under current prices subject to indexation is reported by GAWB (p.123) to be significant at between 12% (Yarwun WTP) and 63% (Boat Creek to East End).

It is important to note here that these price increases exclude two significant projects that will further add to the cost base of GAWB in the medium term and further add to the financial impacts felt by GRC's households and businesses, being the Fitzroy to Gladstone Pipeline and the Awoonga Dam Improvement Project.

While GAWB (p.16) indicates that "...water is not a major cost component of its industrial customers...", this is not the case for households and businesses served by Council and appropriate consideration must be given to customer affordability and the potential financial hardship faced by these customers from GAWB's proposed significant price increases. Therefore, the prudence of all aspects of GAWB's submission must be appropriately evaluated by the QCA to ensure household and business impacts are minimised for the Gladstone community.

Operational Expenditure

Actual operational expenditure was slightly below forecast for 2020/21 to 2022/23 but is expected to be well above (~50%) forecast for 2023/24 and 2024/25, with GAWB (p.51) indicating that the significant increases in operational expenditure are due to transitioning to business-as-usual following COVID-19, increases in materials and operating costs and increased business activity associated with new customer requests and support of the emerging hydrogen industry, prima facie it would appear that these new industry costs are related to GFP and should be excluded from the current assessment or at the very least excluded from residential pricing considerations.

In developing its operational expenditure forecasts for the 2025/26-2029/30 period, GAWB has applied a step-change approach to base year (2022/23) operational expenditure of \$30.76 million. This results in operational expenditure forecasts in 2022/23 dollar terms (i.e., excluding indexation effects) which range from \$39.91 million in 2025/26 (an increase of \$9.14 million or 29.7%) to \$44.73 million in 2029/30 (an increase of \$13.96 million or 45.4%).

The following table (sourced from pp.55-73 of GAWB's submission) shows that the most significant step changes in aggregate over the five-year period include \$32.59 million in labour costs, \$5.06 million in insurance costs, \$5.41 million in electricity costs, \$4.04 million in ICT costs and \$3.30 million in QCA pricing investigations costs.

Cost Component	BASE	STEP CHANGES					2025/26-2029/30
	2022/23	2025/26	2026/27	2027/28	2028/29	2029/30	
Labour	\$ 5,937,791	\$ 6,662,545	\$ 6,662,545	\$ 6,662,545	\$ 6,662,545	\$ 6,662,545	\$ 32,587,971
Electricity	\$ 407,633	\$ 419,888	\$ 925,719	\$ 1,416,394	\$ 2,236,801	\$ 5,406,413	\$ 5,406,413
ICT	\$ 807,538	\$ 807,538	\$ 807,538	\$ 807,538	\$ 807,538	\$ 807,538	\$ 4,037,690
Maintenance	\$ 802,158	\$ 272,024	\$ 846,470	\$ 454,202	\$ 403,288	\$ 1,971,564	\$ 1,971,564
Hatchery	\$ 275,359	\$ 275,359	\$ 275,359	\$ 275,359	\$ 275,359	\$ 275,359	\$ 1,376,795
Insurance	\$ 438,570	\$ 688,840	\$ 972,838	\$ 1,295,330	\$ 1,661,758	\$ 5,057,336	\$ 5,057,336
Chemicals	\$ 277,181	\$ 277,181	\$ 277,181	\$ 277,181	\$ 277,181	\$ 277,181	\$ 1,385,905
QCA Pricing Investigations	\$ 102,687	\$ -	\$ -	\$ 746,815	\$ 2,446,769	\$ 3,296,271	\$ 3,296,271
Review of Tariff Structure	\$ 93,352	\$ 326,731	\$ 326,731	\$ -	\$ -	\$ 746,814	\$ 746,814
Total Step Change		\$ 9,142,267	\$ 9,730,084	\$ 11,094,381	\$ 11,935,364	\$ 13,964,663	\$ 55,866,759
Total Operational Expenditure	\$ 30,763,392	\$ 39,905,659	\$ 40,493,476	\$ 41,857,773	\$ 42,698,756	\$ 44,728,055	
% Increase on Base		29.7%	31.6%	36.1%	38.8%	45.4%	

By far the most significant cost increase is associated with labour costs, with the increased costs noted by GAWB (pp.56-57) to be mainly driven by:

- A new remuneration and benefits strategy in response to challenges in recruiting and retaining staff in a tight regional labour market.
- Additional staff members in view of the changing and increasingly complex business and operating environment, including being able to effectively respond to the potential growth from new hydrogen customers in a timely and efficient manner by ensuring sufficient resourcing to allocate capacity, engage and negotiate with customers, plan, and develop new infrastructure and integrate new assets into its network and operations.

GAWB (p.80) has only adopted an efficiency target of just 0.2% per annum in its operational expenditure forecasts, down from the 1% adopted in the current period. Council believes that a higher efficiency target should be applied to controllable costs to encourage GAWB to minimise costs in servicing the Gladstone region.

When incorporating indexation effects, operational expenditure in 2029/30 is forecast to be 77.4% higher than the base year (2022/23) by GAWB (p.81).

	2022/23	2025/26	2026/27	2027/28	2028/29	2029/30
Real Operating Expenditure (2022/23 \$m)	\$ 30.76	\$ 39.91	\$ 40.49	\$ 41.88	\$ 42.70	\$ 44.73
% Increase from 2022/23		29.7%	31.6%	36.1%	38.8%	45.4%
Nominal Operating Expenditure (\$m)	\$ 30.76	\$ 44.23	\$ 48.09	\$ 48.85	\$ 50.99	\$ 54.56
% Increase from 2022/23		43.8%	49.8%	58.8%	65.7%	77.4%

The QCA must consider the prudence and efficacy of the additional operational expenditure incurred by GAWB in 2023/24 and 2024/25 in addition to the step changes proposed by GAWB from the 2022/23 base year, given the cumulative and compounding effect such significant cost increases have across regulatory periods on the Gladstone community. Some of the cost increases appear excessive. In addition, it is important to note that Council also faces challenges in recruiting and retaining staff in a tight regional labour market, as do many other organisations, but attempting to resolve the issue by significantly increasing remuneration expenditure fails to adequately consider the flow-on impacts on customers and community affordability.

Further, Council also questions how much in additional labour costs are forecast to be incurred to meet the demands associated with network augmentation for new industrial customers. Council connected households and businesses should not be subsidising such additional costs through higher prices than those that currently apply.

Capital Expenditure

GAWB's submission (p.86) includes estimated capitalised expenditure during the 2020/21-2024/25 period totalling \$84.16 million versus a forecast of \$173.11 million, reflecting resourcing shortages, the COVID-19 pandemic, and the deferral of the Awoonga Dam Improvement Project.

For the 2025/26-2029/30 period, GAWB (p.88) is proposing a total capital expenditure of \$504.95 million, with just under half for network augmentation and just under one quarter each for risk mitigation and asset replacement. This reflects a 70% increase in the value of the asset base from the estimated roll-forward value of the Regulatory Asset Base (RAB) at the end of 2024/25. By comparison, GAWB (p.40) forecasts contracted volumes to increase from just under 60,000 ML per annum in 2024/25 to around 68,000 ML per annum in 2029/30, up just 15%.

On face value, it appears from the demand forecasts and capital expenditure forecasts that GAWB's capital expenditure on network augmentation to meet the demands of new industrial customers will flow through to considerably higher costs and prices for Council and the region's households and businesses, implying that households and businesses will be subsidising the delivery of water to the new industrial customers versus the prices that currently apply, this needs to be segregated from a pricing perspective.

WACC

GAWB's submission (p.101) highlights a significant increase in the WACC from 4.740% in 2015-20 to 7.875%. Council questions the appropriateness of selected aspects of the WACC, including:

- **Capital Structure** – GAWB's proposal (pp.94-95) to adopt a capital structure of 50% rather than the 60% commonly applied to other water utilities results in Council households and businesses facing higher costs and prices as a result of the existence of large industrial customers. Council believes that for its community to be treated equitably, the capital structure input should be increased to 60% which is more consistent with other regulatory guidance.
- **Cost of Debt** – GAWB's proposal (pp.97-99) to adopt a weighted approach to transitioning to the trailing average is inconsistent with QCA's preferred treatment and should be amended to reflect the preferred treatment of using a simple average. The benchmark gearing assumption applied in the WACC is intended to reflect an efficient long-term targeted gearing level rather than actual gearing levels.

Form of Regulation

With respect to the form of regulation, GAWB (pp.126-128) is proposing to retain a revenue cap approach subject to a plus or minus percentage deadband, but to change the deadband on water delivery revenue to +/- 5% from +/- 10%. Council believes that the current deadband of +/- 10% should be retained.

Revenue from Short-Term Contract Premiums and Over-Runs

GAWB ended up not applying the pricing premiums for shorter term contracts (<20 years) in the 2020/21-2024/25 period and as such there is no surcharge revenue to offset against administration costs in the 2025/26-2029/2030 period.

However, GAWB (p.106) suggests in its submission that any additional revenues it may receive from any applied surcharges on short-term contracts should be retained by GAWB and not refunded to customers in the next regulatory period (as has been previously recommended by the QCA) on the basis that it remains uncompensated for the additional risk attached to short-term contracts.

Council believes that the approach recommended by the QCA remains appropriate as GAWB is already being compensated for its relative level of risk of its customer base via the adopted WACC.

Tariff Review

While GAWB's submission (pp.120-121) does not suggest a change to the tariff structure during the 2025/26-2029/30 period, it does indicate that it will be undertaking a comprehensive review of its pricing structure during the next regulatory period. Council wishes to ensure that a cost-reflective tariff structure remains in place such that Council's households and businesses do not subsidise large industrial users in any manner.

Review Triggers

Review triggers are events that would allow GAWB to adjust water prices during the regulatory period to take account of unforeseen changes or material variations in revenue resulting from changes in demand. In its submission, GAWB proposes no change, with the two review triggers being a force majeure event and drought response measures. If a review trigger event occurs and the costs incurred exceed the materiality threshold of 15% of revenues, they may be recovered through a mid-period adjustment.

However, GAWB's submission (pp.129-131) does propose that QCA consider the appropriateness an alternative qualitative assessment process to replace the materiality threshold that requires the following to be demonstrated:

- The extent to which the 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.

- Reasonable actions have been taken to mitigate the risk of the event and/or the impacts of the event on the business.
- Costs are sufficiently material that the costs could not reasonably be met by an efficient entity operating with business-as-usual budget constraints, through prudent prioritisation of expenditures, or be otherwise mitigated.

Without additional information regarding GAWB's proposal, including the make-up of aggregate revenue and the timeframes around which the trigger event can be identified and adjustments to pricing made, GRC is unable to comment on its appropriateness. However, what can be said is that GRC and the Gladstone community require certainty over pricing outcomes during the pricing periods. In the absence of such information, Council believes that the current review trigger process remains appropriate.

Summary

In summary Council acknowledges that GAWB needs to be appropriately funded to manage its assets and provide its pivotal service to the community however Council has concern about the quantum of the proposed increase that will see a 106% increase in the cost passed through to Council since the end of the previous regulatory period (30 June 2020) and start of the next reset (1 July 2025), along with the segregation of costs between new connections and new demand.

Council looks forward to outworking a mutually agreed outcome that minimises the impact to all customers whilst providing continuity of service. Should you seek further information with respect to any of these issues please contact General Manager Finance Governance & Risk, Mark Holmes on 4970 0700. Should the opportunity present Council would welcome the opportunity to discuss the matter directly with relevant QCA officers.

Yours faithfully



LEISA DOWLING
CHIEF EXECUTIVE OFFICER