Renewals recovery proposal

Changing the way we recover renewals costs through irrigation prices

Renewals expenditure is required to maintain Sunwater's water supply schemes assets so that the standard of service derived from those assets is maintained over time. Sunwater recovers its renewals through an annuity-based approach.

An annuity allowance methodology was a common feature of regulated irrigation service providers' pricing arrangements when Sunwater adopted that approach in 2001. Since that time, other regulated irrigation businesses in Australia have moved away from annuity funding of expenditure. These include:

- State Water (NSW) – transitioned to a regulated asset base (RAB) approach in 2006
- Goulburn-Murray Water (Vic) – ended its annuity approach in 2005
- Southern Rural Water (Vic) – decided to transition from the annuity approach to the RAB approach in 2013
- Lower Murray Water (Vic) and GWM Water (Vic) also use a RAB-based approach.

The Queensland Competition Authority (QCA) addressed this topic at length in its 2020 Final Report, concluding that a RAB-based approach would:

"*reduce the reliance on long-term renewals forecasts, improve transparency by allowing customers to see the pricing impacts of near-term renewals expenditure, and incentivise Sunwater to achieve efficiencies including the flexibility to re-prioritise its expenditure to pursue least cost opportunities.*"

Sunwater has undertaken an assessment of current asset management, cost forecasting and pricing processes. Sunwater agrees that the current annuity-based approach is overly complicated, inefficient and lacking in transparency. This factsheet sets out our proposal to explore a shift to a RAB-based approach.

Customer feedback

To gauge support for the changes we are proposing, we will invite online feedback from all irrigation customers in impacted schemes. We will provide more information on this process in the coming weeks.

If customers indicate they are supportive of this change, this proposal may form part of our submission to the Queensland Competition Authority (QCA) for the Irrigation Price Path 1 July 2025 to 30 June 2029 price period.

The QCA will review the proposal in line with its requirements under the *Queensland Competition Authority Act 1997* and any conditions set out in a Referral Notice, before making a recommendation back to the Queensland Government.

Current recovery of renewals

Sunwater currently recovers its renewals through an annuity-based approach. An annuity works by taking an uneven time-series of future expenses and turning it into a constant yearly payment over the same period. In Sunwater's case the annuity captures both capital and operating expenditure associated with our renewals program and is calculated annually on a rolling basis using a 30-year expenditure forecast.

Sunwater's irrigation prices are currently set to recover a lower bound revenue allowance, which gives us the revenue we need to fund the operation, maintenance and renewal of our assets. That lower bound revenue allowance currently comprises two primary building blocks:

1. an operating expenditure building block
2. a renewals expenditure building block, in the form of an annuity allowance.

Proposed future state – a regulated asset base (RAB) recovery

This proposal introduces and outlines a possible change in the renewals expenditure building block **from** an *annuity allowance* **to** an *allowance based on a regulated asset base (RAB) methodology*.

A RAB approach separates operating expenditure and capital expenditure and turns capital expenditure into a sequence of repayments over the life of the asset, like paying down a mortgage. A RAB represents the total of all the individual capital investments a business has made to provide a regulated service, not the replacement costs of the assets. Each year a depreciation amount is deducted from it, while the value of any new capital expenditure is added to it.

Sunwater's irrigation prices would continue to be set to recover a lower bound revenue allowance, giving us the revenue we need to fund the operation, maintenance and renewal of our assets. That lower bound revenue allowance would comprise three primary building blocks:

1. an operating expenditure building block
2. a borrowing cost building block
3. a renewals capital "return of" (or depreciation) building block.

This proposal is NOT a change from a lower bound revenue allowance or pricing.

	Features of annuity approach	Features of RAB approach
Price setting for a 4-year period	Requires a 33-year forecast Costs and prices are misaligned	Requires a 4-year forecast Costs and prices are aligned
Confidence in/ accuracy of forecast	We have a high degree of confidence in what we will do and what it will cost over the first four years' time Our confidence decreases, and uncertainty increases materially from years 5 to 33	We have a high degree of confidence in what we will do and what it will cost over this time
Effort	Sunwater expends considerable time and effort in developing long-term forecasts that are ultimately refined and revisited multiple times before they get to project definition and delivery stage	Sunwater's time and effort is focused on the near term – defining and delivering projects
Transparency	What customers pay for, over the price path, is not well aligned with what Sunwater is doing to deliver your services over the price path period	Customers pay for renewed assets that are contributing to your service today You don't pay for something that may (or may not) happen in 30 years' time

The full proposal on transitioning to a RAB will be presented as part of our Stage 2 engagement roll out and made available online following customer meetings. This will include the different pricing outcomes in your scheme of the annuity and a RAB-based methodologies.

Some key terms

Term	Definition
Weighted average cost of capital (WACC)	The rate of return a "typical" or "benchmark" business may earn on its investments. In simple terms, it is like the interest a bank earns on its investment in your home. It considers the money it loans you an investment and needs to make a return on that investment. The rate of return is Sunwater's return on its investments and the WACC is the method that regulators typically use to determine what a reasonable rate of return is. The rate of return is a critical input for calculating Sunwater's revenue allowance for both the annuity and RAB methodologies
Regulated asset base (RAB)	Represents the total of all the individual capital investments a business has made to provide a regulated service, NOT the replacement costs of the assets Each year a depreciation amount is deducted from it, while the value of any new capital expenditure is added to it
Borrowing cost building block	Effectively the amount Sunwater earns via prices on its investments (i.e. the pump stations, channels, weirs etc that Sunwater has "renewed") Calculated as the WACC multiplied by the value of the investment (i.e. an individual asset, or a bundle of assets in the form of a RAB) Importantly, Sunwater does NOT set its own rate of return – we provide an estimate (according to the QCA's methodology) and the QCA sets the final rate
Capital "return of" (regulatory depreciation)	In regulatory terms, depreciation is the allowance a business receives from its customers (via prices) to pay off the principal component of its investment. Typically calculated as the value of the original investment divided by the assumed useful life of the asset. For example, if the asset was worth $20 million, and the remaining life of the asset was 20 years, then depreciation would be $1 million.

Customer engagement

Sunwater is committed to proactive and ongoing engagement with customers and acknowledges the feedback we have received over the past few years. We are rolling out a three-stage engagement plan to share information on our Irrigation Price Path 1 July 2025 to 30 June 2029 draft future prices, as well as:

- refreshing Service & Performance Plans
- how Sunwater recovers its renewals costs through prices
- a permanent electricity cost pass-through mechanism in seven relevant schemes.

We are holding customer forums in regional centres and providing all relevant forum details and information materials online at www.sunwater.com.au/projects/price-path

Stay informed

We will update our website as the project progresses.

www.sunwater.com.au/projects/price-path

Get in touch

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