Water Team
Essential Services Commission
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Assessing the Financeability of Victorian Water Businesses

I refer to the consultation paper released by the Essential Services Commission (ESC) December 2013 seeking feedback to the way the ESC undertakes financeability assessments of Victorian Water Corporations. Goulburn Valley Water (GVW) is pleased to provide comments in relation to the specific matters raised in the consultation paper.

1. Should there be an adjustment to financeability assessment to account for government ownership of the Victorian water businesses.

GVW agrees with NERA's view that there should not be an adjustment to financeability assessments to account for government ownership. Water Corporations are Government Business Enterprises required to trade as financially independent of government with independent balance sheets that are expected to maintain an investment grade credit rating over time.

2. Should any adjustment to prices (for financial viability reasons) be implemented on an NPV neutral basis?

GVW agrees with the principle that adjustments to price should be implemented on an NPV neutral basis. However, we qualify this view based on the term of the NPV calculation and individual circumstances arising to warrant the price adjustment. Each case would need to be assessed individually with NPV neutral price adjustments as the starting position.

3. Are the indicators and ranges currently applied appropriate for financeability assessments for water businesses?

GVW believes the indicators and ranges currently applied by the ESC are appropriate. They are consistent in form and range with indicators used by other regulators in Australia and overseas. However all stakeholders need to understand (and accept) the ramifications of estimating and approving prices based on the ESC's building block model, and using the current indicators (and ranges) to guide fianceability assessment.

The outcome of the current approach is that debt will (in some cases dramatically) increase over the medium term. All stakeholders need to recognise this because of wider implications for Government. The increase in debt may be difficult to influence by management and the board. It can be driven by regulation, and the ESC's building block model used to estimate and approve prices.

GVW understands that the building block model is outside the scope of this consultation paper, and note that this will be reviewed in a separate process. An outcome of the current model can be a water business with lowest quartile prices for customers, but debt rapidly increasing. This situation could arise if, for instance, opening regulatory asset values were set too low. We look forward to being able to contribute to a review of the building block model.

4. Is the Commission's focus on interest cover appropriate? Should the Commission weight or prioritise the indicators for the purpose of financeability assessment?

GVW believes the focus on interest cover and other cash flow based indicators is appropriate. Weighting of the various ratios is not required because they all need to be considered, and different circumstances may change the emphasise on various ratios. In GVW's case, the internal financing ratio is important as it highlights the businesses reliance on debt to fund capital works. We have an obligation to provide services in perpetuity, and therefore we are obliged to renew existing assets. At some point in time, internal financing ratio must get to greater than 1.0 (excluding any significant growth assets from capital expenditure). As gearing and interest rates increase, the interest cover ratio may become the priority.

5. Are there any profit measures (other than statutory profit) that are not beholden to individual businesses' accounting policies or different application of the accounting policies between businesses?

GVW is not aware of any profit measures suitable for inclusion for the purpose of financeability assessment. Financeability assessment should be based on cash. Profit measures incorporate non-cash items such as depreciation, non-cash revenue items (for example gifted assets) and accounting concepts such as provisions.

6. If the Commission were to consider using profit, should the approach be symmetric, potentially increasing prices where profits are low and decreasing prices were profits are high?

As stated above, GVW does not believe measures of profit are relevant for the purpose of financeability assessment. If profit were considered, then significant non-cash items, and the movement in non-cash items from year to year would need to be considered. The impact of various accounting standards on different businesses within the water industry (for instance for profit versus not for profit businesses) would also need to be considered because the impact on reported profit can be significant.

7. Should the Commission make adjustments for operating leases, superannuation obligations or capitalised interest in any financeability assessment? Are there other adjustments that are worth our consideration?

The above items are not significant for GVW, and there are no other items worthy of adjustment that we are aware of. Adjustments should be made for the above items if significant to ensure the cash impact of these items is consistently treated across different businesses.

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