

**Review of Network Service
Plan 2012-2017**

Murray Irrigation Limited

**Report to the ACCC and Murray
Irrigation Limited under Part 5 of
the Water Charge (Infrastructure)
Rules 2010**

**Summary paper
30 July 2012**



Introduction

Murray Irrigation Limited (MIL) has prepared a Network Service Plan (NSP) which provides details of its plans for water service infrastructure over the forthcoming five year period (2012-13 to 2016-17). The NSP includes details of customer service levels, demand for services, operating and capital expenditure and how MIL intends to recover its costs through prices and finance future capital expenditure.

We have undertaken an independent review into the prudence and efficiency of MIL's NSP as per the requirement in the Water Charge (Infrastructure) Rules 2010 (WCIR). This report provides a summary of the findings of our review and recommendations.

Overview of the NSP

MIL has prepared its NSP based on the direction outlined in its Strategic Plan and a number of forecasting assumptions. Key features of the NSP include:

- Prices for most services will increase in line with inflation
- Rationalisation of MIL's network, with a target reduction in channel length of 10% over the next 5 years
- An expanded network of remote controlled and automated assets
- A substantial capital works program funded almost entirely by the Commonwealth government
- Water sales of 750 GL for 2012-13 and 500GL per annum thereafter
- MIL will maintain its strong financial position with reserves increasing from \$100m to \$120m over the NSP period.

Statement of prudence and efficiency

There are many unknowns and uncertainties for MIL over the NSP period, including in relation to water usage, the impact of the Basin Plan, and the effectiveness of its rationalisation program. Nevertheless, we consider that overall MIL's NSP is generally prudent and efficient and represents a sound set of forecasts based around a well-defined strategic direction.

In addition to a small number of minor matters our key finding is that, given MIL's very sound and improving financial position, there is some scope to reduce customer tariffs in real terms over the NSP period.

Adequacy and clarity of information in the NSP

Firstly, we were asked to assess whether the NSP provides sufficient details and is communicated in a way that would be clear to a customer audience. We consider that customers would benefit, and the requirements of the WCIR would be better met, if additional information was included on matters including the following:

- The basis for demand forecasts
- The process whereby information statements are issued to customers
- A clear link between the benefits of effective service delivery and operating and capital costs
- An overview of historical service delivery measured against appropriate KPIs, as well as some indication of how these KPIs are calculated
- Estimated capital expenditure in each year of a given project.

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Customer service standards

Although longer term trends are difficult to identify due to the impact of the drought, MIL's service performance and targets appears reasonable and should improve over coming years under the Private Irrigators Infrastructure Operators Program (PIIOP) and other initiatives.

We consider the development of the customer charter is a positive move towards consolidating and reporting customer service standards in the one document.

We note the move towards providing alternative charges and service level options for domestic customers and generally support this move, but note that the charges for the different service levels need to be cost reflective.

Demand for services

We have not conducted detailed modelling of likely storage levels, allocation levels and sales, however we have conducted some analysis on information provided by MIL and external sources and we consider MIL's demand forecast of 750GL (for 2012-13) and 500GL (for years 2013-14 to 2016-17) to be not unreasonable.

We note the high variability of water sales due to rainfall variability and allocations, the nature of general security entitlements and the variability associated with annual cropping. In addition, Commonwealth buy backs have reduced the base entitlement and the MDB Plan will likely reduce this further. We accept that forecasting likely allocation levels is difficult.

However, the current planning scenarios of 1000GL, 750GL and 500GL used by MIL appear to be somewhat arbitrary. We suggest that a more accurate picture of potential sales beyond the current year could be developed through hydrological modelling of potential water availability and usage scenarios and that this modelling could be used to inform planning scenarios.

Operating costs

The table below shows MIL's forecast expenditure by major cost item over the course of the NSP.

Table E1 Murray Irrigation Limited forecast operating expenditure, 2010-11 to 2016-17 (\$'000s, nominal dollars)

Operating expenditure item	Actual	Budget	Network Service Plan forecast				
	2010-11	2011-12	2012-13	2013-14	2014-15	2015-16	2016-17
Operations	8,682	12,077	10,437	10,576	10,544	10,743	10,651
Wages & on-costs	9,146	9,170	10,231	10,401	10,441	10,198	10,578
Travel, motor vehicles & plant	3,215	3,701	3,666	3,640	3,617	3,594	3,656
Administration	1,507	1,429	1,386	1,427	1,470	1,514	1,559
Buildings	394	452	485	499	514	519	545
Total operating expenditure (\$'000s)	22,944	26,829	26,205	26,543	26,586	26,568	26,989

Source: MIL NSP 2012 and financial model

We reviewed each item of operating expenditure through analysis of historical costs, benchmarking (industry escalation rates, other regulatory decisions, and other rural water providers) and our experience in other similar reviews. Key conclusions are:

A summary of our view on forecast changes in key expenditure items is as follows:

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- The forecast of operations expenditure appears reasonable and takes into account proposed reconfiguration of MIL's network
- At a usage level of 500GL, MIL's forecast of payment for bulk water appears slightly low
- MIL's forecast expenditure on wages and on-costs appears reasonable.

Capital costs

We also consider that MIL has acted prudently in respect of forecast capital expenditure. Forecast capital works are to be funded primarily under the PIIOP program and funding applications were assessed against strict criteria which effectively amounted to an assessment of the prudence and efficiency of the proposed works.

The decision to invest in a Remote Control Pilot project reflects MIL's perception of the risks and uncertainties associated with the full scale Remote Control/Automation project. We consider that MIL has acted prudently in this regard, particularly given that the full scale project involves a substantial proportion of PIIOP funds.

Financing capital expenditure

The funding source for maintenance and refurbishment of existing assets is the Asset Management Replacement Reserve (AMRR) which receives an annual contribution as a component of the delivery entitlement fee. The assumptions adopted for the AMRR model appear to be reasonable.

Tariffs

Despite the recent drought, MIL is in a very sound financial position, with reserves of over \$100 million, split roughly equally between general operational reserves and funds in the AMRR.

MIL forecasts that its general reserves will decline slightly over the NSP period, while the AMRR will continue to increase with the result that total reserves will reach \$120 million by the end of the period. MIL has no borrowings.

Given this, and the prospect of increased water usage over the NSP period, we consider there is some scope for customer tariffs to be reduced in real terms over the NSP period, rather than increased by CPI as MIL has proposed.

For example, we have calculated that in the event that there were no nominal increase in key charges ('MIL water usage fees', 'landholding fees', 'outlet fees', 'account admin fee' and 'annual access charges') over the NSP period, MIL would experience a reduction in cash reserves at the end of the NSP period of less than \$9 million compared to a CPI-increase scenario (which includes forgone interest earnings at 6%). Under this scenario MIL's total reserves would be \$111 million (instead of \$120 million) at the end of the NSP period. This would still leave MIL in a strong financial position but would benefit customers, many of whom are facing difficulties from the high Australian dollar and relatively low commodity prices.

We also note that the declining block structure for usage charges adopted by MIL has some benefits in terms of reducing risk to MIL and its customers. However, the sharply decreasing tariff blocks, particularly in relation to the pass through of government charges, result in tariffs that are not cost-reflective. We recommend that MIL consider adopting a tariff structure that has less of a difference between blocks.

Limitation of our work

General use restriction

This report is prepared for the ACCC for the purposes of reviewing the prudence and efficiency of MIL's NSP in accordance with the *Water Charge Infrastructure Rules 2010* and accompanying Guide. We note that this report will be made publicly available to MIL's customers in accordance with the *Water Charge Infrastructure Rules 2010*.

In preparing this report we have relied on the accuracy and completeness of the information provided to us by the ACCC, MIL and from publicly available sources. We have not audited or otherwise verified the accuracy or completeness of the information. We have not contemplated the requirements or circumstances of anyone other than the ACCC.

Our name or the report should not be used for any other purpose and we accept no duty of care to any other person or entity.

Events may have occurred since we prepared this report which may impact on it and its conclusions.

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