

Over the 2008 regulatory period, Melbourne Water's proposed revenue requirement for waterways and drainage services is \$847 million¹.

The average price path is CPI + 1% per annum for customers in Melbourne Water's existing service area.

This chapter summarises Melbourne Water's forecast revenue requirement based on expenditure proposal and service outcomes discussed in earlier chapters. The prices that are proposed to raise the required revenue are discussed in the next chapter.

11.1 Summary

Melbourne Water has calculated the revenue it needs to fund its activities over the regulatory period using the Commission's building block methodology which includes:

- Return on assets
- Depreciation
- Operating expenditure
- Adjustments from last regulatory period
- Benchmark tax liability.

The Commission also smoothes Melbourne Water's annual raw revenue requirement over the regulatory period to avoid price volatility.

Melbourne Water's proposed raw and smoothed revenue requirements are summarised in Table 11.1.

Table 11.1 Revenue requirement for waterways and drainage services (\$ million)

	Forecast Year Ending					Total
	08/09	09/10	10/11	11/12	12/13	
Melbourne Water's raw revenue requirement	157.6	162.6	170.4	176.0	180.3	846.9
Melbourne Water's smoothed revenue requirement	161.9	166.1	170.4	177.1	171.2	846.7

¹ Total NPV of waterways and drainage services revenue over the regulatory period equates to \$748M, which includes \$15M of miscellaneous revenue.

Melbourne Water has analysed the implications of the smoothed revenue requirement for the financial viability and sustainability of its business² and is of the view that:

- The revenue level is consistent with maintaining (at a minimum) the shareholder's financial interest in the business over the long term (assuming that prices will be increased in subsequent regulatory periods reflecting the revenue requirement generated by rolling-forward the regulatory asset value)
- A lower revenue requirement would potentially impact on Melbourne Water's ability to meet its regulatory and customer service obligations as well as to provide an acceptable return to its shareholder.

11.2 Revenue requirements

11.2.1 Raw revenue requirement

Melbourne Water's proposed waterways and drainage services raw revenue requirement for each year of the 2008 regulatory period is set out in Table 11.2 and summarised in Figure 11.1.

Table 11.2 Raw revenue requirement (\$ million)

	Forecast Year Ending					Total
	08/09	09/10	10/11	11/12	12/13	
Return on capital assets in place 1 July 2008	43.5	42.7	41.9	41.2	40.4	209.7
Depreciation of assets in place 1 July 2008	14.6	14.6	14.6	14.6	14.6	73.0
Return on new assets	1.7	5.7	9.6	13.0	16.1	46.1
Depreciation of new assets	0.8	2.5	4.0	5.5	7.1	19.9
Operating expenditure	88.7	88.4	91.3	92.5	92.8	453.7
Adjustments from last regulatory period ³	4.4	4.4	4.4	4.4	4.4	22.0
Benchmark tax liability	3.9	4.3	4.6	4.8	4.9	22.5
Raw revenue requirement	157.6	162.6	170.4	176.0	180.3	846.9

² This analysis has assumed water, sewerage and recycled water expenditures and revenues are consistent with those provided to the Commission on 26 September 2007.

³ Extended area expenditures were not included in the Commission's 2005 Price Determination given the timing of the Government's decision to extend Melbourne Water's operating area and the uncertainty regarding future expenditure requirements. As directed by the Commission in its June 2005 Final Decision, Melbourne Water has ring fenced the additional extended area expenditures which are eligible to be recovered through prices in the 2008 regulatory period. Expenditure includes estimate costs associated with introducing charges from 2008/09.

11.2.2 Smoothed revenue requirements

Melbourne Water agrees that the Commission’s approach to smoothing the amount by which prices deliver the raw revenue requirement over the regulatory period is appropriate. Using this approach, Melbourne Water’s smoothed revenue requirement over the 2008 regulatory period is shown in Table 11.3.

While the impact on individual customers will vary (see Chapter 12), for customers in Melbourne Water’s existing service area, raising the required revenue will necessitate an average price increase of CPI+1% per annum. Melbourne Water also proposes to commence charging for services provided in the extended boundary areas.

Table 11.3 Proposed smoothed revenue requirement for waterways and drainage services (\$ million)⁴

	Forecast Year Ending					Total
	08/09	09/10	10/11	11/12	12/13	
Melbourne Water’s smoothed revenue requirement	161.9	166.1	170.4	177.1	171.2	846.7

11.2.3 Financial viability

In approving its revenue requirement, the Commission needs to consider the Essential Services Commission Act 2001 objective of maintaining Melbourne Water’s financial viability.

Based on the proposed waterways and drainage expenditure and revenue and the assumed expenditures and revenues for water and sewerage, our analysis suggests that Melbourne Water will achieve the Commission’s benchmark of at least a BBB+ credit rating.

⁴ Proposed revenue requirements include miscellaneous revenue as set out in Chapter 12.