Executive summary

For almost 160 years we have been the major provider of water and sewerage services to South Australians.

We currently service a population of over 1.6 million across a network of over 27,000 kilometres of water pipes and over 8,000 kilometres of sewerage pipes. We employ over 1,400 South Australians directly and many more through our supply, operational and construction contracts. Our customers have been and will continue to be at the heart of our business. We are committed to delivering quality water and sewerage services to customers efficiently and to the agreed level of service.

Since 1 January 2013 we have been regulated by the Essential Services Commission of South Australia (ESCOSA). In May 2013, ESCOSA made its first determination of water and sewerage services for the period 1 July 2013 to 30 June 2016. We are performing well against the allowances and requirements established in that determination.

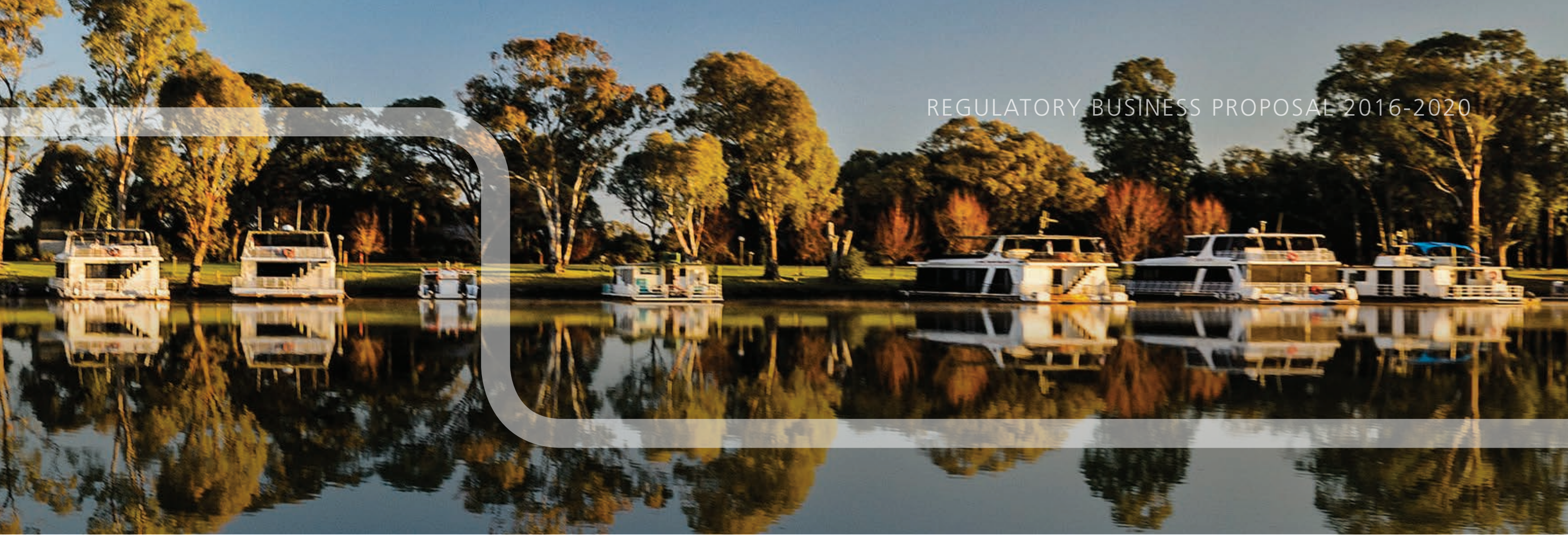
Our sound performance gives us a solid foundation as we head into the second regulatory period.

Regulatory business proposal 2016 (our proposal) summarises our plans for the second regulatory period from 1 July 2016 to 30 June 2020. It outlines the strategic direction we want to take, the expectations customers and stakeholders have of us, our commitment to the levels of service we will provide, the efficient expenditure and investment we will incur to deliver those services and the revenue we will require over the second regulatory period. Our proposal also models the impact on water and sewerage prices and customer bills over the second regulatory period.

In preparing our proposal we:

- Listened to customers to understand their needs and expectations
- Committed to keeping prices as low as possible to deliver the services customers value
- Reduced costs to ensure expenditure is efficient
- Planned investment in infrastructure to maintain service delivery at current levels and deliver long term benefits to customers through optimised investment decisions
- Planned for ongoing support of the South Australian community by providing reliable essential services, environmental protection, sustainable water management and water for future economic development.

ESCOSA will independently review the prudency and efficiency of the proposed expenditure and determine how much revenue we may recover from customers. This process – the second determination – will conclude when ESCOSA issues the Final Price Determination in May 2016. We will set our water and sewerage prices annually in accordance with the allowable revenues determined.



Our strategy for the second regulatory period

Our proposal summarises how we will achieve our strategic direction over the second regulatory period. The strategic direction we will take is more customer focused than ever before, with a clear alignment to 8 outcomes for success as shown in Figure A. Focusing on these outcomes will enable us to continue to play a major role in the growth, prosperity and liveability of South Australia.

Figure A Overview of our strategy 2016-2020, outcomes for success

We did not develop our strategic direction and the key outcomes for success in isolation. We based them on input from customers and stakeholders.

We undertook our most extensive customer engagement to date, Your Say, to understand what customers value about our services and where they want us to improve. Your Say provided invaluable customer insights as summarised in Figure B. The customer consultation reports are included as part of our proposal.

Figure B Your Say customer insights

- Customers would like to improve their experience with SA Water
- Customers see the value in smart meters but are concerned about the costs
- Customers favour multiple channels of communication
- Customers are willing to contribute to an expansion of the Customer Assist Program
- Customers are satisfied with the level of service provided by SA Water
- Customers support cost effective investment in water pressure modulation to minimise infrastructure failures
- Customers favour investment in visual amenity over noise attenuation
- Customers support investment in environmental projects where value and costs are well known
- Customers support investment in water quality initiatives in areas experiencing significant issues
- Customers value water recycling schemes that have broad community impacts
- Customers believe SA Water has a role to play in contributing to the economic development of South Australia

We also proactively engaged with key stakeholders to understand their requirements of us over the second regulatory period. This approach means we can ensure we comply with technical standards and legal obligations, and protect the natural environment.

After developing our plans for the second regulatory period, we kept engaging with customers and stakeholders to ensure they supported the direction we propose to take. Customers and stakeholders broadly support our proposed direction over the second regulatory period.

What do we propose for the second regulatory period?

More affordable water and sewerage bills

Affordable water and sewerage prices are a priority, particularly in the current environment where customers are feeling the impact of rising household bills. We are committed to keeping price increases over the first and second regulatory periods below the rate of inflation.

We achieved our price commitment over the first regulatory period. We reduced water prices by 6.4% in 2013-14 and although we needed to increase sewerage charges by 1.6% in 2013-14 this increase was below the rate of inflation. Water prices and sewerage charges have only increased by the rate of inflation in each of the remaining years.

For the second regulatory period, we propose reductions of 0.7% in water prices and 9.0% in sewerage charges in 2016-17. These price reductions will be followed by inflation only increases in each of the remaining 3 years. This meets our commitment to keep price increases below the rate of inflation over the second regulatory period.

For the average metropolitan residential customer (using 184 kilolitres per year and with a property value of $400,000) the 2016-17 price reductions would mean a $51 (3.9%) saving in the combined water and sewerage bill in 2016-17. The combined bill would only increase by inflation in each of the remaining 3 years of the second regulatory period.

The price and bill impacts provided in our proposal are indicative only, and will be subject to ESCOSA's second determination and actual rates of inflation.

Relevant to our affordability commitment, we will continue to support customers experiencing short or long term financial hardship. We propose to expand our existing Customer Assist Program to offer more services and support to customers in need. Customers indicated they supported an expanded Customer Assist Program as part of Your Say.

Prudent and efficient service delivery

We will continue to focus on keeping operating costs at their most efficient level, because lower costs means lower prices for customers.

We have already achieved significant reductions in operating costs over the first regulatory period, forecasting to save more than the operating efficiency targets ESCOSA set in its first determination as shown in Table A. Achieving these efficiencies, and achieving them early, has not been easy. These results were possible through transformational change involving restructuring our business, improving information technology (IT) systems, actively optimising our water supply mix, innovative energy sourcing methods and increased flexibility and resilience of the water supply network. These savings are good news for customer prices because we factored them into our base costs for the second regulatory period.

Table A Performance against operating efficiency targets (Dec 2014 real $'million)

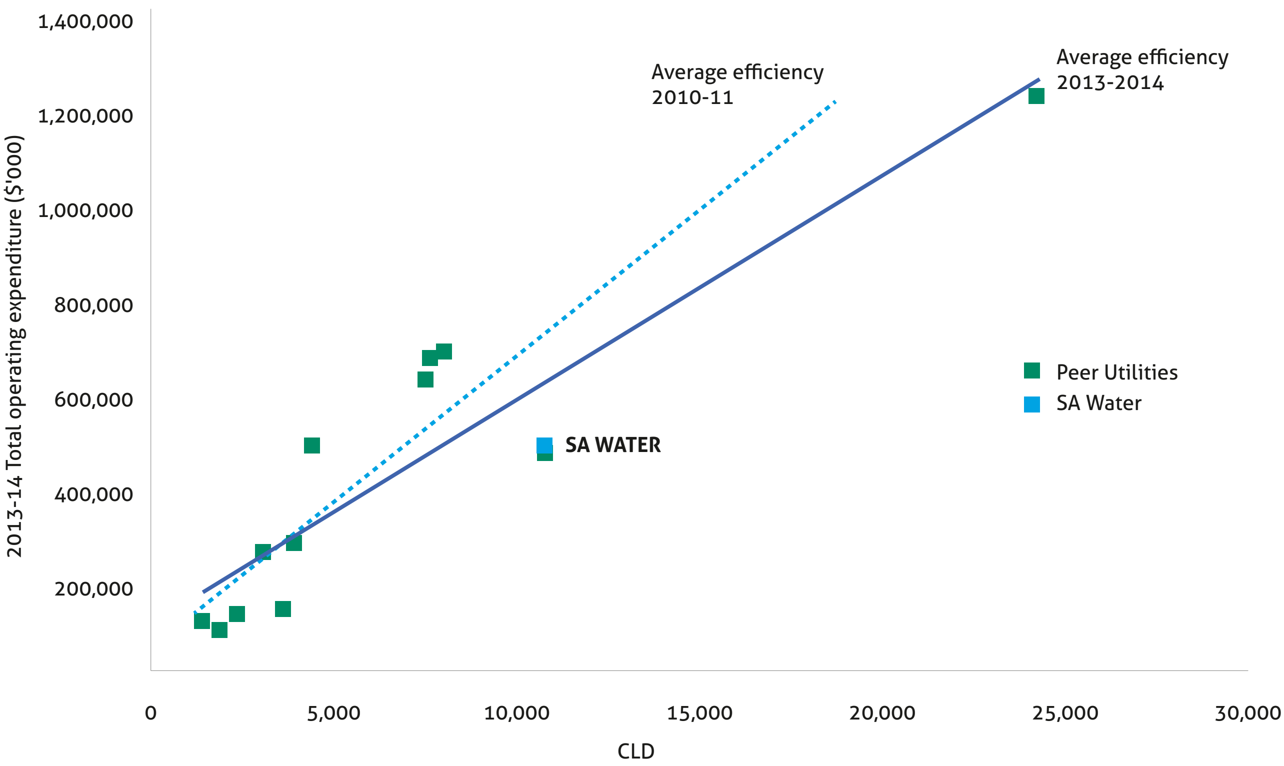
	2013-14		2014-15		2015-16*	
	Target	Achieved	Target	Forecast*	Target	Forecast*
Operating expenditure efficiency (cumulative %)	1.0%	12.5%	2.9%	14.7%	4.9%	11.4%
Operating expenditure efficiency (cumulative $'million)	$4.7	$55.2	$13.9	$65.1	$23.0	$50.6

*Actuals not available at time of submitting our proposal.

Benchmarking of our operating costs for 2013-14 against a peer group of Australian water utilities demonstrates our performance is amongst the most efficient for a combined water and sewerage service provider. This is despite being exposed to a number of unfavourable environmental conditions including a large geographic footprint, unfavourable topography and low rainfall. The benchmarking study also shows we improved our efficiency since a similar benchmarking study of 2010-11 operating costs.

Our comparative performance is shown in Figure C using a multi-dimensional analysis of combined water and sewerage operating costs for the peer utilities. This figure is based on 3 drivers of productivity – customers, length of main and demand (CLD). The figure shows we have established ourselves as one of the efficient utilities in Australia based on this measure.

Figure C Multi-dimensional analysis of 2013-14 combined water and sewerage operating costs*



*KPMG, *SA Water Corporation NPR Cost Benchmarking Study*, June 2015, p. 3.

Building on this strong performance, we propose further efficiencies to operating costs over the second regulatory period of 1% per year (4% by 2019-20).

We also propose to operate the Adelaide Desalination Plant (ADP) in minimum production mode, rather than at zero production mode. This results in marginally lower operating costs to run the ADP than allowed in the first determination. This mode of operation is the most efficient and responsible way to maximise the life of the ADP for the long term, delivering operational resilience and water security for customers at the lowest long term cost. Having this additional water source available will also allow us to defer upgrades to other water infrastructure, a saving of around $5-$6 million of capital expenditure every year.

Despite our efficiency efforts, we face unavoidable operating expenditure increases arising from higher statutory obligations, cost escalation and network growth. In some cases, these increased costs are offset against savings. Adopting new technology is also increasing cost pressures for our business, but we will offset investment in this area with related savings in this and future regulatory periods. We forecast the total unavoidable increases in operating expenditure before savings to be $68.1 million over the 4 years of the second regulatory period.

Prudent and efficient investment

To keep prices as low as possible, we will invest only where and when we need to over the second regulatory period. We will also drive further efficiency across our capital delivery program.

Our capital expenditure approach over the first regulatory period demonstrates we were prepared to alter our plans when the underlying need has changed or where due diligence showed we can defer projects to achieve the same or better outcome. We also reprioritised capital investment to meet emerging business challenges. By doing so, we achieved capital expenditure savings of $176.7 million compared with the capital expenditure allowance of the first determination. This is good news for customer prices in the second regulatory period.

Our method for maintaining, upgrading and replacing assets continued to evolve in the first regulatory period. In particular, we revised the process that aligns proposed capital investment with an investment driver and beneficiary. We can more readily measure the impact of our capital investment on these beneficiaries and we better align with our strategic direction. We can now propose lower levels of capital expenditure for the second regulatory period while still providing the necessary infrastructure to manage risk and maintain levels of service to customers.

We propose to invest $1.27 billion of capital over the second regulatory period. This includes $675.4 million in water infrastructure, $479.7 million in sewerage infrastructure and $115 million in information technology infrastructure. The average annual investment we propose is 13.5% lower than the average annual capital allowance of the first determination. Given lower levels of investment, we will increase asset condition assessments to ensure critical infrastructure does not deteriorate to unacceptable levels.

For water and sewerage infrastructure, the investment driver and target level of performance for proposed capital investment is shown in Table B. Our proposal includes a commitment to reduce infrastructure capital delivery costs by 5% per year over the second regulatory period by using more mature project and program management approaches and improved procurement outcomes.

Table B Proposed capital expenditure (Dec 2014 real $'million)

Water capital investment			Sewerage capital investment		
Investment driver	**Target level of performance**	**Proposed capital**	**Investment driver**	**Target level of performance**	**Proposed capital**
Reliability for our customers	<1,900 properties with 3+ supply interruptions	394.9	Reliability for the environment and our customers	<217 internal overflows per year* 100% compliance with Department for Health and Ageing licence <77 sewer overflows type 1 and 2 reportable incidents per year by 2019-20	146.0
Quality for our customers	Compliance with Australian Drinking Water Guidelines (100% metropolitan, 99.8% country) Incidents per year: <2 priority type 1 <35 type 1 <60 type 2	137.1	Quality for the environment	100% compliance with EPA licence <450 odour complaints associated with sewerage networks	230.9
Safety for the community	Zero serious injuries to members of the community	90.6			
Safety for our workers	Serious Injury Frequency Rate <5 by 2020	44.5	Safety for our workers	Serious Injury Frequency Rate <5 by 2020	49.9
Financial outcomes for our customers/owner	Provide long term financial benefit	36.7	Financial outcomes for our customers/ owner	Provide long term financial benefit	77.7
Technical capital plan**		**703.8**	**Technical capital plan****		**504.5**
Less 5% delivery efficiency		-34.7	Less 5% delivery efficiency		-24.8
Capitalisation ADP reverse osmosis membranes		6.3			-
Efficient capital plan		**675.4**	**Efficient capital plan**		**479.7**

*Total planned investment necessary to deliver the desired outcomes prior to the application of stretch targets of efficiency.

The capital expenditure we propose includes investment of:

- $66.5 million to relocate the Murray Bridge Wastewater Treatment Plant (WWTP) to facilitate continued growth in the region, reduce odour issues for the community and ensure compliance with EPA licence conditions
- $54.8 million (in the second regulatory period) to upgrade Kangaroo Creek Dam to ensure compliance with industry safety standards
- $24.6 million to increase capacity of the Bolivar WWTP to support growth in the greater metropolitan area
- $15.7 million to improve sludge infrastructure at the Port Lincoln WWTP to support growth in the region and ensure ongoing compliance with EPA licence conditions
- $15.0 million to improve the reliability of the water supply for customers at Warooka and Point Turton by changing supply from bore fields to the River Murray system
- $14.3 million to increase the capacity of the Aldinga WWTP to support growth in the southern metropolitan region
- $12.6 million to improve water quality aesthetics and reduce salinity for customers at Orroroo

- $11.1 million to supply safe and reliable drinking water to the Mount Barker residential development to facilitate growth in the Mount Barker area
- $10.3 million to refurbish a large tank ensuring customers continue to receive a reliable water supply from Hope Valley.

In addition to these larger projects, we will continue to invest in asset programs to maintain levels of service for water and sewerage customers.

For our water service, the largest investment driver is ensuring the reliability of water services to benefit customers. As well as maintaining the ongoing water main replacement programs, we propose increased investment in renewing large storage tanks to prevent structural failures that would otherwise interrupt water supplies. We will prioritise these projects on the age and condition of water mains and network structures.

For our sewerage service, we propose increased investment to benefit the environment through the reliability of sewerage infrastructure. This investment will reduce the number of sewerage main breaks and chokes, thereby minimising environmental incidents.

In addition to infrastructure investment, we propose to invest $115 million in IT over the second regulatory period. This investment will maintain the asset lifecycle of existing technology, improve our customers' experience and future proof our technology platform. Importantly, the proposed IT investment includes $32.5 million of technology enabled initiatives to help achieve efficiencies of $11.4 million per year by 2019-20.

Continue to provide high levels of service to customers

We met 65 of 66 service standards in 2013-14 and expect to achieve high levels of service for the remainder of the first regulatory period. Through Your Say, customers told us they were satisfied with our performance in this area. We will continue to deliver the high levels of service expected by customers and continue to meet our legal and regulatory obligations.

We propose a refined hierarchy of service standards to make it easier for customers to monitor our performance. Specifically, we propose to reduce the number of reportable service standards from 66 to 18 key measures, while maintaining the same performance oversight.

Improved customer experience

While customers are satisfied with the overall levels of service we provide, they would like improvements in their service experience. They want us to improve how we interact and communicate with them.

We will lay the foundation in the second regulatory period for an improved customer service experience. As part of our proposed IT investment, we will invest $10.2 million in our digital strategy which will:

- Enhance self-service and payment platforms for customers
- Create more channels for customers to interact with us
- Enhance customer enquiry handling
- Improve how we communicate service issues
- Form better customer relationships
- Improve information management and digital customer research.

Why is our proposal prudent and efficient?

We consider our proposal for the second regulatory period to be prudent and efficient because it:

- Builds on strong performance in the first regulatory period particularly the efficiencies we achieved, which we incorporated into the costs of providing water and sewerage services
- Responds to customer expectations both by maintaining service levels but delivering them more efficiently and by investing in areas customers told us they value
- Ensures ongoing compliance with stakeholder requirements and statutory obligations including new requirements
- Captures the benefits of our enhanced approach to asset management which enables more informed and prudent investment decisions
- Proposes stretch efficiency targets for capital investment and for operating costs, which means we will continue to operate at a higher performance level than the average of peer utilities
- Provides price reductions to customers in the second regulatory period and provides the price reductions as early as possible during the period.

Summary of regulatory proposals

Allowable revenue

ESCOSA will determine the annual building block allowances and annual allowable revenues we may earn over the second regulatory period. The proposed annual building blocks and annual allowable revenues for direct control water and sewerage services are set out in Table C.

Table C Proposed water and sewerage building blocks (Dec 2014 real $'million)*

	Water				Sewerage			
	2016-17	2017-18	2018-19	2019-20	2016-17	2017-18	2018-19	2019-20
Return on asset**	344.8	345.6	346.2	345.5	160.2	161.2	163.1	165.0
Working capital***	1.5	1.5	1.5	1.5	0.6	0.6	0.6	0.6
Operating expenditure	327.6	328.6	326.6	324.4	131.1	131.3	131.1	129.8
Depreciation***	174.7	177.7	180.8	184.3	93.6	96.7	100.2	103.5
Tax*****	5.4	5.6	6.1	6.5	–	–	–	–
Community service obligations	-72.7	-71.1	-69.6	-68.2	-49.8	-48.9	-48.1	-47.4
Recycled water revenue	–	–	–	–	-3.9	-5.1	-6.4	-6.7
Total allowable revenue	**781.3**	**787.9**	**791.6**	**794.0**	**331.8**	**335.8**	**340.5**	**344.8**
Smoothed allowable revenue****	**778.5**	**785.1**	**792.2**	**799.7**	**332.2**	**336.1**	**340.2**	**344.3**

*Building blocks and allowable revenues are summarised outputs from ESCOSA's revenue model. KPMG independently examined the revenue model and did not identify any issues which would have a material impact on the results.
**Calculated on mid year asset values.
***Discounted to mid year values.
****Calculated as a net present value. Smoothed prices rather than revenues which means the smoothed allowable revenue increases slightly each year in line with growth in demand and customer numbers.
*****Changes in the cost of debt and lower revenue results in an income tax liability of zero for the second regulatory period for our sewerage service.

The average allowable revenues we propose for the second regulatory period are less than the average allowable revenues of the first determination. Lower allowable revenues will help keep water and sewerage prices, and hence customer bills, lower. This is good news for customers who told us affordability across household bills is an issue.

The allowable revenue reduction reflects the benefits of our ongoing drive for efficiency, ESCOSA's new method for calculating the regulatory rate of return and the favourable impact of financial markets on the regulatory rate of return.

We broadly support ESCOSA's new method for calculating the regulatory rate of return because it provides improved price stability for customers and better reflects our actual financing costs. In adopting the new method we:

- Assumed immediate transition to the 10 year average trailing cost of debt
- Used a forward estimate for the cost of debt over the second regulatory period to avoid price instability for customers rather than annual adjustments for the cost of debt
- Used observable market inputs at April 2015.

On this basis, we adopted a regulatory rate of return of 4.20% (post-tax real) which is lower than the regulatory rate of return of 4.50% calculated for the first determination. A lower regulatory rate of return helps to keep prices lower for customers.

For the second regulatory period, we propose a revenue adjustment mechanism to calculate and bank annual variations in revenue compared with the allowable revenue. Where the variation is greater than 1%, we propose to adjust 50% of the variation against allowable revenue in the third determination. This approach promotes price stability and certainty over the second regulatory period and ensures we share equally the forecasting risk/benefit with customers.

Indicative prices and bills

We cannot set exact prices and bills at this time because prices are set annually to earn the allowable revenue determined by ESCOSA and to account for the latest inflation figures. The indicative price changes for water and sewerage customers over the first and second regulatory periods are shown in Table D. We expect water and sewerage prices to decrease by 0.7% and 9.0% respectively in 2016-17, then increase by inflation in each of the remaining 3 years of the second regulatory period.

Table D Water and sewerage pricing movements (nominal $)

	First regulatory period			Second regulatory period					Total change (across both regulatory periods)
Change (%)	2013-14	2014-15	2015-16	2016-17	2017-18	2018-19	2019-20	Total	
Water Price	-6.4%	2.9%*	1.3%*	-0.7%	2.5%**	2.5%**	2.5%**	6.9%	4.3%
Sewerage Price	1.6%	2.9%*	1.3%*	-9.0%	2.5%**	2.5%**	2.5%**	-2.0%	3.8%

*Inflation only increase.
**Inflation only increase using an inflation assumption of 2.5% per year.

Bill impacts vary across customer groups and from customer to customer depending on water use and property value. The indicative bill impacts for a range of water and sewerage customers are shown in Table E and Table F.

Table E Indicative water bills (nominal $)

Type of customer	2015-2016	2016-17	2017-18	2018-19	2019-20
Residential bills					
Low water use – 120 kL per year	568	564	578	593	608
Average water use – 184 kL per year	783	778	797	817	838
High water use – 340 kL per year	1,308	1,299	1,331	1,365	1,400
Non-residential bills					
Low water use – 60 kL per year	488	485	497	509	522
Average water use – 1,900 kL per year	6,670	6,630	6,790	6,968	7,146
High water use – 7,000 kL per year	23,806	23,664	24,232	24,869	25,506
Commercial bills*					
Low water use/property value – 30 kL per year/$250,000	387	385	394	404	414
Average water use/property value – 400 kL per year/$1,200,000	2,210	2,196	2,250	2,308	2,366
High water use/property value – 1,300 kL per year/$3,600,000	6,967	6,923	7,092	7,274	7,459

*Based on 2014-15 property values. Actual property rate charges may vary on account of movements in property values. The Valuer-General finalises property values for the following financial year in June of each year.

Table F Indicative sewerage bills (nominal $)*

Type of customer	2015-16	2016-17	2017-18	2018-19	2019-20
Residential bills					
Minimum charge	356	324	332	340	349
$400,000 property value (metropolitan Adelaide)	515	469	480	492	505
$250,000 property value (country SA)	433	396	408	420	433
Non-residential bills					
Low property value ($170,000)	356	324	332	340	349
Average property value ($1,400,000)	2,018	1,836	1,882	1,929	1,978
High property value ($4,500,000)	6,487	5,903	6,051	6,202	6,357
Commercial bills					
Low property value ($250,000)	360	328	336	345	353
Average property value ($1,200,000)	1,730	1,574	1,613	1,654	1,695
High property value ($3,600,000)	5,189	4,722	4,840	4,961	5,085

*Based on 2014-15 property values. Actual property rate charges may vary on account of movements in property values. The Valuer-General finalises property values for the following financial year in June of each year.

Value for money

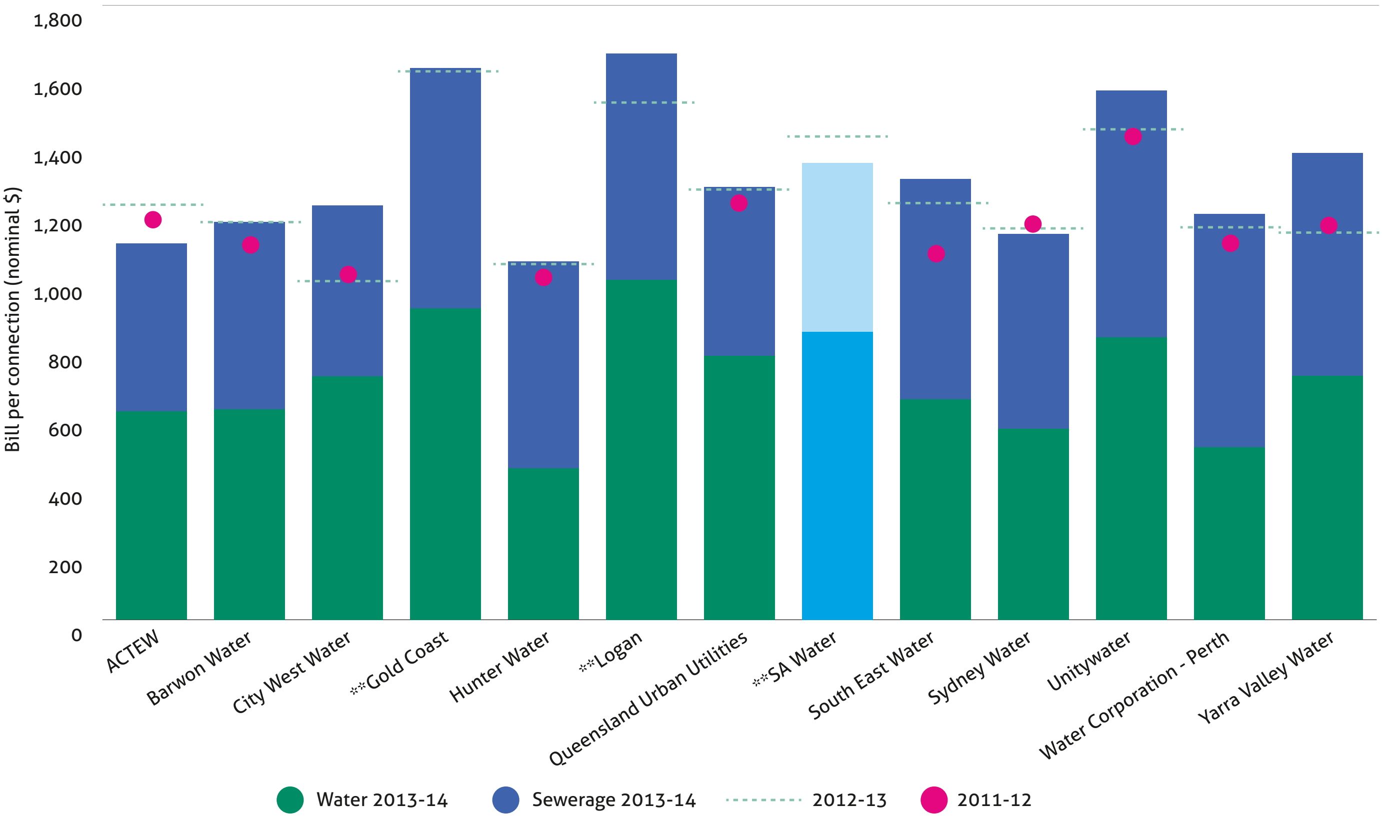
How our bills compare with bills in other jurisdictions

In South Australia, the total combined water and sewerage bill increased significantly from 2008-09 to 2012-13. The increase was due to investments we made in necessary water security measures to respond to unprecedented drought conditions.

The annual combined water and sewerage bill for the peer group of water utilities is shown in Figure D. We are 1 of only 2 utilities to significantly reduce combined water and sewerage bills between 2012-13 and 2013-14. This result reflects our strong drive for efficiency in the first regulatory period. The average combined bill is now in the mid-range of the peer group.

By driving efficiencies throughout our business we are proposing to reduce the combined water and sewerage bill by $51 for the average residential customer. This follows a $43 reduction to water and sewerage bills in the first regulatory period and shows we are committed to reducing our costs for our customers.

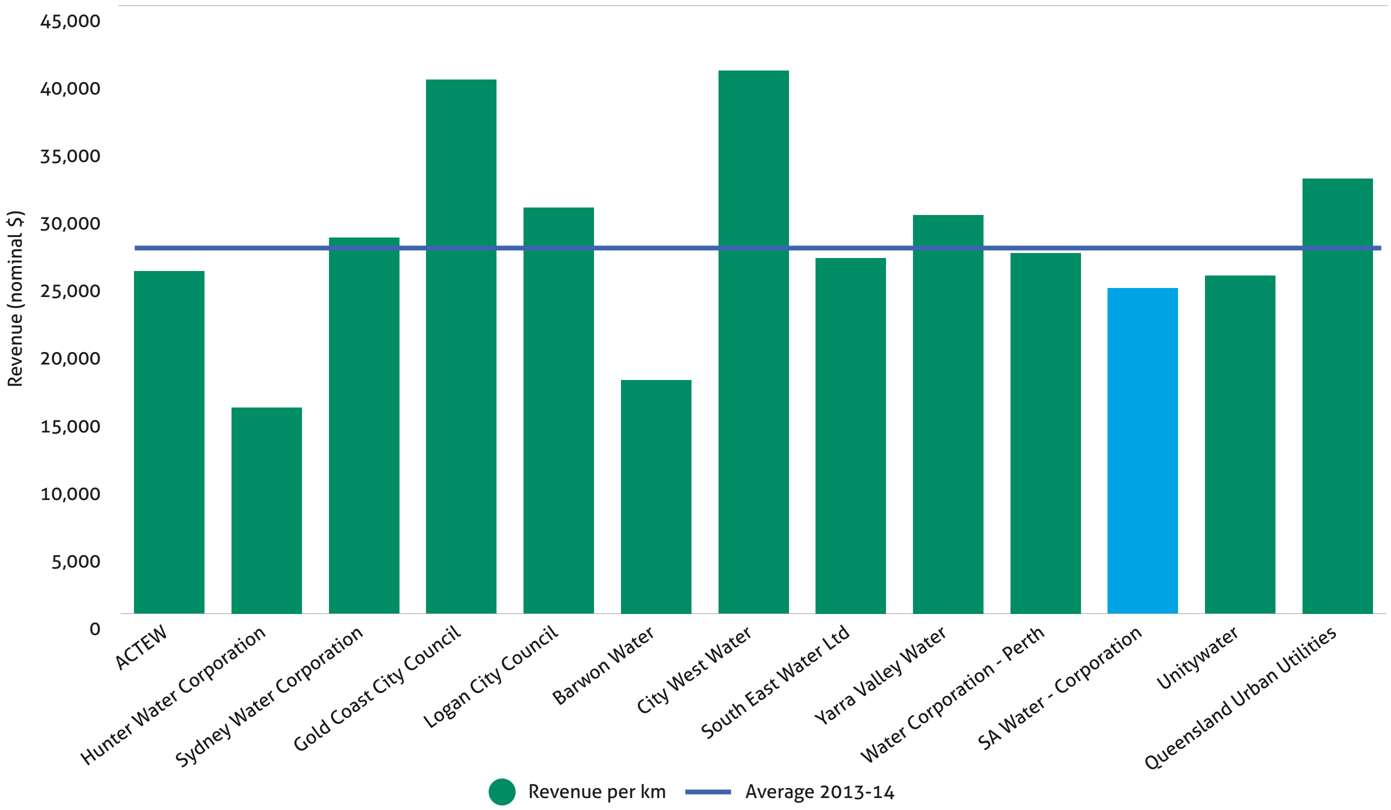
Figure D Annual water and sewerage bill for 200 kL, 2011-12 to 2013-14*



*SA Water data based on consumption of 200 kL per year and the average property value. Not all utilities in the peer group base their sewerage charges on property values. Source: Bureau of Meteorology 2014, *2013-14 National performance report.*
**Did not report against the indicator for 2011-12.

Utilities with more connections tend to have lower prices and customer bills as costs are recovered from a wider customer base. Utilities with a smaller geographic spread also tend to have lower prices and customer bills as smaller lengths of pipes are required, thereby reducing the capital and operating cost to service customers. Even though our combined water and sewerage bill is within the mid-range of the peer group, our revenue per kilometre of main is below the average of the peer group (Figure E).

Figure E Revenue per kilometre of main – combined water and sewerage, 2013-14*

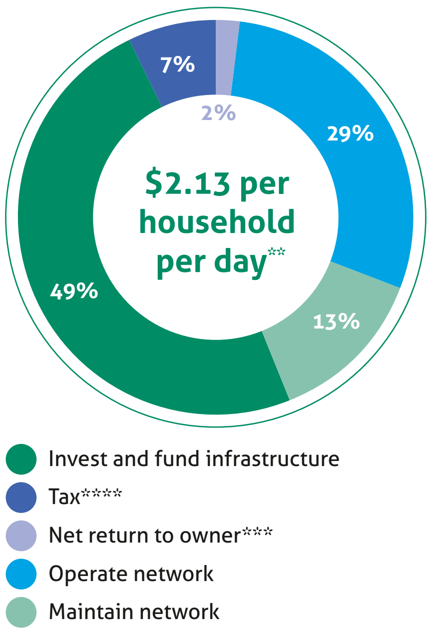


*Source: Bureau of Meteorology 2014, *2013-14 National performance report.*

What customers receive for their bills

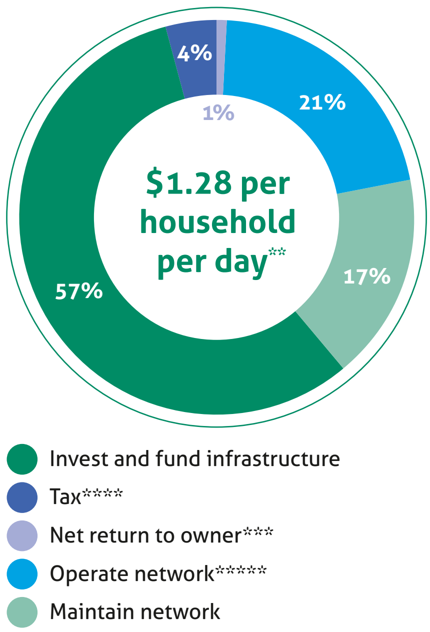
Our proposals represent value for money for customers. We invest the majority of the money we receive from customers directly into providing water and sewerage services (Figure F and Figure G respectively). The government receives only marginal returns.

Figure F What customers are paying for – water*



*Based on 2016-17 bills and allowable revenue.
**Based on average residential customer using 184 kL of water per year (nominal $).
***Net return to owner is net of Community Service Obligation payments from the South Australian government
****Tax is based on accounting values and paid to the South Australian Government as a tax equivalent.

Figure G What customers are paying for – sewerage*



*Based on 2016-17 bills and allowable revenue.
**Based on average metropolitan residential customer with a property valued at $400,000 (nominal $).
***Net return to owner is net of Community Service Obligation payments from the South Australian government.
****Tax is based on accounting values and paid to the South Australian Government as a tax equivalent.
*****Operate network is net of recycled water revenue.

We invest the majority of the money we receive from customers directly into providing water and sewerage services.

Summary

We listened to our customers and stakeholders, and incorporated their views wherever possible into our proposal. Our proposal will deliver:

- The lowest possible prices for customers
- Prudent and efficient investment in infrastructure to maintain current levels of service and to optimise the lifecycle of assets
- Prudent and efficient operating costs, as we have been benchmarked as one of the most efficient water and sewerage providers
- An improved customer experience.

Despite benchmarking favourably against our peers, we also propose ongoing efficiency targets for both operating expenditure (1% per year) and capital expenditure (5%). Lower costs help achieve lower prices for customers.

Our proposal results in a 0.7% decrease to water prices in 2016-17 and a 9.0% decrease to sewerage prices in 2016-17. These price decreases will be followed by inflation only increases for the remaining 3 years of the second regulatory period.

We achieved these prices through sound performance in the first regulatory period, ongoing efficiencies and robust methods for determining the additional levels of expenditure required to maintain current service levels for the second regulatory period.

Our proposal is the first step of ESCOSA's second determination process. ESCOSA will review our proposal and additional supporting information to make recommendations in its Draft Determination. Customers will have the opportunity to comment on the Draft Determination as part of ESCOSA's public consultation process. We will support ESCOSA throughout this process.