

## FACT SHEET 2

### Regulatory Asset Base

**In the Determination, IPART adopted a 'building-block approach' towards cost-recovery. This approach allows recovery of efficient operating expenditure, a return on capital plus depreciation based on the existing Regulatory Asset Base.**

The Regulatory Asset Base (RAB) is the value of the asset base on which pricing is determined by the price regulator, the Independent Pricing and Regulatory Tribunal (IPART).

IPART has set the value of State Water's opening RAB at 1 July 2004 at \$240.8 million (of which \$83.5 million is allocated to users).

In its 1998 pricing determination, IPART considered that all bulk water assets at 1 July 1997 had a zero value, for pricing purposes. The decision to exclude pre-1997 assets from the RAB was reaffirmed in IPART's 2001 determination.

The RAB value of State Water's bulk water infrastructure at 1 July 2004 was initially assessed as \$300 million. This bears no relationship to the \$2.9 billion replacement value of the physical assets. The RAB is the 'market value' of the business based on its potential to earn revenue under existing regulatory arrangements.

IPART adopted an annuity approach in determining capital costs in previous determinations for the former Department of Land and Water Conservation. This led to an asset annuity of \$18 million as at 30 June 2004. The annuity approach calculates an annual capital return (i.e. capital annuity charge), based on the net present value of a 30-year projected capital expenditure program. It is likely that the adoption of the annuity approach contributed to the decision to write off pre-1997 assets for pricing purposes.

The annuity approach focuses on recovering forecast future capital expenditure, rather than providing a return on existing assets and their depreciation. Providing a return on the value of existing assets as well as 30 years of capital expenditure, would have led to unacceptable pricing outcomes.

In its pricing submission State Water proposed a 'building-block approach' with recovery of operating expenditure, a return on capital, plus depreciation based on existing, rather than future, assets. The RAB approach is also used by other water businesses in Queensland and Victoria, as this is a sustainable approach for businesses.

State Water believes an additional benefit of the RAB approach over the current annuity approach is that it is a better method of ensuring the capacity to serve existing assets over their entire life. It is also a more equitable for present and future customers, as it does not rely on 30 year forecasts for the setting of current prices.

#### **For More information:**

Please contact your local Customer Service Manager. Contact details are available at [www.statewater.com.au](http://www.statewater.com.au).