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Mr Charles Millsteed
Chief Executive Officer
Queensland Competition Authority
GPO Box 2257
Brisbane QLD 4000

9 December 2020

Dear Mr Millsteed

Request for Comments Paper (November 2020): Rate of Return Review

Unitywater welcomes the opportunity to provide comment on the Queensland Competition Authority ("QCA") November 2020 'Rate of Return Review' paper ("the RoR Review"). Unitywater notes the importance of such reviews given the rate of return can have major impacts on the prices paid by customers and the ability of regulated entities to make investments in critical infrastructure to service customer needs as well as respond to increasing environmental challenges.

Unitywater's view is fundamentally that the rate of return determined should not create pricing volatility from year to year with price increases minimised and smoothed over time and price reductions carefully managed to minimise future volatility or large subsequent increases.

In establishing prices on an annual basis Unitywater engages the expertise of Queensland Treasury Corporation (QTC) to provide an independent assessment of the weighted average cost of capital that should be applied by Unitywater is setting prices. Unitywater therefore supports the comments made in QTC's submission on the calculation of the cost of debt and equity. Of specific note, Unitywater supports:

a. A 10-year trailing average approach to determine the regulated cost of debt. The trailing average should aim to replicate the cost produced by a benchmark portfolio of 10 fixed rate loans with annual maturities from 1–10 years.

b. Annual updates to the trailing average cost of debt to minimise the difference between the efficiently incurred cost of debt for a benchmark firm and the cost of debt allowance. Annual updates also avoid the need to perform a true-up at the end of each regulatory period.

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c. Allowance to be made to reflect debt management strategies adopted by entities to align with a trailing average approach as supported several years ago. As such, the correct starting value of the benchmark debt yields in the trailing average calculation should be consistent with the timing of these decisions. It is not appropriate to use the prevailing benchmark debt yield as the starting value of the trailing average cost of debt for these businesses.

d. Primacy should be given to how real-world investors actually determine required rates of return.

e. The cost of equity calculation should be somewhat agnostic to the prevailing risk-free rate and for cues to be taken by commercial responses to the current atypical rate. Unitywater also agrees with the need to place weighting on both historical and forward-looking measures for the cost of equity.

Further Unitywater does not support ad hoc adjustments to the rate of return to account for the level of risk that a firm is exposed to, as such adjustments are difficult to adjudicate or explain. Unitywater is of the view that risk adjustments should be made to cash flows rather than to the rate of return as cash flow adjustments are transparent in their application and can be logically tied to identified risks.

Should you have any queries in relation to our submission please contact Danny Power, Manager Corporate Performance on 07 5431 8783 or danny.power@unitywater.com.au.

Regards

DocuSigned by:
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Pauline Thomson
Chief Financial Officer