

MRA

MALTA RESOURCES AUTHORITY

# Proposed Water Tariffs

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## Summary of Review Process and Conclusions

[12<sup>th</sup> December 2009]



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# PROPOSED WATER TARIFFS

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## INTRODUCTION

The Malta Resources Authority ('MRA' or the 'Authority') was requested to approve the proposed water tariffs ('the proposed tariffs') put forward by Water Services Corporation ('WSC' or the 'Corporation') in the final updated KPMG report dated 10<sup>th</sup> December 2009 (the 'KPMG Report' or the 'KPMG Model') attached herewith as Appendix A

The new tariffs were proposed by WSC in the light of the expected significant increase in electricity tariffs, and increases in overheads including interest payments on EIB loans.

The current tariff revision has taken the following into account:

- a) The impact which increases in electricity costs will have on WSC's costs for the 12 months from 1<sup>st</sup> January, 2010 to 31<sup>st</sup> December 2010;
- b) The Corporation's latest projected cost base for the 12 months ending 31<sup>st</sup> December 2010;
- c) The cost of wastewater which was not included in the tariff revision of October, 2008.
- d) Government subvention of €14.176 million for 2010 to cover part of wastewater costs
- e) Grouping of WSC's electricity accounts for billing purposes only.

## REVIEW AND APPROVAL PROCESS

As part of its Review and Approval Process the Malta Resources Authority:

- a) Reviewed and tested the workings and results reflected in the KPMG Report;
- b) Compared workings with the tariff model, approved and agreed to in October, 2008.



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## FUNDAMENTAL PRINCIPLES AND OBJECTIVES

The Fundamental Principles and Objectives used as a basis of the current tariff revision may be summarised as follows:

### *Legality*

The processes and methodologies adopted must conform to applicable legislation, regulations and directives, including the legal obligation imposed on WSC not to operate at a loss.

### *Sustainability and Profitability*

The proposed tariffs should enable WSC to achieve an acceptable rate of return on both its current and future capital employed, which would enable it to service its existing debt obligations and sustain an acceptable fixed asset replacement and upgrade policy.

### *Non-discrimination*

The proposed tariffs must not unjustifiably discriminate between comparable groups of consumers and must avoid potential cross-subsidization within the different user groups.

### *Transparency*

The entire tariff revision process should be transparent with consumers being provided with sufficient information to enable them to secure an acceptable understanding of how:

- i. The proposed tariffs were computed by WSC; and
- ii. The Malta Resources Authority's review and approval process.

## FULL COST RECOVERY METHOD

Consistent with the first tariff revision exercises, the current tariff revision has been computed by WSC on the basis of a 'Full Cost Recovery' method for water. Part of the wastewater costs will be covered by a government subvention.

The 'Full Cost Recovery' method assumes that the proposed tariffs will enable the Corporation to recover all its acceptable costs and earn a reasonable rate of return on its capital employed to enable it to meet its current and future debt servicing obligations as and when they fall due. The 'Full Cost Recovery' method assumes that total variable retail tariffs should be equal to the sum of:

*Electricity Costs*  
*Wages*



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## *Overheads<sup>1</sup>* *Return on Capital Employed ('ROCE')*

After making the appropriate deductions and / or add backs in respect of:

*Government subventions*  
*Fixed Income Charges*  
*Other Services Revenue*

### THE REVIEW PROCESS

The Authority's review process commenced after the submission of the initial draft KPMG report dated 6<sup>th</sup> November 2009 followed by a subsequent draft report of the 17<sup>th</sup> November 2009. The Table below summarises the Corporation's requests based on the final KPMG report dated 10<sup>th</sup> December, 2009:

	WSC revised estimates 2009	Estimates for 2010 (KPMG Report 10th DEC 2009)
	Euro million	Euro million
Electricity Costs	15.656	20.645
Wages	23.430	23.620
Operation of R.Os and STPs	2.885	5.958
Depreciation	9.209	11.172
Overheads	7.162	7.868
ROCE	11.11	3.794
Government Subvention	(11.0)	(14.176)
<b>Target Revenue (Annual Basis)</b>	<b>58.454</b>	<b>58.881</b>

*The cost figures given in the Revised Estimates for 2009 and the KPMG Report dated 10th December, 2009 include the cost of wastewater.*

<sup>1</sup> These include depreciation and the operation of RO,s and STPs



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### *The water tariff review*

- Confirms that the cost model aims to recover the full cost of operations less government subvention
- Target revenue covers the costs of water and wastewater
- Proposed return on capital employed (ROCE) is limited to recover the interest on the Water Services Corporation's existing debt
- On the basis of national interest, Enemalta agreed to treat the Corporation's accounts as a single grouped account for billing purposes

### CONCLUSION:

The Authority has carried out this exercise in accordance with law, which establishes that the tariffs must provide sufficient revenue to the Water Services Corporation in its financial year. The methodology used is identical to the model for the approval of electricity tariffs, which had been approved after public consultation.

In the light of the review process the Authority believes that the proposed revised tariffs included in the updated report of the 10<sup>th</sup> December 2009 fulfil the requirement to generate a target revenue that is sufficient to recover the full cost incurred by WSC less government subvention.

