

	<b>COUNCIL POLICY</b>	
	Wide Bay Water Capital Structure and Distributions Council Policy	
	Policy Number	CP089
	Directorate	Wide Bay Water and Waste Services
	Owner	Ken Diehm, Chief Executive Officer
	Last Approved	25/09/2024
	Review Due	25/09/2027

### 1. PURPOSE

The purpose of the policy is to outline the principles for the sustainable financial management of the Wide Bay Water (WBW) Commercial Business Unit.

### 2. SCOPE

This Policy applies to the distributions provided to Fraser Coast Regional Council from WBW and the management of intercompany transactions. The Policy also defines the assumptions used in WBW Full Cost Pricing Model.

### 3. HEAD OF POWER

*Local Government Regulation 2012*

### 4. DEFINITIONS

To assist in the interpretation of this Policy the following definitions apply:

**“BBB”** means BBB credit rating. Scale begins at AAA which is an exceptionally strong credit rating and ends with a D which is a distressed credit rating. BBB refers to the FCRC current credit rating score.

**“Capital revenue”** means any revenue raised for the purpose of funding capital expenditure including grant funding and developer contribution.

**“Capital Structure”** means the mix of debt and equity finance used by WBW.

**“CBU”** means Commercial Business Unit. A business unit that conducts business in accordance with the key principles of commercialisation.

**“Competitive neutrality”** a CBU that complies with competitive neutrality principles including removing competitive advantage or competitive disadvantages and promoting efficiency of the use of resources to ensure markets are not unnecessarily distorted.

**“Consolidated Entity”** means FCRC including WBW.

**“CPI”** means consumer price index. The overall change in consumer prices based on a representative basket of goods and services over time.

**“CSO”** means Community Service Obligations. The obligation the local government imposes on a business entity to do something that is not in the commercial interest of the business entity.

**“EBITDA”** means earnings before interest tax depreciation and amortisation.

**“Full cost pricing”** means charging for goods and services at the full cost of providing the goods and services.

**“Intercompany loan”** means loan between two related entities for example WBW and FCRC.

**“Opportunity Cost”** means the rate of return that could be earned on another investment with similar risk.

**“Price Path”** means financial model using forecast or budget cost to determine the price of water and sewerage.

**“RBA”** means Reserve Bank of Australia. The RBA is the central bank of Australia.

**“Risk Free Rate”** means the interest an investor would expect from a risk free investment over a specific period of time. Risk free rate is defined by the Reserve Bank of Australia (RBA).

**“WBW”** means Wide Bay Water.

**“Weighted Average Cost of Capital (WACC)”** means average cost of capital, calculated as a weighted average of the costs of the individual sources of debt and equity finance.

## 5. POLICY STATEMENT

Council has identified its water and sewerage services as a significant business activity and resolved to establish Wide Bay Water (WBW) as a Commercial business unit (CBU). As a CBU, WBW applies the key principles of commercialisation to ensure its operations are undertaken in a commercial way. Council is required to apply the principles of competitive neutrality to ensure that those activities do not enjoy a net advantage because they are part of local government. The purpose of this legislation is to ensure that private enterprise can fairly compete with a Local Government CBU.

This Policy defines the principles to ensure competitive neutrality. To develop competitive neutrality WBW must produce separate Statements of Financial Position (Balance Sheet) and Statement of Financial Performance (Profit and Loss Statement). This Policy defines the principles used to ensure competitive neutrality in the financial statements for WBW. The principles define interest rates, intercompany service provision, taxation and Community Service Obligations. To ensure competitive neutrality is achieved WBW’s financial statements must remove any commercial benefits or disadvantages it receives due to the Local Government status.

A commercial business is expected to provide returns to the shareholders. The WBW Business Unit will provide a dividend to FCRC. This Policy defines the principles for calculating and paying dividends.

The commercial principles will be used to develop a price path for water and sewerage services which will be recommended to Council, which will be informed by an approved 5 yearly strategic plan that will be negotiated between FCRC and WBW as an input to the price path.

### **Intercompany Revenue and Expenses**

#### Inter-company loan interest rates

FCRC receives distributions from WBW for interest on inter-entity loans. FCRC will source debt funding at an interest rate applicable for the State Government's credit rating. This rate is lower than the commercial interest rate available. To ensure competitive neutrality, FCRC will apply an interest margin on the debt charged to WBW. FCRC will set the interest rate using the following formula:

Risk Free Rate + Commercial Debt Margin + Swap Costs + Debt Raising Costs

- Risk Free Rate = CW bond/note rate for the applicable loan term\*
- Commercial Debt Margin = BBB + commercial debt premium/margin over the risk free rate\*
- Swap costs = 0.150%
- Debt Raising Cost = 0.108%

\*The risk free rate and commercial debt margin can be located in Table F2 and F3 on the RBA website:

<https://www.rba.gov.au/statistics/tables/#interest-rates>

#### Intercompany charges

The Council provides support services to WBW. These corporate support services include, but are not limited to, financial, IT, HR, payroll, safety and governance. To ensure the costs of the business unit are reflected accurately, the Council will charge a monthly fee to WBW. The annual charge will be determined in the development of the budget. The fee can be varied by CPI or through an evaluation of the cost incurred by FCRC to provide the corporate services.

#### Taxation

To ensure the legislated competitive neutrality principles the Council will complete a tax return for WBW. The tax calculated will be paid from WBW to the Council.

#### Community Service Obligations

A Community Service Obligation (CSO) is an obligation the local government imposes on a business entity that is not in the commercial interest of the entity to do. The CSOs imposed on WBW from FCRC include for example, utility charge concessions.

FCRC will compensate WBW for the cost of providing the community service obligations. The CSOs are managed through the following policies:

- Community Group Concession Policy.
- Water Charges Relief Policy, and

A request for a CSO outside the parameters of the policies listed above must be made by the Director of Wide Bay Water for the approval of the Director of Organisational Services.

### **Dividend methodology**

Returns generated on investments are provided back to the community through the FCRC consolidated budget. WBW will return to FCRC 100% of the Net Profit After Interest, Depreciation and Tax less capital revenue at the end of each financial year. This dividend is subject to the following criteria:

- WBW retains cash and cash equivalents to meet cashflow requirements for the future 4 months.
- WBW does not exceed the 50% debt limit.
- WBW retains cash earnings to ensure key performance indicators are met over the medium to long term as a consequence of the current and forward capital program.

The Dividend will be paid to Council annually. The dividend paid will be calculated once all other financial transactions have been completed for the financial year.

Capital revenue surplus raised with the specific intent of developing the water and sewerage assets will be retained by WBW for future investment in WBW asset base.

If the Net Profit After Interest, Depreciation and Tax less capital revenue is zero or negative, there will be no dividend for that financial year, as the business has not generated sufficient operating revenue to fund the operating costs.

FCRC can call a special dividend subject to WBW retaining cash earnings to ensure key performance indicators are met over the medium to long term as a consequence of the current and forward capital program if it is deemed appropriate to do so and retained earnings are sufficient to meet the payment from current or past profits. Special dividends will be considered by Council during its budget development.

### **Regulated Pricing**

WBW will apply regulated pricing principles and recommend a 5 year price path to Council. The price path model will be reviewed annually and endorsed by the WBWWS Advisory Committee. The model will utilise a commercially reflective capital structure in deriving the rate of return (Weighted Average Cost of Capital WACC) for the purpose of financial modelling. The assumption used in the WACC will be 50% debt and 50% equity.

FCRC will be responsible for considering this price path as an input to its budget and resolving the water and sewerage charges. Council will aim to adhere to the upper bound limit of the cost recovery model. The upper bound limit of the cost recovery model includes operating expenses, depreciation, interest expense and an adequate return on capital.

### **Capital Funding**

WBWs capital renewal funding will be funded from EBITDA (Earnings Before Interest Tax Depreciation and Amortisation) or working capital balances (cash equivalents). Significant new projects to support growth and compliance projects to meet regulatory requirements may be funded by debt funding or Infrastructure charges. Business expenses will be funded via EBITDA or working capital balances.

### **Balance Sheet Structure**

The WBW balance sheet will include intercompany receivables from and loans to FCRC. The FCRC balance sheet will contain the consolidated entity's trade payables/receivables, employee entitlements and provisions. FCRC will hold all cash for the consolidated entity. WBW balance sheet will be formed using intercompany journals to reflect the financial position of the CBU.

## **6. ASSOCIATED DOCUMENTS**

[Community Group Concessions Policy eDOCS# 926846](#)  
[Water Charge Relief Policy eDOCS# 3584934](#)

## **7. REVIEW**

The document shall be reviewed within 3 years or as a result of significant legal and business changes.

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**Version Control**

<b>Version Number</b>	<b>Key Changes</b>	<b>Approval Authority</b>	<b>Approval Date</b>	<b>Document Number</b>
1	New Policy	Council	23/08/2023	4738260
2	Review period changed from 1 year to 3 years Updated Intercompany charges and Community Service Obligations (CSO)	Council	25/09/2024	4738260