

Price-Quality Path for Watercare

Emerging Views Paper
Executive Summary only

25 June 2026



Executive Summary

Whakarāpopotonga Matua

- X1 Watercare is subject to price-quality regulation under Part 4 of the Commerce Act 1986 (**Part 4 of the Act**).¹
- X2 The Emerging Views Paper has been issued in response to stakeholder requests for more detailed guidance on how we propose to set a price-quality path (**PQP**) for Watercare. The paper explains our emerging views on key inputs and approaches to setting the PQP that is due to commence in July 2028 (**PQP28**).

Our proposed approach to setting a PQP that delivers benefits to consumers

- X3 We know Auckland consumers have high expectations of the water and wastewater services provided by Watercare. Setting a PQP for Watercare plays a part in facilitating efficient and quality services to them, and in supporting the growth of Auckland.
- X4 Our focus will be on matters with the greatest potential to improve consumer outcomes. For the first Part 4 PQP for Watercare, we seek a fit-for-purpose PQP, without excess precision, detail or complexity. We aim to strike a balance between predictability and flexibility. We will take account of existing information and context, including the early stage of the regime and Watercare’s evolving capability. Where appropriate, we propose to draw on our established regulatory approaches in other sectors, while tailoring our approach to Watercare’s specific context as the first PQP is developed under a new regime.
- X5 We propose to set a three-year regulatory period for PQP28 to enable the path to be reset again in the near term to reflect learnings from this first PQP.
- X6 We consider that PQP28 should follow a propose/respond approach. That is, Watercare should submit a full PQP proposal (including expenditure forecasts and proposed service quality levels), which is independently verified before it is submitted to us for assessment.

Introducing Part 4 price-quality regulation for Watercare has important benefits

- X7 PQP28 will replace the interim economic regulation under the Watercare Charter (the **Charter**) that currently applies to Watercare.² Like a PQP, the Charter sets revenue limits and quality standards for Watercare but it will expire on 30 June 2028.
- X8 A PQP under Part 4 provides a strong and transparent framework for the economic regulation of Watercare. It sets binding and enforceable limits on the maximum revenues that Watercare can recover from consumers. It would:
 - > take an approach that ensures greater certainty and predictability over time

¹ Section 57E of the Act.

² Local Government (Water Services Preliminary Arrangements) (Watercare Charter) Order 2025.

- > apply a recognised approach for setting price paths that achieves a strong, transparent link between the forecast costs of managing the Watercare network and the maximum revenues Watercare can charge Auckland consumers
- > require scrutiny of Watercare’s proposed expenditure, including independent verification of proposed expenditure, and
- > set quality standards and, if needed, other requirements.

X9 Our goal is to set a PQP that promotes the long-term benefit of consumers by supporting efficient investment and improving cost efficiency and asset management practices, while maintaining service quality and limiting excessive profits. This would promote the s 52A purpose of Part 4 of the Act.

PQP28 will build on the Charter

- X10 The proposed PQP is a further step towards promoting better outcomes for Watercare’s consumers. It builds on the Charter, which has introduced a range of requirements for Watercare including an Infrastructure Delivery and Asset Management Improvement Plan (**IDAM** Plan) and an Operating Cost Efficiency Improvement Plan.
- X11 Watercare is responding to the Charter requirements, and we support its commitment to doing so. The benefits will be realised over time, but we expect to see growing evidence of progress in PQP28 and in subsequent PQPs.

How we propose to limit Watercare’s prices

- X12 We propose that the PQP should cap the total amount of revenue Watercare can seek to recover from water and wastewater use charges, with revenue from Infrastructure Growth Charges (**IGC**) treated separately. We propose that the cap on revenue would be set at our forecast of the costs of managing Watercare’s network in PQP28, having regard to the current maturity of Watercare’s asset management practices and supporting capability.
- X13 The proposed revenue cap would enable Watercare to recover sufficient revenue regardless of fluctuations in demand. In practice, this means consumers would pay lower prices if demand is greater than forecast but higher prices if demand is lower. This approach is consistent with how we regulate in other infrastructure sectors.
- X14 We do not propose separate revenue caps for water and wastewater services. Rather, a combined cap would apply, with the allocation of revenue between the two services subject to monitoring and information disclosure (**ID**).
- X15 The Charter requires Watercare to reform its prices and IGCs. We are currently monitoring its progress on this through our role as Crown monitor, and could monitor this through ID so don’t propose to address it directly through the PQP at this stage.

We propose using the building blocks model to estimate Watercare’s costs during PQP28

- X16 We propose to adopt a building blocks model (**BBM**) to estimate Watercare’s costs during the PQP28 regulatory period. This is same model as we use in other regulated sectors.
- X17 We set out further detail on each of the key components of the BBM and the PQP below.

Regulatory asset base

- X18 The regulatory asset base (**RAB**) represents the financial capital already invested in order to supply water and wastewater services to consumers. It is a key component of the price path. We are assessing two options for estimating the value of the initial or starting RAB as at July 2028: a physical initial RAB based on Watercare’s 2011 deemed asset values rolled forward to 2028; and estimating an initial RAB based on a set of financial assumptions. The physical assets option was proposed by Watercare in its submission on our Approach Paper.
- X19 Our emerging view is a conditional preference for the physical RAB option, which we consider is more transparent and better aligned with the historical costs of previous investment. However—and crucially—our preference requires that the historical records that this option relies on are sufficiently reliable, and that the methodology to calculate these historical costs can be implemented in practice by Watercare. If these conditions can’t be met, we would turn to the financial initial RAB option for the draft decision, which we consider is consistent with the purpose of Part 4. We expect Watercare would use the physical asset approach to develop its proposal and for Watercare’s calculations to be independently audited. The availability of a statutory vesting value that is relatively recent, but prior to economic regulation, may also make Watercare unusual in this respect.
- X20 We propose that Watercare’s forecast (and actual) new investment during PQP28 should be added to the RAB at the cost to Watercare, be depreciated over appropriate asset lives, and be subject to a similar ‘roll-forward’ approach to that used in other regulated sectors.
- X21 Regardless of the option chosen to estimate the initial RAB, we would test whether the resulting revenue path is expected to support the financial sustainability of Watercare. The proposed metrics for this analysis are net debt/RAB and funds from operations (**FFO**)/net debt, as used by the main rating agencies.
- X22 The proposed revenue cap in PQP28 would limit the maximum revenues Watercare can recover from charges on water and wastewater use. Because developers have already contributed to some growth-related costs through IGCs, Watercare’s charges for water use should be based on a RAB that nets off revenue recovered from growth charges, so the same costs are not recovered twice.

Cost of capital

- X23 The cost of capital provides Watercare with a normal return on the capital invested in delivering services.
- X24 Our emerging view is to use the same standard approach to estimating the weighted average cost of capital for Watercare as we use in other regulated sectors. This includes estimating a benchmark return for an efficient firm in the regulated sector, funded by a mix of debt and equity.
- X25 Key proposed inputs to our estimate of the cost of capital include assuming an asset beta of 0.30, leverage of 35%, a market risk premium of 7%, and a five-year term of the debt premium with a Standard & Poor's long-term credit rating of A- (equivalent to a long-term credit rating of A3 from Moody's). We propose to use the prevailing rate to estimate the risk-free rate and a simple trailing average for the debt premium, as we do for other regulated sectors. Our draft PQP28 decision would reflect any changes to our estimates and approaches.
- X26 We propose to use a mid-point estimate of the cost of capital to set Watercare's price path. This is because an uplift in the estimate of the cost of capital is unlikely to materially affect investment incentives as Watercare cannot raise external equity or pay dividends, and its investment programme is driven more directly by statutory obligations, and the operation of other regulatory tools, than by changes in the estimate of the cost of capital.
- X27 Watercare would also be eligible for a separate term credit spread differential allowance where it issues debt with an original term beyond five years. We intend to treat this amount as a separate building block. This removes a possible disincentive to issuing debt with a long original term (beyond five years), as such debt has benefits for consumers including by reducing refinancing risk.

Forecasts of expenditure to manage the Watercare network

- X28 Watercare's proposal should include forecasts of the expenditure needed to deliver services from, and invest in, its network. These forecasts, with supporting evidence, form the heart of the proposal Watercare should submit to us.
- X29 We propose to assess Watercare's expenditure forecasts against two objectives. First, whether the forecast expenditure represents the level of costs that an efficient and prudent supplier would incur during the PQP period, informed by Watercare's IDAM Plan. Second, an efficiency improvement objective: we will assess whether Watercare has credible and well-evidenced plans for achieving ongoing efficiency gains, including whether those planned efficiencies, as set out in its Operating Cost Efficiency Improvement Plan, are appropriately integrated into and reflected in its expenditure forecasts.
- X30 Operating expenditure will be a significant component of costs during PQP28, and we expect Watercare's proposal to explain clearly the drivers of changes in operating

expenditure; the links between operating expenditure, capital investment, and service quality; and its ongoing initiatives to improve operating efficiency.

- X31 Watercare's proposal should clearly set out and evidence its capital expenditure programme, including the need for investment, how projects are prioritised and sequenced, and how the programme is deliverable. It should demonstrate alignment with identified outcomes and explain how key risks and uncertainties have been managed. We propose to scrutinise all material capital projects, including any that are proposed to be funded through the Infrastructure Funding and Financing mechanism.

Service quality levels

- X32 The PQP will include one or more quality standards to ensure Watercare has incentives to maintain the quality of service it provides to consumers. The Charter sets five quality standards that Watercare reports on, and we can seek court orders for breaches of, but these standards will expire with the rest of the Charter in June 2028.
- X33 Watercare's proposal should include its suggestions on the minimum quality standards for PQP28. Watercare should also explain how it measures performance, how past performance has informed its targets, what it has learnt from any consumer engagement, and how (if at all) the proposed expenditure programme is expected to impact service quality levels.
- X34 The Act also allows for setting additional performance requirements and quality incentive schemes. We do not yet have a view on whether performance requirements to incentivise service quality would be appropriate for PQP28. However, at this early stage of the regime we do not propose to establish a quality incentive scheme, such as a consumer compensation scheme.

Taxation

- X35 As Watercare is exempt from corporate income tax, we propose there is no tax building block.

Risk allocation, reopeners and incentives

- X36 We propose that only narrow, clearly defined in-period adjustments to allowed revenues would be allowed in PQP28. Proposed adjustments include specified pass-through costs (such as government levies) and a general reopener for catastrophic events and legislative changes.
- X37 We propose a limited number of wash ups for differences between forecast and actual outcomes, including revenue under- or over-recovery (consistent with a revenue cap), differences between consumer price index (**CPI**) forecasts and actuals, and pass-through costs.
- X38 We are not proposing any bespoke financial incentive mechanisms.

Verification, audit and certification

- X39 We propose to appoint, with Watercare, an independent verifier (**verifier**) to assess Watercare's proposed expenditure programme and proposed service quality levels.
- X40 The verifier's report should serve as a valuable input to our work and help us to prioritise our assessment of Watercare's proposal. We also expect the verifier's work to identify lessons and guidance that Watercare can benefit from in prioritising expenditure and developing proposals for subsequent PQP periods.
- X41 We propose that Watercare's proposal should be certified by two Watercare directors and be subject to audit. That should give us, and other stakeholders, greater confidence in the accuracy and completeness of its proposal.

The Emerging Views Paper improves transparency and certainty for stakeholders

- X42 Transparency and predictability are key goals for us, and we expect that the Emerging Views Paper will prove helpful to all stakeholders. It will improve the predictability of how we expect price-quality regulation will operate for Watercare.
- X43 The paper will be of particular practical benefit for Watercare in preparing its proposal for PQP28. It will also assist all stakeholders to better understand our emerging views on setting a PQP for Watercare.
- X44 We invite all stakeholders to comment on the emerging views set out in the Emerging Views Paper.