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Tēnā koutou,

We seek feedback on the approach to estimating the cost of debt for the cost of capital for Watercare's price-quality path 2028

The Commission has today announced a final decision to adopt a five-year simple trailing-average approach to the cost of debt (TACD) for sectors covered by Input Methodologies (IMs). This decision has been made as part of the Common Cost of Capital Input Methodology Review.[1] A final decision reasons paper and determination will be issued in Q4 of 2026. Alongside the final decisions we will also be consulting on a range of implementation decisions relating to the TACD for sectors covered by IMs.[2]

While water is not currently covered by IMs, in our Emerging Views (EV) Paper for the Watercare price-quality path 2028 (PQP28), we published a method for estimating the cost of capital that was based on the common cost of capital IMs that applied at that time.[3] That emerging view included using the existing prevailing-rate approach to estimating the cost of debt.

The final decision to move to a TACD is a development for sectors covered by IMs, so this letter seeks stakeholder views on whether we should adopt the TACD for PQP28 or retain the prevailing-rate as proposed in our EV paper and reconsider it at a subsequent reset.

We consider that having a common approach to the cost of capital across the sectors we regulate is desirable. If we retain the prevailing-rate approach for PQP28, we are likely to revisit whether to adopt a TACD for Watercare in its subsequent price-quality path.

Watercare is currently preparing its proposal for PQP28, which is due to commence on 1 July 2028. Watercare will consult on its proposal in early 2027 and submit its fin al proposal to us in May 2027.

Because Watercare will need to complete most of its proposal before those draft TACD implementation decisions are known, we consider there are two options for adopting the TACD for Watercare.

[1] For more details see Commerce Commission "2027 Input Methodologies Review – Common cost of capital" webpage.

[2] For example, how to update the revenue path for changes in the TACD, treatment of inflation forecasts, and revaluation of the Regulatory Asset Base.

[3] Commerce Commission "Price-Quality Path for Watercare – Emerging Views Paper" (25 June 2026), p. 58

Option 1: Retain the prevailing-rate approach for Watercare's price-quality path 2028 and adopt a trailing-average cost of debt in the future

Our preferred option would be to retain the prevailing-rate approach for PQP28 and consider adopting the TACD at the subsequent reset.

Watercare's submission on the EV paper expressed concern about the level of regulatory uncertainty in the PQP28 process:[4]

> Third, Watercare is transitioning to a new economic regulatory framework at the same time as investment requirements are accelerating. The challenge is not simply setting an enduring regulatory model, but ensuring the transition occurs in a way that preserves investment capacity, financial resilience and efficient access to debt markets. Equally important, Watercare requires sufficient regulatory certainty to make long-term financing, procurement and delivery decisions with confidence.

The move to a TACD, and the timing of when implementation details would be known, would create additional uncertainty for PQP28. We consider that by delaying the implementation of the TACD to a future reset, we could provide Watercare with more certainty around one element of the economic regulatory framework in time to influence its PQP proposal.

By retaining the prevailing-rate approach, Watercare could continue to firm up its debt management strategy based on those parameters identified in the EV paper rather than having to wait until we make our final decision on the implementation of a TACD for those sectors covered by IMs.

Watercare would also have more certainty around the form that the price path would take, with our proposed approach substantively based on lessons learned from the other sectors we regulate. Under the current prevailing-rate approach, price paths require limited updates once set, and those updates tend to be mechanistic reconciliations between forecast and actual values.

A shift to a TACD for PQP28 would require consideration of a range of implementation details, and there may be no immediately clear preferred approach. Such consideration could divert limited resources (from both us and Watercare) when there is already considerable work required to implement PQP28. Our draft PQP28 decision, likely around the end of 2027, would allow all stakeholders including Watercare the ability to submit on our proposed price-quality path, including the TACD.

Delaying implementation of a TACD until Watercare's next reset, expected in 2031, would not see Watercare on a TACD in similar timeframes to the other sectors we regulate, with electricity lines businesses subject to a TACD from 1 April 2030, and gas pipeline businesses in 2031.

[4] Watercare Services "Submission on PQP for Watercare Emerging Views Paper" (30 July 2026), p. 4

Option 2: Adopt the trailing average cost of debt for Watercare's price-quality path 2028

Alternatively, we could look to adopt the TACD for Watercare's PQP28, which commences on 1 July 2028. By adopting the TACD for PQP28, Watercare could adopt hedging practices in keeping with the long-term trajectory of the regulatory regime.

By adopting a TACD for PQP28, Watercare would be the first of the entities regulated under Part 4 of the Commerce Act to be subject to a TACD, with the other entities following as their price paths are reset. This would prevent Watercare, and the water sector, from benefitting from the implementation experience of other, more established sectors. Watercare would be relying on what could be developed in time for PQP28, rather than an implementation that best fits its circumstances. Since the specific details of how a TACD would apply are not likely to be finalised until some time in 2027, Watercare would likely finalise its proposal, and we would commence our work assessing it, before those details of the TACD are finalised.

As water regulation is not currently subject to IMs, we have a large amount of flexibility in how we could design a price-quality path to accommodate a TACD. This flexibility does mean that Watercare would have limited certainty on how we would apply the TACD until we had developed those details sufficiently.

Providing feedback

We welcome feedback on the views set out in this letter by 5pm, Wednesday 14 October 2026. Responses should be addressed to wai@comcom.govt.nz, with 'Feedback on approach to the cost of capital for Watercare PQP28' in the subject line of your email.

We intend to publish feedback we receive, unless there is a clear and explicit request to not publish it due to confidentiality or commercial sensitivity. We will consider any such requests on their merits.

Ngā mihi nui,

John Small
Commerce Commission Chair