

CHAPTER 5: PUBLIC TRADING ENTERPRISE SECTOR

- ◆ The public trading enterprise (PTE) sector consists of businesses operating in a diverse range of industries, including electricity, water and sewerage, transport, public housing, ports, property, forestry and waste services.
- ◆ Commercial PTEs (e.g. electricity, water and ports) are profitable and provide a return on the assets invested on behalf of the community. Non-commercial PTEs (e.g. transport and public housing) provide important social services and are supported by the Budget through the provision of grants and subsidies.
- ◆ Total assets of commercial PTEs are estimated to increase from \$52.9 billion in 2007-08 to \$65.6 billion in 2010-11. For non-commercial PTEs, the asset base is estimated to increase from \$48.9 billion in 2007-08 to \$55.4 billion in 2010-11.
- ◆ Earnings in the PTE sector are projected to grow strongly over the forward estimates period, with the net operating surplus before interest, tax, depreciation, dividends and amortisation growing at an average 17.4 per cent per annum from 2007-08 to 2010-11, reaching \$8.2 billion by 2010-11. The earnings growth primarily reflects increased budget grants to fund capital expenditure in the rail sector and expected higher revenues in water and electricity to meet increased depreciation and interest expenses associated with record capital expenditure.
- ◆ Cash flows from operations are also expected to grow strongly, from \$3.5 billion in 2007-08 to \$6.1 billion in 2010-11, a growth rate of 20.4 per cent per annum. This increase reflects the higher budget grants to the rail sector and the expected revenue increases in water and electricity.
- ◆ Reflecting the increased profitability of the commercial PTEs and against a record investment of \$21.5 billion over the forward estimates period, dividends and tax equivalent payments to the State Budget are estimated to increase from \$1.8 billion in 2007-08 to \$2.1 billion in 2010-11.
- ◆ The PTE sector represents more than half of the total State sector's infrastructure program, and continues to be in a very strong capital investment phase. Capital expenditure is expected to increase from \$5.5 billion in 2006-07 to \$7.6 billion in 2007-08 and reach \$8 billion by 2010-11. In total, expenditure of about \$31 billion is expected over the next four years, up from \$17 billion over the four years to 2006-07. The substantial increase is driven primarily by the planned upgrading of Sydney's rail system, securing future water supplies in the greater metropolitan region, growth in demand for electricity and ensuring continued electricity network reliability.
- ◆ Net debt grows significantly over the forward estimates period, as a result of the increased capital expenditure. However, gearing remains at prudent levels, reaching 43.1 per cent for commercial PTEs by 2010-11.

5.1 INTRODUCTION

The public trading enterprise (PTE) sector is comprised of businesses operating in a diverse range of industries. This sector includes commercial businesses (e.g. electricity, water, waste services and ports) that are profitable and provide a return on the assets invested on behalf of the community. The sector also includes non-commercial businesses that address important social policy objectives (e.g. public transport and housing). Non-commercial PTEs receive budget support through grants and subsidies, but they differ from general government budget dependent agencies in that they have significant other independent sources of income (e.g. fare revenue).

The efficiency of PTEs and their ability to meet defined service delivery objectives have a major impact on the NSW economy and community well-being.

5.2 OVERALL PERFORMANCE OF THE SECTOR

THE COMMERCIAL POLICY FRAMEWORK

PTEs are not subject to debt and equity market monitoring in the same manner as private sector businesses. They are, however, subject to the Government's *Commercial Policy Framework*, which was introduced in the early 1990s. The framework attempts to replicate private sector disciplines and incentives that promote efficient commercial practice. This framework applies to all PTEs including State owned corporations which are governed by the *State Owned Corporations Act 1989*. Under the *Commercial Policy Framework*, PTEs are expected to enhance the wealth of NSW citizens through efficient resource allocation and effective financial management.

The *Commercial Policy Framework* has contributed to improved financial performance in the PTE sector. The book value of the government's equity investment in the PTE sector has grown from \$48.1 billion in 2001-02 to an estimated \$67.9 billion in 2007-08. Over the same period the return on assets achieved by the electricity and water businesses has increased from 6 per cent to an estimated 6.9 per cent.

Since the introduction of the framework PTEs, after funding their own operational and capital expenditure requirements, have provided significant dividend, tax equivalent and government guarantee fee payments to help fund general government sector services such as health, education and law and order.

Under the *Financial Distribution Policy for Government Businesses*, commercial businesses are expected to make dividend payments from available residual cash after allowing for working capital, funding of investments, and providing an appropriate contingency for financial flexibility, while maintaining a level of gearing consistent with industry norms. Tax equivalent and government guarantee fee payments replicate normal private sector business costs and place commercial PTEs on a level playing field with the private sector.

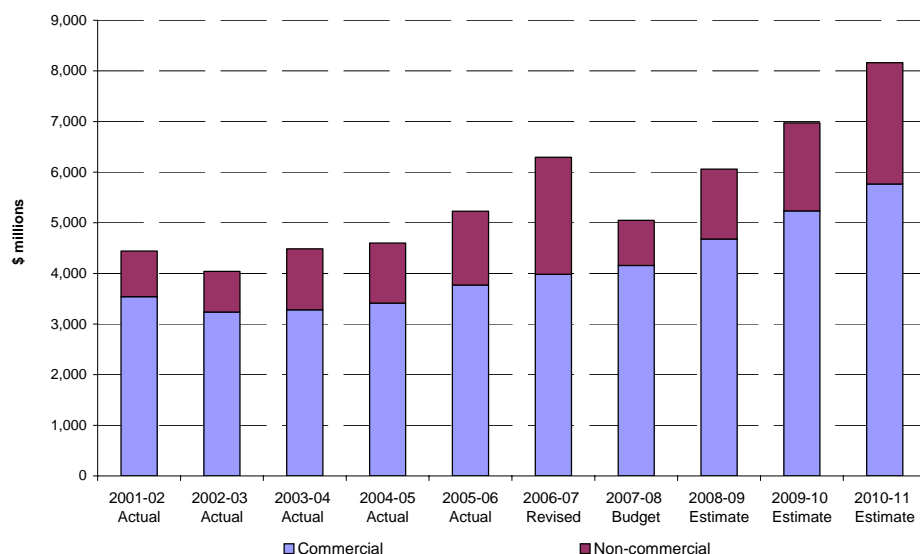
The *Capital Structure Policy for Government Businesses* outlines how commercial PTEs are to be financed by a commercially prudent debt and equity mix. This policy sets the general requirement for government businesses to retain an investment grade credit rating and provide an appropriate stream of dividends. Under this policy, borrowings can move within an approved range, recognising the lumpy nature of capital expenditure.

The Government continues to refine the *Commercial Policy Framework* and seeks efficiencies in PTE operations to improve overall returns for the community from its investment.

OPERATING PERFORMANCE

Under the accrual government finance statistics (GFS) framework, a good measure of PTE sector financial performance is the net operating surplus before interest, tax, depreciation, dividends and amortisation (termed *adjusted net operating surplus*). This measure is equivalent to earnings before interest, tax, depreciation and amortisation (EBITDA) commonly used in the private sector. Chart 5.1 shows the adjusted net operating surplus for the PTE sector in the period 2001-02 to 2010-11.

Chart 5.1: Adjusted Net Operating Surplus, 2001-02 to 2010-11



In 2006-07, the adjusted net operating surplus is inflated by a payment of \$960 million to the rail sector to retire debt. The resultant reduction in interest expense will reduce future operating subsidies to the rail sector. However, capital grants to the rail sector are expected to increase over the forward estimates period, as discussed below.

The adjusted net operating surplus in the PTE sector is projected to grow strongly at an average 17.4 per cent per annum from 2007-08 to 2010-11. This growth reflects higher grants from the State Budget to fund capital works in the rail sector (capital grants are recorded as revenues in PTEs). Growth in the adjusted net operating surplus also stems from the expected recovery of capital expenditure in the water and electricity sectors through IPART pricing determinations.

The adjusted net operating surplus of the transport sector is forecast to increase from \$582 million in 2007-08 to \$2 billion in 2010-11, driven by the increased budget grants. The underlying trend (i.e. excluding capital grant revenues) shows expenses growing faster than fare revenue. CityRail’s fare revenue as a proportion of operating expenses (excluding depreciation) has fallen from 30 per cent in 2001-02 to an estimated 23 per cent in 2007-08.

The adjusted net operating surplus of the water sector is expected to increase at an average 21.1 per cent per annum between 2007-08 and 2010-11. This increase reflects the expectation that IPART's next pricing determination will result in higher revenue to meet increased depreciation and interest expenses associated with higher capital expenditure required to secure future water supplies.

The adjusted net operating surplus of the electricity sector is expected to increase by 3.1 per cent per annum over the same period. This growth can be largely attributed to:

- ◆ earnings growth from the regulated electricity distribution and transmission sectors, expected to be endorsed by the Australian Energy Regulator, to recover increased capital expenditure requirements;
- ◆ forecast electricity demand growth; and
- ◆ retail electricity prices expected in IPART's 2007 determination.

The adjusted net operating surplus of the housing sector is forecast to increase by 10.1 per cent per annum across the forward estimates period from \$309 million in 2007-08 to \$412 million in 2010-11. This growth largely reflects higher budget grants as part of the *Reshaping Public Housing* reforms announced in 2005.

Strong PTE sector earnings growth is reflected in:

- ◆ return on total assets¹ (excluding housing and transport) improving from 5.3 per cent in 2007-08 to 6.0 per cent in 2010-11; and
- ◆ tax and dividend payments to the State Budget increasing from \$1.8 billion in 2007-08 to \$2.1 billion in 2010-11.

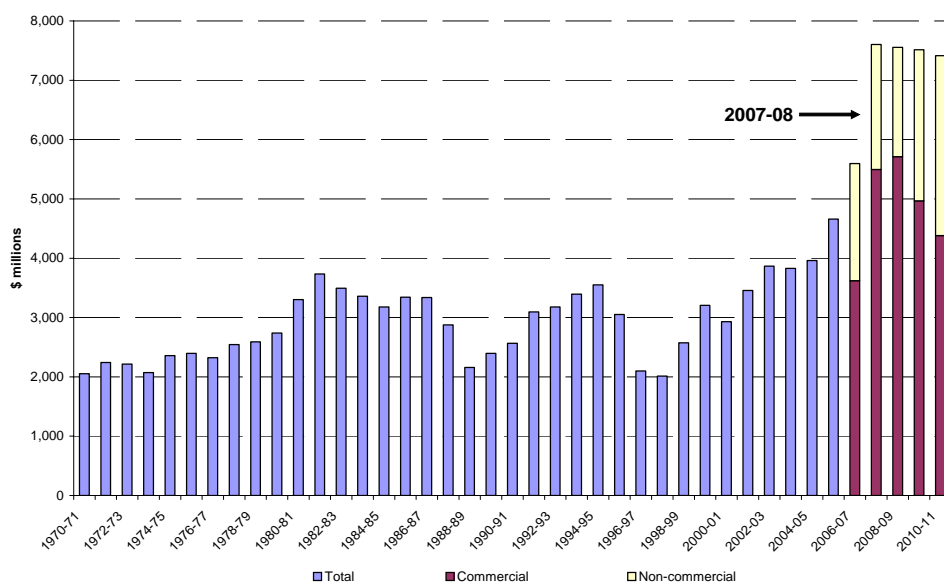
CAPITAL EXPENDITURE

Trends in Capital Expenditure

The PTE sector is a major provider of State infrastructure, accounting for more than half of the total State sector's capital expenditure over the next few years. Total PTE capital expenditure tends to be cyclical due to the lumpy nature of infrastructure investments. The capital program grew significantly in the early 1980s reflecting growth in electricity generation and transmission, rail and ports infrastructure. It peaked again in the mid 1990s, driven by increased expenditure in transport and housing. Chart 5.2 shows the cyclical nature of the program, after removing the effect of inflation.

¹ net operating surplus before interest and taxes divided by total assets

Chart 5.2: PTE Sector Capital Expenditure, 1970-71 to 2010-11, in real 2007-08 dollars^(a)



(a) Figures converted to real dollars using the NSW State & Local Public Gross Fixed Capital Formation Deflator, provided by the Australian Bureau of Statistics.

The PTE sector is currently in a period of record capital expenditure levels, with expenditure anticipated to remain at high levels over the forward estimates period. Investment in water, electricity, transport and ports infrastructure are the main contributors to the significant ramping up in PTE capital expenditure.

Capital Expenditure in the Forward Estimates Period

In *nominal* terms, PTE capital expenditure is expected to grow by 39.3 per cent in 2007-08 to \$7.6 billion, compared with \$5.5 billion in 2006-07. Expenditure continues to grow over the forward estimates period, reaching \$8 billion by 2010-11.

Capital expenditure in the electricity sector is expected to grow by 24.2 per cent in 2007-08 from \$2.3 billion to \$2.9 billion. Expenditure is expected to peak in 2008-09 at \$3.2 billion, then decrease in the following two years. The main focus of this capital expenditure is expanding and upgrading the high voltage and distribution networks in order to meet demand growth and enhance continued reliability and security in electricity supply across the State by meeting new reliability standards.

Investment in the water sector is expected to increase significantly over the coming years. Capital expenditure is expected to rise in 2007-08 by 129 per cent from \$938 million to \$2.2 billion, falling to \$1.6 billion by 2010-11. The main drivers behind the capital spending increase include recycling projects and urban growth in Sydney, the Kurnell desalination plant, and the new Tillegra dam in the Hunter region.

Rail investments, including the Rail Clearways Program, new rollingstock purchases and the planned expansion of the Sydney network substantially boost capital spending plans in the transport sector from \$1.5 billion in 2007-08 to \$2.5 billion by 2010-11.

Capital expenditure by Sydney Ports Corporation on the Port Botany expansion is the major contributor to the substantial increase in capital expenditure in the ports sector from \$191 million in 2007-08 to its peak of \$378 million in 2009-10.

Investment in the housing sector increases by 7.6 per cent in 2007-08 to \$613 million, and then peaks at \$681 million in 2009-10. The increase is a result of the Department of Housing's State-wide, long term plan to reconfigure public housing assets to address changing demographics and smaller sized family units.

Table 5.1: PTE Capital Expenditure by Sector

Sector ^(a)	Revised	Budget	Forward Estimate			Total
	2006-07 \$m	2007-08 \$m	2008-09 \$m	2009-10 \$m	2010-11 \$m	
Electricity	2,314	2,873	3,167	3,121	2,964	14,439
Water	938	2,150	2,129	1,597	1,634	8,448
Transport	1,356	1,485	1,297	1,909	2,456	8,503
Ports	81	191	344	378	175	1,169
Housing	570	613	600	681	642	3,106
Property	103	188	132	108	57	588
Other	97	104	75	99	56	431
Total	5,459	7,604	7,743	7,894	7,985	36,684

(a) More detail on PTE infrastructure plans is outlined in Budget Paper No. 4. PTEs have been classified according to their primary function. For example, Country Energy's Broken Hill water operations have been classified in the Electricity sector. Classifications may not align with the PTE classifications used in Budget Paper No. 4.

Since last year's Budget a number of new capital expenditure projects have been announced in the PTE sector. As a result, PTE capital expenditure is considerably higher than that projected in last year's Budget.

Over the four year Budget period (2007-08 to 2010-11), total PTE capital expenditure is forecast to be approximately \$8.2 billion higher than that estimated over last year's Budget period (2006-07 to 2009-10).

The \$3.3 billion increase in the water sector is mainly due to the inclusion of new projects in the 2007-08 Budget including the Kurnell desalination plant (\$1.9 billion), groundwater borefields (\$207 million), Tillegra Dam (\$245 million) and recycling projects including the Western Sydney return flows scheme (\$321 million). There has also been a significant increase in growth works to service new urban development in the North-West and South-West of Sydney (\$194 million).

In the transport sector, the majority of the \$2.7 billion increase reflects the planned expansion of the rail network (around \$2.1 billion), as well as costs related to the acquisition of 626 new air-conditioned rail carriages and the extension to the Rail Clearways Program to duplicate the Richmond Line to Vineyard.

The \$1.4 billion electricity sector increase is mainly due to costs associated with the growth in electricity demand. An additional \$50 million is projected to be spent by Macquarie Generation on river pumps to assist with drought mitigation, while \$50 million relates to the re-phasing of expenditure on the gas fired power plant at Lake Munmorah.

The remaining \$800 million increase in the PTE sector includes capital expenditure increases in the housing sector (\$434 million), property sector (\$91 million) and the Port Botany expansion.

It is anticipated that additional capital expenditure in the regulated water, electricity network and ports sectors (approximately \$4.9 billion), will earn a commercial rate of return primarily through regulatory pricing determinations.

CAPITAL STRUCTURE

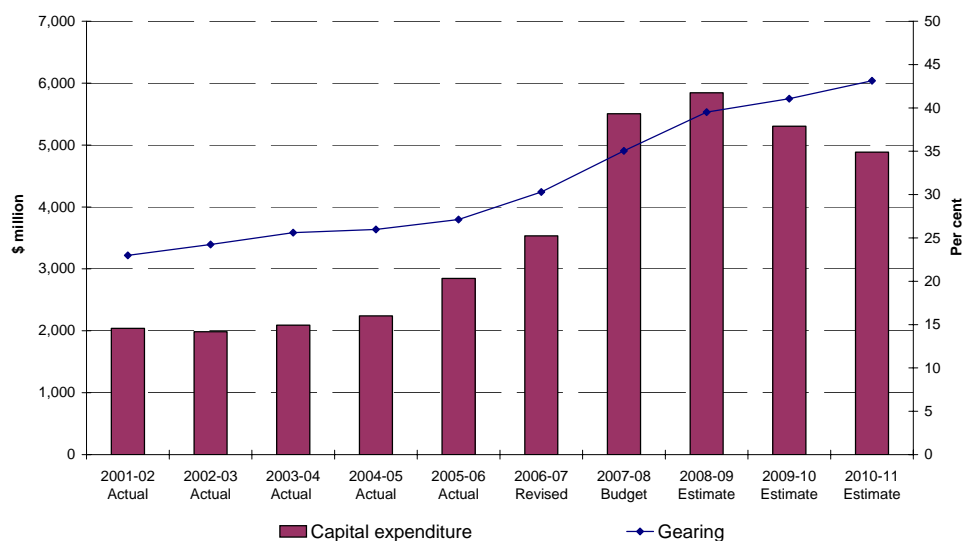
Commercial PTEs such as electricity, water, and ports are financed by a commercially prudent mixture of debt and equity. The transport and housing sectors are not subject to commercial capital structures as capital expenditures in these sectors are largely Budget funded.

As detailed in Chapter 4, net debt in the PTE sector is forecast to grow significantly to 2010-11, due to increasing capital expenditure levels. Borrowing by commercial PTEs to finance capital investments is an important part of applying commercial discipline. Non-commercial PTEs have less debt, as capital grants from the State Budget are the primary source of finance for capital expenditure.

Gearing levels for the commercial PTEs (i.e. excluding transport and housing) are projected to increase from 35.1 per cent in 2007-08 to 43.1 per cent in 2010-11. Although this increase is significant, it remains well within commercially prudent levels. As a guide, for price-regulated electricity and water businesses (which account for most of the borrowings by commercial PTEs), gearing levels of less than 50 per cent are consistent with a strong investment grade credit rating.

The appropriate gearing ranges for individual businesses are assessed according to the Government's *Capital Structure Policy for Government Businesses*.

Chart 5.3: PTE capital expenditure and Gearing^(a) (excluding housing and transport), 2001-02 to 2010-11



(a) Gearing is defined as the ratio of Net Debt to Total Assets

Within the commercial PTE sector, efficient investment decisions require a return which covers the cost of capital. Hence capital investments generate revenues to support the sector's debt levels, and pay a return on the Government's equity investment.

Investment in the regulated electricity network and water businesses accounts for over 80 per cent of capital expenditure by commercial PTEs. Prices charged by these businesses are set by independent regulators, who allow for a commercial rate of return on efficient capital expenditures.

Due to increased debt levels, net operating surplus interest coverage (defined as adjusted net operating surplus divided by interest expense) for the commercial PTE sector is projected to fall from 4 to 3.3 times over the forward estimates period.

During periods of high debt funded capital expenditure, it is expected that growth in interest expense will outstrip growth in earnings in the short to medium term. This is consistent with the Government's *Capital Structure Policy*, which allows for borrowings (and resulting debt servicing capacity) to move within a prudent range during phases of the investment cycle. With capital expenditures expected to generate returns above the cost of capital, overall shareholder returns will continue to increase.

5.3 MAJOR FUNCTIONAL AREAS

ELECTRICITY

The State owns the major NSW electricity utilities:

- ◆ three *generators* – Macquarie Generation, Delta Electricity and Eraring Energy;
- ◆ the high voltage *transmission* corporation – TransGrid; and
- ◆ three *distribution and retail* businesses – EnergyAustralia, Integral Energy and Country Energy.

In total, State-owned generators have approximately 12,000 megawatts of installed capacity, generating around 68,000 gigawatt hours per year. NSW distributors have approximately 3.1 million network customers. The State also owns a 58 per cent share in the hydro electricity generator, Snowy Hydro Limited, which has a capacity of 3,700 megawatts, and generates around 4,000 gigawatt hours per year.

Directions in Electricity

Balancing Supply and Demand

Demand for electricity in New South Wales continues to grow. A key driver is population growth, particularly in the North-West and South-West of Sydney, and the North coast and the South coast of New South Wales, resulting in more new households being connected to the network.

In addition, peak demand is growing at a faster rate than average demand. Since electricity cannot be stored, generators must be available to meet the peak demand when it occurs, and the network must be able to carry the peak load for the few days of the year when it occurs. Historically, the NSW peak demand occurred in winter. However, with the rapid increase in the number of households with air conditioning, peak demand is now more likely to occur in summer.

The National Electricity Market Management Company has forecast a tightening of the demand-supply balance such that New South Wales will require additional peak generating capacity from around 2010-11 to maintain reserve capacity. Reserve capacity is generating capacity that is on standby so that demand can still be met if another generator ceases to generate.

The Minister for Energy revised the licence conditions for the three NSW distributors in 2005 to ensure that they maintained reliability and network performance for their customers. The standards include design planning criteria for various network components, and indices of the average number of interruptions to supply per customer and the average duration of interruptions to supply per customer.

Abolition of the Electricity Tariff Equalisation Fund

In 2005 the Government announced that the Electricity Tariff Equalisation Fund (ETEF) will be progressively phased out. The Government introduced ETEF in 2001 to enable retail electricity prices to be regulated without exposing retailers or the Government to unacceptable financial risk. As retail competition has developed, fewer customers remain on regulated electricity prices. When ETEF commenced, approximately 35 per cent of total electricity demand in NSW was sold on regulated tariffs, and hence subject to ETEF. With the introduction of full retail competition from 1 January 2002, all NSW customers have a choice of retail supplier at negotiated prices. Consequently, the proportion of total load that is subject to ETEF has now fallen to approximately 21 per cent.

Currently, 100 per cent of regulated retail load is supported by the ETEF. From September 2008, the level of support will reduce to 80 per cent and then to 60 per cent in March 2009, 40 per cent in September 2009 and 20 per cent in March 2010, with ETEF fully phased out by June 2010.

Investment in the Electricity Networks

The NSW electricity network businesses (transmission and distribution) are driving the high capital expenditure levels in the electricity sector. Over the next four years, distribution and transmission businesses are forecasting capital expenditure of around \$10.7 billion. This reflects customer growth, with high numbers of new connections, increasing summer peak demand, renewal of the asset base and stringent regulatory requirements.

The network businesses have also significantly increased their planned capital expenditure to maintain continued reliability in electricity supply across the network, in response to the licence conditions introduced in 2005.

Investment in Generation

Delta Electricity is constructing a 667 megawatt gas fired power plant at Lake Munmorah on the Central Coast. This power plant will cater for growing peak energy demand and is expected to be completed by 2009-10. Delta Electricity will also upgrade the capacity of Mount Piper power station near Lithgow by up to 180 megawatts by 2008-09.

The private sector is also committed to investing in gas fired generation, with a 434 megawatt plant at Tallawarra near Wollongong due to be completed in winter 2008.

In May 2007 the Government appointed Professor Anthony Owen to advise on the future baseload electricity needs in New South Wales. The Owen Inquiry into Electricity Supply in New South Wales will provide advice on the actions required to ensure timely investment in generation capacity that addresses greenhouse gas emissions while maintaining New South Wales' triple-A credit rating. Public submissions to the Inquiry close on 29 June 2007 and Professor Owen is expected to report to the Government by 31 August 2007.

TRANSPORT

The transport sector incorporates:

- ◆ *Rail services* – Rail Corporation New South Wales (RailCorp) is responsible for passenger rail services (CityRail and CountryLink) and Rail Infrastructure Corporation manages the country regional network. The Transport Infrastructure Development Corporation (TIDC) is a construction authority managing major rail infrastructure projects. The State Rail Authority (SRA), formerly responsible for passenger services, is being wound up;
- ◆ *Bus services* - State Transit Authority (STA) provides passenger bus services in metropolitan Sydney and bus and ferry services in Newcastle;
- ◆ *Ferry services* - Sydney Ferries operates passenger services on Sydney Harbour and the Parramatta River; and
- ◆ *Port facilities* - three Port Corporations, Sydney, Newcastle and Port Kembla, manage the State's major ports, including navigation and on-shore facilities.

The sector also includes the Public Transport Ticketing Corporation, responsible for the development of a smart card ticketing system for all public transport operators in the greater Sydney region.

Financing the Transport Sector

Table 5.2 presents a summary of the budget support provided to the transport PTEs.

The projected Budget support of \$3.1 billion in 2007-08 is an increase of \$544 million or 21 per cent over 2003-04 grants of \$2.6 billion. In 2007-08 budget grants will decline, reflecting the debt reduction payment made in 2006-07 and a higher proportion of the rail capital program being funded by debt with the ramping up of the Rail Clearway Program and winding down of the Epping to Chatswood Rail Line. Overall capital spending by Rail Corporation will increase by \$118 million or 14.3 per cent.

In 2007-08, Rail Corporation plans to spend \$2.4 billion on operating costs (excluding depreciation) on CityRail and CountryLink services. Operating costs will be financed by budget grants of \$1.5 billion (which includes a contribution to concessional rail travel provided to students and pensioners), farebox revenue of \$590 million and miscellaneous income. Capital investment by Rail Corporation is projected at \$948 million, an increase of \$118 million or 14.3 per cent on last year, financed by budget grants of \$390 million, borrowings and internal funds.

Table 5.2: Budget Support for the PTE Transport Sector^(a)

	<i>Actual 2003-04 \$m</i>	<i>Actual 2004-05 \$m</i>	<i>Actual 2005-06 \$m</i>	<i>Revised 2006-07 \$m</i>	<i>Budget 2007-08 \$m</i>
Rail Services					
Operating grants	1,471	1,518	1,683	1,692	1,722
Capital grants (plus asset sale proceeds)	394	530	673	674	465
Debt reduction payment	960	...
Sub-total – Rail Services	1,865	2,048	2,356	3,326	2,187
Bus and Ferry Services					
Operating grants	240	282	290	337	328
Capital grants	...	5
Private Operators / Community Groups	458	455	521	572	592
Sub-total – Bus and Ferry Services	698	742	811	909	920
Total Net Budget Funding: Transport	2,563	2,790	3,167	4,235	3,107

(a) The Budget also supports borrowings by transport agencies to fund capital works. Operating grants also include fare concessions for pensioners and students. From 2007-08, grants for acquisition of new buses by the STA are reflected through the Ministry of Transport capital program.

Rail Infrastructure Corporation will receive \$201 million in budget grants in 2007-08, including \$130 million for maintenance of the country regional network and \$50 million for works on the interstate and Hunter Valley networks.

TIDC will spend over \$350 million in 2007-08 including \$297 million on the Epping to Chatswood Rail Line, due for completion in the second half of 2008, and \$56 million for investigation and planning for the proposed expansion of the Sydney rail network.

Payments for bus and ferry services are estimated at \$920 million, an increase of \$11 million, or 1.2 per cent on 2006-07.

Directions in Transport

Rail services

Every day CityRail moves one million passengers between 304 stations in a fleet of more than 1,500 carriages, covering over 1,300 kilometres of track.

Significant structural reforms have been implemented in the rail sector since 2004.

Rail Corporation was established as the single passenger rail entity, combining passenger operations (formerly undertaken by SRA), with ownership and responsibility for maintenance of the metropolitan track network (formerly undertaken by the Rail Infrastructure Corporation). Integration enables greater emphasis on network operations, safety, reliability and customer service.

Contractual arrangements implemented with the Australian Rail Track Corporation (ARTC) include a 60 year lease of the interstate and Hunter Valley coal networks and a 60 year regional network management agreement over the remaining country rail corridors. The ARTC and the Commonwealth have given major commitments to New South Wales to upgrade rail infrastructure as part of the arrangements.

These structural reforms, together with recent initiatives, underpin a significant increase in capital investment in both metropolitan and regional rail services, which includes:

- ◆ the \$1.8 billion Rail Clearways Program, to reduce congestion and improve network capacity for more services;
- ◆ a large rollingstock investment program including the \$3.6 billion acquisition and maintenance of 626 new carriages for the suburban rail network under a Public Private Partnership, 122 new outer suburban carriages for the intercity lines and 14 new Hunter Valley carriages;
- ◆ construction of the Epping to Chatswood Rail Line, with three new underground stations, to provide services and connections for commuters;

- ◆ the planned expansion of the rail network into the growth areas of Sydney (\$2.1 billion allocated over four years); and
- ◆ upgrades to safety and network management systems to improve passenger safety and amenity.

Rail Infrastructure Corporation is undertaking signalling and train control improvements for the country regional network to improve system safety and meet operational needs.

Bus services

With the introduction of Metropolitan and Outer Metropolitan Bus System Contracts, the Ministry funds bus services in Sydney, Newcastle, Wollongong and the Blue Mountains through seven year service contracts. These contracts, based on specified service levels, provide greater long-term funding certainty for operators and improved service delivery.

State Transit Authority (STA) of New South Wales is the government owned authority responsible for the operations of Sydney and Newcastle buses and ferries. The Authority services more than 200 million passengers every year, with the largest fleet of buses in Australia, comprising more than 1,900 buses. The Authority also operates ferry services in Newcastle.

Contracted service payments for State Transit Authority bus services are budgeted at \$281.3 million in 2007-08, an increase of \$13.7 million over 2006-07. This funding will support a \$72.7 million capital works program in 2007-08. In addition, 139 buses, comprising 60 standard CNG and 74 Euro 5 diesel buses for the Sydney and Newcastle networks (at a cost of \$63.4 million) and five super metro CBD buses (at a cost of \$4.3 million) will be acquired for use by the STA, but financed by the Ministry of Transport as part of its 2007-08 capital program.

Ports

Port reforms are focused around the implementation of the Ports Growth Plan. The Plan includes Sydney Ports Corporation expanding Port Botany to meet the rapid growth of container movements.

A major redevelopment program is underway to transform Port Kembla into Australia's leading car import centre. A new cargo facility and third berth are under construction to enable Port Kembla to handle nearly 240,000 vehicles a year, along with increased containers and general cargo. This will provide a significant economic boost to the region.

The Plan also includes nominating Newcastle as the site of a future major container terminal once Port Botany reaches its capacity. In the short term, a smaller multi-purpose terminal will be completed in 2008.

Newcastle remains the largest coal port in the world with the privately operated loader having a capacity in excess of 100 million tonnes per annum. Ongoing development at the existing private terminals, and the construction of a newly approved private terminal, will significantly expand coal loading facilities. This planned expansion is being delivered by those private parties and will not require any major changes to the existing infrastructure (including channels) maintained by the Newcastle Port Corporation. Further, the augmentation of supporting rail infrastructure will be undertaken by the Australian Rail Track Corporation (ARTC), the lessee of the Hunter Valley Rail Network. ARTC is a trading corporation owned and controlled by the Commonwealth.

WATER

The State owns four commercial water businesses:

- ◆ *Sydney Water Corporation* provides water, sewerage and some stormwater drainage services in Sydney, the Illawarra and the Blue Mountains;
- ◆ *Sydney Catchment Authority* is responsible for Sydney's drinking water catchment and its infrastructure, and supplies bulk water to Sydney Water and some councils in the Sydney catchment area;
- ◆ *Hunter Water Corporation* is a vertically integrated bulk and retail water and wastewater business in the Hunter region; and
- ◆ *State Water Corporation* is a bulk water business in rural New South Wales, whose main customers are irrigation companies and country towns.

Country Energy's main business is energy distribution and retailing but it also provides water and wastewater services in Broken Hill. Urban water and wastewater services in the rest of regional New South Wales (including the Central Coast) are the responsibility of local councils.

Directions in Water Planning

Balancing Supply and Demand

The Government's 2006 *Metropolitan Water Plan* addressed the challenge of meeting Sydney's normal water needs as they grow over time, and securing supplies in the face of drought.

The Water Plan assessed that with the range of supply and demand side measures currently in place, Sydney has enough water to meet its growth needs until at least 2015.

The Water Plan aimed to secure water supplies in drought by both diversifying water supplies by increased recycling and having contingency plans to invest in non-rainfall dependent sources such as groundwater and desalination.

Since the release of the 2006 *Metropolitan Water Plan*, Sydney's dam levels have fallen significantly and the Government has committed to building a desalination plant at Kurnell and developing bore fields at the Upper Nepean, Leonay and Wallacia.

In the Hunter region, a decision has been made to bring forward the construction of a new dam at Tillegra and improve the connectivity between the Hunter and Central Water regions. This represents a broader regional solution and ensures supply security for both regions for the next 60 years.

Increasing Competition

The Sydney and Hunter regions are being opened to water and wastewater competition. The *Water Industry Competition Act 2006* allows third parties to access water and wastewater infrastructure. Increased competition is expected to encourage new investment and innovation in the metropolitan water industry, while continuing to protect public health, the environment and consumers. Access arrangements are based on a negotiate/arbitrate model and will be regulated by IPART.

Licensing for new entrants is an essential component of the new framework. New entrants will need to obtain a retail licence to provide water or wastewater services and/or a network licence for water or wastewater infrastructure.

Investing in Water Infrastructure

Total capital expenditure for Sydney Water, Sydney Catchment Authority and Hunter Water for the four year period to 2010-11 is forecast to reach \$7.3 billion, an increase of \$4.5 billion or 155 per cent over the preceding four year period. This growth is driven by measures aimed at ensuring water supplies will meet current and future demand in both regions.

The increased capital program will add to water agency debt levels but is not expected to lead to an inappropriate deterioration in the underlying financial position. Stand alone credit ratings remain above investment grade. Regulatory outcomes are expected to ensure the businesses receive a commercial rate of return on capital investments.

In Sydney, the impacts of the current drought on dam storage levels has resulted in government decisions to proceed with a number of major projects including a desalination plant at Kurnell, at a capital cost of around \$1.9 billion.

Sydney Water's capital program over the four year forward estimates period totals \$5.9 billion. This is an increase of \$3.7 billion or 164 per cent over the preceding four year period. Sydney Water's program is driven by:

- ◆ the Kurnell desalination plant;
- ◆ a number of recycling schemes including the Western Sydney return flows scheme at a cost of \$708 million;
- ◆ providing for growth in North West and South West Sydney; and
- ◆ asset renewals.

Sydney Catchment Authority's capital program over the four year forward estimates period totals \$502 million. This is an increase of \$222 million or 79 per cent over the preceding four year period. The Authority's program is being driven by Metropolitan Water Plan projects including:

- ◆ developing borefields at the Upper Nepean, Leonay and Wallacia in response to continuing drought at a cost of \$207 million;
- ◆ infrastructure to enable environmental flow releases from the Upper Nepean and Tallowa dams at a cost of \$52 million; and
- ◆ Shoalhaven transfer infrastructure improvements at a cost of \$36 million.

Hunter Water's capital program over the four year forward estimates period totals \$946 million. This is an increase of \$583 million or 160 per cent over the preceding four year period. Hunter Water's program is driven by:

- ◆ the 450 billion litre dam at Tillegra at a cost of \$245 million;
- ◆ the continuing upgrade of a pipeline and pumps connecting the Hunter and the Central Coast, at a cost of \$5.5 million;
- ◆ the Kooragang Island recycling project at a cost of \$26.3 million;
- ◆ water and wastewater treatment works (at Morpeth, Raymond Terrace, Dora Creek, Belmont, Boulder Bay, Newcastle and Paxton) at a cost of \$142.7 million;

- ◆ providing for urban growth; and
- ◆ the renewal of existing assets.

SOCIAL HOUSING

The Department of Housing manages the State's social housing portfolio and develops broader housing strategies. The Department provides tenancy and property management for around 130,000 public housing dwellings. Total recurrent expenditure in 2007-08 is estimated at \$1.35 billion, with a further \$601 million for capital works. The Department will receive a grant of \$491 million from the budget in 2007-08.

While the Department sets market rents for its properties, around 90 per cent of current tenants are eligible for a subsidy. These tenants pay a subsidised rent based on a percentage of the total income of the household. In 2007-08, the value of the Department's rental subsidies is estimated at \$683 million.

The NSW Government is continuing implementation of the *Reshaping Public Housing* reforms announced in 2005. These reforms ensure a fairer and sustainable public housing system that promotes responsibility and better aligns with community needs. Changes have included revisions to the eligibility and length of tenure to better reflect tenant circumstances, and a staged reconfiguration of the housing portfolio to more accurately meet the tenant profile.

In 2007-08, reconfiguration of the housing portfolio, including community housing stock, will result in 1,199 new one and two bedroom dwellings to suit changing demographics and smaller sized family units. This includes 262 dwellings to suit the elderly under the *New Directions in Social Housing for Older People* initiative, and 216 dwellings adaptable or specifically built for people with disabilities.

In accordance with the *NSW Housing and Human Services Accord* released in April 2007, cross-agency partnerships will also be developed to provide housing and support services for tenants with complex needs.

As announced in March 2007, the NSW Government will expand affordable housing initiatives. This will include a boost in funds to community housing providers, and the provision of long term leases over certain public housing stock to attract private investment. The plan also includes the establishment of a \$49.8 million Affordable Housing Innovations Fund, including funding to provide 70 new rental properties on the ADI St Mary's site in Western Sydney.

Over the next five to ten years, the Government will work with local councils, the private sector and the local community to renew public housing estates in Bonnyrigg and Minto. This is part of the *Living Communities* program to renew high-need public housing estates in New South Wales. In addition, a staged plan will be implemented over the next three years to transform the West Dubbo Estate and provide better, more appropriate housing for clients in the area.

The Department of Housing is continuing to trial the Maintenance Reform program across a number of pilot areas. The objective of the program is to establish a new direction in the maintenance of public housing through a more cost effective, systematic, lifecycle planning approach.