

CHAPTER 7: PUBLIC TRADING ENTERPRISES

- ◆ The public trading enterprise (PTE) sector includes commercial businesses that are profitable and provide a return to government on the assets invested (e.g. electricity, water, waste services and ports).
- ◆ The sector also includes non-commercial businesses that address important social policy objectives (e.g. public transport and social housing).
- ◆ The commercial PTE sector is forecast to experience strong earnings growth over the Budget and forward estimates period, almost entirely due to expected earnings growth in the water and electricity distribution and transmission sectors.
- ◆ Reflecting this increased profitability, contributions to the Budget from commercial PTEs in the form of dividends and tax equivalent payments are estimated to increase from \$1.8 billion in 2008-09 to \$2.2 billion in 2011-12.
- ◆ The PTE sector is currently in a period of record capital investment with \$36.4 billion expected to be spent over the Budget and forward estimates period.
- ◆ This capital expenditure is projected to be \$2.7 billion higher between 2008-09 and 2010-11 than estimated in last year's Budget, reflecting increased expenditure by the electricity distribution and transmission businesses to address ageing assets and new transport projects announced since last year's Budget.
- ◆ To fund this record capital expenditure, net debt in the PTE sector is forecast to grow from \$18.6 billion in June 2008 to \$37 billion in June 2012.
- ◆ The gearing level of commercial PTEs will increase to 54.4 per cent by June 2012. This remains well within commercially prudent levels.

7.1 INTRODUCTION

The public trading enterprise (PTE) sector includes commercial businesses which provide a return to government on the assets invested on behalf of the community (e.g. electricity, water, waste services and ports). Dividend and tax equivalent payments from commercial PTEs will contribute an estimated \$1.8 billion to the Budget in 2008-09, and will be applied towards the cost of providing high quality public services, such as health, education, and law and order.

The sector also includes non-commercial businesses that address important social policy objectives (e.g. public transport and social housing). Non-commercial PTEs receive a significant portion of their funding from the budget through grants and subsidies. However, they differ from general government budget dependent agencies in that they also derive substantial revenue from independent sources, such as user charges.

In response to the recommendations of the *Inquiry into Electricity Supply in New South Wales* (the Owen Inquiry) ¹, the Government has announced that the future energy needs of the State will be secured at no cost to taxpayers. To provide for new energy generation by the private sector, the Government will lease existing electricity generators to private operators and transfer the retail operations of Country Energy, EnergyAustralia and Integral Energy to the private sector. The electricity networks (distribution and transmission) will remain publicly owned.

This transaction will have no future budget impact, as sufficient funds realised from the reforms will be invested in the Community Infrastructure (Intergenerational) Fund to provide an income stream equal to the budgeted long-run returns (dividends and tax equivalents) foregone from the retail and generation sectors. Dividends and tax equivalents will continue to be received from the network businesses as these will continue to be operated by the Government.

Following normal budget practice, estimates of the proceeds of the transfer of generation and retail activities to the private sector have not been included in the 2008-09 Budget or the forward estimates.

7.2 COMMERCIAL POLICY FRAMEWORK

PTEs are not subject to debt and equity market scrutiny in the same way as private sector businesses. To ensure government businesses operate efficiently, the NSW Government introduced the *Commercial Policy Framework* in the early 1990s. The framework aims to replicate within government businesses the private sector disciplines and incentives that promote efficient commercial practice. The framework applies to all PTEs, including State owned corporations, which are governed by the *State Owned Corporations Act 1989*.

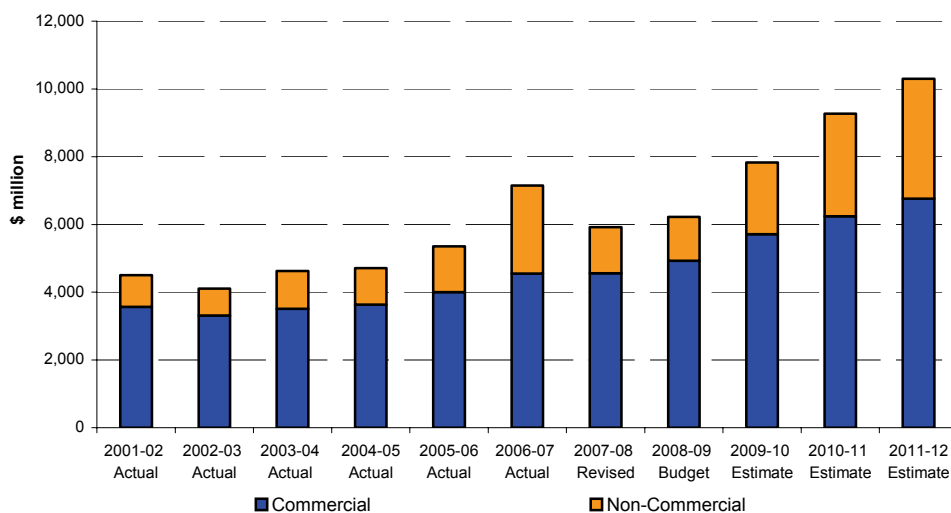
¹ NSW Government, *Inquiry into Electricity Supply in NSW* (Professor Anthony D. Owen), September 2007.

Since its introduction, 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 billion in June 2002 to an estimated \$71.6 billion in June 2009. Over the same period, the return on assets achieved by the electricity and water businesses has increased from 6 per cent to an estimated 6.4 per cent.²

7.3 OPERATING PERFORMANCE

A good measure of PTE sector financial performance is the net operating surplus before interest, tax, depreciation, and amortisation (referred to as the *adjusted net operating surplus*). This measure is equivalent to earnings before interest, tax, depreciation and amortisation (EBITDA) which is commonly used in the private sector as a measure of a business's cash profits independent of its capital structure.³ Chart 7.1 shows the adjusted net operating surplus for the PTE sector over the period 2001-02 to 2011-12.

Chart 7.1: Adjusted net operating surplus^(a)



(a) In 2006-07, the adjusted net operating surplus was inflated by a payment of \$960 million to the rail sector to retire debt.

² Return on assets is defined as the net operating surplus before interest and taxes (EBIT) divided by total assets.

³ EBITDA provides an effective measure to compare the performance of businesses within and across industries, in cases where businesses have a large amount of fixed and intangible assets and a significant amount of debt financing.

The adjusted net operating surplus in the PTE sector is projected to grow strongly at an average of 14.8 per cent per annum over the Budget and forward years, reaching \$10.3 billion by 2011-12. This growth largely reflects expected earnings arising from the recovery of capital and debt servicing costs, as well as a return on the asset investment, in future pricing determinations by the Australian Energy Regulator (AER) and the Independent Pricing and Regulatory Tribunal (IPART). Growth in the adjusted net operating surplus also reflects higher cash grants from the State budget to retire debt in the rail sector in 2009-10, and to fund major capital works in this sector over the Budget and forward estimates period.

COMMERCIAL PTE SECTOR PERFORMANCE

The commercial PTE sector is forecast to experience strong earnings growth, moving from a forecast adjusted net operating surplus of \$4.9 billion in 2008-09 to \$6.8 billion in 2011-12.⁴ This improved performance is almost entirely due to forecast earnings growth in the water and electricity network sectors.

The adjusted net operating surplus of the water sector is expected to increase from \$1.2 billion in 2008-09 to \$1.7 billion in 2011-12, growing at an average rate of 16 per cent per annum over the Budget and forward estimates period. This primarily reflects stronger earnings growth for Sydney Water Corporation resulting from an increase in its regulated water price from 1 July 2008 (based on the current IPART draft determination released in March 2008).

The adjusted net operating surplus of the electricity sector is expected to increase by 9 per cent per annum over the Budget and forward estimates period, growing from \$3.3 billion in 2008-09 to \$4.6 billion in 2011-12. This represents over 65 per cent of the expected increase in the adjusted net operating surplus of commercial PTEs, and is largely attributed to:

- ◆ expected earnings growth in the regulated electricity distribution and transmission sectors, based on the expectation that the AER will make allowance for the recovery of increased capital expenditure requirements in the new regulatory pricing determinations due to commence in July 2009 and
- ◆ forecast growth in electricity demand.

⁴ *The commercial PTE sector covers PTE businesses in all sectors, except the housing and transport (excluding ports) sectors.*

Stronger commercial PTE sector earnings growth is reflected in:

- ◆ return on total assets⁵ improving from 5.6 per cent in 2008-09 to 6.4 per cent in 2011-12 and
- ◆ dividend and tax equivalent payments increasing from \$1.8 billion in 2008-09 to \$2.1 billion in 2011-12.⁶

NON-COMMERCIAL PTE SECTOR PERFORMANCE

Non-commercial PTEs receive support through budget grants to provide important services below commercial prices. The adjusted net operating surplus for the non-commercial PTE sector is expected to increase from \$1.3 billion in 2008-09 to \$3.5 billion in 2011-12. This improved result is almost entirely due to increased grants to the rail sector.

The adjusted net operating surplus of the transport sector is forecast to increase from \$924 million in 2008-09 to \$3.1 billion in 2011-12. This result reflects increased budget grants to the rail sector over the Budget and forward estimates period to fund major new capital works, including the North West Metro and South West Rail Link.⁷ The result also reflects a cash payment of \$530 million to the rail sector in 2009-10 to retire debt incurred in prior years on major capital projects, including the Epping to Chatswood Rail Line and the Rail Clearways projects.⁸

Excluding capital grants and payments to retire debt, the transport sector is operating at a deficit of \$223.2 million in 2008-09. The underlying trend (i.e. excluding capital grant revenues and debt repayments) 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 24.6 per cent in 2008-09.

⁵ Return on assets is defined as the net operating surplus before interest and taxes (EBIT) divided by total assets.

⁶ A further \$81 million in dividend payments is expected to be received from Snowy Hydro Limited in 2011-12.

⁷ Capital grants are recorded as revenues to PTEs.

⁸ Payments to reduce the build up of debt within the rail sector were announced in the NSW Government's 2007-08 Half-Yearly Budget Review. The improved Budget position for 2007-08 enabled the Government to bring forward into 2007-08 the debt repayment foreshadowed for 2008-09.

The adjusted net operating surplus of the housing sector is forecast to increase from \$373 million in 2008-09 to \$412 million in 2011-12. Excluding capital grants, the housing sector is forecasting a slight operating surplus of \$23.5 million in 2008-09 which is expected to increase to \$101 million in 2011-12. This improved result largely reflects lower operating expenses in this sector.

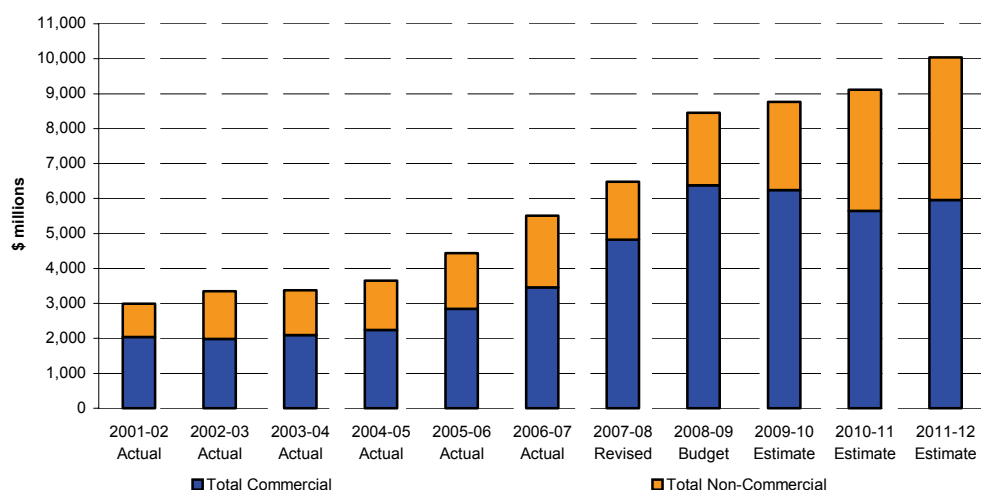
7.4 CAPITAL EXPENDITURE

One of the commitments in the NSW State Plan is for the Government to maintain and invest in infrastructure (Priority P2). The Government has committed to undertake record infrastructure spending over the 10 year period until 2015-16 and has set a target in the State Plan to maintain an average annual growth in infrastructure expenditure of 4.6 per cent (nominal) over that period. This target is consistent with a total 10 year capital program of \$110 billion, as detailed in the initial *State Infrastructure Strategy* (SIS) published in 2006. This record investment will ensure that enhanced government services can continue to be delivered to the community and that important economic infrastructure is available for private sector growth.

The Government is currently well on track to meet this 10 year State Plan target, with record capital investment in the PTE sector. Over the Budget and forward estimates period, the PTE sector will play a major role in providing State infrastructure in New South Wales, with expenditure rising from over 60 per cent of total State capital expenditure in 2008-09 to around 67 per cent in 2011-12. Investment in electricity, transport and water infrastructure are the key contributors to the significant ramping up in PTE capital expenditure in the forward years.

Chart 7.2 shows PTE capital expenditure from 2001-02 through to the forward estimates period.

Chart 7.2: PTE sector capital expenditure



In nominal terms, PTE capital expenditure is forecast to grow by 30.6 per cent in 2008-09 to \$8.5 billion, up from \$6.5 billion in 2007-08. Expenditure will continue to increase over the forward estimates period, at an average rate of 5.9 per cent per annum, reaching \$10 billion by 2011-12. Over the Budget and forward estimates period, total PTE capital expenditure is expected to be \$36.4 billion.

Capital expenditure in the PTE sector is projected to grow significantly over the Budget and forward estimates period, driven by periodic requirements for major capacity expansions and the replacement of assets that are reaching the end of their economic life. Over the longer term, it is expected that PTE capital expenditure will average 4.6 per cent (nominal) consistent with the SIS.

Table 7.1 provides details of PTE capital expenditure by sector for 2007-08, the Budget year and the forward estimates period.

Table 7.1: PTE capital expenditure by sector

Sector ^(a)	2007-08	2008-09	2009-10	2010-11	2011-12	Total Budget Estimates
	Revised	Budget	Forward estimates			
	\$m	\$m	\$m	\$m	\$m	
Commercial PTEs						
Electricity	2,709	3,533	3,897	3,920	4,370	15,720
Water	1,732	2,192	1,719	1,395	1,214	6,520
Ports	128	397	422	192	107	1,118
Property	158	179	111	63	199	552
Other	93	77	95	79	63	315
Total Commercial PTEs	4,821	6,377	6,244	5,650	5,953	24,224
Non Commercial PTEs						
Transport	1,156	1,515	1,917	2,905	3,549	9,886
Housing	502	568	605	564	542	2,278
Total Non-Commercial PTEs	1,658	2,083	2,522	3,469	4,091	12,165
Total	6,479	8,460	8,766	9,119	10,044	36,388

(a) Further detail on PTE capital expenditure is outlined in Budget Paper No. 4 Infrastructure Statement. PTEs have been classified according to their predominant activity. This differs from the classifications used in Budget Paper No. 4 where capital expenditures by PTEs are classified according to policy areas, based on the Australian Bureau of Statistics categories. For example, Sydney Water Corporation's sewerage related capital expenditure is classified as part of Environment Protection expenditure in Budget Paper No. 4, rather than Water expenditure.

COMMERCIAL PTE SECTOR CAPITAL EXPENDITURE

Commercial PTE capital expenditure is expected to grow by 32.3 per cent in 2008-09 to \$6.4 billion, compared to \$4.8 billion in 2007-08, largely driven by increased capital expenditure in the electricity network and water sectors. After peaking in 2008-09, total capital expenditure by commercial PTEs is expected to remain relatively constant in 2009-10 before declining in 2010-11, following the completion of major water and port infrastructure projects.

Capital expenditure in the electricity sector is forecast to grow by 30.4 per cent in 2008-09 from \$2.7 billion to \$3.5 billion. Expenditure is expected to remain strong over the forward years, growing at an average rate of 7.3 per cent per annum. The major driver is the levels of expenditure by NSW electricity network businesses (transmission and distribution) necessary to meet significant asset replacement and renewal, growth in demand and regulatory requirements to enhance system reliability. Over the forward estimates, total capital expenditure by the distribution and transmission businesses is expected to total \$14.4 billion, or around 91 per cent of total infrastructure expenditure in the electricity sector.

The Owen Inquiry signalled the need for further significant capital expenditure over the next decade should the Government retain ownership of retail and generation assets. The Inquiry indicated that the majority of this expenditure, including new investment for baseload generation and the retrofit of existing plant, will be required from 2013 onwards. Given the Government's response to the Owen Inquiry, and indicative time line for new baseload investment, no provision has been made in this Budget for new baseload investment by NSW generators.

Investment in the water sector is expected to rise by 26.5 per cent in 2008-09 from \$1.7 billion to \$2.2 billion, before declining in the following three years. Increased expenditure in 2008-09 is largely driven by Sydney Water's capital program, including the Sydney Desalination Plant, recycling schemes and infrastructure needed for housing growth in the north west and south west growth areas of Sydney.

Increased capital expenditure in the water sector in 2008-09 can also be attributed to an increase in Hunter Water's capital program, which includes ongoing planning and construction of the Tillegra Dam to improve water security of the Hunter and Central Coast.

NON-COMMERCIAL PTE CAPITAL EXPENDITURE

Capital expenditure in the non-commercial PTE sector is forecast to grow by 25.6 per cent in 2008-09 from \$1.7 billion to \$2.1 billion. Expenditure is expected to increase significantly over the forward years, growing at an average rate of 25.2 per cent per annum over this period. This increase is largely driven by increased expenditure in the rail sector.

Significant expenditure on the Rail Clearways Program, new rollingstock purchases and the commencement of the North West Metro and South West Rail Link will boost capital spending over the forward estimates period. Capital expenditure in the transport sector is expected to more than double from \$1.5 billion in 2008-09 to \$3.5 billion by 2011-12.

Capital expenditure in the housing sector will increase by 13.2 per cent in 2008-09 to \$568 million, peaking at \$605 million in 2009-10. The increase reflects the Department of Housing's State-wide, long-term plan to reconfigure public housing assets to address changing demographics and smaller sized family units.

CHANGES IN CAPITAL EXPENDITURE

Between 2008-09 and 2010-11 (the period for which the 2007-08 Budget projections can be contrasted), total PTE capital expenditure is forecast to be \$2.7 billion higher than estimated last year.

This variation reflects a significant upward revision in proposed capital expenditure by the electricity network businesses over the forward estimates period, as well as the announcement of a number of new capital expenditure projects in the transport sector since last year's Budget.

Increased expenditure in the electricity sector accounts for \$2.1 billion of the \$2.7 billion increase over the three year period from 2008-09 to 2010-11. This variation, which will be subject to a determination by the AER, is largely due to an increase in expected expenditure by electricity network businesses of \$1.3 billion to replace assets that are reaching the end of their economic life. Upgrades to network infrastructure to accommodate increased growth and expected cost escalations will also contribute approximately \$635 million to the increase in capital expenditure of network businesses over this period.

The transport sector accounts for \$675 million of the \$2.7 billion increase in expenditure over the three years period from 2008-09 to 2010-11. This primarily reflects the Government's announcement in March 2008 of major rail expansions in the north west and south west regions of Sydney. In addition, expenditure between 2008-09 to 2010-11 in the ports sector is forecast to be around \$100 million higher than estimated at last year's Budget, primarily due to costs associated with the relocation of the Passenger Terminal (\$33 million) and the increased scope of the Port Botany expansion.

Capital expenditure in the water sector between 2008-09 and 2010-11 will remain largely unchanged from last year's Budget. Expenditure on the Sydney Desalination Plant will be higher than anticipated in 2008-09 and 2009-10, due to a revision in the timing of the project. Increased expenditure in these two years, however, will be offset by a reduction in the expected cost of growth and recycling works over this period. This reflects revised urban growth forecasts, as well as an expected reduction in the cost of the Replacement Flows project, resulting from tendered costs being lower than pre-tender estimates.

FINANCING OF CAPITAL EXPENDITURE

Consistent with best practice financial principles, commercial PTEs such as electricity, water and ports are financed by a prudent mix of debt and equity. An appropriate level of gearing for the commercial PTE sector encourages the boards of these businesses to make efficient investment decisions. Also, the requirement to finance capital investments through a prudent level of borrowings provides an important discipline on commercial PTEs by requiring businesses to make regular interest payments.

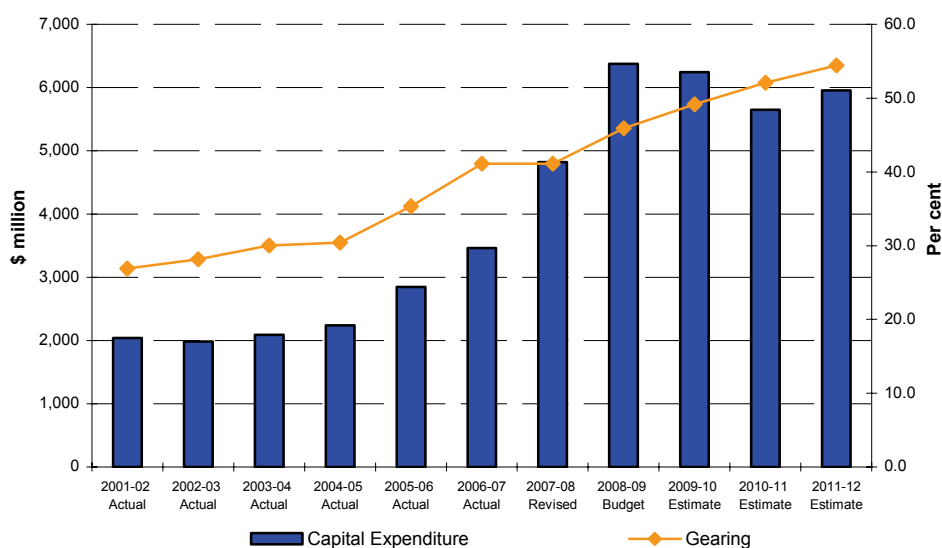
Non-commercial PTEs are not subject to commercial capital structures. As a result, non-commercial PTEs tend to carry less debt, as capital grants from the State budget are the primary source of finance for their capital expenditure.

As detailed in Chapter 6, PTE sector net debt is forecast to increase by \$18.3 billion over the Budget and forward estimates from \$18.6 billion in June 2008 to \$37 billion in June 2012. Commercial PTE net debt is expected to account for \$15.6 billion of the increase over this period, rising from \$17.9 billion in June 2008 to an expected \$33.5 billion in June 2012. This mainly reflects a significant increase in borrowings by the electricity network businesses (of \$8.1 billion), as well as an increase in borrowing by the water sector (of \$2.7 billion) to fund more than \$22 billion in capital expenditure in these sectors.

Consistent with this increase in net debt, gearing levels for the commercial PTEs are projected to increase from 41.1 per cent in June 2008 to 54.4 per cent in June 2012.⁹ Although this increase is significant, it remains well within commercially prudent levels. In setting prices for electricity network and water businesses, regulators allow for a commercial rate of return on efficient capital expenditures. This means that the revenues of these businesses, which account for over 86 per cent of capital expenditure by commercial PTEs over the forward estimates period, are expected to support the sector's increased debt levels and yield a return on the Government's equity investments.

⁹ *Gearing is defined as the ratio of net debt to net debt plus equity (total capitalisation).*

Chart 7.3: Commercial PTE capital expenditure and gearing^(a)



(a) Gearing is defined as the ratio of net debt to total capitalisation.

In response to increased debt levels, the net operating surplus interest coverage ratio (defined as adjusted net operating surplus divided by interest expense) for the commercial PTE sector is projected to fall from 3.8 in 2008-09 to 2.9 in 2011-12

This decline in the interest coverage ratio is consistent with the Government's *Capital Structure Policy*, which allows for borrowings (and resulting debt servicing capacity) to move within a prudent range over the investment cycle. 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. However, with capital expenditures expected to generate returns above the cost of capital, overall shareholder returns will continue to increase over the forward estimates period.

Further consideration of the PTE sector's net debt and its implications for the Government's fiscal strategy is outlined in Chapter 2.

7.5 MAJOR SECTORS

This section presents a broad overview of the key PTE sectors, including an outline of strategic directions and expected capital expenditure programs for each sector over the Budget and forward years.

ELECTRICITY

The State owns the major NSW electricity utilities, including:

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

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.

Strategies and objectives

Demand for electricity in New South Wales continues to grow, driven by population growth, which results in more households being connected to the network. This growth in electricity consumption, however, is occurring at a declining rate. Over the next decade, growth is projected to average 1.8 per cent per annum, compared with 2.5 per cent per annum over the last decade. This is largely due to the impact of energy efficiency improvements and the public's growing awareness of environmental impacts.

The *Inquiry into Electricity Supply in New South Wales* (the Owen Inquiry) found that despite expected lower rates of growth in future electricity demand, New South Wales needs to be in a position where new baseload generation can be operational by 2013-14 in order to avoid potential energy shortfalls.

The Owen Inquiry found that should the NSW Government choose to continue to own most of the State's electricity industry, the State will almost certainly have to both fund the next tranche of baseload generation and invest further in the State owned electricity corporations. The potential impact on the State could be a requirement for investment of up to \$15 billion over the next 10 to 15 years comprising new investment in generation capacity in the vicinity of \$7 billion to \$8 billion, \$2 billion to \$3 billion to maintain the viability of Government-owned retail businesses viable and \$3 billion to \$4 billion to retro-fit some existing power stations with carbon reduction technologies.

The Owen Inquiry recommended that the State divest the retail arms of EnergyAustralia, Integral Energy and Country Energy. The Inquiry also recommended that the State divest the generation businesses of Macquarie Generation, Delta Electricity and Eraring Energy. In the event that the Government did not wish to sell its generation businesses, the report recommended that the State should implement an appropriately structured long-term lease of current generation assets. The State would retain ownership of the assets, with operational and commercial control by the private sector.

The Government's response to the Owen Inquiry is a decision to:

- ◆ lease the generation assets to the private sector
- ◆ transfer the retail operations of Country Energy, EnergyAustralia and Integral Energy to the private sector and
- ◆ retain ownership of electricity transmission and distribution assets.

The private sector can manage the commercial risks of retail and generation operations and of developing new generating capacity. In leasing/transferring generation and retail operations to the private sector, the Government will quarantine risk to the State's fiscal position and the Triple A credit rating, realise proceeds not otherwise available and likely to be eroded over time, and reduce the future demand on the State budget.

The Government proposes to invest a significant proportion of the proceeds from the proposed transactions into a Community Infrastructure (Intergenerational) Fund. Income earned from the Fund will substitute for the dividend and tax equivalents currently earned from the retail and generation activities of the State owned electricity corporations. The revenue stream would be maintained under this arrangement, ensuring that there is no budget impact. Dividends and tax equivalents will continue to be received from the network businesses as these will remain in Government ownership and operation.

Phasing out of the Electricity Tariff Equalisation Fund

In 2005, the Government announced that the Electricity Tariff Equalisation Fund (EETF), which enabled retail electricity prices to be regulated without exposing retailers or the Government to unacceptable financial risk, will be gradually phased out. From September 2008, the percentage of regulated retail load supported by the EETF will decrease from 100 per cent to 80 per cent and in March 2009, the level of support will be further reduced to 60 per cent. The level of EETF support will reduce to 40 per cent in September 2009 and 20 per cent in March 2010 and will be fully phased out by June 2010.

EETF is no longer required, as ordinary hedge contracts enable retailers to manage financial risks and protect the profitability of their retail businesses.

Capital expenditure

The NSW electricity network businesses (transmission and distribution) are driving high capital expenditure levels in the electricity sector across the forward estimates period.

Capital expenditure in distribution and transmission businesses is forecast to increase from \$2.8 billion in 2008-09 to \$4.2 billion in 2011-12, totalling \$14.4 billion over the four years. This reflects customer growth, with high numbers of new connections, increasing summer peak demand and renewal of the ageing asset base. This capital expenditure is consistent with Priority E2 in the NSW State Plan which sets a target for average electricity reliability for New South Wales of at least 99.98 per cent by 2016.

The capital expenditure programs of TransGrid and the electricity distributors are funded approximately 30 per cent through operating surpluses (net of depreciation) and 70 per cent through debt. This gearing is sustainable because the networks have a regulated revenue stream and the assets typically have long lives.

Significant capital expenditure is also expected in the generation sector, totalling \$1.3 billion over the next four years. This expenditure will peak at \$690 million in 2008-09, before declining to \$124 million in 2011-12.

The peak in generation expenditure in 2008-09 is being driven by the deferred commencement of Eraring Energy's cooling water tempering reservoir, Delta Electricity's Mt Piper power station upgrade and improvements by Macquarie Generation in the performance of Bayswater and Liddell power stations. Other key projects over the forward estimates period include the construction by Delta Electricity of its 667 megawatt Colongra gas fired power station on the Central Coast to increase generating capacity, and generator, transformer and boiler works at Delta's Vales Point and Wallerawang facilities.

TRANSPORT

The transport sector incorporates:

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

The Public Transport Ticketing Corporation (PTTC), responsible for delivering an integrated public transport ticketing system for Sydney, is also within the transport sector.

Strategies and objectives

New South Wales has the largest public transport system in Australia. The share of journeys to work undertaken on public transport in Sydney is double that of any other State capital. Reliability of the CityRail network has increased in recent years, reflecting more robust timetables, new rollingstock and track improvements. More bus services operate on priority lanes on more routes which are being re-aligned to better meet commuter needs. These factors, combined with sustained increases in petrol prices, have seen actual and projected increases in public transport patronage of nearly 5 per cent since 2005-06.

Capital expenditure – rail

The capital program for rail services is expected to total \$9.7 billion over the forward estimates period, increasing from \$1.4 billion in 2008-09 to \$3.5 billion in 2011-12. This is higher than the rail infrastructure expenditure projected in last year’s Budget, driven primarily by major new projects announced since the 2007-08 Budget.

Highlights over the forward estimates period include:

- ◆ the planned expansion of the rail network into the north west and south west growth areas of Sydney (\$4.1 billion allocated over four years). In March 2008, the Government announced a new generation public transport network for Sydney. Some \$170 million will be available in 2008-09 for the first stages of SydneyLink for spending on the North West Metro and the South West Rail Link
- ◆ further work on the \$1.8 billion Rail Clearways Program, to reduce congestion and improve network capacity and reliability. A new station platform at Hornsby is due for completion during 2008-09, with works continuing on the duplication of the Cronulla line, duplication of the Richmond line and the quadruplication of the line between Kingsgrove and Revesby
- ◆ completion of the contracts for 122 new Outer Suburban carriages. Commuters in the Central Coast and Illawarra are already benefiting from the first stage of 41 carriages. The second stage of 81 carriages will be completed during 2008-09. Over \$106 million will be available in 2008-09 to progress ancillary works for the contract for new rollingstock for the suburban network. The first carriages under the \$3.6 billion acquisition and maintenance program for 626 new air conditioned carriages are due for delivery in early 2010
- ◆ completion of the Epping to Chatswood Rail Line, with three new underground stations, to provide services and new connections for commuters 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.

Capital expenditure – bus services

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

Over the Budget and forward estimates period, the Authority's capital program is estimated at \$130.8 million, with the majority of this expenditure (\$75.4 million) expected to occur in 2008-09. Passenger growth, bus safety and the emerging focus on environmentally friendly public transport are the key drivers of STA's capital investment strategy.

The forward capital program largely provides for the acquisition of bus servicing equipment, depot redevelopments and upgrades, and the installation of on-board surveillance cameras and driver security screens.

The STA will also acquire new and replacement buses to meet anticipated growth in passenger demand. This includes:

- ◆ 122 replacement buses for the Sydney and Newcastle networks (at a cost of \$60.8 million) and five new buses for a super metro bus system trial (at a cost of \$4.6 million) in 2008-09 and
- ◆ placing orders for a further 150 new articulated buses (at a cost of \$111.7 million) for delivery commencing in 2009.

Capital expenditure related to the purchase of bus fleet, however, is not included in the STA's capital program. Acquisition costs associated with STA's bus fleet are funded through bus contracts with the Ministry of Transport.

Capital expenditure – 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. Contracts were awarded in December 2007 and construction of five new berths has commenced. In 2008-09, over \$287 million will be spent on the expansion.

The major redevelopment program to transform Port Kembla into Australia's leading car import centre is nearing completion. The new cargo facility and third berth will enable Port Kembla to handle nearly 240,000 vehicles a year, along with increased containers and general cargo. Car imports have already commenced at the port and the complete transfer from Port Jackson will occur in September/October 2008. 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. A smaller multi-purpose terminal at Mayfield will be completed in late 2008, to accommodate increased demand for general cargo.

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 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 Government.

Funding and financing the transport sector

The transport sector relies heavily on budget support to finance operating and capital expenditures. Unlike other public trading enterprises, which receive the majority of their income from user charges, fares by rail, bus and ferry commuters are insufficient to meet operating expenses and cannot therefore fund capital expenditure on new infrastructure.

Table 7.2 presents a summary of budget support to transport PTEs. The table also shows the proportion of fare revenue, relative to operating expenditures, recovered from commuters. For rail services in particular, the level of cost recovery is low and has remained stable, notwithstanding increases in the absolute level of fare income.

Table 7.2: Budget Support for the PTE transport sector

	2004-05 Actual \$m	2005-06 Actual \$m	2006-07 Actual \$m	2007-08 Revised \$m	2008-09 Budget \$m
Rail Services					
Operating grants	1,518	1,683	1,692	1,722	1,835
Capital grants (plus asset sales)	530	673	674	437	656
Debt reduction payment	960	390	...
Sub-total – Rail Services	2,048	2,356	3,326	2,549	2,491
Bus and Ferry Services					
Operating grants	282	290	337	344	360
Capital grants	5
Private Operators/Community Groups	455	521	572	596	645
Sub-total – Bus and Ferry Services	742	811	909	940	1,005
Total Net Budget Funding: Transport^(a)	2,790	3,167	4,235	3,489	3,496
Fare revenue/operating costs%^(b)					
Rail services	24.4	23.4	24.7	23.9	n.a. ^(c)
Bus services	49.9	51.3	54.0	53.9	n.a. ^(c)
Ferry services	58.3	52.9	51.0	43.3	n.a. ^(c)

(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.

(b) Independent Pricing and Regulatory Tribunal, Fare Revenue Reports. See www.ipart.nsw.gov.au and advice from Rail Corporation.

(c) Dependent on future price determinations by IPART.

WATER

The State owns four commercial water businesses:

- ◆ Sydney Water Corporation – providing water, sewerage and some stormwater drainage services in Sydney, the Illawarra and the Blue Mountains
- ◆ Sydney Catchment Authority – responsible for Sydney’s drinking water catchment and its infrastructure and bulk water supply to Sydney Water and some councils in the Sydney catchment area
- ◆ Hunter Water Corporation – a vertically integrated bulk and retail water and wastewater business in the Hunter region and
- ◆ State Water Corporation – a bulk water business in rural New South Wales whose main customers are irrigators 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.

Strategies and objectives

State Plan Priority E1 commits the NSW Government to strategically and effectively manage the limited and vital water resources of New South Wales to ensure a secure and sustainable water supply for all users.

The capital programs of the State's water businesses support this priority by focusing on measures to:

- ◆ meet reliability performance standards for water continuity and quality
- ◆ increase water recycling and
- ◆ improve the efficiency of water use.

NSW water businesses face the challenges of managing the needs of a growing population, ageing infrastructure and securing the water supply in the face of future drought.

The overriding objective of the water sector is to balance supply and demand for water by increasing recycling, reducing demand and increasing supply. The *Metropolitan Water Plan 2006*, together with the 2007 Progress Report, shows that, through a mixture of these measures, there is sufficient water to meet Sydney's needs to 2015 and Sydney Water is well placed to deal with growth after 2015.

Securing water supplies

The most significant project being undertaken by Sydney Water to secure water supplies is the Sydney Desalination Plant, which will provide up to 250 million litres a day from early 2010. The project will cost approximately \$1.9 billion and, as a non-rainfall dependent source of water, will significantly improve Sydney's water security.

Sydney Water is also expanding Australia's largest residential recycling scheme at Rouse Hill and is building similar systems of dedicated recycled water pipes to supply Ropes Crossing and Hoxton Park. A further 8,500 new homes in other new suburbs in Sydney's north west and south west will be supplied with recycled water through separate, dedicated recycled water pipes by 2012.

In addition, Sydney Water is building a \$250 million advanced water treatment plant and pipes to supply a further 18 billion litres a year of recycled water to substitute for current releases from Warragamba Dam. This is part of the Western Sydney Recycled Water Initiative. The Liverpool to Ashfield pipeline, which will be the backbone of the Sydney Recycled Water Grid, is expected to be commissioned in 2010. The Grid is forecast to supply 30 billion litres of recycled water per year by 2030.

To secure water supplies for the Lower Hunter and Central Coast over the next 60 years, Hunter Water is building the \$379 million, 450 billion litre Tillegra Dam. Hunter Water expects the first water from Tillegra Dam will be available in around 2013. It will provide much needed drought security for the Lower Hunter community and cater for the predicted 160,000 additional people who are expected to join over half a million people currently living in the region over the next 25 years.

The Government will continue to maintain dam integrity and security of rural water supply, including major upgrades at Keepit and Blowering Dams. Later years will see major upgrades to Copeton, Burrendong and Wyangala Dams.

Increasing competition

The Sydney and Hunter regions are being opened to water and wastewater competition. The *Water Industry Competition Act 2006* is Australia's first legislation expressly designed to facilitate and encourage competitive entry by the private sector into the water industry, allowing 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 will be regulated by IPART.

Capital expenditure and funding of the capital program

Capital expenditure for the water sector is expected to total \$6.5 billion over the forward estimates period. Expenditure is expected to rise by 26.6 per cent in 2008-09 to \$2.2 billion from \$1.7 billion in 2007-08. After peaking in 2008-09, expenditure is expected to decrease to \$1.2 billion in 2011-12.

Sydney Water's capital program of \$5 billion accounts for 77 per cent of the total capital program of the water sector. Capital spending will peak at \$1.9 billion in 2008-09 before declining to \$884 million in 2011-12. The peak in 2008-09 is driven primarily by expenditure on the Sydney Desalination Plant and recycling schemes in that year.

Hunter Water's capital program over the forward estimates period totals \$948 million or 14.5 per cent of total capital expenditure in the sector. This expenditure is primarily attributed to the construction of Tillegra Dam at a cost of \$379 million, projects to improve the water supply in the Hunter of \$425 million and wastewater treatment and transport upgrades at a cost of over \$380 million.

Capital expenditure by the Sydney Catchment Authority over the forward estimate years totals \$293 million. This is a decrease compared to last year's Budget due to an amending of the scope of the borefield development program.

State Water's capital program over the forward estimates period totals \$255 million. Expenditure to upgrade State Water's dams accounts for over 75 per cent of the total program over the forward years.

A significant proportion of the capital program in the water sector will be financed from borrowings, while 33 per cent of the program will be financed from operating surpluses. Gearing for the water sector will increase from 36.1 per cent in June 2008 to a sustainable level of 48.2 per cent in June 2012.

Regulatory outcomes are expected to ensure the businesses receive a commercial rate of return on capital investments. This expectation has been supported by the recent draft determination on Sydney Water prices by IPART.

SOCIAL HOUSING

The Department of Housing manages the State's social housing portfolio and develops broader housing strategies. It provides tenancy and property management for around 125,000 public housing dwellings. Total recurrent expenditure for the Department in 2008-09 is estimated at \$1.32 billion, with a further \$553.9 million for capital works. The Department will receive a grant of \$543.1 million from the 2008-09 Budget.

The Department of Housing sets market rents for its properties. However, around 89 per cent of current tenants cannot afford market rents and are eligible for a subsidy. These tenants pay a subsidised rent based on a percentage of the total income of the household. The value of the Department's rental subsidies in 2008-09 is estimated at \$738.1 million.

Strategies and objectives

The Department of Housing is helping build stronger communities through providing housing solutions for those most in need. This covers the spectrum of housing needs, including homeless people, people with mental illness, and people with a disability that have complex needs.

The Department continues to implement the *Reshaping Public Housing* reforms announced in 2005. The reforms are designed to ensure a fair, more efficient and effective public housing system capable of meeting current and future demands. Changes implemented include revisions to the eligibility and length of tenure for public housing to better reflect tenant circumstances.

The Department of Housing is responsible for implementing *Planning for the Future - New Directions for Community Housing in NSW 2007-2012*, launched in November 2007. This strategy sets a new vision for an expanded community housing sector in New South Wales that offers responsive housing services to more people in need and takes advantage of new opportunities to deliver more affordable housing. Growth is central to this vision and the plan proposes to increase the supply of community housing from 13,000 to 30,000 dwellings over 10 years.

The Department also administers the *Care Call Program* to contact frail and aged tenants living in public housing and connect them to necessary services.

Capital expenditure

The Department of Housing's total capital expenditure in the four years to 2011-12 is forecast at \$2.2 billion.¹⁰ This expenditure will be largely driven by the Department's commitment to upgrade and reconfigure social housing stock to ensure it meets future demand.

Specific key drivers of the capital program in 2008-09 and the forward years include:

- ◆ the *NSW Planning for the Future: New Directions for Community Housing in NSW 2007-2012* which aims to expand the community housing sector in New South Wales by increasing the of community housing from 13,000 to 30,000 dwellings over 10 years
- ◆ the *Social Housing for Older People* strategy which includes a significant investment in the 2008-09 capital budget for new homes for the elderly
- ◆ the provision of 228 new homes in the Sydney's inner west under the *Inner West Redevelopment Strategy*

¹⁰ This section focuses on the capital program of the Department of Housing. Total capital expenditure reported for the housing sector in Table 7.1 also includes expenditure provided by City West Housing Pty Ltd and the Teacher Housing Authority.

- ◆ continued implementation of major strategic redevelopments currently underway including the West Dubbo Transformation, the Living Communities Program at Bonnyrigg and Minto and the Building Stronger Communities 2007-2010 Program
- ◆ continued implementation of long-term asset planning to realign the Department's asset portfolio to better meet the needs of clients. (This overarching strategy to realign dwelling encompasses some of the above listed strategies)
- ◆ implementation of the Commonwealth Government's *A Place to Call Home* strategy through the provision of additional homes for homeless families and individuals and
- ◆ reducing backlog maintenance over the next 8-9 years.