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# Updated cost of debt estimates for Seqwater

**PRESENTED TO: SEQWATER**

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**PREPARED BY QUEENSLAND TREASURY CORPORATION**



## 1 Background

- Queensland Treasury Corporation (QTC) has been asked by Seqwater to estimate its cost of debt for FY22–FY28.
- The estimates will be used in Seqwater's submission to the Queensland Competition Authority (QCA) regarding the bulk water price to apply from 1 July 2022.

## 2 Seqwater's debt facilities

- Seqwater currently has three Portfolio-Linked Loans (PLL) from QTC:
  - Water Infrastructure Debt (WID) Core PLL,
  - Water Infrastructure Debt (WID) Super-Long PLL, and
  - Water Grid Manager (WGM) PLL.
- The portfolio that provides the WID Core PLL is comprised of a diversified mix of fixed-rate debt instruments with staggered maturity dates and an average duration of about 6.00-6.25 years.
  - The average duration is maintained by progressively refinancing short-term debt, which makes up a relatively small percentage of the total funding, with new long-term debt.
  - The interest rate on the WID PLL is appropriate to use in the calculation of Seqwater's rate of return.
- The portfolio that provides the WID Super-Long PLL is comprised of long-dated fixed-rate debt instruments. Unlike the WID Core PLL, there is no regular rebalancing of the WID Super-Long PLL portfolio.
- The portfolio that provides the WGM PLL has been structured to approximately match the duration of a principal and interest (P&I) loan maturing in 2028.

## 3 Estimating the cost of debt

### 3.1 Water Infrastructure Debt – Core PLL

- The cost of debt for the WID Core PLL has been estimated by simulating the annual refinancing transactions required to maintain an average funding duration of about 6.00 – 6.25 years.
- QTC has used two scenarios to estimate the long-term interest rates to apply to the future refinancing transactions:
  - *Scenario 1:* The long-term QTC rate remains unchanged at its current value of 2.65 per cent until 2028.
  - *Scenario 2:* The long-term QTC rate changes annually based on the implied forward yield curve.
- These scenarios represent different ways of using observable market data (rather than forecasts) to estimate the annual WID Core PLL cost of debt.
- QTC considers both approaches to be reasonable for the purpose of estimating Seqwater's cost of debt. As such, the estimate in a given year equals the simple average of estimated cost for that year under Scenario 1 and Scenario 2.

### 3.2 Water Grid Manager Debt

- The WGM PLL cost estimate is based on a P&I repayment profile and a 2028 maturity date. There is no *expected* change in the cost of debt, however some changes are likely to occur over time.

### 3.3 Cost of debt estimates

- The cost of debt estimates are shown in the Table 1. The estimates include QTC's administration fee and are expressed on an annual effective basis.

TABLE 1: ANNUAL EFFECTIVE COST OF DEBT ESTIMATES

Financial year	WID Core PLL (%)	WID Super-Long PLL (%)	WGM PLL (%)
2021–22	4.90	4.30	5.15

Financial year	WID Core PLL (%)	WID Super-Long PLL (%)	WGM PLL (%)
2022–23	4.65	4.30	5.15
2023–24	4.40	4.30	5.15
2024–25	4.20	4.30	5.15
2025–26	4.05	4.30	5.15
2026–27	3.90	4.30	5.15
2027–28	3.70	4.30	5.15

## 4 Additional considerations

- The actual WID Core PLL cost of debt will depend on factors such as:
  - the actual amount of refinancing performed each year
  - the long-term QTC rate at the time of each refinancing transaction, and
  - any other changes to the duration and/or composition of the WID PLL portfolio.
- Although these factors will produce differences between the actual and estimated debt costs used in the rate of return, QTC understands that, subject to a decision of the Government at the time, any differences in the period FY19–FY21 will be trued-up in the prices to apply post 30 June 2021.
- Similarly, additional changes to the duration and/or composition of the WGM PLL funding portfolio will cause the cost of debt to change. It is unclear if a similar true up mechanism will apply to interest on price path debt.

## 5 Historical Water Grid Manager cost of debt

- The historical WGM debt costs are shown in Table 2.

TABLE 2: ANNUAL EFFECTIVE WGM PLL COST OF DEBT

Financial year	Average cost (%)
2017–18	5.11
2018–19	5.11
2019–20	5.07
2020–21	5.02
2021–22	5.13

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