



PRICE REVIEW 2013: REGIONAL URBAN WATER BUSINESSES

Draft Decision – Executive Summary

March 2013

SUMMARY OF DRAFT DECISION

BACKGROUND — THE PRICE REVIEW PROCESS

In October 2012, the Commission commenced its formal review of the regional water businesses' proposals for the five year regulatory period commencing on 1 July 2013.

Under the price review process, the 12 regional water businesses submitted Water Plans setting out the expected costs involved in delivering water and sewerage services, their planned capital works programs, the forecast volumes of water that will be delivered and the levels of service promised to customers. Each business also proposed prices that would raise sufficient revenue to recover its expected costs over the regulatory period. The water businesses were required to consult their customers during the development of their water plans.

Consultation with stakeholders is also an important part of the Commission's price review process. To inform water businesses and their customers of our expectations regarding the water planning process, we released a guidance paper in October 2011. In November 2012, we released a paper summarising the businesses' proposals and highlighting issues on which we were seeking stakeholder comments. The Commission received over 50 submissions. In addition, during November and December 2012 the Commission held a series of public meetings around the State where the water businesses presented their proposals. Customers and community and business groups then had the opportunity to respond.

The Commission has also formed a Customer Reference Panel. It includes consumer and business representative groups as well as individual customers. The Panel provides the Commission with its views on the issues its members consider important for our price review.

This draft decision is the next stage in the Commission's consultation process. It sets out the Commission's views on whether the prices proposed by the businesses satisfy the pricing principles set by the Government.

Interested parties now have a further opportunity to comment on the Commission's approach and our proposed decisions. These views will inform the Commission's final decision in June. Written submissions are invited by 2 May 2013:

We would prefer to receive them by email at water@esc.vic.gov.au.

You can also send comments by mail to

Essential Services Commission
Level 37, 2 Lonsdale Street
Melbourne VIC 3000

We will also be holding further public meetings in April and May. These will be advertised locally and on the Commission's website (www.esc.vic.gov.au).

CONTEXT AND KEY ISSUES

This assessment relates to the third regulatory period for Victorian water businesses, commencing 1 July 2013. Price Reviews are conducted in accordance with the Water Industry Regulatory Order (WIRO) issued by the Minister for Water. The WIRO was last updated in 2012 (see chapter 1). It outlines the principles to which the Commission must have regard when reviewing water plans. As a consequence, water businesses are expected to submit plans that are consistent with the WIRO. Moreover, the Commission issued guidance notes well ahead of formal submission to assist businesses in their preparation of water plans. Among other things, we required that the water plans should be informed by robust analysis, thorough consultation and reasonable assumptions about the future.

The Victorian water sector has confronted some major challenges. While the second regulatory period (2008-13) was overshadowed by a period of drought that resulted in major investments in new sources of water supply, the third regulatory period (2013-18) will see reduced spending reflecting the completion of this investment phase.

The key issues for the price review include:

- keeping price increases as low as possible given the substantial increase over the last five years without compromising service levels and
- ensuring water businesses continue to pursue improvements in service delivery and operational efficiency
- Understanding customers' expectations and their willingness to pay for different service offerings.

Other specific concerns raised by customers, and community and business groups include:

- the impact of past and proposed price increases, particularly for customers experiencing financial hardship
- the implementation of any proposed price increases, namely, whether increases should be 'smoothed' over a number of years rather than implemented as a "one-off" initial increase
- the mix of fixed and variable water charges and the consequences for different customer groups such as tenants (who only directly pay the variable charge)
- expectations that service levels should at least be maintained and
- support for the introduction of a Guaranteed Service Level scheme for all businesses.

In its guidance material, the Commission stated that it would also take a narrower view of non-contractual obligations; that is, it would exclude from allowed revenue the costs associated with alleged but unclear obligations. The Commission found there were few claims for such projects in the Water Plans.

THE COMMISSION'S APPROACH

The Commission is required to assess the prices and revenues proposed in the businesses' Water Plans against the principles set out in the WIRO. The WIRO principles require that prices are set to:

- generate a business's revenue requirements and allow it to meet the costs of delivering services to customers
- ensure the business's financial viability, including a reasonable return on capital
- reflect costs and provide incentives for sustainable water use and
- take into account the interests of customers.

In applying these principles, the Commission's main focus has been to ensure that prices are as low as possible but still sufficient to recover the businesses' efficient costs of providing services. In approving tariff structures, the Commission has had regard to aligning prices with underlying costs as well as the expressed interests of customers.

In reaching its draft decision, the Commission assessed whether each business's proposed expenditure is efficient and prudent, its capital works program is deliverable over the period, and its business strategy is consistent with its objectives over a longer term planning horizon. The Commission also considered whether the proposed profile of capital expenditure should be smoothed to occur more evenly over the period, instead of being concentrated at the beginning of the period. In addition, it assessed whether it was prudent and efficient to defer some expenditure into the following regulatory period.

This draft decision outlines our approach to each element of the businesses' water plans. All supporting material is provided on our website. This includes the Commission's guidance documents, each business's Water Plan, our independent consultants' assessments of the Water Plans, fact sheets and summaries of the Commission's decision for each water business.

Unless otherwise specified, all values shown in this draft decision and supporting material are nominated in \$2012-13.

DRAFT DECISION OUTCOMES

SERVICE STANDARDS

Service standards will generally be maintained by the regional urban water businesses during the coming five years (see chapter 3). Further, with major supply augmentations and increased storage levels in the current regulatory period, customers will generally enjoy a higher security of supply.

REVENUES

In their water plans, the businesses' identified their revenue requirements for the third regulatory period (2013-18). These revenue forecasts reflect their expected operating expenditure, a return on assets (existing and new assets) and regulatory depreciation (return of assets). The 12 water businesses covered in this draft decision sought total revenues of \$4.2 billion over the next five years. The Commission's draft decision results in a revenue requirement for the regional urban water businesses of \$4.0 billion, which is \$185 million lower than that proposed by the businesses. This downward adjustment to their proposed revenue reflects the Commission's draft decision not to approve all the revenue sought by the water businesses in their Water Plans. By way of comparison, in the last price review the Commission approved \$3.7 billion for the same 12 businesses.

Each business's proposed revenue requirement and the Commission's draft decision is shown in Table 1. Revenue requirements are discussed more fully in chapter 5.

TABLE 1 PROPOSED REVENUE REQUIREMENT (ALL BUSINESSES)
\$2012-13

	Proposed by business	Draft decision	Difference	Per cent difference
Barwon Water	919.9	880.6	-39.4	-4.3
Central Highlands Water	414.2	396.9	-17.2	-4.2
Coliban Water	520.2	498.7	-21.5	-4.1
East Gippsland Water	153.6	149.5	-4.0	-2.6
Gippsland Water	569.8	552.2	-17.6	-3.1
Goulburn Valley Water	348.2	328.0	-20.2	-5.8
GWMWater	295.7	281.5	-14.2	-4.8
Lower Murray Water	162.3	157.8	-4.5	-2.8
North East Water	275.7	258.0	-17.7	-6.4
South Gippsland Water	135.7	125.8	-9.9	-7.3
Wannon Water	328.7	315.8	-12.9	-3.9
Westernport Water	102.4	96.3	-6.1	-5.9
Total revenue requirement	4 226.3	4 041.1	-185.1	-4.4

The main adjustments made by the Commission that resulted in the lower revenue requirements shown in table 2 include the following:

Operating expenditure (chapter 7)

The Commission's preliminary approved total operating expenditure over five years is \$2481 million, which is \$84 million (or 3.3 per cent) lower than the total proposed by the water businesses. Key areas of adjustment included labour and energy costs, and revisions to assumptions about the Environmental Contribution.

Capital expenditure (chapter 8)

The Commission's preliminary approved total capital expenditure over five years is more than \$120 million (or 8.1 per cent) lower than proposed by the water businesses. This reflects proposed changes to the timing of delivery of projects and the removal of some projects.

Financing costs (chapter 9)

Based on current market conditions, the Commission proposes to approve a real post tax weighted average cost of capital of 4.7 per cent. This is significantly lower than the 5.8 per cent that applies in the current regulatory period.

PRICES

The Commission is responsible for approving the maximum prices each water business can charge its customers in each year during the outlook period.

As a result of this downward revision to the water businesses' expenditure and revenue requirements, the Commission has reduced the maximum price increases proposed by each regional business. In a number of instances, we expect prices to decline in real terms over the coming five years.

The price increases over five years proposed by the 12 water businesses in their Water Plans ranged from -3.4 per cent to 28.3 per cent. Following the adjustments made by the Commission, these price increases have been moderated. The Commission proposes to accept price adjustments that range from -10.8 per cent to 20.0 per cent over the coming five years. Table 2 outlines the proposed and adjusted prices for each regional water business. Chapter 2 discusses price outcomes in greater detail.

TABLE 2 PRICE CHANGES PROPOSED BY BUSINESSES AND PRICES UNDER THE DRAFT DECISION — AVERAGE 2013-14 TO 2017-18

	Proposed by business	Draft Decision	Difference
Barwon Water	0.7	-10.8	-11.4
Central Highlands Water	8.4	2.9	-5.5
Coliban Water	28.3	20.0	-8.3
East Gippsland Water	6.9	1.0	-6.0
Gippsland Water	5.0	-5.6	-10.6
Goulburn Valley Water	12.6	-0.9	-13.5
GWM Water	12.4	3.1	-9.3
Lower Murray Water (Urban)	11.4	7.5	-3.8
North East Water	12.0	-4.4	-16.4
South Gippsland Water	10.2	-8.1	-18.3
Wannon Water	-3.4	-10.8	-7.4
Westernport Water	18.6	1.8	-16.8

In most instances, the proportional reduction in prices exceeds the reduction in revenues because of some upward revisions we have made to the water businesses' forecasts of growth in water consumption and growth in customer numbers over the next five years (see chapter 9). For some businesses, such as Barwon Water, which proposes higher new customer contributions, this has the effect of reducing the revenue that is needed to be collected through general customer tariffs and therefore result in lower real price increases.

HOUSEHOLD BILLS

As a result of this draft decision, household water and sewerage bills would not increase as much as sought by the businesses in their Water Plans.¹ Table 3 compares indicative bills for owner-occupiers in 2012-13 and 2017-18, based on

¹ The prices detailed in this draft decision are subject to consultation and may change under the Commission's final decision.

the prices proposed by the businesses' in their Water Plans and prices resulting from the Commission's draft decision. Table 4 compares indicative bills for tenants.

Most water businesses prices will vary with location. The typical bills shown in Tables 3 and 4 are based on typical consumption figures for owner-occupiers and tenants, respectively, in the largest town serviced by each water business. Bill outcomes will vary for individual customers.

The Commission's draft decision to limit price increases will go some way to addressing concerns about affordability. Nonetheless, we have encouraged all water businesses (particularly those facing price increases) to put in place measures to support customers who may have difficulty paying their bills and we will continue to monitor implementation of these measures.

TABLE 3 ILLUSTRATIVE ANNUAL RESIDENTIAL OWNER-OCCUPIER BILLS^a
\$2012-13

	Current bill	Bills based on businesses' proposals		Bills based on draft decision	
	2012-13	2013-14	2017-18	2013-14	2017-18
Barwon Water	1 049	1 050	1 055	1 011	933
Central Highlands Water	1 147	1 245	1 245	1 181	1 181
Coliban Water	1 003	1 153	1 297	1 153	1 256
East Gippsland Water	1 102	1 123	1 126	1 068	1 076
Gippsland Water	1 236	1 249	1 298	1 222	1 167
Goulburn Valley Water	819	839	926	811	806
GWMWater	1 168	1 204	1 323	1 204	1 207
Lower Murray Water	774	809	881	803	851
North East Water	836	855	935	824	795
South Gippsland Water	956	969	1 068	944	882
Wannon Water	1 163	1 131	1 131	1 127	1 045
Westernport Water	1 029	1 044	1 214	1 029	1 044

Note: real values. ^a Based on the businesses' proposed prices and draft decision prices. Bills are calculated using each business's average consumption.

TABLE 4 ILLUSTRATIVE ANNUAL RESIDENTIAL TENANTS BILLS^a
 \$2012-13

	Current bill	Bills based on businesses' proposals			Bills based on draft decision	
	2012-13	2013-14	2017-18	2013-14	2017-18	
Barwon Water	338	338	340	326	300	
Central Highlands Water	235	255	255	242	242	
Coliban Water	328	346	390	346	377	
East Gippsland Water	224	258	340	255	257	
Gippsland Water	312	315	328	309	295	
Goulburn Valley Water	248	254	280	254	252	
GWMWater	321	330	363	330	331	
Lower Murray Water	174	196	214	195	206	
North East Water	417	427	467	412	397	
South Gippsland Water	189	193	218	188	176	
Wannon Water	264	263	263	262	243	
Westernport Water	108	129	150	125	127	

Note: real values. ^a Based on the businesses' proposed prices and draft decision prices. Bills are calculated using businesses' average consumption.