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CENTRAL HIGHLANDS WATER

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Via email:
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Dear Marcus,

RE: Response to ESC's Central Highlands Water draft decision 2023 Water Price Review

Thank you for the opportunity to respond to the Essential Services Commission's (ESC's) Draft Decision[1] of our 2023 Price Submission, received as per your email on 11 April 2023.

As part of this response we have also provided 3 supporting Excel files:

1. ESC Financial model with changes incorporated as requested in the Draft Decision by the ESC. As per email from the ESC on 4 May 2023 we have also made changes to the model we believe we can justify through this response. Please note that all of the changes we have made to the model are clearly logged and described in the 'Adjustments log' tab;

2. New Customer Contribution model with changes incorporated as requested; and

3. Updated 2021-22 Regulatory Accounting Statements as agreed and emailed to the ESC on 4 May 2023.

We have drafted our response as below in accordance with the points in your email and provided supporting information in several Attachments as indicated.

This response is structured in 3 sections:

- Section A - those draft decisions we agree with and accept;
- Section B - those draft decisions we disagree with. We have provided additional information to support these views; and
- Section C - those areas where the ESC has specifically requested a response.

[1] Essential Services Commission 2023. *Central Highlands Water draft decision: 2023 Water Price Review,* 12 April

SECTION A: Central Highlands Water agrees with the following proposed changes

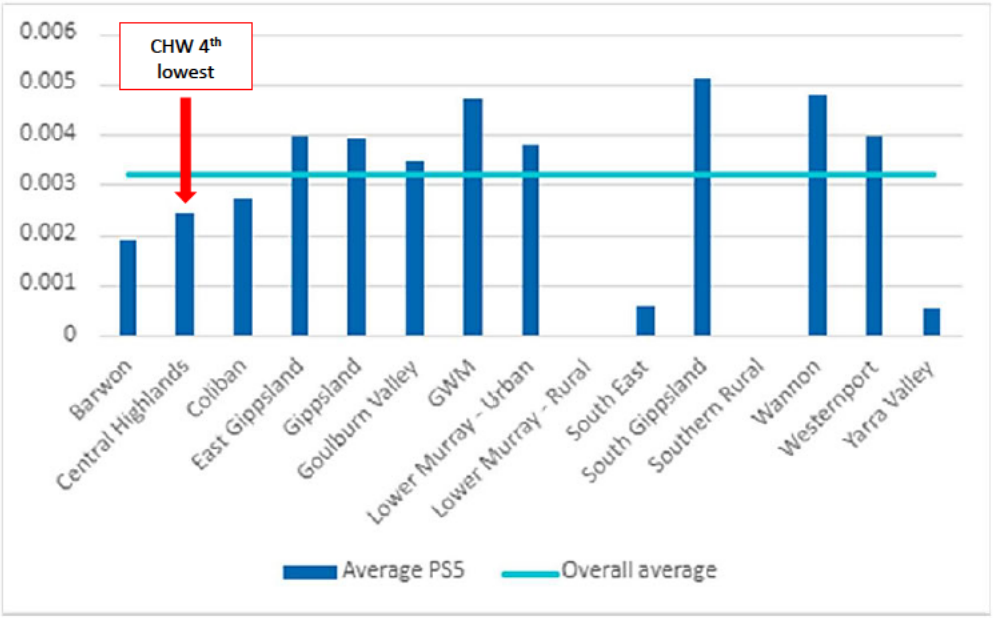
This section (A) of our response lists the proposed changes in the Draft Decision that Central Highlands Water (CHW) agrees with.

4.1.1.3 Cost adjustments p.25

ESC Draft Decision: For the $4.5 million for two additional full-time equivalent staff positions to meet service commitments across capital delivery, ICT and digital, and customer service, our expenditure consultant was not satisfied that sufficient justification or level of detail were provided to justify this step change. Our consultant noted that Central Highlands Water already had $0.4 million for increased customer service roles in its operating baseline, and that while Central Highlands Water is preparing an overarching ICT and digital strategy, this is yet to be finalised.

CHW Response: Central Highlands Water accepts the reduction of the $4.5 million in total over the 5-year plan period which allowed for 9 additional full-time equivalent employees and instead additional employees will be funded via CHW's 1.2% p.a. operating expenditure growth allowance as endorsed by the ESC. It is important to note that based on benchmarking presented in the *FTI Consulting Review of Expenditure Forecasts 2023 Water Price Review* report, CHW's number of FTE per water connection is considerably lower than its peers which includes Coliban Water, Wannon Water, Goulburn Valley Water and Gippsland Water, as shown by the following chart.[2]

Figure A8: PS5 forecast average number of FTEs per water connection



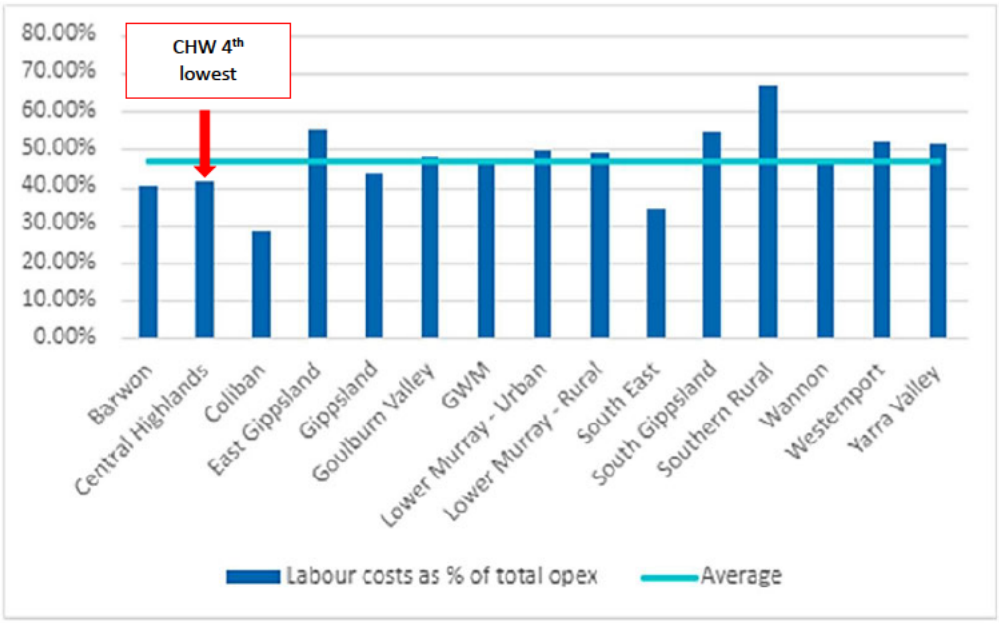
Source: Victorian water businesses, 2023 Price Review Models.

Similarly, labour costs as percentage of total controllable operating expenditure also highlights that CHW is below the average across the Victorian Water sector, as shown by the following chart from the FTI Consulting report.

[2] FTI Consulting 2023. *Central Highlands Water: Review of Expenditure Forecasts, 2023 Water Price Review.* February

Although CHW accepts the ESC's decision to not fund the additional roles, CHW will continue to recruit for these resourcing needs by considering alternative options including contractors, labour hire, fixed term and/or permanent ongoing contract arrangements to ensure that CHW can continue to service both its existing and new customers to the level of service expected by our community.

Figure A9: PS5 forecast labour costs as a percentage of total controllable operating expenditure (%)



Source: Victorian water businesses, 2023 Price Review Models.

4.1.2 Non-controllable operating expenditure p.28

ESC Draft Decision: Our draft decision proposes to reduce Central Highlands Water's forecast non-controllable operating expenditure by $8.11 million across the 2023–28 period, resulting from our adjustments to the environmental contribution to reflect a flat rate in nominal terms based on the actual figure from 2021-22.

CHW Response: Central Highlands Water accepts this reduction to the non-controllable operating expenditure relating to the environmental contribution. Central Highlands Water acknowledges that this approach was not consistent with ESC guidance paper, however CHW had applied a consistent methodology as to the approach used in the 2018 Price Submission whereby it is anticipated the environmental contribution levy will be increased every 5 years (next on 1 July 2025) by using the previous formula of 5% of total revenue forecast at this date.

CHW also notes that, as stated on page 29 of the Draft Decision, prior to making the final decision, the ESC will update the forecast licence fee and environmental contributions with input from the relevant regulatory bodies and adjust where necessary for the latest inflation and external bulk water charges data.

SECTION B: Central Highlands Water disagrees with the following proposed changes

This section (B) of our response lists the proposed changes in the Draft Decision that Central Highlands Water disagrees with. Information is provided to support these positions.

Summary p.vi

ESC Draft Decision: Our draft decision proposes to not accept Central Highlands Water's self-rating of its price submission as 'Standard' for the Management element of PREMO. We found Central Highlands Water's financial model (lodged with its price submission) contained a number of errors and included changes to some formulas that we embedded in the model.

Also, substantive corrections were needed to its financial model, with the corrections both greater in number and more complex to resolve than other businesses. The formula changes Central Highlands Water made to the financial model also impeded our review process.

CHW Response: Central Highlands Water was surprised by such a finding in the Draft Decision and refutes the assertions on the following grounds:

- Central Highlands Water do not believe we changed any formulas in any cells in the model without ESC permission and it was our understanding we had worked collaboratively with ESC staff to resolve any matters with the model and that these were in essence, what could be reasonably expected in the completion of a complex financial model.[3] At no time was it raised with Central Highlands Water that these discussions were of such apparent severity that they would warrant a downgrade in the PREMO rating for the Management component.

- That the ESC did not provide Central Highlands Water with reasonable notice that they had such concerns during the assessment period and that such a comment was being considered to be published. Central Highlands Water management were professional and highly responsive to all queries raised by the ESC on all matters requiring attention during the development and assessment period.

Central Highlands Water sought an urgent meeting with the ESC to clarify the comments and this was held online on 17 April 2023, but in our opinion the ESC was unable to satisfactorily provide supporting information regarding these published comments.

As these comments are a major reason for the ESC's decision to downgrade the PREMO rating for Management from Standard to Basic, Central Highlands Water does not support this downgrade, particularly as the PREMO Standard rating for Management was proposed at mid-point in the PREMO range.[4]

Central Highlands Water also request the ESC in their assessment of our PREMO Management rating consider our deferral of $144 million of capital expenditure during the development of our

[3] Central Highlands Water sought, and received, written permission from the ESC on 16 September 2022 (prior to submission on 30 September 2022) to populate data in an unlocked version of the ESC financial model.
[4] Central Highlands Water proposed PREMO Management rating at 2.25 on a scale of 1.75 to 2.5 reference: Price Submission 2023-28 p.10

$256 million capital program as per our Price Submission. We believe that this indicates the Management of Central Highlands Water has prudently demonstrated the acceptance of a significant financial risk during this period of elevated regional development.

4.1 Operating expenditure p.21 - Regulatory Accounting Statement Reconciliation

ESC Draft Decision: Since lodging its price submission with us, we identified that Central Highlands Water's 2021-22 Regulatory Account Statement figure for total prescribed operating expenditure is $4.0 million lower than the figure provided in its financial model for the price review. Further investigation to reconcile this with Central Highlands Water and our auditor has confirmed an error in the 2021-22 regulatory accounts. Correcting for this increases the 2021-22 figure by $2.9 million, and we accept this adjustment to the total operating expenditure figure, noting it is $1.16 million lower that the figure initially proposed by Central Highlands Water in its price submission.

CHW Response: CHW acknowledges the variance between the 2021-22 regulatory accounting statements operating expenditure as submitted to the ESC did not reconcile to the operating expenditure that was used as the 2021-22 baseline number within our Price Submission financial model. This was due to inadvertently classifying some costs to incorrect categories within the regulatory accounting statements.

The table below outlines the changes required to be made and that these changes relate to the re-classification of some operating expense categories between prescribed/non-prescribed operating expenditure and depreciation caused by some incorrect classifications in the original Regulatory Accounting Statements submitted. The total Operating Expenditure in the Profit and Loss remains the same. We will ensure to classify the operating expenses categories correctly for future Regulatory Accounting Statements.

Following is a summary of the adjustments made:

	Nominal $		
	FY22	Adj required	Total after adj
Controllable Opex	60,614,000	956,525	61,570,525
Non-controllable opex			
External bulk water charges (excl. temporary purchases)	547,000	-	547,000
Licence Fees	292,000		292,000
Environmental Contribution	4,472,000		4,472,000
Other - temp water purchases	135,000		135,000
Total Non-controllable opex	5,446,000	-	5,446,000
Total Prescribed Opex	**66,060,000**	**956,525**	**67,016,525**
Non-prescribed Opex	2,077,000	- 419,637	1,657,363
	68,137,000	**536,888**	**68,673,888**
Adjustment to depreciation		- 536,888	
Total Opex change		-	

These changes show that the numbers between the pricing model and the 2021-22 baseline operating expenditure number and regulatory accounting statements align closely, with only a small variance of $154k calculated in real terms. Central Highlands Water has provided the revised

2021-22 Regulatory Accounting Statements file for review to the ESC on 4 May 2023 and it is provided with this response as well.

4.2.2 Forecast Capital Expenditure p. 31

ESC Draft Decision: For the reasons set out below, our draft decision is to adopt a forecast capital expenditure of $244.7 million, $11.4 million (or 4.4 per cent) lower than the $256.0 million forecast proposed by Central Highlands Water for the purpose of calculating its revenue requirement (Table 4.5).

Table 4.5 Our proposed adjustments to Central Highlands Water's proposed total forecast capital expenditure
$ million 2022-23

	2023-24	2024-25	2025-26	2026-27	2027-28	Total
Central Highlands Water's proposed total forecast capital expenditure	**45.99**	**48.00**	**50.01**	**54.01**	**57.99**	**256.00**
Adjustment – Ballarat Water Growth Project – Western and North-Western growth area	0.00	0.00	0.00	0.00	−0.43	−0.43
Adjustment – Ballarat Sewer Growth Project – Western and North-Western growth area	0.00	0.00	0.00	−0.35	−0.77	−1.12
Adjustment – Growth and Development Upsizing and Efficiency Program	−1.30	−0.90	−0.90	−0.90	−0.90	−4.90
Adjustment – ICT Business Solutions Enhancements	−1.13	−1.00	−0.63	−1.26	−0.87	−4.90
Draft decision - total forecast capital expenditure	**43.56**	**46.10**	**48.48**	**51.50**	**55.02**	**244.66**

CHW Response: CHW does not agree with the ESC's view regarding the proposed reductions to the 4 capital programs listed above. The ESC's Draft Decision highlighted uncertainty around timing, scope or cost as the basis for its initial assessment. However, CHW believes that fair and reasonable assumptions have been made in preparing the justification for these projects which reflect a prudent and efficient approach to managing both risk and expenditure.

Each of the proposed adjustments is specifically addressed below.

Ballarat Water Growth Project – Western and North-Western growth area and Ballarat Sewer Growth Project – Western and North-Western growth area

The ESC noted the following in its Draft Decision on p.32:

'Our consultant considered that as the required land is not yet subject to a rezoning application, the expenditure included in Central Highlands Water's forecast for the next regulatory period should be reallocated into the 2028–33 regulatory period, alongside the remainder of the relevant projects' expenditure. We agree with our consultant's view, noting this is an appropriate approach to address timing risk on behalf of customers.'

CHW response: The Western and North-Western Growth Areas are 2 of the 5 Growth Areas discussed in the PR23 Price Submission. Their proposed development contributes to providing sufficient greenfield development for Ballarat in line with Victorian Government policy.

CHW acknowledges that some timing risk is associated with the rezoning and development of this land. However, we offer the following explanatory notes to support that our proposal reflects fair and reasonable assumptions, including risk allocation, to servicing these areas in an efficient manner:

- The City of Ballarat (being the local planning authority) resolved at their meeting on 23 February 2022 to apply to the Minister for Planning to rezone 3 Growth Areas (Northern, Western and North-Western) to an Urban Growth Zone and this is in the process of being enacted.[5]

- The City of Ballarat has already engaged a consultant to develop an Infrastructure Servicing Strategy for the Western and North-Western Growth Areas, which is anticipated for completion in mid-2023. The current growth rates within Ballarat and the available land stock also suggests that our proposed construction timing is fair and reasonable.

- The intent of the $1.55 million of capital investment is to enable CHW to undertake significant planning work during the 2023-28 regulatory period to ensure that our next price submission (for the period commencing 2028) contains accurate and reflective costings, as would be expected by the ESC.

- CHW's proposal only assumes expenditure towards planning and design costs during the 2023-28 regulatory period. This reflects prudent and efficient expenditure as projects of this magnitude have long lead times and require sufficient planning during the early phases of the project.

- The overall capital investment to deliver water and wastewater services to these 2 new growth areas amounts to $77.9 million up to the end of the 2033-38 regulatory period on current estimates, so is important that preliminary planning is undertaken in a methodical way to avoid unnecessary capital expenditure.

[5] City of Ballarat. Council Meeting Minutes. 22 February 2022 p.22 https://www.ballarat.vic.gov.au/sites/default/files/2022-05/D-22-28671%2023%20February%202022%20Council%20Meeting.pdf

- Construction costs are solely reflected within the 2028-33 and 2033-38 regulatory periods for this suite of projects. Construction is expected to commence during 2028-29. This timing reflects a balanced risk position.

- Adopting the ESC's approach of condensing all expenditure into the construction period is not practical or feasible. This increases the risk in providing efficient infrastructure delivery and will also impact on the 2028-33 price pressures.

In summary:

- This body of work is an essential step to preparing a prudent and efficient capital works program for the following regulatory period. The current delivery timing is a balanced risk position and is reflective of current work and projections undertaken by the City of Ballarat.

- These are large scale projects with significant lead times that require careful and considered forward planning.

- Our proposed PR23-28 expenditure is for planning and design work only, not construction. It is highly feasible that a scenario may eventuate requiring the construction of these future works in PR23-28, requiring developers, CHW and/or the ESC to look at different mechanisms for funding this essential growth infrastructure.

- Our approach is both practical and prudent. It supports managing infrastructure delivery risks and provides accurate and reflective costings for the subsequent PR28-33 regulatory period.

- A number of public submissions provided by local land developers to Engage Victoria during the 2023-28 Price Submission feedback period also strongly supported the planning of these 3 growth areas to enable future development, such as:

  > *"Proposed NCCs and staged increase are reasonable to enable delivery of major infrastructure. It is encouraged to utilise collection of NCCs to plan/deliver key infrastructure for all three identified growth fronts. This will enable faster collection of NCCs via multiple growth fronts".*[6]

- The $0.43 million for water projects and $1.12 million for sewer projects are both considered prudent and efficient capital expenditure within the PR23-28 regulatory period.

[6] Submission #28 received through Engage Victoria 28 November 2023 from Beveridge Williams (Land development consultants)

Growth and Development Upsizing and Efficiency Program

The ESC noted the following in its Draft Decision on p.33:

'Our consultant identified the forecast expenditure for the Growth and Development Upsizing and Efficiency program was derived using the actual costs of projects delivered in the current regulatory period, which included two high-cost projects, along with a contingency allowance of $0.5 million per year. While noting that the drivers for this program were appropriate and justified the need for the program, given the timing uncertainty around the growth drivers for this work and uncertainty in the scope of works to occur, our consultant recommended reducing the annual allowance for this program to $1.5 million, with an overall adjustment of $4.9 million across the period.'

CHW response: This program provides additional funding towards growth-related projects that cannot be entirely funded by developers, other utility providers or statutory authorities. This typically involves CHW requesting for assets to be upsized or upgraded during construction to service additional growth beyond the minimum servicing solution for the proposed project boundary.

Central Highlands Water acknowledges that some timing and scope risk is associated with the Growth and Development Upsizing and Efficiency program as it is largely informed and driven by external factors outside the control of CHW. However, we offer the following explanatory notes to support that our proposal includes accurate and reflective costings and is an appropriate risk allocation for the 2023-28 regulatory period:

- Historically, CHW's networks have contained considerable spare capacity to enable new developments to be serviced without significant capital expenditure to upgrade the capacity of assets. This spare capacity is reaching its limits and is driving up capital investment in upsizing and efficiency upgrades.
- Elevated growth projections remain a feature of the region (particularly for Ballarat) and are forecast to continue for the foreseeable future, as confirmed by the recent Victoria in Future (VIF) 2022 projections. This additional growth has been driving investment in recent years and will continue to do so.
- Whilst the ESC's consultant highlights that a portion of recent costs were attributable to 2 major projects, it failed to acknowledge that there has been an overall spend increase which directly correlates with higher growth rates and more developments occurring. These are not isolated occurrences, they reflect a sustained trend over multiple years. In addition, construction costs have increased significantly in recent years and have driven up expenditure requirements per project.
- Our proposed expenditure in this program aligns with our Pricing Submission assumptions regarding future accelerated and sustained regional growth. The proposed expenditure is a key pillar in ensuring that our capital investments aligns with our key assumptions and customer outcomes which includes investing in long-term projects and future proofing now.
- Importantly, this program extends beyond regular land development projects. Regional investment projects continue to be funded in Ballarat by a range of bodies, which is demanding greater CHW investment into upsizing projects. Some examples include

providing infrastructure to support the 2026 Commonwealth Games events and athletes' village in Ballarat (Victorian Government)[7], Keeping Ballarat Moving (Regional Roads Victoria), and Roads and Drainage Upgrade Programs (Local Councils).[8] These works present opportunities for CHW to coordinate works and upsize or upgrade capacity constrained assets in a manner which derives maximum efficiency and minimal community disruption. This approach avoids the risk of CHW needing to come back some years later and disturb newly created roads and streetscape works.

- At present, CHW is already committed to 4 major land development upsizing projects within the first year of this program. These projects will easily amount to a net capital expenditure of more than the proposed $2.8 million during Year 1 of the 2023-28 regulatory period. This does not include any allowance for smaller and emerging land development projects or for the regional investment projects listed above.
- Based on a balanced risk position and conservative estimates, CHW expects ongoing annual expenditure for the final 4 years of the 2023-28 regulatory period to be $2.4 million per annum. This includes land development projects, 2026 Commonwealth Games projects, 'Keeping Ballarat Moving' projects and local roads/drainage projects. This represents a minimum acceptable position, albeit with some degree of financial risk carried by the business if additional needs emerge.
- As such, the overall allocation for this program is strongly recommended to remain at $12.4 million across the 5-year period as per the following table:

Table 1 Price Submission capital expenditure Growth and Development Upsizing and Efficiency program ($2022-23, million)

2023-24	2024-25	2025-26	2026-27	2027-28	Total
2.8	2.4	2.4	2.4	2.4	**12.4**

In summary:

- The absorption of existing capacity, combined with the increased cost of capital works, ongoing growth and major regional investment projects are driving up the requirement for investment in CHW's upsizing program.
- Investments beyond $2.8 million have already been identified during Year 1.
- An ongoing investment of $2.4 million per annum for the final 4 years of the program reflects a prudent budget which results in some ongoing financial risk to CHW.
- Sufficient capital expenditure is required to seize upsizing opportunities, deliver works efficiently, minimise community disruption, service major growth and facilitate major events

[7] Ballarat has been chosen to be one of 5 regional centres to host the 2026 Commonwealth Games https://www.vic.gov.au/victoria-2026-commonwealth-games

[8] 'Keeping Ballarat Moving' is a Regional Roads Victoria program investing more than $60 million to upgrade 6 traffic hotspots and surrounding roads to improve travel around the Ballarat city and reduce the risk of crashes at key intersections. https://regionalroads.vic.gov.au/map/grampians-improvements/keeping-ballarat-moving

such as the 2026 Commonwealth Games.[9] Avoiding timely investment increases the risk of incurring greater overall cost to customers and the broader community at a later time.

- An overall capital expenditure requirement of $12.4 million as per the 2023 Price Submission is justified for the 2023-28 regulatory period, and CHW requests the $4.9 million reduction in the Draft Decision to be reinstated.

ICT Business Solutions Enhancements

The ESC noted the following in its Draft Decision on p.33:

Our consultant identified the justification and expenditure associated with several specific initiatives within the ICT Business Solutions Enhancements program were well justified and appropriate but considered the scope and associated benefits of other works to be delivered through the program were still in development and required further refinement. Our consultant also noted Central Highlands Water is still preparing its overarching ICT and digital strategy connected with this program. Given this, our consultant recommended $4.9 million of expenditure connected to this program be deferred to the 2023–28 regulatory period.

CHW response: As noted, at the time of preparing the PR23 Price Submission, the Central Highlands Water 2040 Strategy – *More than Water* had not been fully endorsed and therefore delayed the complete development of the supporting ICT and Digital Strategy. The 2040 Strategy was fully endorsed by the Board of Central Highlands Water at their meeting on 5 April 2023. The Digital Strategy has been fully updated and finalised to reflect the endorsed 2040 Strategy.

As a result of this review, it has been identified that not only is the initial $14.9 million of capital expenditure justified, an additional $4.2 million of expenditure has been identified in order to deliver the strategic outcomes and which more accurately reflects current prices.

However, Central Highlands Water has decided to only advocate for the initial $14.9 million in the Price Submission and accept the financial risk on the additional expense required. This is summarised in the following tables and shown in more detail in the ICT & Digital strategy document at Attachment A.

Table 2 ICT & Digital final strategy expenditure estimates following revision ($2022-23, $,000)

Category / Program	2023-24	2024-25	2025-26	2026-27	2027-28	Total
Digital transformation solutions	3,990	2,495	2,157	2,580	2,270	**13,492**
ICT and Digital (ICTD)	738	860	455	320	293	**2,666**
Industrial Automation and Control Systems (IACS)	596	414	220	220	166	**1,616**
Cyber security	630	279	144	144	144	**1,341**
TOTAL	**5,954**	**4,048**	**2,976**	**3,264**	**2,873**	**19,115**

[9] The Minister for Water has requested through the Letter of Expectations (dated 9 March 2023) that Central Highlands Water support planning for the delivery of the Victoria 2026 Commonwealth Games.

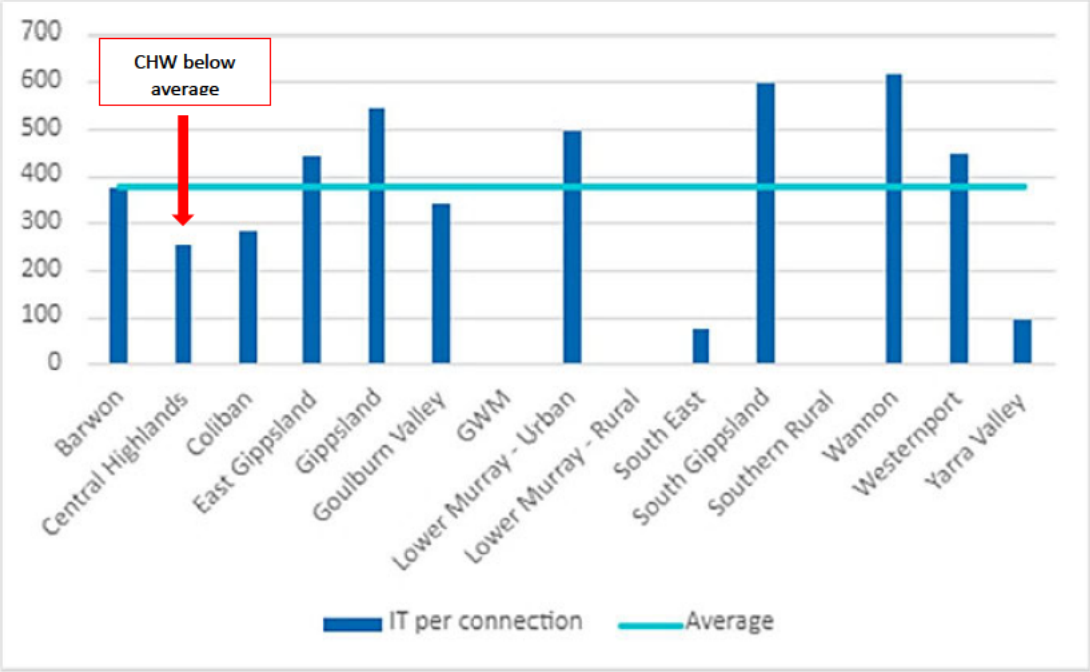
Table 3 ICT & Digital strategy expenditure - difference between original Price Submission and revision ($2022-23, $,000)

Category	2023-24	2024-25	2025-26	2026-27	2027-28	Total
Original Price Submission	3,133	2,997	2,633	3,264	2,873	**14,900**
Revision	5,954	4,048	2,976	3,264	2,873	**19,115**
Difference	**+ 2,821**	**+ 1,051**	**+ 343**	**0**	**0**	**+ 4,215**

The ICT and Digital Strategy demonstrates that the investment is necessary to correct historic underspend of expenditure in the ICT and Digital areas that has resulted in many systems not being 'fit-for-purpose' and/or not being able to adequately meet current business requirements, regulatory requirements or customers' expectations.

The following 2 charts taken from the *FTI Consulting Review of Expenditure Forecasts 2023 Water Price Review* report, show that Central Highlands Water's ICT-related operating expenditure has also been well below expenditure levels of other comparative regional water corporations. This provides further evidence that the period of historical under-investment in the ICT and Digital areas has been across both capital and operating expenditure categories.

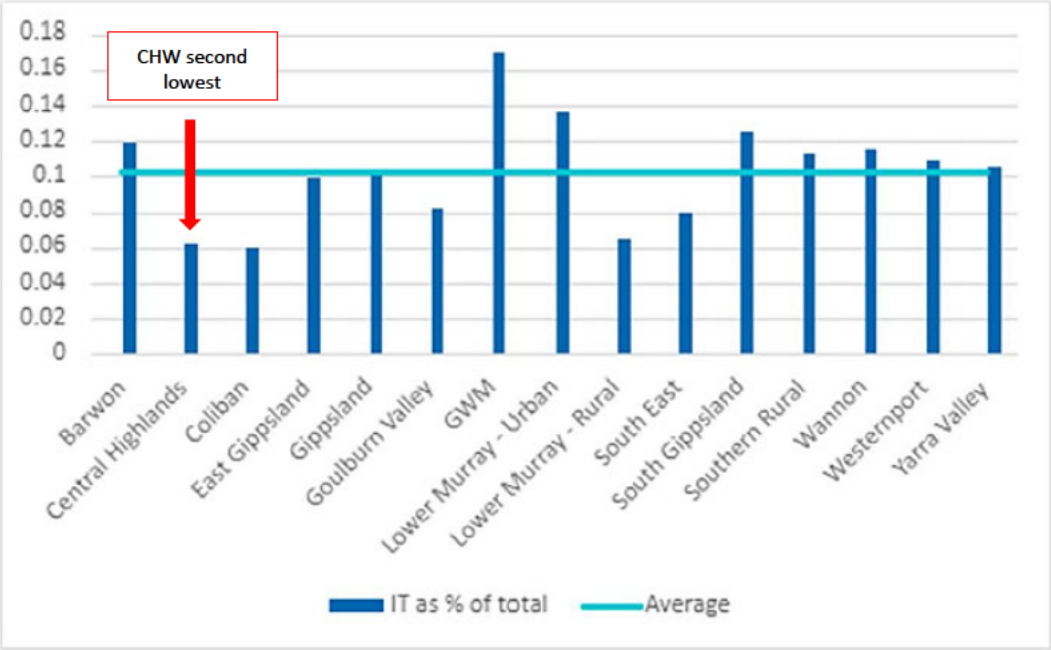
Figure A4: PS5 forecast: ICT operating expenditure per water connections ($ per average number of water connections, 1 January 2023)



Source: Victorian water businesses, 2023 Price Review Models.

Central Highlands Water does not consider these relative measures an indicator of efficient performance, but rather they are indicators of under-investment in the ICT and Digital capability.

Figure A5: PS5 forecast: ICT operating expenditure as a percentage of total controllable operating expenditure (%)



Source: Victorian water businesses, 2023 Price Review Models.

The final ICT and Digital Strategy outlines the strategy connections to the broader 2040 business strategy and the proposed investment program in some detail. The proposed capital expenditure to deliver on this strategy during the 2023-28 period is included in the document at Attachment A. In summary, this presentation-style document contains the following:

- p.2 Context
- p.3 Key challenges and trends
- p.4 Our 2040 Strategy on a page, highlighting the crucial role required of the ICT & Digital strategy
- p.5 Phased delivery of Strategic Action Areas over the PR23 period
- p.6 Impact of removing $1.0 million p.a. on average from the digital and ICT program as recommended in the Draft Decision
- p.7 ICT & Digital Strategy roadmap, showing individual projects totalling $19.1 million, with estimated annual costs and timing over the 5-year period
- p.8 Financial overview by category, showing adjusted costs
- p.9 Key Strategic Initiatives – Digital Transformation Solutions: System integration, Data management and warehousing
- p.10 Key Strategic Initiatives – Digital Transformation Solutions: Application deficiencies, Financial Services
- p.11 Key Strategic Initiatives – Industrial Automation and Control Systems: Operational asset management, Internet of Things (IoT)

p.12 Key Strategic Initiatives – Industrial Automation and Control Systems: Operational technology, Communications network

p.13 Key Strategic Initiatives – ICT & Digital: ICT Asset lifecycle, Disaster recovery/business continuity

p.14 Key Strategic Initiatives – Cybersecurity

p.15 Strategic risks

It is important to note that the International Financial Reporting Standard (IFRS) number 16, which sets out the definition of a lease, highlights that 'Software As a Service' arrangements should be treated as a service contract (i.e. operating expenditure).[10] CHW is now anticipating that many of its projects will be cloud-based during the 2023-28 period.

However, as CHW has currently included its IT program of works expenditure as capital expenditure it does not propose to reclassify but seek to have the ESC note this matter. This approach reduces the allowable revenue in the ESC financial model and ultimately reducing costs to customers. This also means that the costs will be recognised as an operating expense in our statutory accounts rather than a capital expense during the 2023-28 period.

[10] IFRS 16 is the new lease accounting standard for business reporting under the International Financial Reporting Standards

SECTION C: Central Highlands Water responses to ESC's requests for further information

This section (C) of provides responses to the ESC's request for further information in the Draft Decision.

- **Outcomes – Section 3.2.3 p.14**

  ESC: Following the release of our DD, we will provide the business with our standard Outcomes Reporting Template to complete and submit with its response to the draft decision. We will work with the business to ensure the final set of measures complies with our guidance requirements.

  Central Highlands Water's response to this draft decision must provide sufficient clarity to demonstrate its proposal does reflect customer value consistent with an Advanced rating.

  CHW response: Central Highlands Water met with the ESC online on 26 April 2023 to clarify the requirements. The Outcomes Reporting Template has been completed and is included as Attachment B. Central Highlands Water understands that the measures and targets will continue to be refined in collaboration with the ESC.

  At the ESC's request, the *Safe Drinking Water Act non-compliances* output from the current PR18 period has been incorporated into the 'Equity' outcome.

  We believe all these changes enhance the existing value proposition to customers.

- **Revenue Requirement - Section 4 p.18**

  ESC: Our final decision on Central Highlands Water's revenue requirement will be based on the latest available information. Accordingly, as well as responding to our draft decision and providing an updated price schedule, Central Highlands Water must update its revenue requirement and prices to reflect our updates to estimates for the cost of debt and inflation, which we will advise in April 2023.

  CHW response: As per the ESC's email of 6 May 2023 we have adopted cost of debt to be 6.76% and the inflation rate to be 3.50% and have incorporated these into the financial model as specified.

  There may be changes in laws or government policy before we make a price determination. If any such changes occur between the draft decision and the price determination that impact on its forecast costs and the revenue requirement, Central Highlands Water should update its price submission and provide us with an updated financial model. It also should notify us of any material changes that impact its forecast costs, revenue requirement or prices (including demand). Any updates to its submission or pricing model will be made publicly available on our website.

  CHW response: Central Highlands Water is not aware of any changes in laws or government policy that have impacted our price submission as at this date (12 May 2023).

- **Cost adjustments - Section 4.1.1.3 p.25**
  ESC: We request that in its response to our draft decision, Central Highlands Water quantify the cost savings to customers to be delivered through digital metering, and demonstrate how these savings are reflected in its financial model and passed through to customers.

  CHW response: At the time of the lodging the PR23 Price Submission, the digital metering contract had not been finalised and therefore the ongoing costs of the project had not been included in CHW's submission. Following a competitive tendering process, CHW entered into a contract that provides value-for-money to deliver customer outcomes. The project was publicly announced on 8 May 2023.[11]

  The 3-year installation period will commence mid-2023 and the benefits are not likely to be realised until late in the regulatory period. CHW's ongoing operating expenditure for costs associated with digital metering have not been incorporated into CHW's controllable costs. This is a direct saving reflected in the financial model that benefits customers and an additional efficiency consideration for the ESC as it is in addition to the annual efficiency rate of 1.0% p.a. incorporated into CHW's Price Submission.

  It is also important to note that the primary benefits to be realised from the implementation of digital metering include:

  a) Significantly improving our customer's experience by encouraging closer involvement and appreciation of their water use

  b) Support for customers (particularly vulnerable customers) by being able to better identify leakage in residential properties with savings estimated in the range of 3% to 8% p.a. over time.[12] CHW is planning a comprehensive customer communication and engagement program so that customers will become familiar with the new technology which will include water use apps. This will enable customers to have more visibility over their water usage and ability to manage their water consumption to achieve financial savings. It is expected that these benefits will become more apparent towards the end of the regulatory period.

  c) CHW is also undertaking modelling on how this forecast reduction in water consumption may result in the ability to defer the future water supply augmentation for our smaller water supply systems which will also ultimately provide long-term financial benefits to our customers. This supported several water supply augmentation projects to be deferred as part of CHW's robust risk assessment of the capital program.

  d) Meeting the requirements of the ESC Act s8A(1)(d) where the relevant health, safety, environmental and social legislation applies to the industry. This project will significantly reduce safety risks to meter reading staff primarily relating to potential incidents caused

[11] Central Highlands Water 2023. *New data insights to drive customer benefits in digital water meter rollout*. 8 May 2023. https://www.chw.net.au/news/latest-news/new-data-insights-to-drive-customer-benefits-in-di

[12] Araine Liu, Pierre Mukheibir, Institute for Sustainable Futures, University of Technology Sydney (2018). *Digital metering feedback and changes in water consumption – A review.* Resources, Conservation & Recycling 134 (2018) 136-148. https://doi.org/10.1016/J.RESCONREC.2018.03.010
This research paper reviewed 25 published studies regarding the impact that the introduction of digital water metering had on residential water consumption, citing mean savings across all the studies of 5.5%, within the 10th–90th-percentile envelope of 3.0%–8.0% savings (excluding the extreme outliers).

by entering properties and exposure to dangerous dogs, aggressive customers and other hazards, resulting in lower WorkSafe costs long-term.

e) Significantly reducing time traveling on roads, resulting in financial savings and also reduced greenhouse gas emissions due to less vehicle usage

f) Improving CHW's environmental and sustainability footprint by using the data to identify water leaks in real-time resulting in reduced wastage of water. This will also produce savings for CHW in treating unnecessary water, pumping water and associated power costs and associated greenhouse gas emissions.

g) The upgraded digital water meters will empower customers with the ability to monitor their water usage digitally. This can assist with leak detection and to identify areas where water can be saved, resulting in a lower water bill.

ESC: We also request the business explain any benefits associated with its move to quarterly billing, such as the more frequent collection of revenues, and how this may benefit customers.

CHW response: Central Highlands accepts the reduction in operating costs to implement quarterly meter reading of $50,000 per annum in years 1 and 2 ($100,000 in total).

Quarterly meter reading was strongly supported through CHW's customer engagement program as it provides customers the ability to manage bill payments more frequently during the year and result in less bill shock.

Due to an aging billing system, the cost of modifying the payment options is in line with CHW's original submission, however due to the customer value associated with this change, CHW will incorporate the financial risk into its budget.

ESC: For the $1 million ($0.2 million per annum) in proposed operating expenditure to move a stockpile of contaminated biosolids and the $1.97 million ($0.39 million per annum) to complete lagoon desludging work, we note Central Highlands Water has presented these costs in its financial model as steady across all 5 years of the regulatory period, seemingly to smooth the pricing impact. We ask Central Highlands Water to consider whether it might be more appropriate to capitalise these associated costs, for recovery over a suitable longer time period, and quantify the customer pricing benefits of its chosen approach.

CHW response: Central Highlands Water has considered the opportunity to recognise the costs associated to move the stockpile of contaminated biosolids and the costs associated to complete the lagoon desludging works, however when considering these costs from an accounting treatment perspective, both costs relate to operations of the business and the costs expensed as the work is performed rather than depreciated over a useful life. In addition, the costs to be expensed do not provide any long-term value in terms of an asset that can be recognised on CHW's balance sheet and as the expenditure incurred will not add value to CHW's existing assets, this also reinforces the requirement to treat these costs as operating expenditure.

As a result, CHW will continue to recognise these costs within its operating expenditure forecasts for each year across the 5-year pricing period.

- **Non-controllable operating expenditure - Section 4.1.2 p.28**
  ESC: We have reviewed Central Highlands Water's forecast bulk charges with Goulburn-Murray Water's 2022-23 approved tariffs and request that Central Highlands Water respond to our draft decision by:
    - updating its forecast bulk charges for the period 2022-23 to 2027-28 by using the approved prices for Goulburn-Murray Water in 2022-23
    - maintaining the forecast bulk charges at a flat rate in real terms (using a price path of 0 per cent and not applying the consumer price index) during the next regulatory period
    - submitting an updated financial model which takes into account these changes.

  CHW response: The Goulburn-Murray Water 2022-23 price list was obtained from: https://www.g-mwater.com.au/customer-services-resources/pricing/price-list

  Using these prices, the annual bulk charges are calculated to be: $645,363.68 (as compared to $647,644.98 for Year 1 in the submitted model) as per:

$, 01/01/23		2023-24		
Bulk water charge	**Unit**	Price ($)	Quantity	Total ($)
Goulburn 1A HRWS	ML	10.03	8,654.00	86,799.62
Goulburn 1A LRWS	ML	4.58	325.00	1,488.50
Campaspe LRWS	ML	4.58	11,442.00	52,404.36
Campaspe HRWS	ML	10.03	80.00	802.40
Distribution access	ML/d	2547.00	55.00	140,085.00
Bullarook entitlement	ML	486.60	500.00	243,300.00
Loddon entitlement	ML	46.50	1,650.00	76,725.00
Murray 7, Murray 6 and Broken CK HRWS	ML	9.72	1,040.00	10,108.80
RUSAF (Newlyn and Loddon)	ML	10.00	2,150.00	21,500.00
Above Entitlement Storage Fee	ML	4.05	3,000.00	12,150.00
Total				**645,363.68**

  This value has been used to populate the updated financial model as requested.

- **Forecast regulatory asset base - Section 4.3.2 p.36**
  ESC: We require Central Highlands Water to update its forecast customer contributions in response to our draft decision. For the purpose of our draft decision, we have adopted the forecasts provided by Central Highlands Water noting these will be reviewed for our final decision.

  CHW response: The forecast customer contributions have been updated to the following:

Table 4 New Customer Contributions revenue ($2022-23, $ million)

2023-24	2024-25	2025-26	2026-27	2027-28
4.17	5.73	7.34	9.17	11.38

  As a result of these changes the forecast Regulatory Asset Base has also been updated.

- **Customer contributions - Section 4.3.2.1 p. 38**
  ESC: Central Highlands Water must update its customer contribution forecasts in response to our draft decision and must ensure that the forecast customer contributions in the financial model and new customer contributions model reconcile.

  CHW response: The forecast customer contributions have been updated to reconcile in both models. These models have both been provided as part of this response.

- **Regulatory Depreciation - Section 4.5 p.40**

  ESC: Given our draft decision to adopt a different forecast regulatory asset base than proposed by Central Highlands Water, we require Central Highlands Water to recalculate its depreciation in its response to our draft decision. As it used the deprecation override function in our financial model, Central Highlands Water must also explain its approach to calculating depreciation and how it complies with our guidance. For the purpose of our draft decision, we have adopted the forecasts provided by Central Highlands Water noting these will be reviewed for our final decision.

  CHW response: Central Highlands Water has updated the depreciation rates to reflect the changes made to forecast revenue from the adjusted New Customer Contributions.

- **Tax Allowance - Section 4.6 p.41**

  ESC: The tax allowance is a component of the revenue requirement. Central Highlands Water has proposed a tax allowance of $5.9 million in its revenue requirement for the 2023–28 regulatory period. As we have proposed adjustments to its revenue requirement, the business must provide an updated estimate in response to our draft decision.

  CHW response: Central Highlands Water has provided an updated tax allowance of $5.8 million in 2027-28 to reflect the changes made in the financial model for both operating expenditure and revenue from New Customer Contributions.

- **Demand - Section 5.1 p.42**
  ESC: Since lodgement of its price submission, updated Victorian Government population and dwelling growth estimates have been made available to water businesses.

  In its response to our draft decision, Central Highlands Water must demonstrate how it has considered these updated estimates and if required, identify and justify any changes to its demand forecasts (any updates must also be included in its pricing model submitted in response to our draft decision).

  CHW response: The growth forecasts in the PR23 Price Submission were based on a number of sources, including the Central Highlands Water 2022 Urban Water Strategy, which in turn was informed by the unpublished and confidential VIF 2021 data.

  Central Highlands Water also relied upon forecasts from other reliable sources including the City of Ballarat and other influences. As a result, we considered that a material uplift in growth from 1.7% p.a. to 2.2% p.a. for the 5-year planning period was appropriate. Central Highlands Water has reviewed the unpublished and confidential VIF 2022 data and while there are some minor changes to the unpublished and confidential VIF 2021 data (some growth rates are marginally higher and some are marginally lower) they are not considered material changes in

the overall context and still indicate significant increases in growth from the current regulatory period.

We have also reviewed recorded growth in connected services and the year-end estimate (as at 30 June 2023) is 2.4% p.a. after 10 months of data, indicating continuing high levels of growth. Collectively, this data continues to support Central Highlands Water PR23 Price Submission forecasts of growth of 2.2% p.a. and we recommend maintaining this growth rate as submitted.

- **Prices - Section 5.3.2 p.44**

  ESC: We are seeking further information from Central Highlands Water in response to our draft decision on how it intends to address the impacts of relatively high inflation on its proposed prices and customer bills for 2023-24.

  As part of its response to our draft decision, Central Highlands Water must demonstrate how it has considered the impacts of inflation on its forecast expenditure in 2023-24, and whether these are reasonable taking into account that some of its key costs (such as labour) are unlikely to increase as much as near-term inflation.

  CHW response: The CPI to be applied for our 1 July 2023 tariff adjustment is 7.0% and is based on the most recent actual March 2022 to March 2023 inflation rate advised by the Australia Bureau of Statistics (ABS) and is the maximum CPI that Victorian water businesses may apply under the regulatory framework.

  We recognise that this is higher than the 2022-23 CPI of 5.1% that was applied to customer prices by the ESC and in the years prior of 1.1% (2021-22), 2.2% (2020-21), 1.3% (2019-20), and 1.9% (2018-19).

  Our Price Submission proposes to double our customer assistance program to $2.5 million over the 2023-28 period through a range of targeted support programs and we will divert more resources if required to help customers manage their 2023-24 bills.

  As noted above, the CPI is part of the annual adjustment prices so that we can recover the increase in costs of Central Highlands Water's expenses due to inflation in the economy so that we can deliver the levels of water security, customer service and outcomes that we committed to in our 2023 Price Submission and that the community expect.

  Due to the different composition of our costs as compared to a 'household basket of goods' which the CPI measures, we are seeing some of our costs increase by less than 7.0% while others are increasing by much more, for example costs of building materials which have increased by an average of 28% over the past 3 years as per the following table:

Percentage cost increase in building materials in 3 years (since Dec 2019) [13]

Building material	Increase
Steel products	53.9%
Timber/joinery	40.4%
Other metal products	35.8%
Electrical equipment	36%
Plumbing products	26.8%
Ceramic products	22.9%
Concrete/cement/sand	19.8%
Average price increase of building materials	28.4%

In assessing the options open to Central Highlands Water in designing a price pathway that responds to both the ESC Draft Decision and the desire to minimise the size of the year 1 (2023-24) price increase, we have recommended the following price pathway:

Table 5 Price pathway (% change per annum - real)

Proposal	**2023-24**	**2024-25**	**2025-26**	**2026-27**	**2027-28**
Response to Draft Decision	**-1.5**	**1.0**	**1.0**	**1.0**	**1.0**
Initial Price Submission	0.0	1.0	1.0	1.0	1.0

The benefits of this proposed price pathway are as follows:

- In 2023-24 the impact of the application of CPI of 7.0% will be reduced by 1.5%. This means customer prices will effectively be increasing by 5.5%, which is below the cost of inflation.
- The price pathway for years 2 to 5 remains unchanged. As inflation is expected to decrease from year 2 onwards and return to 3% in mid-2025,[14] the need to reduce the price increases to mitigate the impacts of high inflation in these years are lessened.
- Keeping the proposed price changes the same in years 2-5 provides an important signal of 'no change' to customers who collaboratively developed the initial Price Submission price pathway which was subsequently endorsed by the Board. This recognises we continue to place customers at the centre of the PREMO model and be faithful to their preferences.

Accordingly, we propose to apply the 5.5% price increase to our annual tariff adjustment process for 2023-24 while working closely with our Customer Engagement Panel and Careflow

[13] Source: Master Builders Victoria, April 2023

[14] Reserve Bank of Australia 2023. *Statement by Philip Lowe, Governor: Monetary Policy Decision Number 2023-10*. 2 May

Advisory Group to ensure we remain alert and responsive to our customers' needs through this high inflation period.[15]

- **New customer contributions - Section 5.4 p.46**

ESC: In response to our draft decision in relation to new customer contributions, Central Highlands Water must:

- explain how it has allocated its capital expenditure to new customer contributions
- explain its transition plan towards achieving full cost reflectivity for each service including the timeframes of this plan and provide reasons for adopting this transition plan and its timing
- set out how it proposes to fund any shortfall in revenue from new customer contributions, compared to the estimated costs of providing the service
- explain how it considered setting new customer contributions that distinguish between infill and greenfield growth areas and its reasons for not proposing charges to reflect this distinction
- ensure that its proposed new customer contribution charges and connection numbers by service reconcile between its new customer contributions model and financial model
- explain how its proposed new customer contribution is greater than the avoidable cost of that connection and less than the standalone cost of that connection.

Alternatively, in response to the draft decision, Central Highlands Water can recalculate its new customer contributions using the current methodology.

CHW response: A thorough response to all the questions raised above is included at Attachment C.

- **Justification of proposed transition to cost reflective pricing – Section 5.4.2.1 p.49**

ESC: In response to the draft decision Central Highlands Water must provide...separate new customer contributions modelling for its new growth zones and existing growth zones/infill.

CHW response: As requested, Central Highlands Water has modelled the New Customer Contributions (NCC) for the New Growth Zones and Existing Growth Zones/infill separately according to the Average Incremental Cost (AIC) methodology and this file is provided to the ESC as part of this overall response to the Draft Decision.[16]

Allocation of growth capital expenditure to these 2 segments was included in a separate email to the ESC on 26 April 2023 which included details on the methodology and a flowchart showing the allocation process. Further details on growth capital expenditure allocated to specific asset categories was provided to FTI Consulting via email on 27 April 2023 following their request.

The outcome of the model is as follows:

[15] The Careflow Advisory Group is a group of local community support organisations facilitated by Central Highlands Water that meets regularly to develop initiatives and coordinate support for vulnerable customers in the region.
[16] The definition of a New Growth Zone and Existing Growth Zones/infill is unchanged as per the Central Highlands Water Price Submission 2023-28 p.108

Table 6 New Customer Contribution (NCC) modelled by separate segments ($2022-23)

Segment	New Growth Zone	Existing Growth Zones and infill
Water	$5,101.18	$4,552.35
Wastewater	$6,892.47	$4,143.78

As the outcome for each component is in excess of the $4,000 cap initially proposed by Central Highlands Water (for each of water and wastewater) in our Price Submission, no change is proposed to the NCC pricing pathway for the 2023-28 period, the main components being:

- the maximum fee to be $4,000 for each of water and wastewater, as signalled to our local developer community in May 2022 and informed by preliminary modelling
- a differential fee between the New Growth Zone and the Existing Growth Zone and infill that recognises existing contributions from to Existing Growth Zone and infill development
- the transition period to the full capped fee for New Growth Zones is by Year 3 and for the Existing Growth Zones and infill by the next regulatory period

The transition to the full NCC fee as calculated is modelled to occur during the 2028-23 regulatory period. Full details and justification of this transition period is contained in the detailed report at Attachment C, which also summarises our extensive engagement with the Developer community.

This pricing approach meets the specific ESC guidance regarding the introduction of increased prices in 2 important areas:

- whether the business has considered and demonstrated appropriate transition strategies will be implemented for any materially effected customers[17]
- provide evidence of consultation with developers and how their views have informed the proposed charges, particularly if proposed Standard NCCs are significantly higher than the existing NCCs[18]

The key elements of our developer engagement program were verified and supported by Integra, one of the region's largest land developers who attended the ESC's online public forum to discuss the Draft Decision, held on 28 April 2023. The recording of this session can be viewed on the ESC Water Price Review 2023 website.[19]

In addition, in their submission through Engage Victoria to our Price Submission, the Consumer Action Law Centre provided strong support for Central Highlands Water:

> *"It has also been positive to observe increases in the New Connection Costs (NCCs) charged to developers and not unduly burdening existing residential customers…*
>
> *… We note that CHW has specifically cited NCC increases as a means of decreasing cross-subsidies, and hope that the ESC will more closely scrutinise those submissions that do not address this point."* [20]

[17] Essential Services Commission 2021. *2023 water price review: Guidance paper. Section 3.19.2,* 26 October.
[18] Essential Services Commission 2021. 2023 water price review: Guidance paper. *Section 3.21.2*, 26 October.
[19] https://www.esc.vic.gov.au/water/water-prices-tariffs-and-special-drainage/water-price-reviews/water-price-review-2023/central-highlands-water-price-review-2023
[20] Submission #22 received through Engage Victoria 30 November 2023 from Consumer Action Law Centre

In conclusion

Once again, we thank the ESC for the opportunity to clarify several areas of our Price Submission and provide supporting information where our views differ. We believe this additional information provides the appropriate evidence and support for our original proposal and we look forward to continuing the conversation with the ESC as both organisations work to improve customer value in a financially sustainable and responsible way.

Yours sincerely,

Jeff Haydon
Managing Director

ATTACHMENTS

A ICT & Digital Strategy Capital Expenditure 2023-28

B Outcomes Reporting Template 2023-28

C NCC response to Draft Decision

Doc code:

CENTRAL HIGHLANDS WATER

ATTACHMENT A **ICT & Digital Strategy Capital Expenditure 2023-28**

Context for the revised ICT & Digital Strategy

At the time of preparing the PR23 Price Submission in September 2022 for the PR23 regulatory period 2023-28, the Central Highlands Water 2040 Strategy had not been fully endorsed and therefore delayed the final development of the supporting ICT & Digital Strategy.

The Board of Central Highlands Water subsequently endorsed the 2040 Strategy on 5 April 2023, enabling the completion of the ICT & Digital Strategy. This identified continuous and rapid changes in the technology landscape such as growth in IoT, increased cyber security threats, mobility and field service expectations, advancements in AI, virtual and augmented reality, data analytics, and adoption of many internet-based technologies and platforms. Additionally, a large portion of the previous Digital Strategy was not implemented or was paused due to COVID-19 response activities and the ICT Division restructure. The emphasis on the Digital Water Metering Program, has been an ongoing commitment through this period and the successful completion of the tender process now clears the way for full implementation.

This strategic review has identified the following deficiencies regarding Central Highlands Water's ICT and digital capability:

- antiquated and end-of-life systems
- inadequate cyber security focus
- inconsistent hardware and software lifecycle management practices
- difficulty in resourcing, and retaining skilled staff in regional Victoria
- limited use of best practices across IT operational standards across hardware, software and systems

The PR23 Price Review submission identified the urgent need to build our digital capability. ICT plays a pivotal role in enabling much of the delivery of the 2040 strategy and without the appropriate funding, the first phase of the strategy cannot be adequately delivered.

This is clearly illustrated through the creation of the second Strategic Action Area which provides the overarching strategic basis for the revised ICT & Digital Strategy:

1. Drive resilience and water security for our region
2. ***Proactively embrace technology and innovation***
3. Be an engaged community partner
4. Rapidly reduce our environmental impact and invest in regeneration
5. Build internal capability and pursue strategic partnerships
6. Explore growth opportunities for new strategically aligned services

The revised strategy has identified an additional $4.2 million capital expenditure in addition to the initial $14.9 million, bringing the total to $19.1 million over the 5 year period 2023-28.

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Background - What are the key challenges and trends for the water industry?

CHW's challenges and trends mirror those of the wider Australian water sector which is now facing unprecedented risks and challenges across a range of technological, regulatory and societal areas, as illustrated by the following.

- Water utilities across the globe are transitioning **from water distribution to water management and recycling**, due to increase in demand and clean water scarcity.
- Also, they are **investing more on technology** and equipment associated with water treatment and its management.

- **Advanced analytics** is leveraged to generate intelligence from the enormous amount of data generated within the connected utility network.
- **Artificial intelligence (AI)** handles structured and unstructured data, to optimise production by autonomously tracking consumption as well as enable informed decision making across the value chain to drive efficiencies

- **Digitisation and automation** of operational processes to reduce organisational costs to serve or deliver more with less , whilst enhancing consumer experience
- Digitisation is driving greater cyber security focus to **safeguard grid IT assets,** and data prone to cyber attacks using advanced connected technologies

- Demand for commercial and residential information needs drive **digitally-connected** social and economic activities.
- Private companies are entering the water management segment and providing **higher levels of ICT and Digital capability** which needs to be matched by public utilities
- **Key enablers:** Wireless meter reading systems, Sensors and signal analysis; and, GPS and GIS technology

- **Digital infrastructure** e.g. digital meters: Infrastructure modernisation and automation to support artificial AI based systems
- **Modernising legacy IT infrastructure** to access and enable latest technologies
- **Adopting public cloud services** to reduce operating costs, and improve customer satisfaction

- Customers are looking for **real time interactions** and access to information that allows them to track and manage their water usage and advise on how to minimise environmental impacts and lower their bills
- **Customer experience automation** to enhance consumer experience e.g. virtual agents to address general queries, service requests and feedback

- Increasing labour costs, material prices, and growing demand to maintain aging plants is increasing operating expenditures (OPEX) of the utilities, putting pressure on better **digital operational data.**
- **Automated network data** can help provide for efficient investment in pipeline maintenance and replacement, and leak minimisation which is a major cost for water utilities

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Our 2040 Strategy on a page – with ICT & Digital references highlighted*

Our Vision

Fostering sustainable living, thriving communities and a healthy environment

Our Purpose

We care for our community and environment ensuring essential water services are safe, reliable and affordable now and in future.

Our 2040 Outcomes

Exceptional value for our customers and community

A trusted and reliable provider of safe and secure water

A valued partner in advancing our region

A healthy environment and caring for country

A thriving, innovative workforce and culture

Our Strategic Action Areas

Shape growth, and drive resilience and water security for our region

Proactively embrace technology and innovation

Be an engaged community partner

Rapidly reduce our environmental impact, and invest in regeneration

Build internal capability and pursue strategic partnerships

Explore growth opportunities for new strategically aligned services

Values

Integrity | Teamwork | Leadership | Care

*Endorsed by the Board on 5 April 2023

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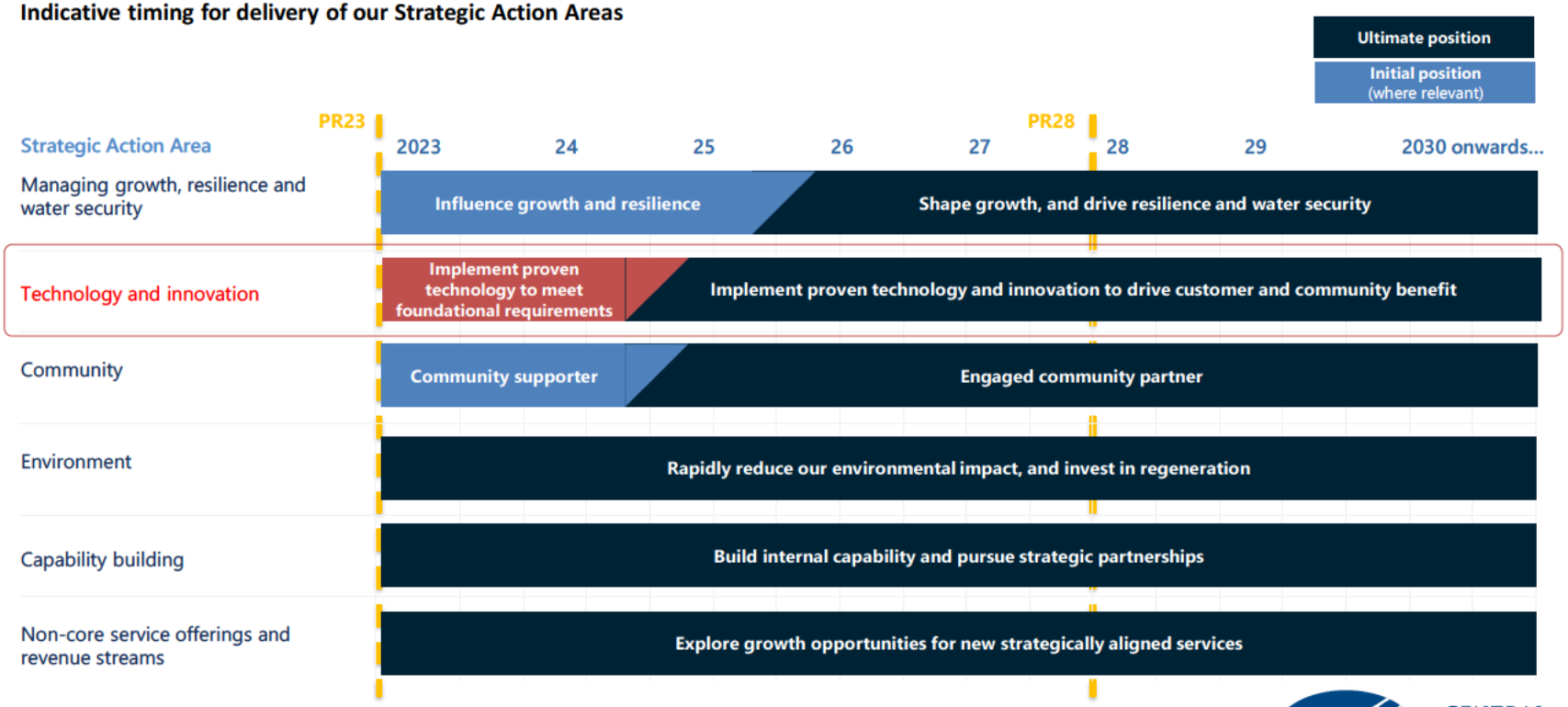
chw.net.au

Phased delivery of Strategic Action Areas over the PR23 period

Indicative timing for delivery of our Strategic Action Areas



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Impact of removing $1.0 million p.a. as per the ESC Draft Decision

An analysis of projects over the PR23 period that would be impacted by the proposed reduction is reflected below. Also of note, the ERP tender process has indicated the project costs to be higher than originally estimated

Project Impacts

- ERP[#] (Finance, Asset Management, Procurement, HRIS, CRM, Works Management)
- PMO Suite
- Major IT & OT Network upgrades/segmentation
- Website Enhancements / Customer Portal
- Compute & Storage Infrastructure Upgrades
- Removal of EUC device renewals for the next 5 years
- Building Information Management (BIM)
- Drawing Management Platform
- OSIsoft Cloud Services (Takadu Replacement)
- Business Services Program
  - OVIC Protective Marking
  - Windows 11 SOE
  - Migration to Microsoft 365 suite of tools
  - Digital First foundations (Cloud Prep)
  - Digital Transformation Agency - Perimeta for Azure
  - Digital Twin
  - Advanced Analytics and Business Intelligence
  - Maintaining current fleet of MFDs

Business Impacts

- Legacy applications/systems becomes unsupported
- Non-compliance to State Government security requirements
- Process improvement opportunities unable to deliver operation efficiency gains
- Additional vendor support costs required to maintain 'End of Life' systems
- Employee dissatisfaction with CHW technical currency
- Contemporary application features not available
- Increased cyber security risks as vendors reduce investments in outdate products
- Talent acquisition and retention compromised
- Increased maintenance costs and energy consumption
- Increased Environmental impact as manual and paper based processes continue
- Customer water security compromised
- Business Process Automation not realised

[#] Original Estimated were ~$1 33 M, current expectations are closer to $4.5M excluding ongoing OPEX

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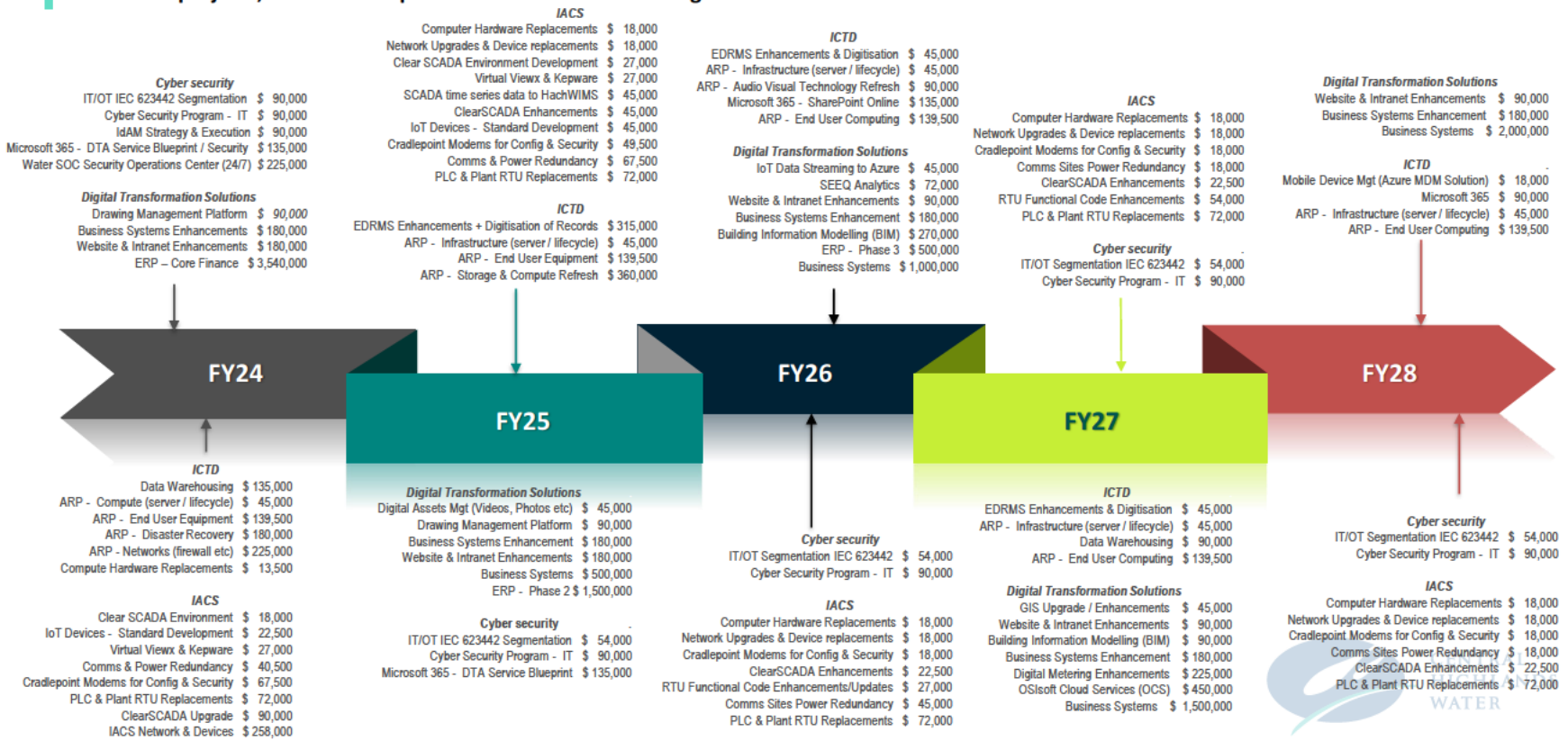
ICT & Digital Strategy capital expenditure roadmap, totalling $19.1 million over 5 years

Individual projects, estimated implementation costs and timings



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ICT & Digital capital expenditure overview

Revised capital expenditure summary (2022-23 dollars $,000)

Category	FY24	FY25	FY26	FY27	FY28	Total
Digital transformation solutions	3,990	2,495	2,157	2,580	2,270	**13,492**
ICT and Digital (ICTD)	738	860	455	320	293	**2,666**
Industrial Automation and Control Systems (IACS)	596	414	220	220	166	**1,616**
Cyber security	630	279	144	144	144	**1,341**
TOTAL	**5,954**	**4,048**	**2,976**	**3,264**	**2,873**	**19,115**

Difference between original Price Submission and Revised (2022-23 dollars $,000)

	FY24	FY25	FY26	FY27	FY28	Total
Original Submission	3,133	2,997	2,633	3,264	2,873	**14,900**
Revised Submission	5,954	4,048	2,976	3,264	2,873	**19,115**
Difference*	**+2,821**	**+1,051**	**+343**	**0**	**0**	**+4,215**

* Including updated estimates for the revised ERP solution

CENTRAL HIGHLANDS WATER

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Key Strategic Initiatives

Theme	Key Topics	CHW 2040 Strategy Strategic Action Areas	Benefits / Business Value	CHW Strategic Risks Addressed#
Digital Transformation Solutions	**System Integration:** The inability of business systems to exchange data encourages manual and double handling, inefficient use of both human and technology resources, and allows for the introduction of erroneous information.	• Drive resilience and water security for our region • Proactively embrace technology and innovation • Be an engaged community partner • Rapidly reduce our environmental impact, and invest in regeneration • Build internal capability and pursue strategic partnerships • Explore growth opportunities for new strategically aligned services	• Enables a seamless customer service experience • Future systems will be 'open' to allow integration with any future system enabling improved Accessibility, Accuracy, and Coordination of data transfer. • Enables the introduction of artificial intelligence, robotics, expert systems, intelligent retrieval, knowledge engineering, machine learning, natural language processing and neural network to automate processes, transaction handling, manual handling and reporting. • A single source of truth, combined with robust system integration ensures data handling efficiencies, increased productivity leading to cost efficiency within CHW operations.	2. Customer 3. Cyber 6. Financial 7. Governance 8. Health & Safety 10. Transformation 11. Biz Model 14. People
Digital Transformation Solutions	**Data Management and Warehousing:** Data integrity and quality are inconsistent across business systems resulting in multiple points of data entry and different data structures, reducing confidence in information and analytics for decision making and increasing workload through unnecessary data entry and additional reconciliation.	• Proactively embrace technology and innovation • Be an engaged community partner • Rapidly reduce our environmental impact, and invest in regeneration • Build internal capability and pursue strategic partnerships	• Data is difficult to find with no single trusted place to access information (Single Source of Truth). The visibility of data assets makes it easier to quickly and confidently find the correct data for analysis. • Data reliability minimises potential errors by establishing systems for usage and building trust in the data used to make decisions. Reliable, up-to-date data allows for rapid, efficient responses to organisational requirements, changes, and customer needs. • Protection from data losses, thefts, and breaches. Robust data security ensures that vital information is retrievable should the primary source become unavailable. Additionally, security becomes increasingly important if your data contains any personally identifiable information that must be carefully managed to comply with consumer protection and privacy laws. • Data management systems and practices for effectively scaling data and usage occasions with repeatable processes to keep data and metadata up to date. With easy-to-repeat processes, CHW can avoid the unnecessary costs of duplication, such as employees conducting the same research again or re-running costly queries unnecessarily. • Data warehousing is an increasingly important business intelligence tool, allowing CHW to ensure consistency. Data warehousing will apply a uniform format to all collected data, making it easier for decision-makers to analyse and share data insights, to build predictive modelling and incorporate Artificial Intelligence capabilities.	2. Customer 3. Cyber 6. Financial 7. Governance 9. Infrastructure 10. Transformation 11. Biz Model 14. People

refer to slide 15 for strategic risk details

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Key Strategic Initiatives

Theme	Key Topics	CHW 2040 Strategy Strategic Action Areas	Benefits / Business Value	CHW Strategic Risks Addressed#
Digital Transformation Solutions	**Application Deficiencies:** Poor functionality of crucial business systems means critical business functions are not adequately supported.	• Drive resilience and water security for our region • Proactively embrace technology and innovation • Be an engaged community partner • Rapidly reduce our environmental impact, and invest in regeneration • Build internal capability and pursue strategic partnerships • Explore growth opportunities for new strategically aligned services	• Delivery of the strategic ICT & Digital strategy (as outlined in this document) to establish an acceptable application stack, particularly in regards to critical business functions e.g. GIS, AMS, ERP, CRM, HRIS and EDRMS • Enhanced customer facing technologies allowing for additional online transactions providing customer flexibility and support when engaging with CHW divisions • Transforming CHW into a Digital utility by optimising business operations and processes to improve service delivery and customer experience • Taking advantage of innovation and thought leadership to better support CHW staff • Using enhanced applications and system to embed safety in business operations to minimise the risk of harm and negative impacts on health and wellbeing • Cost efficiencies through better systems	2. Customer 3. Cyber 4. Water Quality 5. Environmental 6. Financial 7. Governance 8. Health & Safety 10. Transformation 11. Biz Model 14. People
Digital Transformation Solutions	**Financial Services:** CHW's Great Plains system is at the end of its life and provides limited support to the organisation as CHW seeks to improve operations impacting business functions such as budgeting, billing and financial control.	• Proactively embrace technology and innovation • Be an engaged community partner • Build internal capability and pursue strategic partnerships • Explore growth opportunities for new strategically aligned services	• Provide a unified digital platform (via our website) for our water users to interact with CHW no matter their query or issue. • Urgently replace the existing antiquated financial system and associated applications to address CHW financial functionality, supportability and compliance concerns • Consolidate all revenue processes within a single platform, utilising best practice systems with uniform integration across the stack. • Introduction of automation and processing functionality leading to improved process efficiency, reduction in end to end processing of customer and supplier facing transactions and confidence in CHW's fiscal transparency and capability and to meet CHW's reporting needs • Reduce the manual handling and effort required for budgeting and forecasting across the CHW organisation • Provide visibility and transparency of the current financial position of CHW across all levels of the organisation	2. Customer 3. Cyber 4. Water Quality 5. Environmental 6. Financial 7. Governance 8. Health & Safety 10. Transformation 11. Biz Model 14. People

refer to slide 15 for strategic risk details

CENTRAL HIGHLANDS WATER

10

Key Strategic Initiatives

Theme	Key Topics	CHW 2040 Strategy Strategic Action Areas	Benefits / Business Value	CHW Strategic Risks Addressed#
IACS	**Operational Asset Management:** Allowing CHW to develop, operate, maintain, and replace/retire assets in a cost-effective manner.	• Drive resilience and water security for our region • Proactively embrace technology and innovation • Rapidly reduce our environmental impact, and invest in regeneration • Build internal capability and pursue strategic partnerships • Explore growth opportunities for new strategically aligned services	• Manage assets for more effective maintenance management. • Generate insights into asset management regarding replacement and renewals • Manage assets with ease and speed up workflows and customer satisfaction • Provide one source of truth. • Improves utilisation, reduces risks, and cuts duplication. Information stays updated, which helps maintenance teams be more efficient and increase utilisation. • Increases productivity without losing reliability • Reduces costs through constant review of maintenance data • General cost reduction and improve efficiencies through technology.	2. Customer 3. Cyber 4. Water Quality 5. Environmental 6. Financial 7. Governance 8. Health & Safety 9. Infrastructure 10. Transformation 11. Biz Model 13. Partnerships 14. People
IACS	**Internet of Things:** IoT for short, is a new interconnection of technology and instrumental sensors measuring and reporting diverse data sets for the benefit of the organisation and industry	• Drive resilience and water security for our region • Proactively embrace technology and innovation • Be an engaged community partner • Rapidly reduce our environmental impact, and invest in regeneration • Build internal capability and pursue strategic partnerships • Explore growth opportunities for new strategically aligned services	• Communication between devices, Machine-to-Machine (M2M) communications allows for better automation and control, flexible monitoring, time and cost efficiencies • To help achieve customer-centric decision making • Gathering rich data for reporting, analysis, modelling and sharing. • Enhanced security measures as IoT can enable access control systems to provide additional security. • Reduction in operational cost. Advancement of IoT technologies can benefit CHW to reduce operational costs by providing real-time access to network operating data to minimise service interruptions and provide predictive capability through the application of Artificial Intelligence.	2. Customer 3. Cyber 4. Water Quality 5. Environmental 7. Governance 8. Health & Safety 10. Transformation 11. Biz Model 14. People

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Key Strategic Initiatives

Theme	Key Topics	CHW 2040 Strategy Strategic Action Areas	Benefits / Business Value	CHW Strategic Risks Addressed#
IACS	**Operational Technology:** CHW heavily relies on its Industrial Automation and Control Systems to ensure safe drinking water, sewerage, trade waste and recycled water services.	• Drive resilience and water security for our region • Proactively embrace technology and innovation • Rapidly reduce our environmental impact, and invest in regeneration • Build internal capability and pursue strategic partnerships • Explore growth opportunities for new strategically aligned services •	• Inclusion of IoT technology enabling the adoption of innovative technologies, processes and business opportunities • Securing the OT network to maintain water quality, ongoing service provision and safety of the CHW water supply • Improved data acquisition, engineering and business analysis through data warehousing, integration, analytics and reporting • Asset Management – improved visibility of assets, maintenance cycles and optimisation, extending asset lifecycle • Automating manual processes enabling efficient use of CHW resources • Addressing OHS concerns via technology such as Lone Worker scenarios, use of technology to minimise risks in hazardous environments.	2. Customer 3. Cyber 4. Water Quality 6. Financial 7. Governance 9. Infrastructure 10. Transformation 14. People
ICT & Digital	**Communications Network:** CHW's operations are dispersed, making the organisation reliant on communications infrastructure for both telephony and data transfer.	• Drive resilience and water security for our region • Proactively embrace technology and innovation • Build internal capability and pursue strategic partnerships	• Architect and implement a resilient solution to ensure communication availability • Review communication infrastructure options, pricing and risk of alternative technologies to identify opportunities for consolidation, price optimisation and improvements in performance and stability to prepare for the increased adopt of mobile and hybrid working technologies. • More efficient working environment providing consistency and standardisation across communications • Separation of IT and OT networks will enhance the security of the OT network and assets and enable the dynamic business model to take advantage of IACS focused opportunities as well as providing a greater level of control. • Provide efficient network performance insights and analysis leading to transparency of the supporting networks to ensure the continued supply of safe and high-quality drinking water • Investment in networking security will decrease the chance of disruption from threat actors while also increasing the integrity, confidentiality and availability of CHW systems and data.	3. Cyber 6. Financial 7. Governance 9. Infrastructure 10. Transformation

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Key Strategic Initiatives

Theme	Key Topics	CHW 2040 Strategy Strategic Action Areas	Benefits / Business Value	CHW Strategic Risks Addressed#
ICT & Digital	**ICT Asset Lifecycle:** ICT Assets have not been fully tracked within their lifecycle. This has led to system instability, security concerns, compliance adherence, functionality concerns, and service availability.	• Drive resilience and water security for our region • Proactively embrace technology and innovation • Be an engaged community partner • Rapidly reduce our environmental impact, and invest in regeneration • Build internal capability and pursue strategic partnerships • Explore growth opportunities for new strategically aligned services	• Maintaining access and availability and supportability of ICT assets • Replace and renew technology to ensure currency and suitability to CHW's needs, compliance and security. • Review technology to ensure compatibility with overall systems and to establish necessary support. • Elimination of current system instability, security concerns, compliance adherence, functionality concerns, and service availability challenges • Enabling the adoption of contemporary system features, innovations, automations and collaboration techniques leading to operational efficiencies and flexibility in hybrid/WFH environments • Maintaining financial sustainability through decision making and lifecycle management	2. Customer 3. Cyber 4. Water Quality 5. Environmental 6. Financial 7. Governance 8. Health & Safety 9. Infrastructure 10. Transformation 11. Biz Model 14. People
ICT & Digital	**Disaster Recovery/Business Continuity (DR/BC):** Events such as natural disasters or cyber security events could see CHW's operations impacted for an extended period making DR/BC capability a crucial business risk decision.	• Drive resilience and water security for our region • Proactively embrace technology and innovation • Rapidly reduce our environmental impact, and invest in regeneration	• DR/BC requirements to meet organisational expectations and service commitments • Maintain and implement a reliable and robust backup and recovery solution. • Backup testing cycles to ensure acceptable performance levels and compliance with CHW's requirements • Reduction of the Recovery Time Objective (RTO) and Recovery Point Objective (RPO) of CHW. • Reducing the cost of possible damage due to data loss or downtime. • Enhances business continuity by lessening the interruption of business operations. • Maintains business integrity by preventing compromise and building trust. • Strengthen network security.	2. Customer 3. Cyber 4. Water Quality 7. Governance 9. Infrastructure 14. People

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Key Strategic Initiatives

ICT&D supports CHW's Strategic Action Areas by focusing on the following Key Strategic Initiatives as outlined by the CHW 2040 strategy:

Theme	Key Topics	CHW 2040 Strategy Strategic Action Areas	Benefits / Business Value	CHW Strategic Risks Addressed#
Cyber Security	**Cyber Security:** Increasing our security posture to meet today and future threats	• Drive resilience and water security for our region • Proactively embrace technology and innovation • Be an engaged community partner • Rapidly reduce our environmental impact, and invest in regeneration • Build internal capability and pursue strategic partnerships • Explore growth opportunities for new strategically aligned services	• Increased compliance with state and federal obligations, increasing data protection from unauthorised access, loss or deletion of CHW/customer information • Securing the environment for the growing use of personal devices accessing corporate email and content, Bring-Your-Own-Device (BYOD) capability • Mitigation of risk factors across Ransomware, Data Breaches, internal and external threat detection and supply chain risks • Enables rapid response and reduces the likely scope, severity and impacts of cyber security incidents and creates a resilient cyber security environment for CHW • Facilitating privacy and confidence in CHW systems thereby ensuring customer and staff data remains secure • Meeting Victorian Protective Data Security Standards (VPDSS)	2. Customer 3. Cyber 4. Water Quality 5. Environmental 6. Financial 7. Governance 10. Transformation 11. Biz Model 14. People

refer to slide 15 for strategic risk details

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Central Highlands Water Strategic Risks – threats and opportunities

#	Description
1	**Climate Change (threat)** Failure to put in place strategies to mitigate the impact of a change in our climate and/or variability that result in a deterioration to our service levels.
2	**Customer Needs (threat)** Current and future needs of customers and community are not met or considered in the delivery of services resulting in a decrease in confidence and reputational damage.
3	**Cyber and Security (threat)** Financial loss, compromise of customer data, disruption or damage to reputation from failure of information technology systems or malicious physical security breach.
4	**Drinking Water Quality (threat)** Failure to supply safe drinking water to our customers and community.
5	**Environmental Impacts (threat)** In the delivery of our services we have a detrimental impact on the natural environment and/or sites of indigenous or cultural significance.
6	**Financial Sustainability (threat)** Deficient governance structures or changes to government policy leading to financial shortfalls.
7	**Governance and Compliance (threat)** People, systems and governance processes are not aligned with strategic objectives and/or regulatory obligations, resulting in fines or sanctions being incurred.

#	Description
8	**Health & Safety (threat)** Safety is not embedded in business operations resulting in risk of harm and negative impacts on health and wellbeing.
9	**Infrastructure Sustainability (threat)** Our life cycle asset management is inadequate that results in adverse outcomes to service delivery and/or negatively impacts our reputation.
10	**Business Transformation (opportunity)** Optimise business operations and processes to improve service delivery and customer experience by embracing digital technologies.
11	**Dynamic Business Model (opportunity)** Build a dynamic business model which is adaptive in delivering strategic objectives and harnessing opportunities.
12	**Environmental Regeneration (opportunity)** Protect and enhance our natural assets and deliver continuous improvement in environmental management.
13	**Partnerships & Stakeholders (opportunity)** Leveraging from valuable partnerships and collaborations with stakeholders to build resilience, pursue commercial opportunities and achieve shared outcomes.
14	**People & Culture (opportunity)** Fostering the right culture to drive innovation, leadership, succession planning, diversity and empowerment of our people.

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ATTACHMENT B **Outcomes Reporting Template 2023-28**

Central Highlands Water – Outcomes – 2023-2028

In this document, the water business provides a summary report of its actual performance against each of its outcome commitments for the 2023-2024 reporting year. The business has given itself a "traffic light" rating (green = met target, red = not met, yellow = close or largely met) for its performance on each measure, outcome and an overall rating. The business has provided its own comments about its performance on each outcome and overall.

Summary table

Outcome	23-24	24-25	25-26	26-27	27-28	Overall for the period to date
1. Customer Care						
2. Equity						
3. Sustainability						
Overall, for reporting year						

Business comments

Outcome 1: Customer Care

Output	Unit		22-23	23-24	24-25	25-26	26-27	27-28
a First call resolution - Measure: Percentage of customer calls to Contact Centre which are resolved during initial call, based on customer response to automated post-call survey. - Target 1: 75% responding 'yes' initially, improving to 95% by 30 June 2028	% of 'yes' responses	Target	-	75	80	85	90	95
		Actual	-					
- Target 2 Review other Customer Contact channels to establish separate targets during 2023-24	Measure under development	Target	-					
		Actual	-					
b Net Positive Score - Measure: Percentage of Promoters (rating 8 & 9) less the percentage of Detractors (rating 0-5), as measured by customer response to automated post-call survey question: *'Based on your overall experience about this enquiry, how likely are you to talk positively about us, on a scale where zero is not likely and 9 us extremely likely?'*	Net score	Target		>0	>5	>10	>15	>20
		Actual						

Output	Unit		22-23	23-24	24-25	25-26	26-27	27-28
c More frequent billing - Measure: Quarterly billing has been introduced - Target: Implement quarterly billing by 31 December 2023. Further targets will be set following the roll out of digital metering	Pass/fail	Target	-	Complete	N/A	N/A	N/A	N/A
		Actual	-					
d Guaranteed Service Levels (GSLs) - Measure: Improved performance and value of all GSLs - Target 1: 10% reduction in total number of annual GSL rebate payments by 30 June 2028	Number	Target	TBD	- 2% reduction	- 4% reduction	- 6% reduction	- 8% reduction	- 10% reduction
		Actual	-					
- Target 2: GSL rebate amounts to increase by 50% commencing 1 July 2023	Pass/Fail	Target	-	Pass	N/A	N/A	N/A	N/A
		Actual	-					
e Priority Guaranteed Service Levels (GSLs) - Measure: Improved performance and value of priority GSLs - Target 1: Leaking water service not repaired within 3 days: 25% reduction in occurrence of rebates by 30 June 2028	Number	Target	16 PR18 average	15 5% reduction	14 10% reduction	14 15% reduction	13 20% reduction	12 25% reduction
		Actual						
- Target 2: GSL rebate to double to $200 for 'Failure to repair leaking water service' and 'Failure to provide clean drinking water'	Pass/Fail	Target	-	Pass	N/A	N/A	N/A	N/A
		Actual	-					

How is CHW tracking for outcome 1 in the regulatory period so far?

Business comment

Outcome 2: Equity

Output	Unit		22-23	23-24	24-25	25-26	26-27	27-28
a Funding regional growth - Measure: Decrease cross subsidy between existing and new customers from new developments by and increase in New Customer Contributions (NCCs) - Target: Increased revenue YOY from reformed New Customer Contributions model	$	Target	-	Base year	>23-24 actual	>24-25 actual	>25-26 actual	>26-27 actual
		Actual	-					
b Safe Drinking Water Act non-compliances - Measure: Non-compliances due to water sampling and audit - Target: Zero non-compliances each year	Number	Target	0	0	0	0	0	0
		Actual	3 YTD					
c Improve water quality for customers in towns without access to potable water i.e. Raglan, Amphitheatre and Redbank - Measure: Undertake a detailed study of customer needs in Raglan, Amphitheatre and Redbank. Develop measures from the study outcomes. - Target: Study completed for each town, outcomes developed and measures established by 30 June 2025	Completed	Target	-	N/A	Pass	N/A	N/A	N/A
		Actual	-					

Output	Unit		22-23	23-24	24-25	25-26	26-27	27-28
- Measure: Provide a rebate program to assist customers in maintaining water quality in rainwater tanks - Target 1: Rainwater tank maintenance support program established ($750 per connection)	Develop program	Target	-	Pass		50%	65%	80%
		Actual	-	Pass				
- Target 2: 80% take up by customers of rebate by 30 June 2028.	%	Target	-	N/A	40	50	65	80
		Actual	-					
d Support for vulnerable customers - Measure: $ amount on direct customer support, including Community Rebate Program (CRP), Community Housing Retrofit Program (CHRP) and direct assistance	$	Target	-	500,000	500,000	500,000	500,000	500,000
		Actual	PR18 average 250,000					
e Impact of vulnerable customer support programs - Measure: Demonstrate the positive impact of our vulnerable customer support programs through various indicators - Target 1: Lower consumption/bills through leak reduction cohort analysis (%TBC)	Measure under development	Target	-	Pass	TBC	TBC	TBC	TBC
		Actual	-					
- Target 2: Customer satisfaction survey to measure the effectiveness of the support (rating level TBC)	Measure under development	Target	-	Pass	TBC	TBC	TBC	TBC
		Actual	-					

Output	Unit		22-23	23-24	24-25	25-26	26-27	27-28
f Traditional Owner partnerships - Measure: $ amount spend on CHW/Traditional Owner partnership opportunities. Baseline level of spending is $25,000 p.a. - Target: Is an average of $100,000 p.a. or $500,000 across the 5-year period	$	Target	-	100,000	100,000	100,000	100,000	100,000
		Actual	PR18 average 25,000					
- Measure: Central and Gippsland Region Sustainable Water Strategy. Specific action 4-6 *Streamlining temporary water trades* - Target: Implemented by 31 December 2027.	Project status	Target	-					
		Actual	-	On track	On track	On track	Complete	N/A
- Measure: Staff employed directly by CHW who identify as Aboriginal and/or Torres Strait Islander - Target: Include staff who identify as Aboriginal and/or Torres Strait Islander employment at 3% by 2025	%	Target	-	2	2.5	3	N/A	N/A
		Actual	-					
- Measure: Demonstrate the positive impact of partnership with Traditional Owners - Target: Partner satisfaction survey to measure the effectiveness of the partnership (rating level TBC)	Measure under development	Target	-	Pass	TBC	TBC	TBC	TBC
		Actual	-					

How is CHW tracking for outcome 2 in the regulatory period so far?

Business comment

Outcome 3: Sustainability

Output	Unit		22-23	23-24	24-25	25-26	26-27	27-28
a Renewable energy - Measure: Percentage of electricity from renewable sources - Target: 100% renewable by 2025	%	Target	-	On track	On track	Pass	N/A	N/A
		Actual	-					
b Greenhouse gas emissions reduction - Measure: Emissions reduction from 2011-16 baseline - Target: 55% reduction by 30 June 2028	Tonnes % by calculation	Target	-	14,772 19% reduction	14,738 20% reduction	8,178 55% reduction	8,178 55% reduction	8,178 55% reduction
		Actual	-					
c Recycled water - Measure: Increase amount of recycled water used for community benefit e.g. irrigation for community parks and greenspaces - Target: 75% increase by 30 June 2028. (Baseline amount of recycled water used is 286 ML p.a.)	ML % by calculation	Target	-	372 15% increase	447 30% increase	502 45% increase	542 60% increase	582 75% increase
		Actual	-					
d Water efficiency - Measure: Amount of unaccounted water losses (i.e. leaks or unauthorised use) - Target: 15% reduction by 30 June 2028 (Baseline amount of unaccounted water losses is 1,250 ML p.a.)	ML % by calculation	Target	-	1,212 3% reduction	1,175 6% reduction	1,138 9% reduction	1,100 12% reduction	1,062 15% reduction
		Actual	-					

How is CHW tracking for outcome 3 in the regulatory period so far?

Business comment

ATTACHMENT C: NCC Response to Draft Decision

CENTRAL HIGHLANDS WATER

1. Our proposal

During the current regulatory period, Central Highlands Water and a number of regional water businesses worked with VicWater to review the appropriateness of the current approach to forecasting new customer contributions (NCCs). This review adopted a principled, evidenced, transparent and consultative reform process.

[redacted] objective of the review was to consider NCC approaches that not only manage the uncertainty surrounding future regional growth, but also to establish a pricing methodology that best meets the WIRO and ESC's principles and is consistent with customer expectations. The output of this review was a strong case to a change the methodology for forecasting standard NCCs from the current net cashflow approach to an average incremental cost (AIC) approach.

The AIC approach calculates NCCs as the net present value of the optimal costs of servicing connections growth on a per lot basis. The advantage of an AIC approach relative to the current approach is that it is:

- More transparent, the calculation is simpler and more intuitive than the net cashflow calculation which incorporates an estimation of forward revenues and expenditures over extremely long-time horizons.
- Better placed to provide developers incentives for efficient timing decisions by adopting a forward-looking approach to cost and excluding sunk assets.
- Better able to address risks associated with uncertainty around the long-term profile of development in our region.
- Better meets the WIRO regulatory principles regarding efficiency and, understandability.

Our proposed NCCs are unchanged from our original Price Submission and outlined in table 1.

Table 1. Proposed NCCs (excluding inflation)

$2022-23	2023-24	2024-25	2025-26	2026-27	2027-28
New growth zones					
Water	3,000.00	3,535.00	4,040.00	4,080.40	4,121.2
Wastewater	3,000.00	3,535.00	4,040.00	4,080.40	4,121.2
Existing growth zones and infill					
Water	1,300.00	1,641.25	1,969.50	2,297.75	2,626.00
Wastewater	1,300.00	1,641.25	1,969.50	2,297.75	2,626.00

Our proposed NCCs are to be implemented on the following basis:

- We are proposing to introduce separate water and wastewater NCCs for new and existing growth zones.
- New growth zones NCCs are phased in until 2025-26 at $4,040. New Growth Zone NCCs are then capped at a one percent price increase per annum for 2026-27 and 2027-28. The one percent price increase relates to the application of our proposed one percent price path which is universally applied across all our prices.

- Existing growth zone NCCs are set at 43 percent of the New Growth Zone NCCs in 2023-24 and then transitioned to 64 percent of New Growth Zone NCCs in 2027-28.

Our proposal addresses our customers expressed preferences for a single per lot charge that maximises at approximately $8,000 per lot. This customer preference is the reasoning for our adoption of a common NCC across both water and wastewater.

2. FTI Consulting review

As part of the 2023 Price Review the ESC engaged FTI Consulting (FTI) to review our proposed NCC forecasts. Subsequent to the Draft Decision, on 14 April the ESC provided preliminary observations from FTI. These preliminary observations were followed by a Draft Report that was provided to us on 8 May 2023.

FTI has made the following preliminary observations:

- Observations on methodology:
    - Our general approach is conservative, however FTI found the allocation methodology is lacking detail.
    - FTI noted that no historical capital expenditure (sunk costs) are included in the NCC models.

We note that the AIC approach we are proposing is forward looking and excludes sunk assets on the basis that they distort the ability of NCCs to provide developers with efficiency signals about the timing of their development.

- Further observations:
    - The methodology for how capital contributions is included in NCCs has not been articulated in any policy documents.
    - Projects that are triggered by growth but provide shared benefit for new and existing customers are allocated a percentage of the capital cost based on the number of new connections as a proportion of total customers. FTI noted that while this approach is easily calculated, an assessment to determine the actual incremental increase in cost of any upgrade has not been made.

We are proposing a simple approach to allocating growth capital expenditure that utilises the existing ESC regulatory framework and reflects what we believe is an appropriate balance between the costs associated with a more detailed forensic allocation at the individual project and program levels and the benefits that Central Highlands Water and its customers would derive from such an approach.

In its Draft Report FTI provided confidence ratings based on an assessment of the capital expenditure included in the calculation of our proposed NCCs. FTI's Draft Report makes the following key findings that potentially impact on our proposal:

- Section 3.3.1 of the draft report rates our proposed NCC growth capital expenditure as "medium confidence". The stated rationale for the rating is that FTI could not reconcile our proposed growth only allocated capex with the growth capex proposed in the financial template and that FTI considered the documentation provided by us in support of the price submission and in responses to FTI was 'limited'.
- Section 3.3.2 of the draft report rates our proposed capacity-based allocation approach for shared growth capex as "low confidence".

2.1 Our response to FTI's reconciliation rating

The FTI Draft Report does not outline the calculations underlying their assertion that the proposed NCC growth capital expenditure does not align with the growth expenditure outlined in the financial template. We note that the numbers quoted in the Draft Report imply that FTI is seeking to reconcile the proportion of the NCC growth capex that has been solely attributed to growth to the total growth capex being proposed net of NCC contribution revenue. This number is reported in cells D12 to N12 of the "Capex_FO" Input sheet in the financial template.

In our view this is an inappropriate basis for a reconciliation as it does not clearly account for:

- Combined water and wastewater NCC revenue that is incorporated into the net growth capex forecasts.
- The $108 million in NCC growth capex that is directly attributed to new customers, the $80.6 million that has been allocated as new customer's allocation of shared growth capex, and the remaining existing customers allocation of shared growth capex.
- The $29 million in recycled water growth capex that has been proposed and is excluded from our NCCs for water and wastewater.

We believe this reconciliation is a relatively straight forward process if FTI follows the outline of the allocation process we provided to the ESC on 26 April 2023 that provides a detailed decision tree that when combined with the expenditure provided to FTI on 27 April 2023 is sufficient to allow FTI to replicate the following reconciliation (see table 2).

Table 2. Reconciliation of NCC growth and financial template growth

Source	Capex $m
ESC financial template gross proposed growth capex	305.7
NCC proposed growth capex reconciliation	
NCC growth solely attributed to new customers	108.3
Shared NCC growth attributed to new customers	80.6
Shared NCC growth attributed to existing customers	87.9
Recycled Water growth capex	29.0
Total	305.7

2.2 Our response to FTI's rating of our capex allocator

The allocator is the tool we are proposing to adopt to allocate shared growth capex between existing customers and new customers. The FTI Draft Report does not provide sufficient information for us to understand the basis for FTI's rating. FTI have verbally informed us at the workshop we held 9 May 2023 that the rating is based purely on the criteria that the allocation method does not provide a technically accurate estimation of incremental cost. Based on the outcomes of the workshop it appears that FTIs expectation of what constitutes a technically accurate allocation is based on a theoretically purist approach that requires the identification of incremental cost as the difference between forecast capex inclusive of growth and forecast capex exclusive of growth.

We note that FTI's assessment criteria references the reasonableness of the approach, however it is not clear how FTI's rating takes into consideration:

- Practicality – that the approach was reasonably achievable given businesses current capital planning resources and capabilities and the nature of the capital expenditures themselves. And importantly that the approach is suitable within the context of its application for a pricing outcome for NCCs.
- Compliant – that the approach aligns with the ESC's interpretation of its incremental cost principles as evidenced over the 2018 and 2013 price reviews. We note that the current ESC guidance for NCCs does not require businesses to estimate incremental growth capex by undertaking comparative assessments of growth and non-growth capital planning, and that we are not aware of a previous ESC decision that required businesses to define incremental capital expenditure in this manner.

Given growth is a secondary driver for a number of compliance and improvement proposed capital expenditure that are excluded from our proposed NCC expenditure, satisfaction of this criterion requires the reforecasting of the majority of our capital program (it would only exclude those renewals and improvement expenditures that did not have secondary growth drivers) or potentially our entire capital program. The administrative cost associated with undertaking this analysis would outweigh the benefits of any application of incremental capital expenditure within a pricing context. This observation is true for either the AIC based approach we are proposing or for our existing net cashflow NCC approach. Undertaking this analysis to justify our adoption of a simple proxy-based allocator would also undermine any savings we would achieve from our proposed proxy-based allocator and would be inappropriate within the context of price setting.

We have proposed a relatively simple approach to allocating growth capital across new and existing customers based on the primary drivers for capital expenditure. The approach provides a reasonable accounting of growth-related costs and recognises that both new and existing customers are often beneficiaries of growth-related capital projects and programs. The rationale for our proposed allocation approach is outlined in section 4.1 of this response.

2.3 Our response to FTI's commentary on the lack of documentation

In relation to FTI's observations regarding the lack of formal documentation of our allocation methodology, it is important to recognise that that the allocation method has been developed as part of our proposed AIC based NCC approach. We will formalise the documentation already provided to the ESC and FTI outlining the process adopted following the Final Determination.

3. ESC's draft decision

The ESC's draft decision dated 12 April 2023 provides a qualified acceptance of the AIC method. The ESC considers the methodology capable of meeting its NCC pricing principles and the relevant requirements of the *Water Act 1989*. The draft decision does not reference the ESC's position in relation to our proposal meeting the principles outlined in the WIRO.

While the Draft Decision includes a qualified acceptance of the AIC methodology, noting that the ESC has already approved the AIC and the allocator approach used by CHW in the evaluation of other comparative water corporations' 2023 Price Submission.

The ESC has not accepted our proposed NCCs on the following basis:

- Fair and reasonable costs - The ESC's preliminary view is that Central Highlands Water has not undertaken an assessment to determine the actual incremental increase in cost of any upgrade. It also considers our methodology to allocating costs to new customer contributions is unclear.

- Incremental infrastructure and associated costs – The ESC's preliminary view is that the proposed standard NCCs do not have regard to incremental cost. This view is based on the observation that the proposed NCCs are less than the AIC calculated NCCs set out in our system-based AIC model. The ESC also noted that it was not clear in our proposal if we intended to transition system-based AIC NCC in the future.
- Avoidable cost – The ESC raised concerns that the NCCs for new and existing growth zones were below avoidable cost. The ESC noted that we had not provided any evidence that the cap on our proposed NCCs has not caused NCCs to fall below avoidable cost.
- Justification of proposed transition to cost reflective pricing – The ESC raised concerns that our proposal resulted in the broader customer base funding revenue shortfalls from NCCs. The ESC stated it was unclear whether the proposed NCCs for existing growth zones/infill are cost reflective or below the avoidable cost of these connections and if the transition plan for existing growth zones/infill achieves full cost reflectivity.
- Cost allocation – The ESC was not able to verify if our allocation approach is reasonable attributing capital expenditure between multiple drivers and catchments. The ESC noted concerns that assets have not been double counted between the NCC model and the financial template.
- Incremental future revenues – The ESC was not satisfied that we had regard to incremental future revenues that will be earned from customers at the relevant connections, in our NCC proposal. The ESC stated that including new customers in the demand forecasts in the pricing model is a sufficient condition if the numbers reconcile between the pricing model and the new customer contributions model.
- Transparency – The ESC observed that we had not provided sufficient transparency to stakeholders to allow them to provide meaningful comments on the proposed methodology.

In response to the draft decision the ESC requires Central Highlands Water to provide the following:

- An explanation of how it has allocated its capital expenditure to new customer contributions.
- An explanation of its transition plan towards achieving full cost reflectivity for each service including the timeframes of this plan and provide reasons for adopting this transition plan and its timing.
- Set out how it proposes to fund any shortfall in revenue from new customer contributions, compared to the estimated costs of providing the service.
- Explain how it considered setting NCCs that distinguish between infill and greenfield growth zones and its reasons for not proposing charges to reflect this distinction.
- Ensure that its proposed NCC charges and connection numbers by service reconcile between its NCC model and financial model.
- Explain how its proposed NCC is greater than the avoidable cost of that connection and less than the standalone cost of that connection.
- Provide the ESC with sufficient information about its transition plan towards achieving full cost reflectivity for both new growth zones and existing growth zones/infill including the timeframes of this plan and provide reasons for adopting this transition plan (including timeframes).
- Provide separate new customer contributions modelling for its new growth zones and existing growth zones/infill.

4. Our response

This response provides further supporting information for our approach to allocating growth-related capital, restates the engagement on AIC methodology that we undertook with developers and provides a succinct overview of the reconciliation of NCC model data inputs and our submitted ESC pricing model and addresses the issue of potential double counting.

4.1 Allocating growth related capital expenditure between new and existing customers

We have proposed a relatively simple approach to allocating growth capital across new and existing customers based on the primary drivers for capital expenditure. The approach provides a reasonable account for growth related costs and recognises that both new and existing customers are often beneficiaries of growth-related capital projects and programs. The rationale for our proposed allocation approach is:

- The approach is relatively simple to understand and communicate to our customer base, developers, and our broader stakeholders.
- The approach utilises the ESC's established regulatory accounting framework, with a minimal level of adjustment to the established regulatory capital expenditure cost categories to account for existing customers who benefit from growth expenditure.
- The approach is objective and based on observable data which provides both Central Highlands Water and the ESC a readily measurable criteria for allocation.
- The approach provides an adequate approximation of growth-related expenditure.

Our cost allocation approach adopted the following process/methodology:

- Step 1. All capital expenditure categorised as growth (as its primary driver) under the ESC's regulatory accounting framework is identified. All capital expenditure with the ESC primary drivers of compliance, service improvement or renewal and replacement is excluded from the NCC calculation.
- Step 2. Growth capital programs and projects that only service new customers are 100% allocated to NCCs. Growth programs and projects that service both new and existing customers are allocated to NCCs based on the proportional share of new connections. Connections are adopted as a reasonable proxy for the allocation of capacity.
- Step 3. The resulting NCC growth capital (the sum of 100 percent allocated expenditure and partially allocated shared expenditure) is split into product categories of water or wastewater. Expenditure that is shared across the services (such as corporate expenditure) is allocated to service based on relative connections.
- Step 4. For both water and wastewater, projects and programs that service existing growth zones are allocated to existing growth zones. Similarly, projects and programs that exclusively service new growth zones are allocated to the new growth zones NCC. Expenditures that service both existing and new growth zones are allocated to the respective NCCs based on connection numbers.

The following provides a summary of the resulting NCC capex allocations:

- Of our total $1,252 million capex program (over the 20-year NCC forecast period), $593.1 million is identified as relating to growth capital projects and programs.
- Of the $593.1 million growth capital projects and programs, $380.64 million is either directly attributed to new customers and allocated 100 percent to NCCs or is identified as allocated

to NCCs from a project or program that benefits both new and existing customers based on relative capacity share.

- Of the $380.64 million attributable to NCCs, $194.70 million is identified as water and further allocated as:
    - Existing growth/infill areas $95.68 million
    - New growth zones $99.02 million
- Of the $380.64 million attributable to NCCs, $185.94 million is identified as wastewater and allocated as:
    - Existing growth/infill areas $68.82 million
    - New growth zones $117.12 million

The alternative to our proposed approach would be to allocate our entire capital expenditure program based on project and program specific allocators. This approach would require the individual assessment of each project and project that has multiple or secondary drivers (which include growth) with project or program specific allocators. Such an approach would be overly complex, requiring the application of a range of different allocation criteria depending on the nature of the individual project or program. This approach would also potentially introduce a level of subjectivity into our allocation that we do not consider appropriate.

We note that the complexity of this alternative approach would severely constrain our ability to consult effectively with developers and with our customers. We do not believe the benefits associated with this alternative approach would outweigh the administrative costs of implementing it. This is particularly true for many of the relatively minor projects or programs that we deliver.

4.2 Modelling growth allocations and NCC calculations for new and existing growth zones

In response to the Draft Decision, we have developed a revised NCC model, that aligns our NCC calculations to new and existing growth zones and addresses reconciliation issues between the NCC model and the ESC's financial template.

Table 3 provides a summary of the changes that were made to the NCC model. The revised model has been appended to this response.

Table 3. Model revisions

	Revision
Systems	The model has been restructured to align with our proposed new and existing growth area NCC categorisations. The model now fully aligns with our proposed NCC charges.
Capex allocation	The underlying NCC capital allocations and forecast expenditures remain consistent with those proposed in our price submission. Dollar values for PR23 projects were adjusted as per the ESC's draft determination for capex projects. Capital expenditure has been allocated as outlined above in section 4.1.
Opex allocation	The baseline opex included in the model is unchanged from the price submission. Opex allocations for shared expenditure are based on relative connections for new and existing customers.
Connections	To reconcile the NCC model with the financial template connection growth figures have been reduced to 2.2% per annum from a previous average of 2.25% across the 20-year period. New connections were assigned to either existing growth/infill areas or new growth zones based on CHW's greenfield transition ratios for each respective year (as approved by the Board on 19 August 2022).

4.3 Our proposed transition

We are acutely aware of the potential impact of reform to NCC's on both developers and on new customers. To mitigate these impacts, we proposed to transition in the introduction of AIC-based NCCs over a 10-year period for water and wastewater across Existing Growth zones and 10 years across New Growth zones. This means that by the end of regulatory period six in 2032-33 Water and Wastewater NCCs for both growth and existing zones will be set at full cost recovery consistent with our AIC calculations.

The profile of our transition over the 2023 regulatory period is outlined in table 1. To achieve full cost AICs in 2032-33 we will apply the following compounding prescribed price movements rates to our NCCs in 2028-29 through to 2031-32:

- New Growth Zones Water – 4.36 percent per annum.
- New Growth Zones Wastewater – 10.83 percent per annum.
- Existing Growth Zones Water – 11.63 percent per annum.
- Existing Growth Zones Wastewater – 9.55 percent per annum.

The proposed transition period reflects the outcomes of consultation with developers. There were specific stages of our engagement program with developers that targeted the issue of implementation of AIC NCCs. A consultation session was held on 30 May 2022 to discuss options for introducing AIC based NCCs. Rather than a stepped increase in NCCs, developers clearly indicated a preference to phase in NCC changes over the course of the regulatory period.

4.4 Impact of transitioning on the broader customer base

The NCC revenue foregone by the proposed transitioning arrangements are outlined in Table 4. The total revenue foregone through transition will result in a net present value of $56 million being rolled into our regulatory asset base and recovered from both new and existing customers through water and wastewater prices.

Table 4: Transition foregone revenue

NPV $2022-23, $,000	2023–24 to 2027-28	2028-29 to 2032-33	Total
New Growth Zones Water	6,309.2	1,942.7	8,022.1
New Growth Zones Wastewater	14,619.2	5,804.5	19,737.1
Existing Growth Zones Water	12,071.6	4,060.5	15,651.7
Existing Growth Zones Wastewater	10,176.1	3,146.3	12,950.2
Total Revenue shortfall	43,176.2	14,954.0	56,361.1

Foregone revenue is calculated as the forward revenue from full cost recovery AIC NCCs less forward revenue from transition NCCs. NPV calculations adopt the price submission template regulated rate of return of 2.55% as the discount rate.

Our proposed transition is aimed at addressing the WIRO requirement that prices consider the interests of customers. Our transition strikes a balance between the interests of existing customers, which are met by the adoption of an AIC based NCC that can send appropriate incentives for efficient development and smoothing over time the potential impact on developers and new customers, who may have already made investment decisions based on the previous NCC approach. We believe our proposal strikes an appropriate balance during a transition phase between the interests of existing customers and new customers.

AIC is generally accepted as an appropriate approximation of avoidable cost. We acknowledge that the revenue shortfalls associated with the transitional arrangements result in our NCCs temporarily not achieving avoidable cost.

4.5 Infill vs greenfield

In its Draft Decision, the ESC required Central Highlands Water explain how we had considered setting NCCs that distinguish between infill and greenfield growth zones and our reasons for not proposing charges to reflect this distinction. We note that we have proposed charges that distinguish between New Growth Zones and Existing/Infill Growth Zones.

Our proposal embeds infill areas in our Existing Growth Zone NCC on the basis that our infill development occurs exclusively in the systems we have classified as Existing Growth. These systems are characterized as primarily infill in nature, whereas development in the New Growth Zones is primarily greenfield in nature.

We have defined greenfield development as development occurring within New Growth Zones, as defined in our 2023 Price Submission (page 108). Development in areas other than these is defined as infill development. Based on these definitions approximately 84 percent of development over the 5-year regulatory period across Central Highlands Water's existing growth systems has been defined as infill.

4.6 Customer engagement

As outlined in our pricing submission, we undertook extensive engagement of developers on our NCC proposal. This engagement included:

- All local developers on our Land Development contact list were invited to an in-person 'Developer Forum' information session held on 30 May 2022 in Ballarat. At the forum we presented the rationale behind the proposed changes to our NCC approach. The forum included a formal Q&A session and an informal morning tea to enable discussions to continue with senior Central Highlands Water staff.
- We circulated the forum presentation and accompanying newsletter to our Land Development contact list on 1 June 2022, seeking feedback and received written feedback from 3 respondents, reinforcing the feedback received at the forum.
- The proposed new NCC pricing pathway was emailed to our Land Development contact list on 25 August 2022. We received no objections to the implementation of the proposed NCC changes.
- Central Highlands Water also engaged directly with DEWLP and the ESC who were broadly in support of our proposed changes, provided that the local developer community and the Urban Development Industry of Australia (UDIA) had been satisfactorily engaged.
- CHW engaged more indirectly with the UDIA – Victoria Branch, as part of a VicWater stakeholder workshop presentation on 1 August 2022, where no major objections to the proposed NCC changes were raised.

A summary report of our engagement was provided to the ESC on 16 January 2023. Additional feedback provided by Integra (one of the region's largest land developers) at the ESC's online public forum to discuss the Draft Decision on 28 April 2023 was highly supportive of our engagement and the proposed NCCs.

4.7 Reconciling the NCC model with the ESC financial template

In its Draft Decision the ESC asked us to ensure that its proposed NCC charges and connection numbers by service reconcile between its new customer contributions model and financial model. The following reconciles each of the primary parameters in the NCC calculation and NCC model to the ESC's financial template.

Reconciling growth capex

The growth capex outlined in the financial template's Capex_FO input sheet varies materially from the growth capex incorporated into the NCC model. This variation is due solely to the allocation method outlined in section 4.1. It is important to note that consistent with the recognition of existing customer beneficiaries and the resulting partial allocation of growth capex, the proposed template capex exceeds the growth capex in the NCC model (see table 5).

It is also important to note that our treatment of growth capex eliminates the possibility of double counting. The NCC growth forecasts are derived directly from the template growth program, they are not developed separately. Subsequently, each allocation between existing and new customer capacity aggregates to 100 percent of the specific capex project or program being allocated. In addition, the template model ensures that the capital being rolled into our regulatory asset base is net of NCC revenue.

Table 5: Reconciliation of NCC growth capex

$22-23 million	2023-28	2028-33
ESC template growth capex		
Water	46.6	113.1
Waste	50.0	67.1
Total	96.6	180.2
NCC model capex: New Growth Zones		
Water	8.8	35.2
Waste	11.9	37.3
Total	20.7	72.5
NCC model capex: Existing Growth Zones		
Water	13.4	36.8
Waste	27.6	17.9
Total	41.0	54.7
Variance		
Water	24.4	41.1
Waste	10.5	11.8
Total	34.9	52.9

- Model variance is due to the NCC model containing cost apportionment attributable to new connections only
- Analysis of annual variations may uncover some discrepancies due to projects without definitive timing being placed centrally within the regulatory period (Year 3) of the NCC model to avoid skewing NPV calculations over time (as per good practice guidance).

Reconciling NCC revenue

The difference between the financial template NCC revenues and the NCC model revenues is outlined in Table 6. This difference reflects the application of the transitional arrangements on the NCCs in the ESC financial template. The NCC revenue is fully reconcilable to the ESC template once the transitional arrangements have been accounted for. The ESC template revenues are referenced in the models Capex_FO input sheet. We note that the model's price cap sheet does not include connection numbers of NCCs and therefore does not generate a revenue for comparison.

Table 6: Reconciliation of NCC revenues

$22-23 million	23/24	24/25	25/26	26/27	27/28	28/29	29/30	30/31	31/32	32/33
Template rev	4.51	6.15	7.91	9.86	12.16	17.60	17.60	17.60	17.60	17.60
Transitional rev	4.17	5.73	7.35	9.17	11.38	13.56	15.04	16.68	18.53	20.59
AIC model rev	13.98	14.58	15.18	16.08	17.55	18.87	19.29	19.71	20.15	20.59

The connections underlying both the NCC model revenue and the NCC calculation are outlined in table 7.

Table 7: NCC new connections

Connection	23/24	24/25	25/26	26/27	27/28	28/29	29/30	30/31	31/32	32/33
New Growth										
Water	0	99	197	393	785	1,121	1,145	1,170	1,196	1,222
Waste	0	86	171	341	681	971	993	1,014	1,037	1,060
Existing Growth										
Water	1,717	1,656	1,596	1,439	1,088	793	811	829	847	866
Waste	1,488	1,435	1,383	1,247	943	688	703	718	734	750

Reconciling tax, gifted assets and discount rates

The other primary inputs into the NCC model and the financial templates are:

- Tax: Our proposed NCCs do not incorporate a positive tax allowance.
- Gifted assets: We are not incorporating a tax allowance in the NCC model, therefore the NCC model does not reference gifted assets in the NCC calculation.
- Discount rate: A discount rate of 3.09 percent is incorporated in the NCC model. This was based on the best available information at the time of the model development. This discount rate varies from the regulated real rate of return of 2.55 percent in the ESC financial template. CHW note the variation in these rates and have tested the sensitivity and this demonstrated an immaterial change. We acknowledge the ESC may wish to update the model at the time of the Final Determination.

5. Freezing NCCs for the 2023 regulatory period

On 8 May 2023 the ESC notified us that in the absence of what it considers to be a compliant proposal, its intention is to approve our current new customer contributions plus CPI from 1 July 2023. In effect the ESC has notified us that its intention if it does not approve our AIC NCCs is to freeze our NCCs at our current rates and escalate them annually by CPI.

As per the email received from the ESC on 9 May 2023, CHW will provide our response to this proposal by 18 May 2023.