



# Melbourne Water Draft Decision

2026 Water Price Review

2 April 2026



## Acknowledgement

We acknowledge the Traditional Owners of the lands and waterways on which we work and live.

We acknowledge all Aboriginal and Torres Strait Islander communities, and pay our respects to Elders past and present.

As the First Peoples of this land, belonging to the world's oldest living cultures, we recognise and value their knowledge, and ongoing role in shaping and enriching the story of Victoria.

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# Summary

## **Our draft decision considers Melbourne Water’s proposed prices for a 5-year period starting 1 July 2026.**

This draft decision sets out our preliminary view of Melbourne Water’s price submission.<sup>1</sup> Our draft decision should be read together with Melbourne Water’s price submission.

We invite interested parties to comment on this draft decision before we make a final decision and issue a price determination in June 2026.

You can provide feedback via Engage Victoria: <https://engage.vic.gov.au/water-price-review-2026>.

## **Melbourne Water has committed to delivering outcomes that reflect customer priorities**

Melbourne Water provides wholesale water supply and sewerage services to retail water businesses that we also regulate. These retail water businesses are Greater Western Water, South East Water, Yarra Valley Water, Barwon Water, Gippsland Water, South Gippsland Water and Westernport Water.

Melbourne Water also provides waterways and drainage services in and around Melbourne.

This price review informs the maximum charges customers pay for these services. Almost 2.4 million water customers and 4.2 million waterways and drainage customers ultimately incur these prices passed on through their retail water businesses, which serve about 5.8 million Victorians.

Melbourne Water plans to deliver the following outcomes for its customers:<sup>2</sup>

1. Safe and reliable bulk water supplies for now and for the long term
2. Environmentally sustainable bulk sewerage services
3. Healthy, resilient waterways
4. Urban drainage and flood resilience
5. A valued partner in water cycle services

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<sup>1</sup> Clause 16 of the Water Industry Regulatory Order 2014 requires the Essential Services Commission to issue a draft decision; Melbourne Water’s price submission is available on our website at [www.esc.vic.gov.au](http://www.esc.vic.gov.au).

<sup>2</sup> Melbourne Water 2025, *2026 price submission*, September, p. 71.

Among key initiatives to deliver on its commitments, Melbourne Water will:

- partner with metropolitan water businesses to support customers experiencing financial hardship through a new waterways and drainage hardship grant, funding a water efficiency program, and delivering a sector uplift program.<sup>3</sup>
- increase investment to improve drinking water security and quality, water transfer networks and storage capacity, treatment plant compliance and emissions reduction, waterway management, flood mitigation and modelling, urban land development and stormwater harvesting.<sup>4</sup>

Melbourne Water stated these investments are driven by its commitment to deliver on customer expectations and ensure it meets the challenges it faces from population growth, a changing climate, ageing assets, increased household and business costs, and increased network interconnectedness.<sup>5</sup>

## **Our draft decision is to adopt a lower revenue requirement than that proposed by Melbourne Water**

Our draft decision adopts a revenue requirement that will allow Melbourne Water to deliver on its customer service commitments, government policy, and legal obligations monitored by the Environment Protection Authority Victoria and the Department of Health.

Our draft decision is to adopt a revenue requirement of \$9,991.9 million for Melbourne Water over a 5-year period starting 1 July 2026 (see chapter 4).<sup>6</sup> This figure is \$140.5 million or 1.4 per cent lower than proposed by Melbourne Water, mainly reflecting our adjustments to Melbourne Water's forecasts of operating and capital expenditure.

Melbourne Water's proposed bulk water and bulk sewerage charges would result in a modest increase to bills for end-use customers. For household customers of the metropolitan water businesses, Melbourne Water's proposed prices would result in an average increase to bills of 1.8 per cent across the next 5 years, or 0.4 per cent per year (before inflation). The impact of Melbourne Water's price increase varies between water businesses, and it is a matter for those

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<sup>3</sup> Melbourne Water 2025, 2026 *price submission*, September, p. 85. The water efficiency program involves Melbourne Water providing water saving solutions to reduce bills for customers experiencing financial hardship. The sector uplift program involves Melbourne Water providing support to and partnering with community sector organisations, increasing marketing and education campaigns in collaboration with metropolitan water businesses, and contributing to the Financial Counselling Industry Fund.

<sup>4</sup> Melbourne Water 2025, 2026 *price submission*, September, pp. 72–79.

<sup>5</sup> Melbourne Water 2025, 2026 *price submission*, September, pp. x–xi.

<sup>6</sup> The revenue requirement is the forecast amount a water business needs to deliver on customer outcomes, government policy, and obligations monitored by technical regulators including the Environment Protection Authority Victoria and the Department of Health. Along with forecast demand, it is an input to calculating the prices to be charged by a water business.

businesses to determine how they pass through Melbourne Water's charges, subject to the limits specified in their price determinations.

We do not approve prices for each tariff at the draft decision stage of a price review. Prices will need to be updated by Melbourne Water to reflect our draft decision on its revenue requirement and our updates to inflation and cost of debt estimates prior to our final decision.

Our draft decision also provides an opportunity for Melbourne Water to provide further information on the elements of our draft decision that differ from what it proposed in its price submission.

In June 2026, we will determine prices for Melbourne Water in 2026-27 dollar terms. This means we will add the annual change in the March Quarter 2026 consumer price index (published by the Australian Bureau of Statistics) to its 2026-27 prices, which will also flow through to bills for end-use customers.

## **Melbourne Water proposed changes to its bulk water tariff structures to reflect the South-Central Pool Bulk Entitlement reform**

Melbourne Water's proposed bulk water tariff structure reflects the South-Central Pool Bulk Entitlement reform, currently being considered by the Minister for Water.<sup>7</sup> Under its proposed tariff structure, Melbourne Water would recover a higher proportion of its bulk drinking water revenue from variable (usage based) charges (see section 7.1). This means Melbourne Water would take on more demand risk.

Our draft decision is to accept Melbourne Water's proposed bulk water tariff structure, subject to Ministerial approval of the South-Central Pool Bulk Entitlement. The minister is expected to make a decision in early April 2026, prior to us making our final decision.

Our preliminary view is that the proposed tariff structures for bulk water reflect the pricing principles set out in our guidance.

## **Melbourne Water also proposed changes to its bulk sewerage tariff structures**

Melbourne Water proposed bulk sewerage and trade waste tariff structures that are largely consistent with its current approach with the exception of introducing a common sewage transfer variable charge for both its Eastern and Western Treatment Plants. This common charge would replace the two separate variable charges it has currently. Our draft decision is to not accept

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<sup>7</sup> Bulk Entitlements – South-Central Pool Bulk Entitlement Actions, State Government of Victoria, accessed 3 March 2026, <https://www.water.vic.gov.au/about-us/water-entitlements-and-the-water-act/bulk-entitlements>.

Melbourne Water's proposal to move to a common charge, as it does not reflect the underlying costs at the Eastern and Western Treatment Plants.

Our draft decision is to approve Melbourne Water's proposed bulk sewage treatment charges and trade waste charges for each treatment facility, as well as its sewerage treatment/transfer fixed charge. We consider the proposed tariff structures reflect underlying costs, align with our tariff principles and satisfy the requirements of our guidance.

### **We propose to make a consequential amendment to South East Water's determination to allow the pass-through of changes in bulk water and sewerage costs**

Melbourne Water's proposed bulk tariff reform involves significant changes to the prices it charges South East Water. Under South East Water's current determination, it is unable to pass through the bulk sewerage component. If South East Water is unable to pass-through all of the changes to bulk costs, it would have a material impact on its revenue and prevent it from implementing cost-reflective end-use prices. South East Water requested that we use our discretion to amend its determination to enable a pass-through of bulk water and sewerage costs. We propose to amend South East Water's determination to enable the full pass-through of bulk costs as a consequence of our decision on Melbourne Water's bulk prices.

### **Tariff structures for waterways and drainage services will generally remain the same**

Our draft decision is to accept Melbourne Water's proposed tariff structures for its core waterways and drainage services applied to both residential and non-residential customers.

Our draft decision is also to accept Melbourne Water's proposed tariff structures for its special drainage area services to end-use customers in Patterson Lakes and the Koo Wee Rup – Longwarry district.

### **We propose to accept Melbourne's proposed form of price control and adjustment mechanisms**

Melbourne Water proposed a price cap form of price control for its waterways and drainage charges, and a tariff basket for its water and sewerage charges with a 3 per cent rebalancing constraint. This is the same as its current approach. Our draft decision is to accept the proposal as it provides sufficient revenue to cover the forecast efficient costs of providing services to its customers and the community, and satisfies our guidance requirements.

Melbourne Water proposed continuing its current annual price adjustment process, with updates to reflect the South-Central Pool Bulk Entitlement reform.

## **We are considering Melbourne Water’s proposed pricing principles for large and/or complex connections**

Melbourne Water submitted a late addendum to its price submission outlining the principles and charges it proposed to apply to large and/or complex connections.<sup>8</sup> Melbourne Water identified the issue of large and/or complex connections through its ongoing engagement since 2025 with interested parties and the commission. This engagement informed the development of its current proposal, which looks to respond to emerging challenges associated with servicing these types of connections. We acknowledge Melbourne Water’s proactive approach in raising this issue with us and engaging constructively in what is a relatively new and evolving area of economic development. However, we consider that Melbourne Water was generally slow to respond to the issue of large load demand (particularly from data centres) – there are no estimates of the impact of large loads in its proposed demand and expenditure forecasts, and interested parties were not consulted on the addendum. We would have expected these issues to be addressed in the pricing proposal submitted in September 2025.

The pricing principles outlined in the addendum form part of a new framework Melbourne Water proposed for charging ‘special charges’ and miscellaneous fees for large and/or complex connections and sewer mining, driven by demand from large data centres.

The proposal includes:

- upfront capital contributions, recovering the costs of constructing or bringing forward infrastructure required for the new connection – charged to the retail water businesses, which then pass them on to a customer via a negotiated new customer contribution or to an applicant connecting directly to Melbourne Water’s infrastructure assets
- miscellaneous fees for investigation, application processing, ongoing fixed and usage charges, reservation charges, disconnection charges and any other up-front or ongoing operating costs incurred by Melbourne Water to service the new connection
- fees for sewer mining activities for the purpose of on-selling water, sewage and/or recycled water and discharging back into the source sewer.

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<sup>8</sup> Melbourne Water 2026, *Addendum to Melbourne Water’s 2026 Price Submission – large and complex connections*, 27 February, pp. 1–11.

Melbourne Water also proposed to develop a negotiating framework, connections policy, and tripartite agreements during the 2026–31 regulatory period in collaboration with water businesses, the Department of Energy, Environment and Climate Action, and the commission.

Melbourne Water consulted with the Department of Energy, Environment and Climate Action when preparing its proposed pricing principles.

Our preliminary view is that Melbourne Water's has not yet provided us with adequate information or justification for us to be satisfied that its proposed pricing principles for large and/or complex connections are compliant with our guidance. Also, given the lateness of the proposal, water businesses and other interested parties have not been provided with an opportunity to comment or provide feedback on Melbourne Water's proposal. Therefore, we are not yet able to accept the proposal.

We will fully review Melbourne Water's proposal together with any further information we receive from Melbourne Water or other interested parties in response to our draft decision before making our final decision.

## **Our draft decision rates Melbourne Water's price submission overall as 'Standard' under the PREMO framework, but 'Basic' for the Performance element**

Our draft decision is to rate Melbourne Water's price submission as 'Standard' under the PREMO framework (Table A). This is the same as the business's overall self-rating of its price submission.

However, our draft decision is to rate its price submission as 'Basic' for the Performance element of PREMO, rather than to agree with the business's self-rating of this element as 'Standard'.

Key factors supporting this overall 'Standard' PREMO rating for Melbourne Water's price submission include:

- Its effective implementation of the South-Central Pool Bulk Entitlement reform, with support from affected water retailers. The proposed bulk water and sewerage tariff structures are generally consistent with pricing principles, except for the proposed common variable sewage transfer charge.
- Its proposed developer charges are broadly consistent with the relevant pricing principles.
- It proposed to take on more demand risk by increasing the proportion of revenue recovered through variable charges. Proposed price adjustment mechanisms for uncertain or unforeseen events are largely continuing existing arrangements.
- Its demand forecasts were based on reasonable assumptions.
- It proposed an efficiency improvement rate of 2 per cent, being an ambitious target that places greater delivery risk on the business.

- It sought to manage uncertainty in its capital program by excluding costs for ‘priority 4’ projects and including only development costs for ‘priority 2’ projects.
- Melbourne Water demonstrated strong engagement practices, including early and structured engagement. Engagement was designed to inform and test key elements of the proposal, including with First Nations communities.
- Information provided to participants was generally clear and appropriate for the engagement activities. The submission demonstrated how customer feedback informed the proposal, including investment priorities.
- Melbourne Water also undertook extensive engagement with the development industry, including initiatives to address backlogs in drainage scheme applications.
- Melbourne Water’s proposal was submitted on time and included board attestation.
- Its proposed outcomes aligned with core services and customer priorities, and new measures and targets are simpler and easier for customers to understand than the current framework.
- It introduced initiatives to strengthen accountability and support to end-use customers.

In assessing Melbourne Water’s submission for the performance element of PREMO, we considered that:

- it has largely met its outcome commitments to date
- its controllable operating expenditure in 2024 25 was \$51 million (11 per cent) above the benchmark of \$467.4 million set at the 2021 price review
- its actual capital expenditure overspend above its benchmark was largely assessed as reasonable and it was able to explain the delays in major project delivery and identify lessons it has applied for the 2026–31 regulatory period.

While we accept that some costs have increased in the current regulatory period, we consider that businesses should still seek to manage and reprioritise costs closely having regard to their price review benchmarks. Efficiency is a key focus of the pricing framework. Melbourne Water’s 2024-25 controllable operating expenditure variance of \$51 million is significant and we only verified \$40 million of the overspend as being prudent and efficient.

In addition, the delays in capital expenditure, that was not incurred in the early years of the regulatory period, meant Melbourne Water was able to keep the forecast costs of the planned capital (depreciation and return on) in those years, at customers’ expense.

It is on these basis, that our draft decision is to rate Melbourne Water’s price submission as ‘Basic’ for the Performance element of PREMO.

See section 1.4 and chapter 11 for an explanation of the PREMO framework.

Our PREMO (Performance, Risk, Engagement, Management and Outcomes) rating is an assessment of the water business's price submission, including whether commitments for the current regulatory period have been delivered, and its ambition to deliver outcomes that are valued by its customers over the next regulatory period.

It is not an assessment of the water business itself.

**Table A** Draft decision – PREMO rating

	Overall PREMO rating	Performance	Risk	Engagement	Management	Outcomes
Melbourne Water's self-rating	Standard	Standard	Standard	Standard	Standard	Standard
Commission's preliminary rating	Standard	Basic	Standard	Standard	Standard	Standard

## We invite feedback on our draft decision

We invite feedback from interested parties on our draft decision before we make a final decision and price determination. We expect to release our final decision and price determination in June 2026.

Interested parties may comment on any aspect of our draft decision, including:

- The information we have relied upon in our assessment (such as Melbourne Water's price submission)
- Additional matters or issues we should consider before making our final decision
- Whether our draft decision on Melbourne Water's price submission has adequate regard to the matters in clause 11 of the Water Industry Regulatory Order 2014 and our guidance.<sup>9</sup>

Table B lists specific issues we are seeking feedback on to inform our final decision and price determination for Melbourne Water.

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<sup>9</sup> Essential Services Commission, *2026 Melbourne Water price review: Guidance paper*, 19 November 2024. This guidance is available on our website.

**Table B**      **Issues we are seeking feedback on**

Topic	Specific issue	Draft decision reference
Developer charges and large loads	Pricing principles for large and/or complex connections	Section 9.2
Pricing	Consequential amendments to South East Water's determination	Section 7.4

### **How to provide feedback and stay up to date**

You can stay up to date with our review via the dedicated Engage Victoria website:

<https://engage.vic.gov.au/water-price-review-2026>

You can provide feedback by:

- taking part in a public forum
- providing written comments or submissions.

### **Public forum**

We plan to hold a public forum on 23 April 2026. The forum will provide an opportunity for interested parties to discuss key features of our draft decision. Details of the public forum will be published on the Engage Victoria website.

### **Provide written comments or submissions**

Written comments or submissions in response to this draft decision will be due by 1 May 2026.

We require submissions by this date so that we have time to fully consider submissions for our final decision. Comments or submissions received after this date may not be afforded the same weight as submissions received by the due date.

We would prefer to receive comments and submissions via Engage Victoria.

Alternatively, you may send comments and submissions by mail to:

2026 Water Price Review  
Essential Services Commission  
Level 8, 570 Bourke Street  
Melbourne VIC 3000

### **Submission and privacy statement**

We encourage transparency in our review processes. It is our policy to publish all submissions to the 2026 Water Price Review on our website unless the submitter has requested confidentiality.

When we publish a submission, we will also include some details about the submitter (your name, but not your address) unless the submitter has requested not to be identified.

## Next steps

Activity	Date
Public forum	23 April 2026
Closing date for submissions on our draft decision	1 May 2026
Release of our final decision and price determination	June 2026

# 1. Our role and approach to water pricing

## 1.1. We are Victoria's independent economic regulator

Our role in the water industry is based on the Water Industry Regulatory Order 2014 (WIRO), which is made under the *Water Industry Act 1994* (WI Act) and sits within the broader context of the *Essential Services Commission Act 2001* (ESC Act). Our role under the WIRO includes regulating the prices and monitoring the service standards of the 18 water businesses operating in Victoria.

## 1.2. We are reviewing Melbourne Water's proposed prices

We are reviewing the prices Melbourne Water has proposed to charge customers for prescribed services from 1 July 2026. These services include:

- storage operator and bulk water services
- bulk sewerage services
- bulk recycled water services
- metropolitan waterways and drainage services.<sup>10</sup>

Melbourne Water provides wholesale water supply and sewerage services to retail water businesses that we also regulate. These retail water businesses are Greater Western Water, South East Water, Yarra Valley Water, Barwon Water, Gippsland Water, South Gippsland Water and Westernport Water. Melbourne Water also provides waterways and drainage services in and around Melbourne.

Melbourne Water provided a submission to us proposing prices for a 5-year period starting 1 July 2026. Our task is to assess the price submission using the legal framework and make a price determination that takes effect from 1 July 2026. The price determination will specify the maximum prices Melbourne Water may charge for prescribed services, or the manner in which prices are to be calculated, determined or otherwise regulated. We will also issue a final decision that explains the reasons for our price determination.

## 1.3. We assess prices against the WIRO and other legal requirements

Clause 11 of the WIRO specifies the mandatory factors we must have regard to when making a price determination, including matters set out in the WIRO, the WI Act and the ESC Act. In

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<sup>10</sup> The prescribed services are listed at clause 7(b) of the Water Industry Regulatory Order 2014.

reaching this draft decision, we have had regard to each of the matters required by clause 11 of the WIRO, including:

- The objectives and matters specified in clause 8 of the WIRO, which include economic efficiency and viability matters, industry specific matters, customer matters, health, safety, environmental and social matters, and other matters which are specified in sections 8 and 8A of the ESC Act and section 4C of the WI Act.
- The matters set out in section 33(3) of the ESC Act, which include the return on assets, relevant benchmarking and any other matters that we consider relevant.
- The matters specified in our guidance.<sup>11</sup>
- The principle that prices should be easily understood by customers and provide signals about the efficient costs of providing services, while avoiding price shocks where possible.
- The principle that prices should take into account the interests of customers of the regulated entity, including low income and vulnerable customers.

Appendix B lists the specific objectives and the various matters we must have regard to when making a price determination and provides a guide to where we have done so in this draft decision. Table 1.1 summarises the matters we must have regard to and groups them into themes.

### 1.3.1. Commission guidance and approval process

In November 2024, we issued guidance to Melbourne Water to inform its price submission. The guidance sets out how we would assess Melbourne Water's submission against the matters we must consider under clause 11 of the WIRO. It also outlines our expectation that Melbourne Water would comply with certain requirements and specified information that Melbourne Water must provide to us when submitting its price submission.<sup>12</sup>

If we consider the price submission has adequate regard for the matters in clause 11 of the WIRO and complies with our guidance, we must approve Melbourne Water's proposed prices.<sup>13</sup>

If we consider the submission does not have adequate regard for the matters specified in clause 11 of the WIRO or does not comply with our guidance, we may specify maximum prices, or the manner in which prices are to be calculated, determined or otherwise regulated.<sup>14</sup>

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<sup>11</sup> Essential Services Commission, *2026 Melbourne Water price review: Guidance paper*, 19 November 2024.

<sup>12</sup> Among these expectations are matters that progress our 'Getting to fair' strategy relating to the water industry. See Essential Services Commission, *Getting to fair: Breaking down barriers to essential services*, August 2021.

<sup>13</sup> This is a requirement of the Water Industry Regulatory Order 2014, cl. 14(b).

<sup>14</sup> This is provided for under the Water Industry Regulatory Order 2014, cl. 14(b)(i).

**Table 1.1 Matters businesses and the commission must have regard to**

Economic efficiency and viability matters	Industry/business specific matters	Customer matters
<ul style="list-style-type: none"> <li>• promotion of efficient use of prescribed services by customers [cl. 8(b)(i), WIRO]</li> <li>• promotion of efficiency in regulated entities as well as efficiency in, and the financial viability of, the regulated water industry [cl. 8(b)(ii), WIRO]</li> <li>• provision to regulated entities of incentives to pursue efficiency improvements [cl. 8(b)(iii), WIRO]</li> <li>• efficiency in the industry and incentives for long term investment [s. 8A(1)(a), ESC Act]</li> <li>• efficient costs of producing or supplying regulated goods or services and of complying with relevant legislation and relevant health, safety, environmental and social legislation applying to the regulated industry [s. 33(3)(b), ESC Act]</li> <li>• financial viability of the industry [s. 8A(b)(1), ESC Act]</li> </ul>	<ul style="list-style-type: none"> <li>• particular circumstances of the regulated industry and the prescribed goods and services for which the determination is being made [s. 33(3)(a), ESC Act]</li> <li>• return on assets in the regulated industry [s. 33(3)(c), ESC Act]</li> <li>• ensure that regulatory decision-making and regulatory processes have regard to any differences between the operating environments of regulated entities [s. 4C(b), WI Act]</li> </ul>	<ul style="list-style-type: none"> <li>• in performing its functions and exercising its powers, the objective of the commission is to promote the long-term interests of Victorian consumers [s. 8(1), ESC Act] without derogating from that objective. The commission must in seeking to achieve the objective have regard to the price, quality and reliability of essential services [s. 8(2), ESC Act]</li> <li>• enable customers or potential customers of the regulated entity to easily understand the prices charged by the regulated entity for prescribed services or the manner in which such prices are calculated, determined or otherwise regulated [cl. 11(d)(i), WIRO]</li> <li>• provide signals about the efficient costs of providing prescribed services to customers (either collectively or to an individual customer or class of customers) while avoiding price shocks where possible [cl. 11(d)(ii), WIRO]</li> <li>• take into account the interests of customers of the regulated entity, including low income and vulnerable customers [cl. 11(d)(iii), WIRO]</li> </ul>

Continued on next page

Table 1.1 (continued)

Benchmarking	Health, safety, social and environmental obligations	Other
<ul style="list-style-type: none"> <li>any relevant interstate and international benchmarks for prices, costs and return on assets in comparable industries [s. 33(3)(d), ESC Act]</li> </ul>	<ul style="list-style-type: none"> <li>the relevant health, safety, environmental and social legislation applying to the industry [s. 8A(1)(d), ESC Act]</li> <li>to ensure that regulatory decision-making has regard to the health, safety, environmental sustainability (including water conservation) and social obligations of regulated entities [s. 4C(c), WI Act]</li> </ul>	<ul style="list-style-type: none"> <li>the degree of, and scope for, competition within the industry, including countervailing market power and information asymmetries [s. 8A(1)(c), ESC Act]</li> <li>consistency in regulation between states and on a national basis [s. 8A(1)(f), ESC Act]</li> <li>the benefits and costs of regulation (including externalities and the gains from competition and efficiency) for: (i) consumers and users of products or services (including low income and vulnerable consumers); (ii) regulated entities [s. 8A(1)(e), ESC Act]</li> <li>wherever possible, to ensure that the costs of regulation do not exceed the benefits [s. 4C(a), WI Act]</li> </ul>

**Note:** References in the table are to the Water Industry Regulatory Order 2014 (WIRO), the *Essential Services Commission Act 2001* (ESC Act), and the *Water Industry Act 1994* (WI Act).

## We first publish a draft decision

Consistent with clause 16 of the WIRO, we publish this draft decision setting out our reasons before making our final decision on Melbourne Water's proposals. This allows the business to respond to our preliminary views and provide further information to support its initial proposals or to amend its proposals in accordance with our draft decision and any requirements we specify. The draft decision also allows submissions from customers and other interested parties to inform our final decision.

### 1.4. PREMO

PREMO stands for Performance, Risk, Engagement, Management, and Outcomes (see Box 1.1).

#### Box 1.1 PREMO

Water businesses must demonstrate their level of ambition in delivering value for money for customers in their price submissions across the five PREMO elements:

- **Performance**  
Have the performance outcomes to which the business committed in the previous regulatory period been met or exceeded?
- **Risk**  
Has the business sought to allocate risk to the party best positioned to manage that risk? To what extent has the business accepted risk on behalf of its customers?
- **Engagement**  
How effective was the business's customer engagement to inform its price submission?
- **Management**  
Is there a strong focus on efficiency? Are controllable costs increasing, staying the same, or decreasing? Is the price submission succinct and free of material errors?
- **Outcomes**  
Do proposed service outcomes represent an improvement, the status quo, or a reduction of service standards?

The purpose of the PREMO framework is to provide incentives for water businesses to deliver outcomes most valued by customers. PREMO includes reputation incentives, via the rating of price submissions as Leading (the highest available rating), Advanced, Standard or Basic, depending on the level of ambition expressed by a water business in its price submission. Financial incentives are provided by linking the return on equity to the PREMO rating.

A key priority under PREMO is to provide incentives for a water business to engage with customers to understand their priorities and concerns and take these into account in forming its proposals, as outlined in its price submission. These should be evidenced in price submissions by linking the outcomes proposed with findings from a business's engagement.

Our guidance specifies the way in which we expect water businesses to assess themselves by reference to the PREMO elements.

PREMO links the return on equity allowed in the revenue requirement to the value delivered by a water business to its customers. Under PREMO, a higher level of ambition in terms of delivering customer value results in a higher return on equity.

For Melbourne Water's 2026 price review, its ambition in terms of delivering customer value is being assessed against all five elements of PREMO – Performance, Risk, Engagement, Management and Outcomes. It is the first time the Performance element has been included for Melbourne Water. This assesses the business's performance against its outcomes and proposals from the previous price review (which for Melbourne Water was in 2021). We did not assess the Performance element in 2021 because it was the first time that we had applied the PREMO framework and so we did not have a set of previously approved outcomes to inform our assessment.

Taking into account all five elements of PREMO, a water business must self-assess and propose a rating for its price submission as 'Leading', 'Advanced', 'Standard' or 'Basic'. Its proposed return on equity will then reflect its proposed PREMO rating. A 'Leading' submission has the highest return on equity, and a 'Basic' submission the lowest. We assess the self-rating and also assess the price submission more broadly, including the water business's justification for the proposed PREMO rating, and form our own view of the appropriate rating. This process determines the PREMO rating adopted and the return on equity reflected in the revenue requirement.<sup>15</sup>

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<sup>15</sup> Essential Services Commission, *2026 Melbourne Water price review: Guidance paper*, 19 November 2024, pp. 49–51.

## 2. Our assessment of Melbourne Water's price submission

We have made our draft decision on Melbourne Water's price submission after considering:

- Melbourne Water's price submission
- Melbourne Water's presentation made directly to commissioners
- Melbourne Water's responses to our queries
- our consultants' reports
- written submissions from interested parties (a list of submissions is provided in Appendix B).

Any reports, submissions, or correspondence provided to us which are material to our consideration of Melbourne Water's price submission are available on our website (to the extent the content is not confidential).

Our guidance included matters Melbourne Water must address in its price submission. Melbourne Water's price submission addressed each of these matters. Our preliminary assessment of these matters is provided in this draft decision.

We found Melbourne Water's price submission provided evidence that its engagement sought to capture the main priorities and concerns of customers, and that it has taken this feedback into account when developing its proposals (see section 3.1 on customer engagement).

Unless otherwise noted, all financial values referred to in this draft decision are in 2025-26 dollars, which means inflation is excluded from forecast numbers.

Melbourne Water must submit a response to our draft decision and provide an updated financial model by 1 May 2026 (via email to [water@esc.vic.gov.au](mailto:water@esc.vic.gov.au)). The response will be published on our website. We also invite other interested parties to make a submission.

We intend to make a price determination for Melbourne Water in June 2026.

## 2.1. Draft decision paper outline

This *Melbourne Water Draft Decision* is structured around the steps we take to arrive at our price determination:

- Determine the regulatory period (section 2.2).
- Confirm the customer outcomes and service levels that Melbourne Water has committed to over the regulatory period (chapter 3).
- Establish Melbourne Water's revenue requirement using a building block methodology (chapter 4).
- Use demand forecasts (chapter 5) and the form of price control (chapter 6) to convert the revenue requirement to tariffs and prices (chapters 7 and 8).

Chapter 9 outlines our consideration of Melbourne Water's proposed approach to estimating developer charges, including its approach to large and/or complex connections.

Chapter 10 outlines our consideration of Melbourne Water's financial position, which we have also had regard to.

Chapter 11 outlines our assessment of Melbourne Water's price submission under the PREMO framework.

## 2.2. Regulatory period

Our draft decision is to approve a regulatory period of 5 years from 1 July 2026.

We are required to set the term of the regulatory period over which a water business's price determination will apply.<sup>16</sup> Our guidance proposed that we set a 5-year regulatory period, but also noted we were open to justified alternatives proposed in a price submission.<sup>17</sup>

Melbourne Water proposed a regulatory period of 5 years. Accordingly, consistent with the reasons outlined in our guidance, our draft decision is to approve a regulatory period of 5 years.

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<sup>16</sup> This is a requirement of the Water Industry Regulatory Order 2014, cl. 9.

<sup>17</sup> For detail on the reasons for using 5 years as the default regulatory period, see: Essential Services Commission, *2026 Melbourne Water price review: Guidance paper*, 19 November 2024, p. 19.

## 3. Customer outcomes

The customer outcomes Melbourne Water plans to deliver over the regulatory period are a key component of its price submission. The outcomes confirm its commitments to customers, underpin its revenue requirement, and feed into its PREMO assessment.

This chapter:

- Examines Melbourne Water’s engagement with its customers in preparing its price submission (section 3.1).
- Reviews whether Melbourne Water has delivered on the outcomes it committed to for the current regulatory period (2021–26) (section 3.2.1).
- Examines the customer outcomes Melbourne Water is committing to for the next regulatory period (section 3.2.2) and the measures and targets it will use to report on its performance (section 3.2.3).
- Outlines Melbourne Water’s proposed Guaranteed Service Levels (section 3.3).

### 3.1. Customer engagement

Our guidance required Melbourne Water to engage with customers to inform its price submission. Our guidance also identified principles to guide Melbourne Water on its engagement.<sup>18</sup>

#### Melbourne Water’s engagement

We consider Melbourne Water’s customer engagement aligned with our engagement principles in several ways:

- Engagement began in 2023 with early testing of customer values and priorities to develop, refine and test proposals with customers.
- Melbourne Water used a broad range of online and in-person engagement methods, including focus groups, pop-ups, one-on-one meetings, customer drop-in sessions and a deliberative community panel.
- The engagement program gathered the views of around 8,200 customers across the business’s diverse customer groups. This included water businesses receiving bulk water and sewerage services, land developers, licensed diversion customers, direct service and precept customers and end-use customers. It also included engagement with community support organisations, environmental groups, local councils and Victorian Government departments.

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<sup>18</sup> Essential Services Commission, *2026 Melbourne Water price review: Guidance paper*, 19 November 2024, p. 22.

- Melbourne Water designed its engagement to be inclusive. It used targeted approaches to support participation by First Nations customers and Traditional Owner groups, customers experiencing vulnerability, culturally and linguistically diverse communities, and people living with disability.<sup>19</sup>
- The engagement focused on matters that were material to prices and outcomes for each customer group. These matters included customer outcomes and service priorities; investment priorities for waterways and drainage services; transparency and collaboration with partners; affordability; bill impacts; and equity considerations, like support for customers experiencing vulnerability.

See pages 38 to 66 of Melbourne Water’s price submission for more detail about its engagement.

### **Melbourne Water’s engagement influenced its price submission**

The actions Melbourne Water proposed to take in response to customer feedback provide evidence that its engagement influenced its proposals. For example, in its price submission, Melbourne Water proposed:

- Prioritising affordability by proposing no real price increase in year 1 (except for South Gippsland Water). This is followed by bill increases of 1.5 per cent for metro water businesses in year 2 (excluding inflation) and then minor bill increases for the remaining 3 years. This reflects feedback from end-use customers and from water businesses who preferred a smoother price path and to avoid bill shock across regulatory periods.<sup>20</sup>
- Funding programs to support customers experiencing financial difficulties and vulnerability. This was proposed in response to feedback from water businesses, bulk customers and the deliberative community panel emphasising the need for targeted support.<sup>21</sup>
- A new water quality Guaranteed Service Level with a rebate payable to the three metropolitan water businesses where Melbourne Water, or a failure of Melbourne Water’s system causes drinking water quality standards to not be met. This responds to requests from these businesses and recognises that breaches of these businesses’ own Guaranteed Service Levels may be caused by Melbourne Water or its systems.<sup>22</sup>
- Improved service levels through more responsive and consistent communications, including appointing a dedicated resource for the Koo Wee Rup–Longwarry Flood Protection District. This

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<sup>19</sup> Barriers to participation were reduced through tailored support, including accessibility and sensory accommodations, cognitive tests on engagement materials to ensure information was accessible, and translation of playback materials into the five most spoken languages in Melbourne Water’s service area.

<sup>20</sup> Melbourne Water 2025, *2026 price submission*, September, p. 63.

<sup>21</sup> Melbourne Water 2025, *2026 price submission*, September, p. 85.

<sup>22</sup> Melbourne Water 2025, *2026 price submission*, September, pp. 232, 235 and 237.

was in response to feedback from this group of customers on the importance of regular and transparent communication.<sup>23</sup>

- Prioritising vegetation for the environment, wildlife and biodiversity, as well as community grants in response to community and environmental groups' feedback on its Waterways and Drainage investment plan.<sup>24</sup>

However, we note that Melbourne Water submitted a late proposal on pricing principles for large and/or complex loads (February 2026) for us to make a draft decision. We understand that Melbourne Water has undertaken some engagement on its approach. However, we understand that affected water businesses and other interested parties were not consulted on the proposal prior to its submission to us. We support Melbourne Water's efforts to address the issues raised by large and/or complex connections but would expect it to have engaged with retailers on its proposal before submitting to us. We note that Melbourne Water has indicated it will consult with water businesses on its proposal, which we will consider in our final decision.

Overall, Melbourne Water's customer engagement has influenced its proposed actions and price submission. This supports our pricing framework objectives relating to efficiency and the interests of consumers.

### **Melbourne Water's engagement was tailored to meet the needs of its different customer groups**

Melbourne Water provided reasonable opportunities for customers to participate throughout its engagement. This included releasing a public draft of its proposed outcomes and bill levels and giving customers meaningful opportunities over a 3-month period to respond to the draft proposals and likely bill impacts. When engaging with residents of Patterson Lakes, Melbourne Water adapted its engagement activities in response to initial low participation, including additional surveying to test options and confirm customer preferences before finalising proposals.

For the first time, Melbourne Water put forward a program of work specifically aimed at supporting customers experiencing vulnerability. In designing the program, it considered the views of customers including the water businesses and the community support sector.<sup>25</sup> This feedback shaped the program's design and informed a set of actions focused on practical assistance.

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<sup>23</sup> Melbourne Water 2025, *2026 price submission*, September, p. 55.

<sup>24</sup> Melbourne Water 2025, *2026 price submission*, September, p. 57.

<sup>25</sup> Melbourne Water 2025, *2026 price submission*, September, p. 51.

## **Melbourne Water had a dedicated Aboriginal engagement team**

The level and quality of involvement of First Nations people and Traditional Owners in developing Melbourne Water's price submission reflected engagement that was well tailored and appropriate to the circumstances of the people it engaged with.<sup>26</sup> Engagement was led by a dedicated Aboriginal engagement team and designed in collaboration with each Traditional Owner Corporation to reflect each group's preferences. Discussions with Traditional Owners directly informed the development of a defined program of work, structured into priority areas with proposed resourcing and funding commitments. This approach demonstrates how Melbourne Water's engagement extended beyond consultation to shaping how interests would be addressed in practice.

## **We received submissions on Melbourne Water's engagement**

We received submissions acknowledging the inclusivity of Melbourne Water's engagement program and noting Melbourne Water's first-ever hardship package as a measure to support the proposed price increases.<sup>27</sup> We also received two submissions raising concerns about the quality of engagement with environmental groups.<sup>28</sup> We note this feedback and encourage Melbourne Water to continue exploring regular and tailored engagement opportunities and methods, including with environmental groups and other interested parties.

## **Our preliminary view on Melbourne Water's engagement**

Our preliminary view is that Melbourne Water designed and delivered a sound engagement program with strong influence from its varied customer groups on the proposals presented in its price submission.

On this basis, our preliminary view is that we agree with Melbourne Water's self-rating of 'Standard' for its price submission engagement.

We note however, that the commission intends to release updated guidance for future price reviews setting out additional matters that water businesses will need to demonstrate in relation to First Nations rights and interests consistent with the principle of self-determination. This may impact how we assess a 'Standard' rating on engagement in the future.

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<sup>26</sup> First Nations peoples' participation in deliberative community panels was framed as contributing individual perspectives to avoid placing cultural burden on individuals.

<sup>27</sup> Financial Counselling Victoria, *Submission to the Essential Services Commission 2026 Water Price Review*, 12 December 2025, p. 1; Water Services Association of Australia, *Water in transition: WSAA submission to the Essential Services Commission on Melbourne Water's price review*, 11 December 2025, pp. 5.

<sup>28</sup> Concerned Waterways Alliance, *Submission to the Essential Services Commission Melbourne Water Price Review 2026*, 12 December 2025, p. 17; Maribyrnong River and Waterways Association, *Submission to the Essential Services Commission 2026 Melbourne Water Price Review*, 11 December 2025, p. 5.

See chapter 11 for more information about our assessment of Melbourne Water’s price submission under the PREMO framework.

## 3.2. Outcomes

### 3.2.1. Performance against outcome commitments 2021–26

As part of our 2021 Water Price Review, Melbourne Water established outcomes it would deliver to its customers over the following 5 years. These planned outcomes were reflected in the prices we approved for the period 1 July 2021 to 30 June 2026. Progress against these outcome commitments can indicate whether customers got what they paid for.

Melbourne Water’s price submission should account for its actual performance against its outcome commitments for the period 1 July 2021 to 30 June 2026.

We consider Melbourne Water accounted for its annual performance for each measure in its price submission. Table 3.1 lists Melbourne Water’s outcome commitments and includes its annual performance results as reported in its price submission, and the overall annual and period-to-date ratings published in our *Outcomes Report 2024-25*.<sup>29</sup> The information in this table informs our assessment under the Performance element of PREMO (see chapter 11).

Melbourne Water reported it achieved or exceeded 51 of its 72 discreet targets for its 15 performance measures over the first 4 years of the current (2021–26) regulatory period. It rated a further 9 targets (13 per cent) as amber ‘close to achieving target’ and 12 targets (17 per cent) as red, ‘failed to meet target’ in the period to date.

Melbourne Water reported its outcomes performance annually to customers. Through this reporting, it demonstrated transparency and accountability, and acknowledged underperformance. It proactively worked with its customers to make improvements and address issues.

Melbourne Water stated that it had substantially met its targets for its first four outcomes, which represent the delivery of its core services that matter most to its customers.<sup>30</sup>

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<sup>29</sup> Essential Services Commission 2025, [Outcomes Report 2024-25: Performance of Victoria’s water businesses against their own commitments to customers](#), 15 October.

<sup>30</sup> Melbourne Water 2025, *2026 price submission*, September, p. 17.

**Table 3.1 Business self-assessment of performance against outcome commitments**

Outcome	2021-22	2022-23	2023-24	2024-25	Period to date
1. Access to safe and reliable water and sewerage services	Green	Green	Green	Green	Green
2. Melbourne’s environment, rivers, creeks and bays are protected and Melbourne Water’s greenhouse gas	Green	Green	Green	Green	Green
3. Melbourne remains liveable as it deals with the impacts of climate change and population growth	Green	Green	Green	Green	Green
4. Melburnians are empowered to support the design and delivery of service outcomes	Amber	Green	Green	Green	Green
5. Easy, respectful, responsive and transparent customer service	Red	Red	Red	Red	Red
6. Bills are kept as low as possible	Amber	Amber	Amber	Green	Green
<b>Overall rating</b>	Amber	Amber	Amber	Amber	Amber

**Note:** Green = achieved target; Amber = close to achieving target; Red = failed to meet target. The ‘Period to date’ column is Melbourne Water’s self-assessment of its performance across the first 4 years of the 2021–26 regulatory period for each outcome and overall. Melbourne Water’s performance against outcome commitments in the final year of the current regulatory period (2025-26) will be published in late 2026 in our outcomes report for 2025-26.

Source: Melbourne Water 2025, *2026 price submission*, September, p. 18; Essential Services Commission, *Melbourne Water’s outcomes performance 2024-25*, October 2025.

Melbourne Water did not meet any of its targets for its four customer satisfaction measures under its ‘easy, respectful, responsive and transparent customer service’ outcome. It stated these targets were ambitious, and pointed to problems with its adopted survey methodology underpinning the scores, including a low sample size that did not properly represent Melbourne Water’s customer groups. To address this, Melbourne Water developed improved methodologies for measuring

customer satisfaction with its services, and the retail water businesses have agreed to apply these new approaches going forward. Melbourne Water's price submission (pages 32–35) states these alternative measures consistently show strong satisfaction with its services among its customers (including the water businesses, developers and customers interacting with its customer contact centre).

For the first 3 years of the current regulatory period, Melbourne Water did not meet its capital expenditure targets under its 'Bills are kept as low as possible' outcome. It stated this was mainly due to delays in several high-value, complex capital projects, and that it will make up the shortfall in 2025-26 as it scales up the delivery of its capital works program. By forecasting capital expenditure that was not incurred in the early years of the regulatory period, Melbourne Water was able to keep the forecast costs of the planned capital (depreciation and return on) in those years, at customers' expense.

### **Our preliminary view on outcome commitments in the current regulatory period**

Our preliminary view is that we agree with Melbourne Water's self-assessment that it has met most of its outcome commitments for the period to date.

#### **3.2.2. Outcome commitments for 2026–31**

Melbourne Water engaged with its customers to refine its outcomes for the period from 1 July 2026 to 30 June 2031. It developed an entirely new set of outcomes and measures compared to the current regulatory period, simplifying and aligning them with the delivery of each core service. Melbourne Water proposed to deliver the following five outcomes:<sup>31</sup>

1. Safe and reliable bulk water supplies for now and for the long term
2. Environmentally sustainable bulk sewerage services
3. Healthy, resilient waterways
4. Urban drainage and flood resilience
5. A valued partner in water cycle services

### **Melbourne Water's proposals to deliver on its outcomes**

To deliver on its outcomes, Melbourne Water proposed key investments in:

- drinking water security and quality
- water transfer networks and storage capacity
- treatment plant compliance and emissions reduction
- waterway management

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<sup>31</sup> Melbourne Water 2025, *2026 price submission*, September, p. 71.

- flood mitigation and modelling
- urban land development
- stormwater harvesting.<sup>32</sup>

These investments are driven by its commitment to deliver on customer expectations and ensure it meets the challenges it faces from:

- population growth
- a changing climate
- ageing assets
- increased household and business costs
- increased network interconnectedness.<sup>33</sup>

In addition, Melbourne Water proposed to partner with metropolitan water businesses to support customers experiencing financial hardship through a new waterways and drainage hardship grant, funding a water efficiency program, and delivering a sector uplift program.<sup>34</sup>

### 3.2.3. Our assessment of measures and targets

Melbourne Water proposed a set of 19 measures and annual targets for each measure that it will use to report on performance across its 5 outcomes. See Appendix C of its price submission (pages 249 to 251) for details.

We have assessed Melbourne Water's proposed measures against our guidance criteria. The proposed output measures for each outcome must be:

- relevant to, or be a reasonable proxy for, the delivery of the outcome they represent
- measurable
- clearly defined and unambiguous
- easy for customers to understand.

They must also have performance targets listed for each year of the regulatory period.

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<sup>32</sup> Melbourne Water 2025, *2026 price submission*, September, pp. 72–79.

<sup>33</sup> Melbourne Water 2025, *2026 price submission*, September, pp. x–xi.

<sup>34</sup> Melbourne Water 2025, *2026 price submission*, September, p. 85. The water efficiency program involves Melbourne Water providing water saving solutions to reduce bills for customers experiencing financial hardship. The sector uplift program involves Melbourne Water providing support to and partnering with community sector organisations, increasing marketing and education campaigns in collaboration with metropolitan water businesses, and contributing to the Financial Counselling Industry Fund.

Melbourne Water provided evidence that demonstrates its measures and targets were developed in consultation with customers. Most customers consulted agreed the proposed measures and targets adequately reflect the outcomes they represent.

Generally, we consider Melbourne Water's proposed measures and targets were clear and well presented. They will provide a sound basis to track performance and delivery against each outcome, subject to some minor wording clarifications. We are working with Melbourne Water to finalise its measures and targets to ensure its final outcome set complies with our requirements.

Melbourne Water has committed to reporting twice annually to customers via its website on how it has performed against its outcome commitments. It will also take its annual outcomes performance report to water business customers and its ongoing customer forum for feedback before submitting the report to the commission.<sup>35</sup>

On the basis of the above, we are satisfied that Melbourne Water's proposed outcomes, measures and targets are consistent with its self-assessment of its price submission as 'Standard' for the Outcomes element of the PREMO framework. (See chapter 11 for further details.)

### **3.3. Guaranteed Service Levels**

Our draft decision is to accept Melbourne Water's proposed Guaranteed Service Levels.

Guaranteed Service Levels define a water business's commitment to deliver a specified level of service. For each Guaranteed Service Level, typically a water business commits to a payment or a rebate on bills to those who have received a level of service below the guaranteed level.

Melbourne Water proposed to keep its current Guaranteed Service Levels and where relevant, to extend them to regional water business customers. It also proposed an additional Guaranteed Service Level related to water quality, including matching a water retailer's Guaranteed Service Level rebate to customers when Melbourne Water, or a failure in Melbourne Water's system, causes non-compliance with drinking water quality standards. See Appendix D of its price submission (pages 263 to 267).

Melbourne Water consulted on its proposed Guaranteed Service Levels with its retail water business customers and outlined how feedback from these customers directly fed into its proposal.<sup>36</sup> Our draft decision is to accept Melbourne Water's proposed Guaranteed Service Levels, on the basis they were agreed with customers during its engagement. Final Guaranteed

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<sup>35</sup> Melbourne Water 2025, *2026 price submission*, September, pp. 63 and 83.

<sup>36</sup> Melbourne Water 2025, *2026 price submission*, September, p. 84.

Service Levels and rebates will be subject to our consideration of any feedback following the release of our draft decision.

We have included Melbourne Water's proposed Guaranteed Service Levels in Appendix C of this draft decision.

As with other Guaranteed Service Level schemes, it is the responsibility of the water business to identify and apply the Guaranteed Service Level rebate or payment as soon as practicable after a customer entitlement to this payment or rebate arises.

We will require Melbourne Water to:

- publish its Guaranteed Service Levels on its website
- report to us on the number and value of the Guaranteed Service Level rebates or payments it applies through our annual performance reporting process.

## 4. Revenue requirement

The revenue requirement is the forecast amount a water business needs to deliver on its customer service commitments, government policy, and legal obligations monitored by technical regulators including the Environment Protection Authority Victoria and the Department of Health.<sup>37</sup> Along with forecast demand, it is an input to calculating prices.

We have used a building block methodology to establish the revenue requirement. This chapter outlines our preliminary assessment of Melbourne Water's revenue requirement based on the following steps:

- Establish an efficient benchmark level of forecast operating expenditure for the next regulatory period (section 4.1).
- Establish an efficient benchmark level of forecast capital expenditure for the next regulatory period (section 4.2).
- Roll forward the regulatory asset base (section 4.3).
- Apply a rate of return to the regulatory asset base, calculated using:
  - a benchmark cost of debt estimated using a 10-year trailing average approach (section 4.4.1)
  - a benchmark return on equity value determined by Melbourne Water's PREMO rating (section 4.4.2).
- Establish a return of capital through a regulatory depreciation allowance (section 4.5).
- Establish a benchmark tax allowance (section 4.6).

Our draft decision is to adopt a revenue requirement of \$9,991.9 million for the 2026–31 regulatory period, which is \$140.5 million (1.4 per cent) lower than that proposed by Melbourne Water.

Melbourne Water proposed a revenue requirement of \$10,132.4 million over a 5-year period starting 1 July 2026. Our draft decision is to adopt a revenue requirement of \$9,991.9 million (see Table 4.1), which reflects our preliminary assessment of each element of the revenue requirement, including forecast operating and capital expenditure.

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<sup>37</sup> We met with officers of the Department of Energy, Environment and Climate Action, the Department of Health, and the Environment Protection Authority Victoria, to discuss their expectations of Melbourne Water in the regulatory period from 1 July 2026. We had regard to their views in arriving at our draft decision.

**Table 4.1 Draft decision – revenue requirement**  
\$ million 2025-26

	2026-27	2027-28	2028-29	2029-30	2030-31	Total
Operating expenditure	1,098.1	1,090.0	1,092.4	1,075.6	1,055.0	5,411.0
Return on assets	452.5	484.5	522.3	560.4	613.5	2,633.2
Regulatory depreciation	332.4	356.4	377.1	376.8	385.1	1,827.8
Tax allowance	30.5	31.7	27.0	22.4	18.0	129.6
<b>Draft decision – revenue requirement</b>	<b>1,911.5</b>	<b>1,960.6</b>	<b>2,016.8</b>	<b>2,033.3</b>	<b>2,069.7</b>	<b>9,991.9</b>

**Note:** Numbers have been rounded.

Table 4.2 summarises how our draft decision on Melbourne Water’s revenue requirement (row F) differs to the revenue requirement proposed by Melbourne Water in its price submission (row A). Where our draft decision differs from Melbourne Water’s price submission in relation to a component of the revenue requirement, the adjustments we propose are shown in rows B to E.

**Table 4.2 Our proposed adjustments to Melbourne Water’s proposed revenue requirement**  
\$ million 2025-26

	2026-27	2027-28	2028-29	2029-30	2030-31	Total
<b>A. Melbourne Water’s proposed revenue requirement</b>	<b>1,929.6</b>	<b>1,983.0</b>	<b>2,046.3</b>	<b>2,066.0</b>	<b>2,107.4</b>	<b>10,132.4</b>
B. Operating expenditure	-17.0	-18.6	-22.1	-21.2	-22.0	-78.9
C. Return on assets	-1.2	-3.9	-7.5	-11.6	-15.8	-24.2
D. Regulatory depreciation	0.0	0.0	0.0	0.0	0.0	0.1
E. Tax allowance	0.0	0.0	0.1	0.1	0.1	0.2
<b>F. Draft decision – revenue requirement (A+B+C+D+E)</b>	<b>1,911.5</b>	<b>1,960.6</b>	<b>2,016.8</b>	<b>2,033.3</b>	<b>2,069.7</b>	<b>9,991.9</b>

**Notes:** Our proposed adjustments are the differences between our draft decision and what Melbourne Water proposed in its price submission. Row A shows the total revenue requirement proposed by Melbourne Water in its price submission. We have arrived at our draft decision (row F) by proposing the relevant adjustments to the components of the revenue requirement shown in rows B to E. (Numbers have been rounded.)

Our main adjustments relate to Melbourne Water’s operating and capital expenditure, which are further explained in sections 4.1 and 4.2.

Our final decision on Melbourne Water’s revenue requirement will be based on the latest available information. Following the release of the Australian Bureau of Statistics March Quarter 2026

consumer price index, we will provide updated estimates of the cost of debt and forecast inflation. Accordingly, as well as responding to our draft decision and providing an updated price schedule, Melbourne Water must use these updated estimates when calculating the revenue requirement in response to our draft decision.

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 expenditure and the revenue requirement, Melbourne 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 expenditure, revenue requirement or prices (including demand). Any updates to its price submission or financial model will be made publicly available on our website.

#### **4.1. Operating expenditure**

Our draft decision is to adopt a forecast operating expenditure of \$5,411.0 million as the operating expenditure benchmark for the 2026–31 regulatory period. This is \$100.9 million (1.8 per cent) lower than proposed by Melbourne Water.

Operating expenditure is a component of the revenue requirement. Melbourne Water's price submission (pages 135 to 164) provides further details on its forecast operating expenditure.

We assess both:

- Controllable operating expenditure: all costs that can be directly or indirectly influenced by a water business's decisions
- Non-controllable operating expenditure: all costs that cannot be directly or indirectly influenced by a water business's decisions.

We engaged FTI Consulting to provide expert advice to inform our assessment of controllable operating expenditure. Our consultant's report is available on our website.<sup>38</sup>

Table 4.3 sets out our draft decision on Melbourne Water's forecast operating expenditure, for the purpose of establishing the revenue requirement outlined in Table 4.1.

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<sup>38</sup> FTI Consulting 2026, *Review of Melbourne Water's expenditure forecasts – 2026 Water Price Review*, February.

**Table 4.3 Draft decision operating expenditure**  
\$ million 2025-26

	2026-27	2027-28	2028-29	2029-30	2030-31	Total
<b>Controllable operating expenditure</b>	<b>528.34</b>	<b>532.32</b>	<b>539.61</b>	<b>543.74</b>	<b>543.82</b>	<b>2,687.83</b>
<b>Non-controllable operating expenditure</b>	<b>569.73</b>	<b>557.68</b>	<b>552.79</b>	<b>531.85</b>	<b>511.15</b>	<b>2,723.20</b>
Desalination Plant Security Payments	519.46	507.04	501.95	480.81	460.12	2,469.39
Environmental contribution	0.03	0.03	0.03	0.03	0.03	0.16
Licence fees – Essential Services Commission	1.47	1.64	1.64	1.64	1.64	8.04
Licence fees – Department of Health	0.28	0.28	0.28	0.28	0.28	1.38
Licence fees – Environment Protection Authority Victoria	1.45	1.45	1.45	1.45	1.45	7.23
Other	47.04	47.24	47.44	47.64	47.63	237.00
<b>Draft decision – operating expenditure</b>	<b>1,098.07</b>	<b>1,090.00</b>	<b>1,092.40</b>	<b>1,075.59</b>	<b>1,054.97</b>	<b>5,411.03</b>

**Notes:** Numbers have been rounded. Desalination Plant Security Payments are payments Melbourne Water must pay to the current operator of the Victorian Desalination Plant for the infrastructure and water security service delivered. Environmental contributions are funds collected from water businesses under the *Water Industry Act 1994*. Licence fees are paid to cover costs incurred by the Department of Health, the Environment Protection Authority Victoria, and the Essential Services Commission in their regulatory activities related to the water business.

#### 4.1.1. Our proposed adjustments to Melbourne Water’s operating expenditure

Table 4.4 summarises how our draft decision on Melbourne Water’s operating expenditure (row D) and its two components differ from the operating expenditure proposed by Melbourne Water in its price submission (row A). Rows B and C summarise our proposed adjustments to Melbourne Water’s proposed controllable and non-controllable operating expenditure.

Details of our assessment and reasons for our proposed adjustments to Melbourne Water’s proposal are included below in section 4.1.2 (controllable operating expenditure) and section 4.1.3 (non-controllable operating expenditure).

We consider the operating expenditure proposed in our draft decision reflects the expenditure that a prudent service provider would incur when acting efficiently to achieve the lowest cost in delivering the outcomes specified in Melbourne Water’s price submission.

The operating expenditure adopted in our draft decision for Melbourne Water does not represent the amount that Melbourne Water is required to spend or allocate to particular operational, maintenance and administrative activities. Rather, it is a benchmark that represents assumptions about the overall level of operating expenditure (to be recovered through prices) that we consider sufficient to operate the business efficiently and to maintain services over the regulatory period. In proposing to remove some forecast expenditure items from the benchmark, we are not proposing that Melbourne Water should not incur expenditure on these items.

**Table 4.4 Our proposed adjustments to Melbourne Water’s proposed operating expenditure**  
\$ million 2025-26

	2026-27	2027-28	2028-29	2029-30	2030-31	Total
<b>A. Melbourne Water’s proposed total operating expenditure</b>	<b>1,115.09</b>	<b>1,108.56</b>	<b>1,114.46</b>	<b>1,096.81</b>	<b>1,077.01</b>	<b>5,511.93</b>
<b>B. Our total proposed adjustments to controllable operating expenditure (B1 + B2)</b>	<b>-17.12</b>	<b>-18.83</b>	<b>-22.34</b>	<b>-21.51</b>	<b>-22.33</b>	<b>-102.14</b>
<b>B1 – Total baseline adjustments</b>	<b>-11.10</b>	<b>-11.10</b>	<b>-11.10</b>	<b>-11.10</b>	<b>-11.10</b>	<b>-55.49</b>
B1.1 Regulatory accounts alignment	-0.12	-0.12	-0.12	-0.12	-0.12	-0.60
B1.2 Labour related costs	-1.90	-1.90	-1.90	-1.90	-1.90	-9.48
B1.3 Smaller and immaterial costs	-9.08	-9.08	-9.08	-9.08	-9.08	-45.41
<b>B2 – Total step change adjustments</b>	<b>-6.03</b>	<b>-7.73</b>	<b>-11.24</b>	<b>-10.41</b>	<b>-11.23</b>	<b>-46.64</b>
B2.1 Operating expenditure from capital investment: sewerage	-0.41	-0.65	-3.14	-2.30	-3.22	-9.72
B2.2 Maintenance of developer assets	-2.15	-2.76	-2.84	-2.85	-2.90	-13.50
B2.3 Operating expenditure from capital investment: bulk water	-0.20	-0.33	-0.82	-1.04	-1.17	-3.56
B2.4 Fluoride contract	-1.78	-1.85	-1.94	-2.02	-2.10	-9.69
B2.5 Waterway manager	-1.40	-1.40	-1.45	-1.50	-1.55	-7.30
B2.6 Burndap Birrarung burndap umarkoo	-0.08	-0.74	-1.05	-0.71	-0.29	-2.87

Continued next page

**Table 4.4 (continued)**

	2026-27	2027-28	2028-29	2029-30	2030-31	Total
<b>C. Our total proposed adjustments to non-controllable operating expenditure (C1)</b>	<b>0.10</b>	<b>0.28</b>	<b>0.28</b>	<b>0.29</b>	<b>0.29</b>	<b>1.24</b>
C1 Desalination Plant Security Payments – Cost schedule update	-0.19	-0.19	-0.18	-0.18	-0.18	-0.92
C2 Updated licence fees – Essential Services Commission	0.30	0.47	0.47	0.47	0.47	2.16
<b>D. Draft decision – total operating expenditure (D = A + B + C)</b>	<b>1,098.07</b>	<b>1,090.00</b>	<b>1,092.40</b>	<b>1,075.59</b>	<b>1,054.97</b>	<b>5,411.03</b>

**Notes:** Our proposed adjustments are the differences between our draft decision and what Melbourne Water proposed in its price submission. Row A shows the total operating expenditure proposed by Melbourne Water in its price submission. We have arrived at our draft decision (row D) by proposing the relevant adjustments to controllable operating expenditure and non-controllable operating expenditure shown in rows B and C (and itemised in rows B1.1 to B2.6 and rows C1 and C2). (Numbers have been rounded.)

#### 4.1.2. Controllable operating expenditure

Our draft decision is to adopt a forecast controllable operating expenditure of \$2,687.8 million for the 2026–31 regulatory period, which is \$102.1 million lower than proposed by Melbourne Water.

Melbourne Water proposed a total forecast controllable operating expenditure of \$2,790.0 million over a 5-year regulatory period. Our draft decision is to adopt a forecast controllable operating expenditure of \$2,687.8 million for the reasons set out below.

Melbourne Water’s forecast controllable operating expenditure for the period from 1 July 2026 is estimated through a series of steps:

- Establish a controllable operating expenditure baseline – the baseline comprises the efficient recurring costs from the last full year of data (2024-25) after non-controllable expenditure and one-off (non-recurring) items are removed or normally occurring items are added in.
- Apply a growth rate for operating expenditure for the regulatory period – assumed by Melbourne Water to be 2.0 per cent per year on average.
- Apply an annual cost efficiency improvement rate – proposed by Melbourne Water to be 2.0 per cent per year on average.
- Make adjustments for additional costs or cost savings expected in future years.

## Baseline controllable operating expenditure

Following Melbourne Water's lodgement of its price submission, we identified a discrepancy between its price submission and the total prescribed operating expenditure in its 2024-25 regulatory accounts. We revised Melbourne Water's financial model to align with its regulatory accounts. This lowered its operating expenditure baseline by \$0.12 million compared to its price submission. Based on these revised figures, Melbourne Water's controllable operating expenditure baseline of \$518.8 million, after removing \$36.5 million in non-recurring operating expenditure that occurred in 2024-25, is \$51.4 million (or 11 per cent) higher than the benchmark figure of \$467.4 million.

### *Melbourne Water's proposed baseline expenditure increase reflects higher costs across the business*

Melbourne Water explained the recurring variations to the baseline year benchmark were driven by:<sup>39</sup>

- Labour related costs, including superannuation guarantee changes (\$9.6 million)
- Land development (\$9.3 million)
- Information Technology transition costs and licence fees (\$8.7 million)
- Cyber security obligations (\$5.4 million)
- Increased chemical costs – Water (\$4.5 million)
- Mental health care levy costs (\$3.2 million)
- Increased maintenance – Water (\$1.6 million)
- Insurance (\$1.1 million)
- Natural wetlands management program (-\$1.3 million)
- 'Smaller and immaterial' items (\$9.1 million)

Our expenditure consultant verified \$40.4 million of the of the proposed \$51.4 million increase in Melbourne Water's baseline expenditure as recurrent, prudent and efficient. However, it considered \$11.0 million of additional operating expenditure relating to 'smaller or immaterial' items or labour related costs was not prudent and efficient. Melbourne Water's explanation of these items and our consultant's recommendations are summarised in Table 4.5.<sup>40</sup>

We have considered Melbourne Water's price submission and our expenditure consultant's report and our preliminary view is that we accept \$40.4 million of Melbourne Water's proposed

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<sup>39</sup> Melbourne Water 2025, *2026 price submission*, September, pp. 145–148.

<sup>40</sup> FTI Consulting 2026, *Review of Melbourne Water's expenditure forecasts – 2026 Water Price Review*, February, pp. 34–38.

\$51.4 million increase in baseline expenditure as it represents recurrent, prudent and efficient expenditure.

While Melbourne Water may consider its proposed additional ‘smaller or immaterial items’ to be small or immaterial, collectively these items represent \$9.1 million (17.7 per cent) of its proposed baseline increase. If accepted in its baseline for the next regulatory period, this would provide Melbourne Water an additional \$45.4 million in operating expenditure over the 5-year period. We view this as a material amount requiring robust justification for inclusion in ongoing expenditure benchmarks.

**Table 4.5** Our consultant’s recommended reductions to Melbourne Water’s proposed baseline expenditure

Cost item	Melbourne Water’s explanation	Our consultant’s recommended reduction and reasons for the reduction
‘Smaller or immaterial’ cost items (\$9.1 million)	<ul style="list-style-type: none"> <li>Uplift in corporate capability among other things.</li> </ul>	<ul style="list-style-type: none"> <li>Remove all \$9.1 million of ‘smaller or immaterial’ cost items. Melbourne Water has not clarified what additional activities the business has been required to undertake, and why these activities are recurrent. There is insufficient evidence that these items represent efficient, recurrent operating expenditure.</li> </ul>
Labour related costs (\$9.6 million)	<ul style="list-style-type: none"> <li>Increased costs (\$4.6 million) associated with a lower vacancy rate (4.1 per cent) compared to the benchmark vacancy rate (12 per cent).</li> <li>Increase in Superannuation Guarantee Contribution (\$4.1 million)</li> <li>Unexplained increase in labour costs (\$0.9 million).</li> </ul>	<ul style="list-style-type: none"> <li>Reduce the amount associated with a lower vacancy rate by \$0.4 million, to reflect the business’s average vacancy rate of 6.8 per cent between 2018 and 2022. Reduce the proposed amount by a further \$0.6 million to remove double-counting of some labour already captured under the additional ‘Land development’ costs item.</li> <li>Make no reductions to the proposed \$4.1 million for increased Superannuation Guarantee Contributions as these are mandatory and should be included in the baseline as a recurrent obligation.</li> <li>Remove \$0.9 million of unexplained labour costs as these have not been demonstrated to be prudent and efficient.</li> </ul>

**Notes:** Melbourne Water’s relatively high vacancy rate of 12 per cent partly reflected vacancies within the Urban Planning and Development business unit. Some of these roles, which have now been filled, have already been captured in Melbourne Water’s proposed additional baseline expenditure item ‘Land development’.

### *Our draft decision on baseline expenditure*

We reviewed Melbourne Water's proposal and the advice from our expenditure consultant. Our draft decision is to adopt a baseline operating expenditure of \$507.8 million after removing \$11.1 million from Melbourne Water's proposed operating expenditure as follows:

- \$0.1 million to align the business's price submission with its regulatory accounts
- \$11.0 million where additional costs have not been adequately justified by the business, comprising:
  - \$9.1 million of 'small and immaterial' cost items
  - \$1.9 million of labour related costs.

We consider that \$507.8 million reflects an efficient recurring baseline to forecast annual operating expenditure for the purpose of our draft decision. This baseline adjustment results in an overall reduction of \$55.5 million to Melbourne Water's total controllable operating expenditure forecast across the 2026–31 regulatory period.

### **Efficiency improvement and growth rate**

Melbourne Water proposed an annual growth rate of 2.0 per cent to its controllable operating expenditure baseline covering both its water and sewerage services and its waterways and drainage services. After adjusting Melbourne Water's baseline year expenditure to align with our draft decision, this expenditure growth rate would effectively provide Melbourne Water with an additional \$156.7 million in controllable operating expenditure over the next regulatory period.

This expenditure growth rate is the same as its forecast of residential customer connections growth through the metropolitan retail water businesses.<sup>41</sup>

In proposing this level of expenditure growth, Melbourne Water stated its annual rate of expenditure growth has been above annual customer connections growth between 2019-20 and 2024-25.

Melbourne Water also proposed an average efficiency improvement rate on its controllable operating expenditure of 2.0 per cent per year, matching its proposed expenditure growth rate and effectively committing to offset all cost increases covered by the growth allowance.<sup>42</sup> This is a significant increase on the 1.2 per cent per year efficiency improvement rate applied during Melbourne Water's current regulatory period. Melbourne Water has developed a cost efficiency plan to drive and achieve efficiencies in the next regulatory period.

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<sup>41</sup> Melbourne Water 2025, *2026 price submission*, September, pp. 149–151.

<sup>42</sup> Melbourne Water 2025, *2026 price submission*, September, pp. 151–152.

The financial model we provided Melbourne Water allowed it to propose different growth and efficiency rates for each of its water and sewerage and waterways and drainage operating expenditure forecasts. We note Melbourne Water has proposed the same growth and efficiency rates of 2.0 per cent for both areas of its expenditure.

Our consultant considered Melbourne Water's proposed growth rate is likely overstated as:<sup>43</sup>

- other Victorian water businesses have previously proposed increases in operating costs at rates lower than their forecast increase in customer connections
- a large portion of Melbourne Water's costs are fixed, and not all costs are likely to increase at the same rate as customer connections.

Our consultant also found that while Melbourne Water provided evidence that its operating expenditure growth exceeded growth in customer connections during the current period, it did not provide evidence supporting the relationship.

Our consultant considered Melbourne Water's proposed efficiency rate to be ambitious (which is to be encouraged under PREMO) but noted this high rate was:

- proposed alongside a material increase in baseline year expenditure
- inconsistent with the business's proposal to add 19 cost items (totalling \$205.7 million) to its baseline forecast.

As many of these proposed additional costs are minor in comparison to Melbourne Water's proposed operating expenditure benchmarks, our consultant recommended their removal on the basis such costs would be absorbed by a business proposing an ambitious efficiency rate.<sup>44</sup>

#### *Our draft decision on growth and efficiency rates*

The proposed growth and efficiency rates of 2.0 per cent are relatively high. A 2.0 per cent efficiency improvement rate is the second highest of the rates proposed by the 18 Victorian water businesses across the 2023, 2024 and 2026 price reviews.<sup>45</sup>

However, Given Melbourne Water's proposal to effectively absorb growth costs by matching the efficiency rate to its growth rate, we consider this net effect represents good value to customers.

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<sup>43</sup> FTI Consulting 2026, *Review of Melbourne Water's expenditure forecasts – 2026 Water Price Review*, February, pp. 97–98.

<sup>44</sup> FTI Consulting 2026, *Review of Melbourne Water's expenditure forecasts – 2026 Water Price Review*, February, pp. 39–40.

<sup>45</sup> FTI Consulting 2026, *Review of Melbourne Water's expenditure forecasts – 2026 Water Price Review*, February, p. 98.

On this basis, our draft decision is to accept the growth and efficiency rates proposed by Melbourne Water.

### **Cost adjustments**

Melbourne Water proposed \$200.6 million (an average of \$40.1 million per year) in additional operating expenditure above the growth-adjusted annual baseline forecast over the regulatory period. This comprised 22 items:

- Electricity (\$41.5 million)
- Information Technology (\$33.1 million)
- Operating expenditure from capital investment: sewerage (\$29.0 million)
- Operational Technology (\$15.0 million)
- Maintenance of developer assets (\$13.5 million)
- Carbon offsets (\$13.3 million)
- Operating expenditure from capital investment: bulk water (\$9.9 million)
- Fluoride contract costs (\$9.7 million)
- Waterway manager responsibilities (\$7.3 million)
- Floodplain manager responsibilities (\$7.3 million)
- Hardship program (\$6.9 million)
- Traditional Owner partners (\$6.8 million)
- Tarago reservoir recreational access (\$4.8 million)
- Burndap Birrarung burndap umarkoo (formerly Yarra Strategic plan) (\$2.9 million)
- Operating expenditure from capital investment: waterways and drainage (\$1.8 million)
- Ramsar wetland coordinator (\$1.8 million)
- Koo Wee Rup floodplain manager costs (\$0.6 million)
- Quiet Lakes pumping costs (\$0.3 million)
- Diversion maintenance (\$0.3 million)
- Patterson Lakes jetties maintenance (-\$0.1 million)
- Operating expenditure from capital investment: pump renewal (-\$0.2 million)
- Forecast insurance costs (-\$4.8 million)

*We assessed the additional cost items against the criteria in our guidance*

In proposing additional operating expenditure above the growth-adjusted annual baseline forecast, our guidance states Melbourne Water's price submission must demonstrate:<sup>46</sup>

- why any proposed cost increases are not covered within the growth allowance, or by inflation, or absorbed with the stated net efficiency improvement rate
- how proposed cost changes relate to the proposed customer outcomes and the associated outputs and deliverables
- that proposed costs associated with new or revised regulatory obligations and policy requirements are prudent and efficient.

*Our consultant also reviewed the proposed additional cost items*

Our consultant reviewed each of Melbourne Water's proposed variations above the baseline, assessing whether step changes (the additional cost items) were prudent, efficient and consistent with our guidance.<sup>47</sup>

Based on its assessment, our consultant considered that most of Melbourne Water's proposed additions were prudent and efficient. However, it recommended removing \$49.9 million from Melbourne Water's proposed forecast. In particular, our consultant recommended removing cost increases that:

- are driven by growth, which it considered are already covered by the growth allowance claimed by Melbourne Water
- do not meet any key criteria that would justify a step change cost addition above the baseline and growth rate allowances
- are below a materiality threshold of 0.5 per cent of total controllable operating expenditure, which it considered were not consistent with the high efficiency improvement rate proposed by the business.<sup>48</sup>

Our consultant focused its assessment on material step change increases of more than 0.5 per cent of baseline controllable operating expenditure over the 2026–31 regulatory period. It considered this a reasonable threshold, as step changes below this amount should be able to be absorbed or mitigated by a prudent business operating efficiently from within its benchmark

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<sup>46</sup> Essential Services Commission, *2026 Melbourne Water price review: Guidance paper*, 19 November 2024, pp. 35–36.

<sup>47</sup> FTI Consulting 2026, *Review of Melbourne Water's expenditure forecasts – 2026 Water Price Review*, February, pp. 39–95.

<sup>48</sup> FTI Consulting 2026, *Review of Melbourne Water's expenditure forecasts – 2026 Water Price Review*, February, p. 39.

allowance, which includes the proposed growth rate. For Melbourne Water, this materiality threshold equates to \$4.55 million across the regulatory period for each proposed step change for waterways and drainage expenditure and \$8.42 million across the regulatory period for water and sewerage expenditure.

Our consultant's recommended adjustments and its reasons are summarised in Table 4.6.<sup>49</sup>

**Table 4.6 Our consultant's recommended adjustments to Melbourne Water's proposed additional cost items**

Proposed additional cost item	Our consultant's recommended reduction	Our consultant's reasons for the reduction
Operating expenditure from capital investment: sewerage \$29.0 million	\$9.7 million	This amount is attributable to growth and should be covered within the 2 per cent growth rate.
Maintenance of developer assets \$13.5 million	\$13.5 million	There is no evidence of a change in obligations in relation to these assets. Any increase in costs should be covered within the 2 per cent growth rate.
Operating expenditure from capital investment: bulk water \$9.9 million	\$3.6 million	This amount is attributable to growth and should be covered within the 2 per cent growth rate.
Fluoride contract costs \$9.7 million	\$9.7 million	\$2.9 million of the proposed \$9.7 million increase is attributable to growth and should be covered within the 2 per cent growth rate. The remainder then falls below the materiality threshold and should be removed on this basis.
Waterway manager responsibilities \$7.3 million	\$7.3 million	While noting customer support for the expansion of this grant program, Melbourne Water did not provide sufficient evidence to demonstrate it could not be funded through its annual growth allowance (\$56 million across 2026–31) on top of the funding already included in its baseline year. There is no evidence that this is a new or changed obligation.

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<sup>49</sup> FTI Consulting's full analysis and reasoning behind its proposed adjustments is available in its report. FTI Consulting 2026, *Review of Melbourne Water's expenditure forecasts – 2026 Water Price Review*, February.

**Table 4.6 (continued)**

Proposed additional cost item	Our consultant's recommended reduction	Our consultant's reasons for the reduction
Floodplain manager responsibilities \$7.3 million	\$3.3 million	Melbourne Water only provided sufficient information to support \$4 million (related to flood awareness and flood co-delivery and capacity building initiatives) of the proposed \$7.3 million. The prudence and efficiency of the remaining \$3.3 million (flood investigations research) was not sufficiently demonstrated.
Burndap Birrarung burndap umarkoo (formerly Yarra Strategic plan) \$2.9 million	\$2.9 million	Melbourne Water currently receives external funding to support this work and did not provide evidence to support its claim that this funding was ending on 1 July 2026. Melbourne Water has assumed some responsibility for this role currently and costs are already reflected in the baseline allowance.

*We seek further information from Melbourne Water on its electricity cost forecasts in response to our draft decision*

Melbourne Water proposed \$41.5 million in additional costs relating to forecast increases in electricity costs above the benchmark electricity costs included in its baseline year. This cost forecast reflects:

- wholesale electricity prices based on State Electricity Commission contract prices up to 2028
- forecast wholesale prices based on expert advice from 2028 to 2031
- forecast network costs based on indicative prices provided by the Australian Energy Regulator
- a forecast cost of purchasing Victorian Energy Efficiency Certificates
- a forecast cost of renewable energy certificates.<sup>50</sup>

Melbourne Water's electricity forecast is partially offset by revenue generated by its renewable electricity generation assets.

Our expenditure consultant reviewed Melbourne Water's approach to forecasting each of these costs, and considered the proposal was prudent and efficient given:

- it reflects increasing obligations
- the assumptions and methodologies applied are clearly explained and substantiated
- it utilises independent, expert advice to inform its wholesale price forecast.

<sup>50</sup> Melbourne Water has obligations or requirements to meet emission reduction or renewable electricity usage targets throughout the regulatory period.

However, our consultant also noted the information relied upon by Melbourne Water to prepare its price submission may no longer reflect efficient forecasts, given the price submission was submitted in September 2025.<sup>51</sup>

For our draft decision, we have not proposed any change to Melbourne Water's forecast electricity step change, noting our consultant's view and Melbourne Water's use of expert analysis and advice. However, since Melbourne Water prepared its price submission, several factors influencing Melbourne Water's forecast have shifted which would suggest lower electricity cost forecasts may be more appropriate, including:

- the Australian Energy Regulator has progressed its review of Victorian network distributors' pricing proposals and is now considering revised price proposals from distributors
- the spot prices of renewable energy certificates (such as Large-Scale Generation Certificates) and Victorian Energy Efficiency Certificates have fallen significantly.<sup>52</sup>

Given this, in response to our draft decision, Melbourne Water must revisit its forecast electricity costs and its step change proposal to ensure the forecast cost components are prudent, efficient and represent best value for customers. At a minimum, we anticipate this will involve reassessing the price inputs used to calculate its network costs and renewable electricity certificate costs, and considering whether its wholesale electricity forecast for 2028 to 2031 should be refreshed.

We will consider Melbourne Water's response when making our final decision on cost adjustments.

#### *Our draft decision on cost adjustments*

We have considered the advice from our expenditure consultant and Melbourne Water's proposal. We consider that proposed increases already funded through the business's proposed 2 per cent annual expenditure growth rate should be removed.

We also consider that it is appropriate to remove proposed increases that have not been clearly justified by Melbourne Water as costs related to new obligations not already in the baseline allowance. However, in relation to the additional \$3.3 million proposed under floodplain manager costs for further flood investigation research, Melbourne Water has indicated these costs relate to additional specialist flood modelling resources (both internal and external). We acknowledge the increased expectations for additional flood modelling by Melbourne Water, particularly following the reviews conducted into the 2022 flood of the Maribyrnong River. We have retained this additional funding in our draft decision benchmark. We request Melbourne Water provide more detail to confirm that this is a new cost not already included in its baseline allowance, and not covered by

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<sup>51</sup> FTI Consulting 2026, *Review of Melbourne Water's expenditure forecasts – 2026 Water Price Review*, February, pp. 48–49.

<sup>52</sup> <https://www.demandmanager.com.au/certificate-prices/>, accessed Friday 6 March 2026.

the waterways and drainage growth allowance of 2.0 per cent per year (which provides an additional \$56 million over the period).

We consider it is inconsistent for Melbourne Water to propose 19 additional cost step increases above its growth-adjusted baseline allowance, some of them relatively minor, while also proposing a high efficiency improvement rate.

Having already proposed to adopt a higher baseline allowance than the benchmark established at its 2021 price review, and with its relatively high growth allowance, our preliminary view is that there is limited justification for Melbourne Water to ask customers to fund numerous additions while committing to deliver large efficiency gains. This approach raises questions about the extent to which the proposed efficiency improvements are reflected in the overall cost profile.

On this basis, our draft decision is to:

- remove \$29.6 million of proposed increases that are already funded through the growth allowance derived from the 2.0 per cent annual expenditure growth rate
- remove \$10.2 million of proposed increases that have not been clearly justified by Melbourne Water as being costs related to new obligations that are not already in the baseline allowance, except for the \$3.3 million Melbourne Water proposed for the flood investigations research work
- remove \$6.8 million of additional expenditure for items below a materiality threshold of 0.5 per cent of total controllable operating expenditure.

By proposing to remove the expenditure items below the materiality threshold, we are not saying that Melbourne Water should not incur expenditure on these items. We are saying that the business should be able to fund them from its higher baseline expenditure allowance without the need for additional expenditure adjustments.

Accordingly, our draft decision is to remove a total of \$46.6 million from Melbourne Water's proposed \$200.6 million in additional operating expenditure above the growth-adjusted baseline (see Table 4.4).

In its response to our draft decision, Melbourne Water must:

- revisit its forecast electricity costs and update its proposal if necessary
- provide stronger justification for why its proposed \$3.3 million of floodplain manager costs cannot be funded through its baseline allowance.

We will consider this information when making our final decision on cost adjustments.

## Submissions

The Water Services Association of Australia made a submission noting Melbourne Water's controllable operating costs are increasing, which is to be expected in a growing industry.<sup>53</sup> We note that our draft decision accepts the majority of Melbourne Water's proposed operating costs, including the majority of its substantial increase in baseline year costs and step change proposals. Its proposed growth rate of 2.0 per cent per year, which we propose to accept, is intended to fund the growth costs associated with the business.

### Our draft decision on controllable operating expenditure

Our preliminary view is that Melbourne Water's approach to forecasting its controllable operating expenditure is generally consistent with the requirements of our guidance. We are satisfied that the majority of its proposed forecast represents efficient controllable operating expenditure, after removing \$55.5 million in proposed baseline expenditure and \$46.6 million in proposed step change adjustments.

Our draft decision is to adopt \$2,687.8 million as Melbourne Water's controllable operating expenditure benchmark for the 2026–31 regulatory period. This is \$102.1 million lower than Melbourne Water's proposed expenditure forecast.

#### 4.1.3. Non-controllable operating expenditure

Our process for establishing non-controllable operating expenditure involves:

- Obtaining the most recent information from the relevant regulatory authorities on their licence fees, the Desalination Plant Security Payment cost schedule, and the environmental contribution.
- Adjusting the forecasts proposed by Melbourne Water where required.

Table 4.3 shows the values we have adopted for our draft decision.

Melbourne Water proposed \$2,722.0 million (an average of \$544.4 million per year) in non-controllable operating expenditure over the 2026–31 regulatory period. This is a decrease of \$573.2 million (17.4 per cent) compared to the 2021–26 regulatory period (\$3,295.2 million). This decrease reflects Melbourne Water's proposal to increase the portion of its Desalination Plant Security Payment it capitalises each year, with a corresponding decrease in its operating expenditure forecast each year. (See Table 4.8 in section 4.2.2 below.)

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<sup>53</sup> Water Services Association of Australia, *Water in transition: WSAA submission to Essential Services Commission on Melbourne Water's price review*, 11 December 2025.

Our guidance sets out our approach for businesses to forecast their non-controllable operating expenditure. We consider businesses should forecast licence fees for the Department of Health, the Environment Protection Authority Victoria and the Essential Services Commission to remain flat in real terms (where scheduled charges are not available). The environmental contribution should also remain flat in nominal terms (decline in real terms) across the 2026–31 regulatory period.<sup>54</sup> Melbourne Water followed this approach in its price submission.

### **We propose minor changes to Melbourne Water’s forecast Desalination Plant Security Payments and licence fees**

Since 2012-13, Melbourne Water has been required to make payments to the current operator of the Victorian Desalination Plant for the infrastructure and water security service delivered. These ‘security payments’ will continue over a lease period of 27 years until 2039-40, at which time Melbourne Water will acquire ownership of the plant for the remainder of its life. These security payments reflect the cost of financing and maintaining the desalination plant and related infrastructure. At each price review, we assess how Melbourne Water proposes to allocate these payments across both its operating expenditure and capital expenditure forecasts.

We verify Melbourne Water’s forecast Desalination Plant Security Payments against the desalination plant cost schedule provided to Melbourne Water by the Department of Energy, Environment and Climate Action. After Melbourne Water submitted its price submission, the department released an updated schedule of payments.

We have updated Melbourne Water’s forecast Desalination Plant Security Payments to reflect the updated schedule. This has resulted in a reduction of \$0.9 million to Melbourne Water’s proposed forecast non-controllable operating expenditure over the 2026–31 regulatory period.

We have also updated Melbourne Water’s Essential Services Commission licence fees to reflect the current schedule of licence fees (which are in nominal dollars) and deflated them into 2025-26 dollars to express them in real terms.<sup>55</sup> This has resulted in an increase of \$2.2 million to Melbourne Water’s non-controllable operating expenditure.

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<sup>54</sup> The environmental contribution is set as a flat nominal value in 4-year tranches. The nominal value must be deflated by our forecast inflation to produce a real value, which is then subject to the annual inflation adjustments.

<sup>55</sup> The licence fee schedule for 2023-24 to 2027-28 for each relevant Victorian water business was published in the Victorian Government Gazette No. G 39 on Thursday 28 September 2023 in nominal terms. We have adopted the scheduled licence fees for 2026-27 and 2027-28, deflated from nominal to real values. We have then held the annual value for 2027-28 constant in real terms across the last 3 years of Melbourne Water’s regulatory period.

## Our draft decision on non-controllable operating expenditure

Our draft decision is to adopt a total of \$2,723.2 million in non-controllable operating expenditure over the 5-year regulatory period, which is \$1.2 million higher than proposed by Melbourne Water in its price submission.

Prior to making our final decision, we will update the forecast licence fee and environmental contribution values with the relevant regulatory bodies and adjust where necessary for the latest inflation data.<sup>56</sup>

## 4.2. Capital expenditure

Our draft decision is to adopt a forecast capital expenditure of \$7,300.1 million as the capital expenditure benchmark (including \$621.1 million for capitalised Desalination Security Plant Payments) for the 2026–31 regulatory period.

Capital expenditure is an input to estimating the regulatory asset base, which is an input to the revenue requirement. Melbourne Water's forecast capital expenditure and supporting information is provided on pages 101 to 134 of its price submission.

Figure 4.1 shows Melbourne Water's actual gross capital expenditure for 2020-21 and the first 4 years (2021-22 to 2024-25) of the current regulatory period, and forecast gross capital expenditure from 2025-26 to 2030-31. The first 5 years of actual expenditure shown in Figure 4.1 (2020-21 to 2024-25) totalling \$4,466.4 million is relevant to the calculation of the closing regulatory asset base discussed in section 4.3.1.

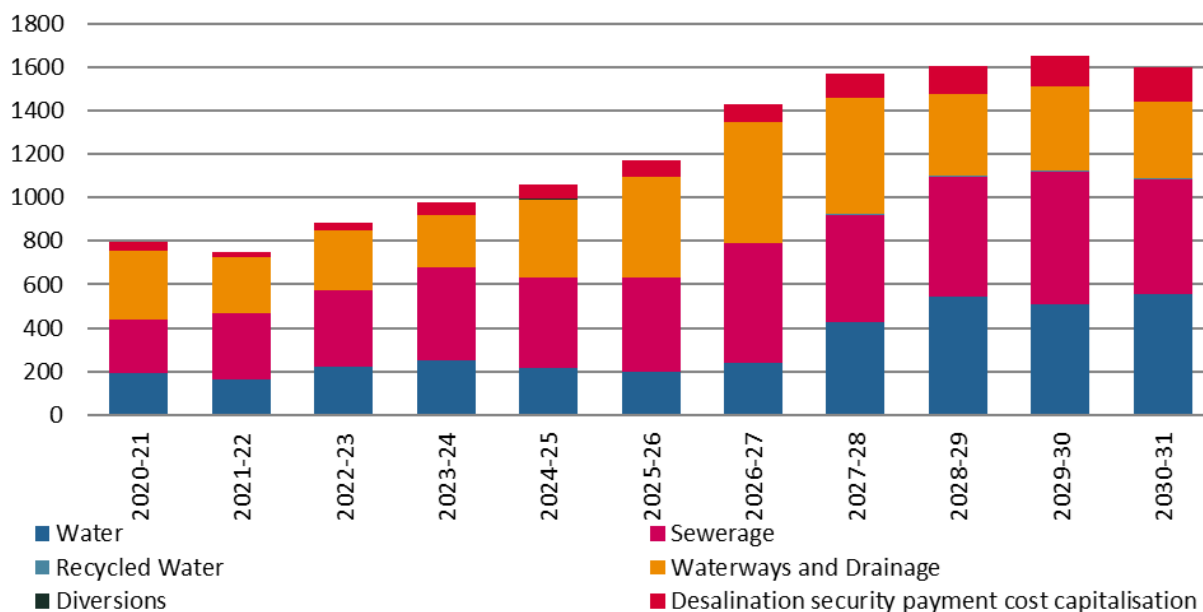
In assessing Melbourne Water's capital expenditure forecasts we consider the prudence and efficiency of expenditure consistent with the requirements set out in our guidance. We engaged FTI Consulting to provide expert advice to inform our assessment of capital expenditure and its report is available on our website.<sup>57</sup>

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<sup>56</sup> The Department of Energy, Environment and Climate Action published the environmental contribution values to apply to each water business for a 4-year period from 1 July 2024 to 30 June 2028. Our final decision will include the latest values for Melbourne Water, holding the 2027-28 value as the forecast value from 2028 to 2031.

<sup>57</sup> FTI Consulting 2026, *Review of Melbourne Water's expenditure forecasts – 2026 Water Price Review*, February.

**Figure 4.1 Gross capital expenditure by service category**  
\$ million 2025-26



**Note:** This graph shows actual figures for 2020-21 to 2024-25, and Melbourne Water’s forecasts for 2025-26 to 2030-31. Expenditure figures for recycled water and diversion categories are very small relative to the other categories, comprising 0.3 per cent (or less) of the total annual capital expenditure.

#### 4.2.1. Actual capital expenditure

The PREMO framework involves reviewing a business’s actual performance over the current regulatory period against the proposals and commitments it made to its customers in its previous price submission. This includes a comparison of its actual capital expenditure against the expenditure benchmarks we approved for the current regulatory period.

#### Melbourne Water has exceeded its capital expenditure benchmark

Based on its latest forecast for 2025-26 expenditure, Melbourne Water will incur \$4,839.7 million in actual gross capital expenditure over the 5 year regulatory period from 2021-22 to 2025-26. This is \$463.1 million (or 10.6 per cent) above the \$4,376.6 million benchmark we set in its 2021 price review. In net terms (meaning once any contributions or asset disposals are accounted for), Melbourne Water has exceeded the benchmark used to approve maximum prices in the current regulatory period by \$35.1 million, or 1.0 per cent.

We note that in our final decision for Melbourne Water’s 2021 price review, we made a notional adjustment of \$250 million (or \$301.7 million in 2025-26 dollars) to Melbourne Water’s capital

expenditure benchmark for 2021–26.<sup>58</sup> We made this reduction to move more of the uncertainty risk associated with delivery of its growth-driven capital program back to the business, rather than its customers. Without this reduction, Melbourne Water’s actual capital expenditure would have exceeded its gross capital expenditure benchmark for the current regulatory period by only \$161.4 million (or 3.7 per cent).

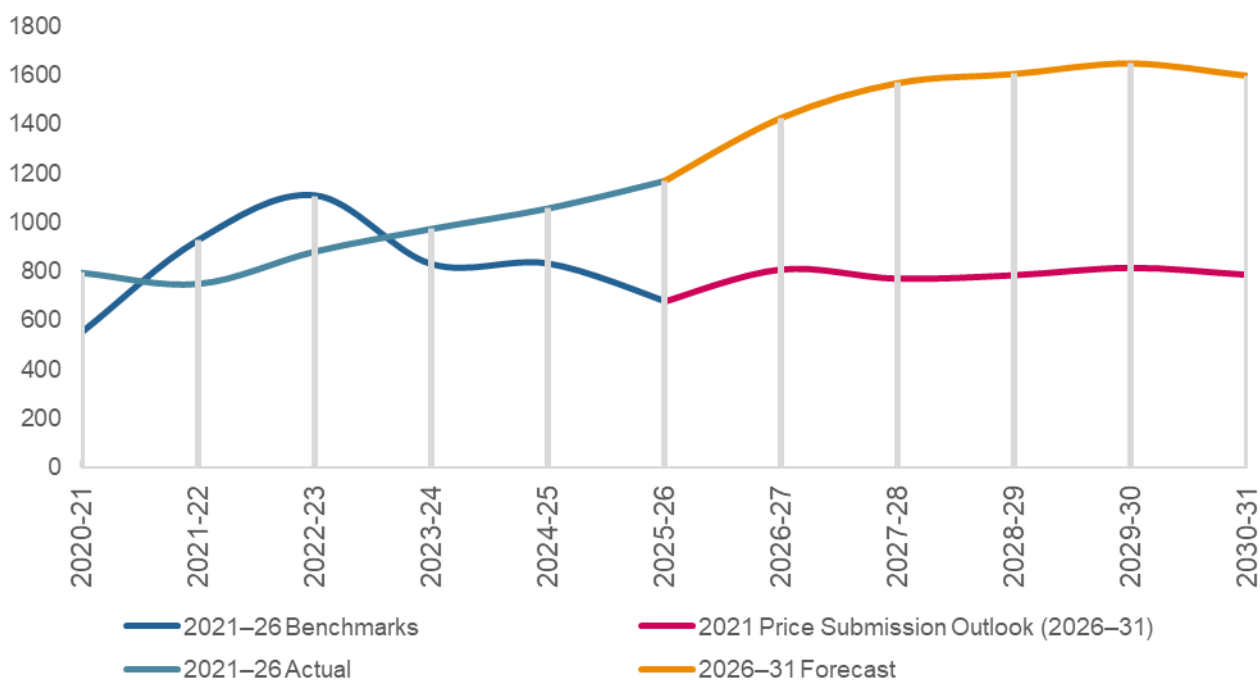
We also note the trend in Melbourne Water’s actual capital delivery which shows annual gross expenditure below the benchmarks in the first 2 years of the current regulatory period, before rising above the annual benchmarks in the last 3 years. Figure 4.2 shows:

- the capital expenditure benchmarks for the current regulatory period (2021–26) that we set in Melbourne Water’s 2021 price review
- Melbourne Water’s actual capital expenditure delivered in the current regulatory period (2021–26), based on the most recent forecast for 2025-26
- Melbourne Water’s forecasts for the 2026–31 regulatory period, which it submitted in 2020 as part of its 2021 price review
- Melbourne Water’s proposed capital expenditure forecasts for the 2026–31 regulatory period, which it submitted as part of the current price review.

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<sup>58</sup> Essential Services Commission 2021, *Melbourne Water Final Decision: 2021 water price review*, 16 June, pp. 36–37.

**Figure 4.2 Gross capital expenditure – Benchmark, actual and forecast**  
\$ million 2025-26



**Note:** Includes Desalination Plant Security Payment capitalisation and developer led waterways and drainage expenditure.

### There has been variation in the capital projects Melbourne Water delivered

Melbourne Water recorded significant variances in delivering the top 19 major capital projects it reported on throughout the current regulatory period. Of these 19 projects, 5 have been completed, 2 are on schedule and 12 have been delayed, deferred, or cancelled.<sup>59</sup> Melbourne Water had initially included 4 projects to be delivered by developers on its behalf that have been delayed outside of its control.<sup>60</sup> After discussions with us, Melbourne Water added 4 different projects within its control to its major projects reporting schedule.

Of the 15 projects within Melbourne Water’s control, 4 have been completed, 2 are on schedule and 7 are progressing but delayed, 1 project has been deferred, and 1 cancelled at the request of the customer.

<sup>59</sup> Melbourne Water 2025, 2026 price submission, September, pp. 252–262.

<sup>60</sup> Of the 4 developer-led projects, 1 has been completed, 2 are delayed, and 1 has been cancelled and replaced by an alternate option.

In its price submission, Melbourne Water explained the delays to its major projects and the reasons for its increased expenditure relative to the benchmark set for the current regulatory period:<sup>61</sup>

- unanticipated planning and land-acquisition approval delays
- delivery dependencies and shared accountabilities across multiple delivery partners
- post-COVID-19 constraints in the early years of the regulatory period, including restricted onsite activities, limited contractor availability, cost escalations and bundling of projects to optimise contracting and delivery.

### **Melbourne Water explained its increase in capital expenditure**

Our expenditure consultant reviewed the capital expenditure delivered in the current regulatory period and the reasoning for variances put forward by Melbourne Water. Our consultant found that the increased level of expenditure compared to the benchmark was reasonable and that Melbourne Water was able to satisfactorily explain the cost variances of its major projects. Based on the information provided by Melbourne Water, our consultant considered the actual capital expenditure incurred from 2020-21 to 2024-25 has been prudent and efficient. Our consultant also noted that while Melbourne Water's capital expenditure was above benchmark and major project delivery varied from original timelines, it had still delivered on key outcomes over the regulatory period. FTI Consulting's findings are set out in its report.<sup>62</sup>

We have considered Melbourne Water's price submission and our expenditure consultant's report. Our preliminary view is to accept the \$4,466.4 million in actual gross capital expenditure Melbourne Water incurred from 2020-21 to 2024-25 as appropriate for the purpose of calculating its closing regulatory asset base at 30 June 2025 (see section 4.3.1).

#### **4.2.2. Forecast capital expenditure**

We have reviewed Melbourne Water's proposed forecast capital expenditure and our consultant's findings. Our draft decision is to adopt a forecast capital expenditure of \$7,300.1 million as the benchmark for the 2026–31 regulatory period. This is \$555.9 million (or 7.1 per cent) lower than that proposed by Melbourne Water (Table 4.7).

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<sup>61</sup> Melbourne Water 2025, *2026 price submission*, September, pp. 30–31.

<sup>62</sup> FTI Consulting 2026, *Review of Melbourne Water's expenditure forecasts – 2026 Water Price Review*, February, p. 106.

**Table 4.7 Our proposed adjustments to Melbourne Water’s proposed total forecast capital expenditure**

\$ million 2025-26

	2026-27	2027-28	2028-29	2029-30	2030-31	Total
<b>A. Melbourne Water’s proposed total forecast capital expenditure</b>	<b>1,427.87</b>	<b>1,570.16</b>	<b>1,607.42</b>	<b>1,650.55</b>	<b>1,600.09</b>	<b>7,856.08</b>
<b>B. Our total proposed adjustments to forecast capital expenditure (B1 + B2)</b>	<b>-84.44</b>	<b>-105.56</b>	<b>-130.16</b>	<b>-125.58</b>	<b>-110.21</b>	<b>-555.94</b>
B1 Water and Sewerage Priority 3 Projects	-10.97	-20.18	-27.39	-18.72	-5.40	-82.66
B2 Water and Sewerage Programs deliverability	-73.47	-85.38	-102.77	-106.86	-104.81	-473.28
<b>C. Draft decision – total forecast capital expenditure (A + B)</b>	<b>1,343.42</b>	<b>1,464.61</b>	<b>1,477.26</b>	<b>1,524.97</b>	<b>1,489.88</b>	<b>7,300.14</b>

**Note:** Numbers have been rounded.

Melbourne Water proposed a total of \$7,856.1 million in capital expenditure over the 2026–31 regulatory period. This is an increase of \$3,016.4 million (or 62 per cent) compared to the capital expenditure Melbourne Water will incur over the 2021–26 regulatory period (\$4,839.7 million, based on the latest forecast for 2025-26).

Melbourne Water’s forecast includes \$621.1 million of capitalised Desalination Plant Security Payments over the 5-year period. (See ‘Capitalisation of Desalination Plant Security Payments’ section below). Excluding capitalised Desalination Plant Security Payment amounts, Melbourne Water’s forecast capital expenditure of \$7,235.0 million represents a 58 per cent increase compared to the 2021–26 regulatory period.

We also note that Melbourne Water’s proposed forecast represents a doubling in annual capital spending compared to the first 2 years of the current period, as is evident in Figure 4.2.

### **Our consultant reviewed Melbourne Water’s top 15 major projects**

Our expenditure consultant reviewed all of Melbourne Water’s top 15 major projects, which represents 25.6 per cent (\$1,849.8 million) of Melbourne Water’s forecast capital expenditure (excluding its desalination payment capitalisation). Our consultant reviewed project synopses and supporting documentation and found the projects were prudent and efficient, addressing long-term

needs and compliance risk in the context of growth, renewals or other needs, and supported by robust analysis and costed appropriately.<sup>63</sup>

### **Our consultant reviewed Melbourne Water's major programs**

Given most of the proposed capital expenditure forecast sits outside Melbourne Water's top 15 major projects, our expenditure consultant also reviewed Melbourne Water's broader expenditure programs, and the forecasts and drivers that underpin them.<sup>64</sup>

In developing its capital program, Melbourne Water has:<sup>65</sup>

- carefully considered relevant customer service outcomes and its regulatory obligations
- applied a strategic Asset Management and Capital Planning approach that demonstrates it has robust processes and systems for developing capital expenditure
- aligned its forecast within a long-term planning outlook which appropriately balances service risks over a longer-term horizon
- linked its proposed capital program to a risk-based assessment of needs
- applied satisfactory processes for estimating project and program costs, which included appropriate contingency allowances.

Melbourne Water provided information which showed it prioritised its water and sewerage programs into four categories:

- Priority 1 – Projects that have an unacceptable risk if deferred and have a high level of development maturity and certainty. Development and construction costs fully included (\$4,331.2 million).
- Priority 2 – Projects that have an unacceptable risk if deferred but do not have a high level of maturity and certainty. Only development costs included (\$343.2 million).
- Priority 3 – Projects that do not have unacceptable risk if deferred but do have a high level of maturity and certainty. Only development costs included (\$82.7 million).
- Priority 4 – Projects that do not have unacceptable risk if deferred and do not have a high level of maturity and certainty. No costs included.

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<sup>63</sup> FTI Consulting 2026, *Review of Melbourne Water's expenditure forecasts – 2026 Water Price Review*, February, p. 126.

<sup>64</sup> FTI Consulting have reviewed Melbourne Water's capital programs across water, sewerage, waterways, drainage, urban development, corporate and IT.

<sup>65</sup> FTI Consulting 2026, *Review of Melbourne Water's expenditure forecasts – 2026 Water Price Review*, February, pp. 109-114.

Our consultant considered it was not appropriate for the \$82.7 million of 'Priority 3' project costs to be included in Melbourne Water's forecast given:

- the already significant proposed increase in capital expenditure associated with these programs before including priority 3 project costs
- supporting business cases have not yet been fully developed or approved
- their omission from the benchmark allowance is unlikely to result in an unacceptable risk if deferred.<sup>66</sup>

We have reviewed Melbourne Water's proposal and our consultant's report. Our preliminary view is that removing the proposed \$82.7 million for Priority 3 projects would shift pricing risk for these costs from the customer back to the business without affecting Melbourne Water's risk profile.

### **We have concerns around Melbourne Water's ability to deliver its proposed capital program**

Melbourne Water's forecast capital expenditure for the 2026–31 regulatory period, excluding Desalination Plant Security Payments, is 58 per cent higher than its actual expenditure over the current regulatory period (based on the latest forecast for 2025-26).

Melbourne Water acknowledged that it had issues activating the full scope of its capital program in the beginning of the current regulatory period. It identified and has committed to implementing changes to improve its capital delivery in the 2026–31 regulatory period.<sup>67</sup> However, these changes have not yet been fully implemented.<sup>68</sup>

Given this, our consultant considered there is a significant risk that Melbourne Water would not be able to deliver its total forecast capital expenditure program due to:

- the increased scale of the capital expenditure program compared to current levels
- Melbourne Water's delivery performance over the current regulatory period (see section 4.2.1).

It considered this deliverability risk was greater in relation to Melbourne Water's capital investment in its water and sewerage programs than in its waterways and drainage programs, but did not specify any particular projects or programs that were more likely than others to not be delivered. Accordingly, our consultant recommended a general reduction of \$473.3 million to Melbourne Water's proposed capital expenditure across the 2026–31 regulatory period would reflect a more realistic and deliverable capital program. This amount is 10 per cent of Melbourne Water's entire

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<sup>66</sup> FTI Consulting 2026, *Review of Melbourne Water's expenditure forecasts – 2026 Water Price Review*, February, p. 122.

<sup>67</sup> Melbourne Water 2025, *2026 price submission*, September, p. 102.

<sup>68</sup> FTI Consulting 2026, *Review of Melbourne Water's expenditure forecasts – 2026 Water Price Review*, February, p. 116.

water and sewerage capital program after excluding the capitalised amount of the Desalination Plant Security Payments, Melbourne Water’s corporate and IT programs, and \$82.7 million of Priority 3 projects. Our consultant did not recommend adjustments to Melbourne Water’s proposed waterways and drainage programs.

We have considered Melbourne Water’s price submission and our expenditure consultant’s report. Given the proposed significant uplift in capital works compared to the current period, and the likelihood that it will not be delivered in full, we consider there is a high risk of customers paying more than they need to if the full amount of proposed capital expenditure is included in the benchmarks for the 2026–31 regulatory period. We expect Melbourne Water to carry more of the uncertainty risk associated with the delivery of its ambitious capital program.

Our preliminary view is that reducing Melbourne Water’s proposed water and sewerage capital expenditure program by \$473.3 million, would appropriately rebalance the delivery risk associated with Melbourne Water’s proposed ambitious capital program. In proposing this adjustment, we note:

- this adjustment is to the benchmark allowance used to calculate the revenue requirement for setting customer prices during the period
- it is not an adjustment to Melbourne Water’s planned capital works programs – the business may proceed as planned
- we have not removed expenditure associated with any particular project or program, nor do we expect Melbourne Water to identify and remove projects or programs of corresponding value.

Melbourne Water also identified in its price submission that it excluded uncertain project costs from its forecast capital program for the 2026–31 regulatory period, and only included development costs for projects that do not have a high level of maturity and certainty.<sup>69</sup>

At the 2031 price review, Melbourne Water can propose to include additional capital expenditure incurred (above its benchmark) over the period in its regulatory asset base. However, it will need to demonstrate the prudence and efficiency of the expenditure and that it was incurred in the period. Any deviations from forecast capital expenditure during the 2026–31 regulatory period will form a key part of our assessment of the ‘Performance’ element of PREMO at the next price review.

### **We received submissions concerning Melbourne Water’s proposed capital expenditure**

The Water Services Association of Australia made a submission that supported Melbourne Water’s proposed increase in capital expenditure.<sup>70</sup> It noted Melbourne Water’s proposal aligns with

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<sup>69</sup> Melbourne Water 2025, *2026 price submission*, September, p. 11.

<sup>70</sup> Water Services Association of Australia, *Water in transition: WSAA submission to Essential Services Commission on Melbourne Water’s price review*, 11 December 2025.

general upward trends in water industry capital investment across Australia to address ageing assets, future growth expectations and changing climate.

We acknowledge the Water Services Association of Australia's submission and note we have also observed general upward trends in capital expenditure forecasts and delivery in other jurisdictions. However, we need to be satisfied that proposed capital forecasts are deliverable and reflect efficient cost recovery from customers during the period as described above. We note Melbourne Water's capital program after our proposed adjustment would still represent a 45.7 per cent increase on its capital expenditure during the 2021–26 regulatory period (excluding the Desalination Plant Security Payments). Further, any capital expenditure Melbourne Water incurs above its benchmark will be assessed for inclusion in its regulatory asset base at the conclusion of the regulatory period.

We also received submissions from the Concerned Waterways Alliance and the Maribyrnong River and Waterways Association, raising concerns about the health of Victoria's waterways, Melbourne Water's performance against its environmental obligations and future funding of environmental protection work.<sup>71</sup> Maribyrnong River and Waterways Association stated it supported the goal of Melbourne Water's 'Healthy, resilient waterways' but the level of capital investment appears insufficient to improve waterway health outcomes. Broadly, both submissions requested the commission to ensure Melbourne Water's proposal reflects its full environmental stewardship responsibilities to address declining waterway health.

We acknowledge the concerns raised by these groups, the importance of Greater Melbourne's waterways, and Melbourne Water's waterway health and environmental obligations. Melbourne Water has proposed \$349.2 million in capital expenditure across its waterways program, which will focus on managing its waterway health and stormwater quality. This is a \$71.4 million (or 20 per cent) increase in capital expenditure related to waterways compared with the current regulatory period. Melbourne Water has also proposed a \$126.8 million (or 42 per cent) increase in capital expenditure related to drainage and flood protection.<sup>72</sup>

However, we note if Melbourne Water must make additional investment to address ecological decline, meet its waterway health obligations or improve its performance in this area, it is not limited to the benchmarks we approve at this price review. Any expenditure incurred above its benchmarks can be considered as part of its next price review, to determine its prudence and efficiency for inclusion in its regulatory asset base.

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<sup>71</sup> Concerned Waterways Alliance, *Submission to the Essential Services Commission Melbourne Water Price Review 2026*, 12 December 2025; Maribyrnong River and Waterways Association, *Submission to the Essential Services Commission Melbourne Water Price Review 2026*, 10 December 2025.

<sup>72</sup> FTI Consulting 2026, *Review of Melbourne Water's expenditure forecasts – 2026 Water Price Review*, February, p. 120.

## Melbourne Water proposed to capitalise some of its operating expenditure

Our guidance allows Melbourne Water to propose to capitalise certain statutory operating expense items where it is appropriate to spread the cost recovery over a longer timeframe than a single regulatory period. This might include expenditure that delivers benefits to customers over a long period of time.<sup>73</sup>

Melbourne Water proposed to capitalise the principal portion of its annual security payments to the desalination plant operator. It also proposed to capitalise the costs for four items that are expensed for accounting purposes:<sup>74</sup>

- Software as a Service – Information Technology (\$57.9 million)
- Software as a Service – Asset Knowledge Technology (\$8.9 million)
- Descumming and desludging works at its Western Treatment Plant (\$35.2 million)
- Sludge carting at its Eastern Treatment Plant (\$23.1 million).

### *Our draft decision on the capitalisation of Desalination Plant Security Payments*

Since 2012-13, Melbourne Water has been required to make payments to the current operator of the Victorian Desalination Plant for the infrastructure and water security service delivered. These ‘security payments’ will continue until 2039-40 at which time Melbourne Water will acquire ownership of the plant for the remainder of its life.

Due to the size of the security payments, passing them on to retail businesses in full each year would have a significant impact on current end-use customers’ bills and provide disproportionate signals about the efficient cost of delivery. We consider that capitalising a portion of the Desalination Plant Security Payments takes the interests of current and future end-use customers into consideration, in line with the Water Industry Regulatory Order 2014.<sup>75</sup> Since 2016-17, in line with our guidance, Melbourne Water has reflected some of its annual security payments as capital

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<sup>73</sup> Essential Services Commission, *2026 Melbourne Water price review: Guidance paper*, 19 November 2024, pp. 36–37.

<sup>74</sup> Melbourne Water 2025, *2026 price submission*, September, p. 130.

<sup>75</sup> Water Industry Regulatory Order 2014, cl. 11(d). In a private ruling dated 29 October 2015 on the appropriate tax treatment of Melbourne Water’s finance lease payments associated with the Victorian Desalination Plant, the Australian Taxation Office established that Melbourne Water’s principal payments under the desalination plant’s finance lease are attributable to the purchase of the asset and reflect the capital component of the security payments. Consistent with the Australian Taxation Office’s view, we consider an amount equal to Melbourne Water’s annual principal payments under the plant’s lease is likely to provide a reasonable benchmark for capitalisation. This would be consistent with providing signals about the efficient costs of the security service over the life of the asset to end-use customers.

expenditure to align cost recovery with the benefit to end-use customers over the plant’s useful life beyond the term of the lease.<sup>76</sup>

Melbourne Water proposed continuing to capitalise a portion (equivalent to its principal repayment) of its forecast annual security payments, with the remainder attributed to non-controllable operating expenditure and directly passed through to end-use customers each year (see section 4.1.3). We confirmed that Melbourne Water’s proposal was consistent with our guidance.<sup>77</sup>

Our draft decision is to accept Melbourne Water’s proposed approach to capitalising a portion of its Desalination Plant Security Payments as set out in Table 4.8.

**Table 4.8 Draft decision on the recovery of forecast Desalination Plant Security Payments**  
\$ million 2025-26

	2026-27	2027-28	2028-29	2029-30	2030-31	Total
Operating expenditure	519.5	507.0	502.0	480.8	460.1	2469.4
Capital expenditure	80.6	112.3	130.0	140.3	157.9	621.1
<b>Total expenditure</b>	<b>600.1</b>	<b>619.4</b>	<b>631.9</b>	<b>621.1</b>	<b>618.0</b>	<b>3090.5</b>

**Note:** Numbers have been rounded and exclude any desalination water order costs. Operating expenditure amounts reflect our draft decision on the operating expenditure component, as discussed in section 4.1.3.

*Our draft decision on the capitalisation of Melbourne Water’s ‘Software as a Service’ expenditure*

Melbourne Water’s ‘Software as a Service’ expense capitalisation proposals are part of a larger suite of capital expenditure (\$179.3 million) related to the business’s information technology assets.

Our expenditure consultant reviewed the business’s forecast IT and corporate capital program, which includes the capital expense proposal. It considered the program was prudent, efficient and deliverable in the regulatory period and did not recommend any adjustment.<sup>78</sup>

However, we have not been able to identify which specific projects, and project costs, Melbourne Water’s ‘Software as a Service’ capitalisation proposals relate to. Melbourne Water’s financial model shows these costs are spread across all years of the 2026–31 regulatory period, which

<sup>76</sup> Melbourne Water can recover the capitalised amounts via a return on the asset base and an allowance for regulatory depreciation over the useful life of the desalination plant, currently estimated at 68 years.

<sup>77</sup> Essential Services Commission, *2026 Melbourne Water price review: Guidance paper*, 19 November 2024, pp. 42–43.

<sup>78</sup> FTI Consulting 2026, *Review of Melbourne Water’s expenditure forecasts – 2026 Water Price Review*, February, pp. 125–126.

suggests they might be related to a number of smaller projects, rather than one or two larger ‘one-off’ projects that are better suited to capitalisation.

While we accept the proposed capitalisation of these costs for our draft decision, in response to our draft decision, Melbourne Water must provide additional detail on the underlying projects behind these costs to confirm they are appropriate costs to be capitalised for pricing purposes. The additional detail will also allow Melbourne Water to reconcile the capitalisation of statutory expense costs when preparing its annual regulatory accounting statements.

#### *Our draft decision on the capitalisation of other operating expenditure items*

We have reviewed Melbourne Water’s price submission and consider its proposal to capitalise the costs for descumming and desludging at its Western Treatment Plant meets our guidance on expense capitalisation, as it is a one-off project performed at an irregular interval (once every 7 years) with benefits incurred across that period. We therefore accept the proposed capitalisation of these costs for our draft decision.

Melbourne Water’s sludge carting proposal relates to the operating cost of transferring sludge from the Eastern Treatment Plant while the plant’s digesters are taken offline to be renewed and upgraded. Melbourne Water considers these carting costs are integral to the digester upgrade project rather than a standalone maintenance activity. Melbourne Water has sought to recover these costs over 35 years as part of the sludge digester project costs. We note that the proposed transport costs are forecast to be a consistent, annual operating expense from 2026-27 to 2031-32. We accept Melbourne Water’s position that this cost is an integral component of the digester project, and on that basis, we accept the proposed capitalisation of these costs for our draft decision.

#### **Our draft decision on total forecast capital expenditure**

We have reviewed Melbourne Water’s proposals and the advice from our consultant. We consider Melbourne Water’s approach to forecasting its capital expenditure is consistent with the requirements of our guidance and the principles in the Water Industry Regulatory Order 2014. However, we consider Melbourne Water should carry more of the uncertainty risk associated with the significant increase in its capital program compared to 2021–26 regulatory period.

Our draft decision is to not accept the forecast capital expenditure of \$7,856.1 million proposed by Melbourne Water and to adopt a lower forecast of \$7,300.1 million as the capital expenditure benchmark over the 2026–31 regulatory period (see Table 4.7). In arriving at our draft decision, we have proposed the following adjustments:

- The removal of \$82.7 million associated with Melbourne Water’s ‘Priority 3’ projects because these projects have not yet been fully developed or approved and their deferral does not result in an unacceptable risk.

- A general adjustment of 10 per cent to lower Melbourne Water's proposed water and sewerage expenditure forecast by \$473.3 million to address delivery risk associated with the large scale of the proposed investment program.

The benchmark that we propose to adopt for Melbourne Water does not represent the amount that Melbourne Water is required to spend or allocate to particular projects. Rather, it represents assumptions about the overall level of expenditure (to be recovered through prices) that we consider sufficient to operate the business and to maintain or improve services over the regulatory period. Where we have made an adjustment to exclude a project's capital expenditure from Melbourne Water's revenue requirement, we are not requiring the business to remove that project. Melbourne Water determines how to best manage the allocation of its revenue and priority of its expenditure within a regulatory period.

### **4.3. Regulatory asset base**

A water business's regulatory asset base is the value of the business's assets for regulatory purposes.<sup>79</sup> The regulatory asset base is used to estimate the return on assets (discussed in section 4.4), and regulatory depreciation (discussed in section 4.5). Both the return on assets and regulatory depreciation are components of the revenue requirement.

Our guidance required Melbourne Water to propose:

- The closing value of its regulatory asset base at 30 June 2025 (using actual data).
- The opening value of its regulatory asset base at 1 July 2026 (calculated according to the criteria outlined in the guidance).
- The forecast value of its regulatory asset base for each year of the regulatory period (2026-27 to 2030-31), in accordance with the prudence criteria outlined in the guidance.

#### **4.3.1. Closing regulatory asset base**

Our draft decision is to accept Melbourne Water's proposed closing regulatory asset base for 30 June 2025 of \$15,621.2 million.

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<sup>79</sup> These values were set initially for the water businesses by the Minister for Water and are adjusted on an ongoing basis to account for new investments, asset disposals, depreciation and inflation.

We update the regulatory asset base to reflect actual gross capital expenditure, less government and developer contributions, and asset disposals for the period from 2020-21 to 2024-25.<sup>80</sup> This helps to ensure prices reflect the actual net expenditure of a water business.<sup>81</sup>

Melbourne Water's proposed closing regulatory asset base at 30 June 2025 is provided on page 166 of its price submission.

We compared Melbourne Water's actual net capital expenditure for 2020-21 to 2024-25 with the forecast used to approve maximum prices for the period from 1 July 2021. Typically, if a water business's net capital expenditure was more than 10 per cent above the forecast, we consider the business's justification for the additional expenditure before including it in the closing regulatory asset base. We consider this approach is reasonable given capital expenditure can be 'lumpy' in nature.

Melbourne Water's net capital expenditure over the period from 2020-21 to 2024-25 was \$3,328.3 million. This is \$189.7 million or 5.4 per cent lower than the forecast used to approve maximum prices during Melbourne Water's 2021 price review.

### **Our draft decision on Melbourne Water's closing regulatory asset base**

As noted in section 4.2.1, our expenditure consultant reviewed the capital expenditure delivered in the current regulatory period and the reasoning put forward by Melbourne Water for variances from the benchmark.

We have reviewed the information provided by Melbourne Water and our expenditure consultant's report. Our draft decision is to accept Melbourne Water's proposed closing regulatory asset base for 30 June 2025 of \$15,621.2 million as it meets our guidance requirements.

Table 4.9 sets out our draft decision on Melbourne Water's closing regulatory asset base at 30 June 2025.

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<sup>80</sup> See section 4.2 for a discussion of Melbourne Water's capital expenditure. We calculate the closing regulatory asset base using the actual expenditure incurred in the last year of the previous regulatory period, and each completed year in the current regulatory period – that is 2020-21 and 2021-22 through 2024-25. This is different to the current period benchmark spanning 2021-22 to 2025-26. The current year, 2025-26, is included in the *forecast* regulatory asset base for this price review, and the *actual* expenditure incurred in 2025-26 will be included in the closing regulatory asset base at the next price review.

<sup>81</sup> Net capital expenditure is calculated by deducting government and developer contributions from gross capital expenditure. Developer contributions reflect revenue earned from new connections made to the water business' water, sewerage or recycled water networks.

**Table 4.9 Draft decision – closing regulatory asset base (RAB)**

\$ million 2025-26

	2020-21	2021-22	2022-23	2023-24	2024-25
<b>Opening RAB 1 July</b>	<b>13,681.4</b>	<b>13,975.0</b>	<b>14,252.1</b>	<b>14,629.7</b>	<b>15,089.7</b>
Plus gross capital expenditure	797.0	751.9	883.3	975.5	1,058.7
Less government contributions	-	-	-	-	-
Less developer contributions	210.9	230.1	244.5	229.9	222.8
Less proceeds from disposals	4.1	13.8	4.7	2.7	1.7
Less regulatory depreciation	288.4	230.9	256.5	283.0	302.8
<b>Closing RAB 30 June</b>	<b>13,975.0</b>	<b>14,252.1</b>	<b>14,629.7</b>	<b>15,089.7</b>	<b>15,621.2</b>

**Note:** Numbers have been rounded.

#### 4.3.2. Forecast regulatory asset base

Our draft decision is to adopt a forecast regulatory asset base as set out in Table 4.10.

The forecast regulatory asset base is calculated having regard to the closing regulatory asset base, and forecasts for capital expenditure, regulatory depreciation, government and developer contributions, and asset disposals.

As our draft decision proposes adjustments to Melbourne Water's proposed forecast capital expenditure (see section 4.2.2), our draft decision is to not accept Melbourne Water's proposed forecast regulatory asset base.

Table 4.10 sets out our draft decision on Melbourne Water's forecast regulatory asset base from 1 July 2026.<sup>82</sup>

Our assessments of the components of the forecast regulatory asset base are outlined in different sections of this draft decision as follows:

- section 4.2 (capital expenditure)

<sup>82</sup> Our guidance required Melbourne Water to provide an estimate of the components of its regulatory asset base for 2025-26. This was so we could calculate the opening regulatory asset base for 1 July 2026. Our guidance noted that where the gross capital expenditure forecast differs from the benchmark for 2025-26, Melbourne Water should adopt the lower amount. Where forecast developer contributions are higher than the benchmark for 2025-26, Melbourne

- section 4.3.2 (developer contributions)
- section 4.5 (regulatory depreciation).

**Table 4.10 Draft decision – forecast regulatory asset base (RAB)**

\$ million 2025-26

	2025-26	2026-27	2027-28	2028-29	2029-30	2030-31
<b>Opening RAB 1 July</b>	<b>15,621.2</b>	<b>15,733.0</b>	<b>16,470.4</b>	<b>17,291.7</b>	<b>18,119.3</b>	<b>18,996.0</b>
Plus gross capital expenditure	678.9	1,343.4	1,464.6	1,477.3	1,525.0	1,489.9
Less government contributions	-	9.3	15.0	0.0	0.0	-
Less developer contributions	244.7	256.7	265.8	266.9	265.8	261.8
Less proceeds from disposals	2.5	7.6	6.2	5.6	5.6	4.2
Less regulatory depreciation	319.8	332.4	356.4	377.1	376.8	385.1
<b>Closing RAB 30 June</b>	<b>15,733.0</b>	<b>16,470.4</b>	<b>17,291.7</b>	<b>18,119.3</b>	<b>18,996.0</b>	<b>19,834.8</b>

**Note:** Numbers have been rounded.

### Developer contributions

Our draft decision is to accept Melbourne Water’s forecasts for revenue from developer contributions.

Melbourne Water’s forecast developer contributions are the amounts of revenue the business expects to generate through its developer charges in each financial year. Revenue from developer

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Water must use the higher amount. We require Melbourne Water to provide its most recent estimate of its year-to-date actuals in its response to our draft decision. The estimates for 2025-26 will be confirmed at the next price review following the 2026 Water Price Review. Essential Services Commission, *2026 Melbourne Water price review: Guidance paper*, 19 November 2024, p. 45.

contributions is deducted from gross capital expenditure so it is not included in the regulatory asset base.<sup>83</sup>

Melbourne Water's developer contributions for the 2026–31 regulatory period are forecast to be 12.5 per cent higher than in the current regulatory period. Melbourne Water calculated its developer contributions forecast by:

- Forecasting the developable hectares (based on external advice) within Melbourne Water's three growth areas – North, West and South-East.
- Multiplying the developable hectares by the average annual development services scheme contribution rate for each of its three growth areas. Melbourne Water has incorporated forecast price rises to achieve net present value neutrality as per the latest scheme reviews completed in 2024-25.

Our draft decision is to accept Melbourne Water's forecasts for revenue from developer contributions because its forecasting methodology is consistent with our guidance.

#### **4.4. Rate of return**

In establishing the return on assets component of Melbourne Water's revenue requirement, we have applied a rate of return to Melbourne Water's regulatory asset base. The rate of return is calculated using a:

- benchmark cost of debt (section 4.4.1)
- benchmark return on equity value (section 4.4.2).

##### **4.4.1. Cost of debt**

Our draft decision is to accept the cost of debt proposed by Melbourne Water for the purpose of calculating the revenue requirement for our draft decision. We will update the 2025-26 nominal cost of debt in May 2026 and reflect this in our final decision.

Our guidance required Melbourne Water to use estimates of the cost of debt provided by the commission to estimate its revenue requirement. Melbourne Water used the nominal cost of debt values we specified to calculate its revenue requirement (see Table 4.11). For this reason, our draft decision is to accept the cost of debt proposed by Melbourne Water for the purpose of calculating the revenue requirement for our draft decision. We will update the 2025-26 nominal

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<sup>83</sup> Revenue from developer contributions reflects revenue earned from developers for funding drainage services schemes in growth areas.

cost of debt in May 2026. Melbourne Water must use the updated figure when calculating the revenue requirement in response to our draft decision.

In our financial model, we use an estimate of forecast inflation to convert the nominal cost of debt to the real cost of debt. We estimated the forecast inflation at 2.9 per cent for Melbourne Water’s price submission model. We will update the forecast inflation in May 2026 after the release of the Australian Bureau of Statistics March Quarter 2026 consumer price index.<sup>84</sup>

**Table 4.11 Draft decision – cost of debt**

	2016-17	2017-18	2018-19	2019-20	2020-21	2021-22	2022-23	2023-24	2024-25	2025-26 <sup>a</sup>
Cost of debt (nominal)	4.91%	4.53%	4.61%	3.31%	3.05%	3.75%	6.76%	6.53%	5.84%	5.84%

**Notes:** Numbers have been rounded. The 2025-26 figure is an estimated cost of debt – we will update this figure before making our final decision and price determination.

#### 4.4.2. Return on equity

Our draft decision is to adopt a return on equity of 4.1 per cent, which reflects our agreement with Melbourne Water’s self-rating of its price submission under the PREMO framework.

Under our PREMO incentive mechanism, the return on equity we adopt to calculate the revenue requirement is linked to the PREMO rating of a business’s price submission. As outlined in our guidance, the return on equity we adopt depends on a water business’s self-rating of its price submission and whether we agree with that rating.

Our guidance included a matrix proposing the return on equity we would adopt, based on the combination of the business’s self-rating and our rating.<sup>85</sup> We consider that the values in our matrix reflect the medium-term real rates of return.

Melbourne Water rated its price submission as ‘Standard’. Based on this PREMO self-rating, Melbourne Water proposed a return on equity of 4.1 per cent per year. This reflects the maximum return rate allowed in our guidance for a price submission rated as ‘Standard’.<sup>86</sup>

<sup>84</sup> In November 2025, the Australian Bureau of Statistics updated its consumer price index methodology from a quarterly data series to a monthly data series to determine the official annual inflation rate. The consumer price index is applied in our forecast methodology as an input to our inflation estimates. The Australian Bureau of Statistics has confirmed that it will continue to publish the quarterly consumer price index.

<sup>85</sup> Essential Services Commission, *2026 Melbourne Water price review: Guidance paper*, 19 November 2024, pp. 49–50.

<sup>86</sup> We will continue to monitor market conditions and may amend the return on equity matrix values to reflect any changes to the medium-term outlook prior to releasing our final decision. We have had regard to the return on equity adopted by interstate regulators in the following publications: Independent Pricing and Regulatory Tribunal NSW, *Final Report – Review of prices for WaterNSW-Rural Valleys from 1 July 2025*, June 2025; Independent Pricing and

As outlined in chapter 11, our draft decision is to agree with Melbourne Water’s overall PREMO self-rating of its price submission and therefore to adopt its proposed return on equity.

#### 4.5. Regulatory depreciation

Our draft decision is to not accept Melbourne Water’s forecast regulatory depreciation. Melbourne Water must revise its regulatory depreciation in response to our draft decision.

Regulatory depreciation is a component of Melbourne Water’s revenue requirement and is also an input to calculating the regulatory asset base. Melbourne Water’s forecast regulatory depreciation was calculated using a straight-line depreciation profile. We noted in our guidance that we prefer this approach.<sup>87</sup>

Melbourne Water’s proposed depreciation for the next regulatory period is \$1,827.8 million. This was calculated in a manner consistent with our guidance. However, because our draft decision is to not accept Melbourne Water’s proposed forecast regulatory asset base, our draft decision is to not accept Melbourne Water’s forecast regulatory depreciation. We have adopted Melbourne Water’s forecast regulatory depreciation, with minor corrections, for the purpose of calculating the revenue requirement in our draft decision.

Our draft decision on regulatory depreciation is shown in section 4.3.2 (Table 4.10). Melbourne Water must update its forecast regulatory depreciation in response to our draft decision.

#### 4.6. Tax allowance

Our draft decision is to not accept Melbourne Water’s proposed tax allowance for the 2026–31 regulatory period. Melbourne Water must revise its tax allowance in response to our draft decision.

The tax allowance is a component of the revenue requirement that allows businesses to recoup the amount of tax they are liable to pay under the National Tax Equivalent Regime.<sup>88</sup> Melbourne Water

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Regulatory Tribunal NSW, *Final Report – Sydney Water prices 2025-2030*, September 2025; Essential Services Commission of South Australia, *SA Water’s water and sewerage retail services: 1 July 2024 – 30 June 2028, SA Water Regulatory Determination*, 1 July 2024; Queensland Competition Authority, *Final report – Seqwater bulk water price review 2022–26*, March 2022; Queensland Competition Authority, *Final report – Rural irrigation price review 2025–29, Seqwater*, January 2025; Office of the Tasmanian Economic Regulator, *Final report – Investigation into TasWater’s prices and services for the period 1 July 2022 to 30 June 2026*, May 2022.

<sup>87</sup> Essential Services Commission, *2026 Melbourne Water price review: Guidance paper*, 19 November 2024, p. 46.

<sup>88</sup> Water businesses are subject to the National Tax Equivalent Regime, which means relevant taxation laws are applied as if the businesses were subject to these laws. Australian Taxation Office, *Manual for the National Tax Equivalent Regime*, Version 13, July 2025.

proposed a tax allowance of \$129.6 million in its revenue requirement for the 2026–31 regulatory period.

As our draft decision proposes an adjustment to its revenue requirement, our draft decision is to not accept Melbourne Water’s proposed tax allowance. However, for the purpose of calculating the revenue requirement in our draft decision, we have adopted Melbourne Water’s proposed tax allowance, with minor corrections. Melbourne Water must provide an updated estimate in response to our draft decision that reflects changes in its revenue requirement.

## 5. Demand

Once Melbourne Water's revenue requirement is established, demand forecasts and the form of price control are used to translate the revenue requirement into tariffs and prices. Demand forecasts also influence Melbourne Water's operating expenditure forecast (see section 4.1).

Melbourne Water's demand forecasts are set out on pages 186 to 199 of its price submission and are also included in its financial model. It has outlined demand forecasts for its three main service areas:

- bulk water
- waterways and drainage
- bulk sewage.

Our guidance required Melbourne Water's proposed demand forecasts to represent the best available estimates using an appropriate forecasting methodology. Assumptions about the drivers of demand over the regulatory period must be well explained and reasonable and based on the latest data and evidence available.<sup>89</sup>

### 5.1. Bulk water demand forecasts

Our draft decision is to accept Melbourne Water's bulk water demand forecasts.

Melbourne Water's proposed bulk water demand forecasts are based on historic trends and demand estimates from the retail water businesses connected to Melbourne Water's water supply system (Greater Western Water, South East Water, Yarra Valley Water, Barwon Water, South Gippsland Water, Gippsland Water and Westernport Water). These retail water businesses use population and dwelling forecasts supplied by the Victorian Government as inputs into their bulk water demand forecasting models. Greater Western Water, South East Water and Yarra Valley Water use integrated supply-demand planning models, which are a type of end-use model.<sup>90</sup>

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<sup>89</sup> Essential Services Commission, *2026 Melbourne Water price review: Guidance paper*, 19 November 2024, p. 56.

<sup>90</sup> These three retail businesses – Greater Western Water, South East Water, and Yarra Valley Water – together accounted for 97.1 per cent of total water supplied by Melbourne Water in 2024-25.

We assessed the reasonableness of Melbourne Water’s demand forecasting methodology, which is a combination of retailers end-use modelling and Melbourne Water’s own modelling of key demand assumptions, and compared its forecasts against historical trends. Our preliminary view is that the underlying assumptions of Melbourne Water’s bulk water demand forecasts:

- are well explained
- align with historical trends
- have been developed using a reasonable forecasting methodology.

We note that forecast demand does not account for retail water businesses receiving application from large load users such as data centres. Our draft decision is to accept Melbourne Water’s bulk water demand forecasts for the purpose of approving maximum prices, because they were developed consistently with the requirements of our guidance. This includes using the Victoria in Future estimates issued by the Victorian Government, that directly informs both Melbourne Water’s forecasts and retailers forecasts, which are inputs into Melbourne Water’s forecasts. We note however, that 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, Melbourne Water must:

- demonstrate how it has considered these updated estimates and whether any changes to its assumptions and forecasts are required
- ensure that any updates to its forecasts are clearly identified, justified and included in its financial model.

## **5.2. Waterways and drainage demand forecasts**

Our draft decision is to accept Melbourne Water’s waterways and drainage demand forecasts.

Melbourne Water’s proposed waterways and drainage demand forecasts are based on dwelling forecast data, and population estimates from the Victorian Government.<sup>91</sup> We assessed the reasonableness of the forecasting method and key assumptions, and compared the forecasts against historical trends.

Our draft decision is to accept Melbourne Water’s forecasts for waterways and drainage demand because they were developed consistently with the requirements of our guidance, including basing

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<sup>91</sup> Unpublished Victorian Government Projections, 2025 – the Department of Transport and Planning is the agency responsible for the development of the official State Government population projections, which incorporate the latest population estimates, evidence from the latest Census plus assumptions regarding future births, deaths, migration and local development trends.

demand forecasts on the latest available Victoria in Future estimates issued by the Victorian Government.

However, since Melbourne Water lodged 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, Melbourne Water must

- demonstrate how it has considered these updated estimates and whether any changes to its assumptions and forecasts are required
- ensure that any updates to its forecasts are clearly identified, justified and included in its financial model.

### 5.3. Bulk sewage demand forecasts

Our draft decision is to accept Melbourne Water's bulk sewage demand forecasts, except for its demand forecasts for South East Water's trade waste.

Melbourne Water's proposed bulk sewage (including trade waste) demand forecasts are based on a common methodology, using a baseline plus growth approach. We consider Melbourne Water's methodology is reasonable.

However, Melbourne Water's demand forecasts do not align with South East Water's trade waste demand forecasts.<sup>92</sup> We investigated the source of the discrepancy between Melbourne Water's trade waste forecasts and South East Water's trade waste forecasts and found that South East Water had provided two sets of actual data to Melbourne Water for recent years:

- unadjusted data that was affected by data issues
- adjusted data that was corrected for data issues.<sup>93</sup>

We found that Melbourne Water's forecasts for South East Water's trade waste were not based on the latest available data from South East Water, which included adjustments for data issues and reflected views of its major trade waste customers. Melbourne Water's demand forecasts for the other retail water businesses align with the latest forecasts provided by those businesses.

Our draft decision is to accept Melbourne Water's bulk sewage demand forecasts, except for its demand forecasts for South East Water's trade waste, which were not developed consistently with the requirements of our guidance.

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<sup>92</sup> South East Water, *Submission to the Essential Services Commission 2026 Melbourne Water Price Review*, 12 December 2025.

<sup>93</sup> The data was adjusted for reporting accuracy of trade waste loads.

We require Melbourne Water to consider the latest available forecast from South East Water in its response to our draft decision. Since lodgement of its price submission, updated Victorian Government population and dwelling estimates have also been made available to water businesses.

In its response to our draft decision, Melbourne Water must:

- demonstrate how it has considered these updated estimates and whether any changes to its assumptions and forecasts are required
- ensure any updates to its forecasts are clearly identified, justified and included in its financial model.

## 6. Form of price control and adjusting prices

This chapter sets out our draft decision on Melbourne Water’s proposed form of price control and price adjustment mechanisms to apply in the next regulatory period.

### 6.1. Form of price control

Our draft decision is to accept Melbourne Water’s proposed price cap form of price control for its waterways and drainage charges, and a tariff basket form of price control for its water and sewerage charges.

Our guidance stated we would have particular regard to whether Melbourne Water proposed to continue its existing approach or introduce a new form of price control.<sup>94</sup>

Melbourne Water proposed a price cap form of price control for its waterways and drainage charges, and a tariff basket form of price control for its water and sewerage charges, with a 3 per cent rebalancing constraint. (See page 224 of its price submission.) This is the same as its current approach.<sup>95</sup>

Our draft decision is to accept the proposed price cap form of price control for waterways and drainage charges because:

- it is a continuation of Melbourne Water’s current approach, which we have previously approved
- it provides sufficient revenue for Melbourne Water to cover the forecast efficient expenditure on delivering services and deliver on any health, safety and environmental obligations
- it is easy for customers to understand and provides them with price certainty
- Melbourne Water can more efficiently manage demand risk on behalf of its customers
- it is otherwise consistent with the requirements of our guidance.

Our draft decision is to accept the proposed tariff basket form of price control for water and sewerage charges, subject to Ministerial approval of the South Central pool bulk entitlement reform because:

- it is a continuation of Melbourne Water’s current approach, which we have previously approved

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<sup>94</sup> Essential Services Commission, *2026 Melbourne Water price review: Guidance paper*, 19 November 2024, pp. 57-58.

<sup>95</sup> Melbourne Water introduced a tariff basket form of price control for water and sewerage as part of the 2022-23 annual tariff approval process.

- it provides Melbourne Water with sufficient revenue to cover the forecast efficient expenditure on providing services and deliver on any health, safety and environmental obligations
- it provides Melbourne Water the flexibility to rebalance prices without over (or under) collecting revenue
- it provides some price stability for customers by limiting price increases for individual tariffs to 3 per cent per year (excluding inflation) under its tariff basket constraint
- it enables Melbourne Water to smooth bill movements over the regulatory period
- it is otherwise consistent with the requirements of our guidance.

## 6.2. Adjusting prices

Our draft decision is to accept Melbourne Water’s proposed price adjustment mechanisms.

Melbourne Water proposed to continue with the price adjustment mechanisms it adopted in the current regulatory period, but with adjustments to reflect the South-Central Bulk Pool Entitlements reform and some minor modifications to formulas. (See pages 224 and 225 of its price submission.)

Melbourne Water proposed to continue to apply price adjustment mechanisms over the 2026–31 regulatory period to allow for:

- events that are uncertain or unforeseen at the time of this price review
- Victorian Desalination Plant Security Payments
- Victorian Desalination Plant water orders<sup>96</sup>
- annual movements in the trailing average cost of debt.

It proposed adjustments to:

- reflect the South-Central Bulk Pool Entitlements reform
- correct the formula to adjust desalination water order costs
- update the list of charges to which the annual update to the regulatory rate of return applies, to correct inconsistencies in previous determinations.<sup>97</sup>

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<sup>96</sup> The Desalination Plant Water Order charge applies in years when there is a desalination water order, or where there are Melbourne Water costs associated with an order from the previous year. Melbourne Water proposed that it will continue as a pass-through and apply to all water businesses connected to its system.

<sup>97</sup> Melbourne Water 2025, *2026 price submission*, September, p. 224.

Our draft decision is to accept Melbourne Water’s proposed price adjustment mechanisms on the basis that they appropriately reflect the South-Central Bulk Pool Entitlements reform, satisfy the criteria in our guidance and are largely a continuation of existing arrangements, which we have previously approved.

## 7. Bulk tariffs

This chapter sets out our draft decision on Melbourne Water’s proposed bulk tariff structures. Our draft decision considers proposals related to tariff structures, price paths and any submissions relating to these proposals. We do not approve prices for each tariff at the draft decision stage of a price review. Prices will need to be updated by Melbourne Water to reflect our draft decision on its revenue requirement and our updates to inflation and cost of debt estimates prior to our final decision. We will approve final maximum prices in our final decision.

Melbourne Water provides bulk water and storage operator services and bulk sewerage services. It supplies these bulk water services to metropolitan retailers (Greater Western Water, South East Water and Yarra Valley Water), as well as regional businesses (Barwon Water, Gippsland Water, South Gippsland Water and Westernport Water), as required. Melbourne Water also provides bulk sewerage services to the three metropolitan retailers.

As outlined in our guidance, we have given Melbourne Water a large degree of discretion to decide on tariff structures. This recognises that Melbourne Water is best placed to design tariffs and tariff structures that meet its customers’ needs, manage its risk, and deliver its desired business outcomes.

To approve any proposed changes, we must be satisfied they meet the WIRO requirements. We have assessed the proposals against the principles and criteria outlined in our guidance. Our assessments and draft decisions are outlined below.

Melbourne Water will need to update its proposed prices to reflect our draft decision on its revenue requirement and our updates to inflation and cost of debt estimates prior to our final decision.

### 7.1. Melbourne Water’s bulk water tariffs

Our draft decision is to accept Melbourne Water’s proposed bulk water tariff structures, subject to ministerial approval of the South-Central Pool Bulk Entitlement.

Melbourne Water proposed a new bulk water tariff structure in anticipation of the Minister for Water approving the South-Central Pool Bulk Entitlement.<sup>98</sup> This reform has been designed over the past 3 years through collaboration between the Department of Energy, Environment and Climate Action and water businesses. If approved, it will result in a new framework for bulk water entitlements. A

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<sup>98</sup> Bulk Entitlements – South-Central Pool Bulk Entitlement Actions, State Government of Victoria, accessed 3 March 2026, <https://www.water.vic.gov.au/about-us/water-entitlements-and-the-water-act/bulk-entitlements>.

key feature of this reform is the creation of a shared urban water source, the South-Central Pool, comprising surface and desalinated water from the Melbourne system.

The Minister for Water is currently considering applications from Melbourne Water and seven other water businesses, which would give effect to the reform. Public consultation on the applications is now closed (no comments were received). Given Melbourne Water's price submission has been prepared on the basis of the reform going ahead, we have also assumed for the purposes of making our draft decision, that the South-Central Pool Bulk Entitlement reforms will be approved. The minister is expected to make a decision in early April 2026.

### **7.1.1. Current entitlements**

Melbourne Water currently manages a shared urban water supply, with water supplied from surface water reservoirs and the Victorian Desalination Plant. This shared supply is the main water supply for Greater Western Water, South East Water and Yarra Valley Water. It is also a supplementary water supply for Barwon Water, South Gippsland Water, Gippsland Water and Westernport Water.

At present, water businesses hold bulk entitlements, which specify their individual share of water available annually. The three metropolitan water businesses have bulk entitlements for water from the Victorian Desalination Plant, but regional water businesses do not. The Victorian Government, in collaboration with water businesses, identified that the current arrangements:

- make it difficult for regional water businesses to access more water from the Melbourne system
- include unclear sharing and cost recovery arrangements for future water supplies
- are unclear on individual retail water business's accountability for water security, resulting in inequitable cost sharing.<sup>99</sup>

### **7.1.2. Proposed tariff reforms to reflect the South-Central Pool Bulk Entitlement**

Melbourne Water's proposed bulk water tariffs:

- reflect the proposed South-Central Pool Bulk Entitlement
- shift a higher proportion of cost recovery to variable charges.

Under the proposed South-Central Pool Bulk Entitlement, water businesses will no longer have a specified volume of water available annually. Instead, their bulk entitlements will allow access to a shared pool of water to meet annual demand, including access to Victorian Desalination Plant water for all water businesses connected to the Melbourne system. As demand for water grows,

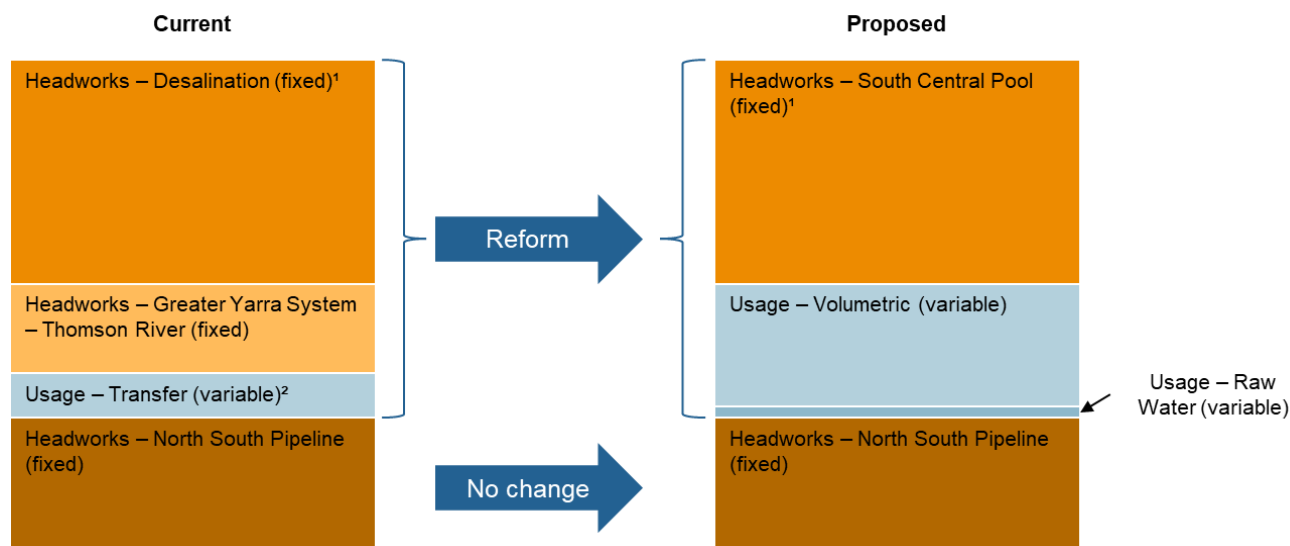
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<sup>99</sup> Department of Energy, Environment and Climate Action, South-Central Reforms Briefing, November 2025.

future augmentations will increase the available water, and all bulk entitlement holders will be involved in managing water availability and security.<sup>100</sup>

Melbourne Water’s proposed tariff structure for bulk water includes both fixed and variable charges, as indicated in Figure 7.1.

**Figure 7.1 Melbourne Water’s current and proposed bulk water tariffs**



**Notes:** <sup>1</sup> The Desalination Plant Water Order charge is not reflected in this diagram. <sup>2</sup> Currently an interim arrangement exists between Melbourne Water and Gippsland Water for the supply of untreated water. Under Melbourne Water’s proposal, a formal charge will be created for the provision of bulk raw water.

Source: Essential Services Commission’s summary of Melbourne Water’s proposal.

### Bulk drinking water usage charge – South-Central Pool (\$/ML)

Melbourne Water proposed a variable drinking water charge for the South-Central Pool. We reviewed this charge and consider it is set with regard to the marginal cost of drinking water. In addition, Melbourne Water proposed to shift more cost recovery to volumetric charges to take more demand risk.<sup>101</sup> Under the proposed structure, the proportion of revenue recovered through fixed charges would drop from 86 per cent to around 60 per cent, with the remaining 40 per cent recovered through variable charges.

We reviewed Melbourne Water’s proposed bulk drinking water charge and consider it is cost reflective, and sends signals about the efficient costs of providing bulk drinking water services. Our

<sup>100</sup> Department of Energy, Environment and Climate Action, South-Central Reforms Briefing, November 2025.

<sup>101</sup> Melbourne Water 2025, *2026 price submission*, September, p. 206.

draft decision is to accept Melbourne Water’s proposed bulk drinking water usage charge – South Central Pool.

### **Bulk raw water usage charge (\$/ML)**

Melbourne Water proposed to introduce a lower bulk raw water usage charge, compared to potable drinking water, for Gippsland Water, Yarra Valley Water and South East Water.<sup>102</sup>

We reviewed Melbourne Water’s proposed charge and consider it is cost reflective, and consistent with the requirements of our guidance criteria. On this basis, our draft decision is to accept Melbourne Water’s proposed bulk raw water usage charge.

### **7.1.3. Melbourne Water’s proposed bulk water fixed charges**

Melbourne Water’s proposed bulk water fixed charges include the:

- bulk water headworks charge for the South-Central Pool
- bulk water headworks charge for the North South Pipeline.

The Victorian Desalination Plant Water Order charge will also apply in years when there is a desalination water order.

### **Bulk water headworks charge – South-Central Pool (fixed, \$/month)**

Melbourne Water proposed a fixed bulk water headworks charge – South-Central Pool, to be recovered from each water business connected to the Melbourne system on a monthly basis. Melbourne Water proposed to allocate fixed charges to each water business based on their relative share of historical 10-year (moving) average total demand.<sup>103</sup>

We assessed Melbourne Water’s methodology to determine the bulk water headworks fixed charge and consider the 10-year (moving) average is cost reflective and transitions regional water businesses gradually. Melbourne Water engaged with water businesses and they supported this approach.<sup>104</sup>

Melbourne Water’s proposal is consistent with our guidance criteria and minimises impacts of significant price changes for affected retailers and their end-use customers.<sup>105</sup> Our draft decision is to accept the proposed charge.

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<sup>102</sup> Melbourne Water 2025, 2026 price submission, September, p. 207.

<sup>103</sup> Melbourne Water 2025, 2026 price submission, September, p. 206.

<sup>104</sup> Melbourne Water, 2026 price submission supporting documents, Regulatory and Tariff Forum meeting minutes, 30 September 2025; Melbourne Water 2025, 2026 price submission, September, p. 206.

<sup>105</sup> Essential Services Commission, 2026 Melbourne Water price review: Guidance paper, 19 November 2024, p. 61.

### **Bulk water headworks charge – North South Pipeline (fixed, \$/ML entitlement)**

Melbourne Water is not proposing any changes to the tariff structure for bulk water headworks charges related to the North South Pipeline. These charges are currently recovered from the three metropolitan water businesses.<sup>106</sup>

We reviewed Melbourne Water's proposal and consider that it meets our guidance requirements. Our draft decision is to accept Melbourne Water's proposed bulk water headworks charge – North South Pipeline.

### **Victorian Desalination Plant Water Order charge (\$/month)**

Melbourne Water proposed to extend the Victorian Desalination Plant Water Order to all water businesses connected to the Melbourne system, consistent with the proposed South-Central Pool Bulk Entitlement. Melbourne Water noted that the charges would be passed through in years when there is a desalination water order, or where it will incur costs associated with an order from the previous year.<sup>107</sup>

We reviewed Melbourne Water's proposal and consider it is consistent with our guidance cost reflectivity criteria. Our draft decision is to accept Melbourne Water's proposed Victorian Desalination Plant Water Order charge.

## **7.2. Melbourne Water's bulk sewerage tariffs**

Our draft decision is to accept Melbourne Water's proposed bulk sewerage treatment charges, trade waste load charges and bulk sewerage treatment/transfer fixed charges.

Our draft decision is to not accept Melbourne Water's proposed sewerage transfer variable charge for the Eastern and Western Treatment Plants.

Melbourne Water recovers the cost of its bulk sewerage services through fixed and variable tariffs, as well as through variable trade waste load charges for named contaminant loads.

Melbourne Water proposed:

- to retain the majority of its existing bulk sewerage tariff structure
- reforms to its bulk sewerage transfer variable charge and its bulk sewerage treatment/transfer fixed charge.

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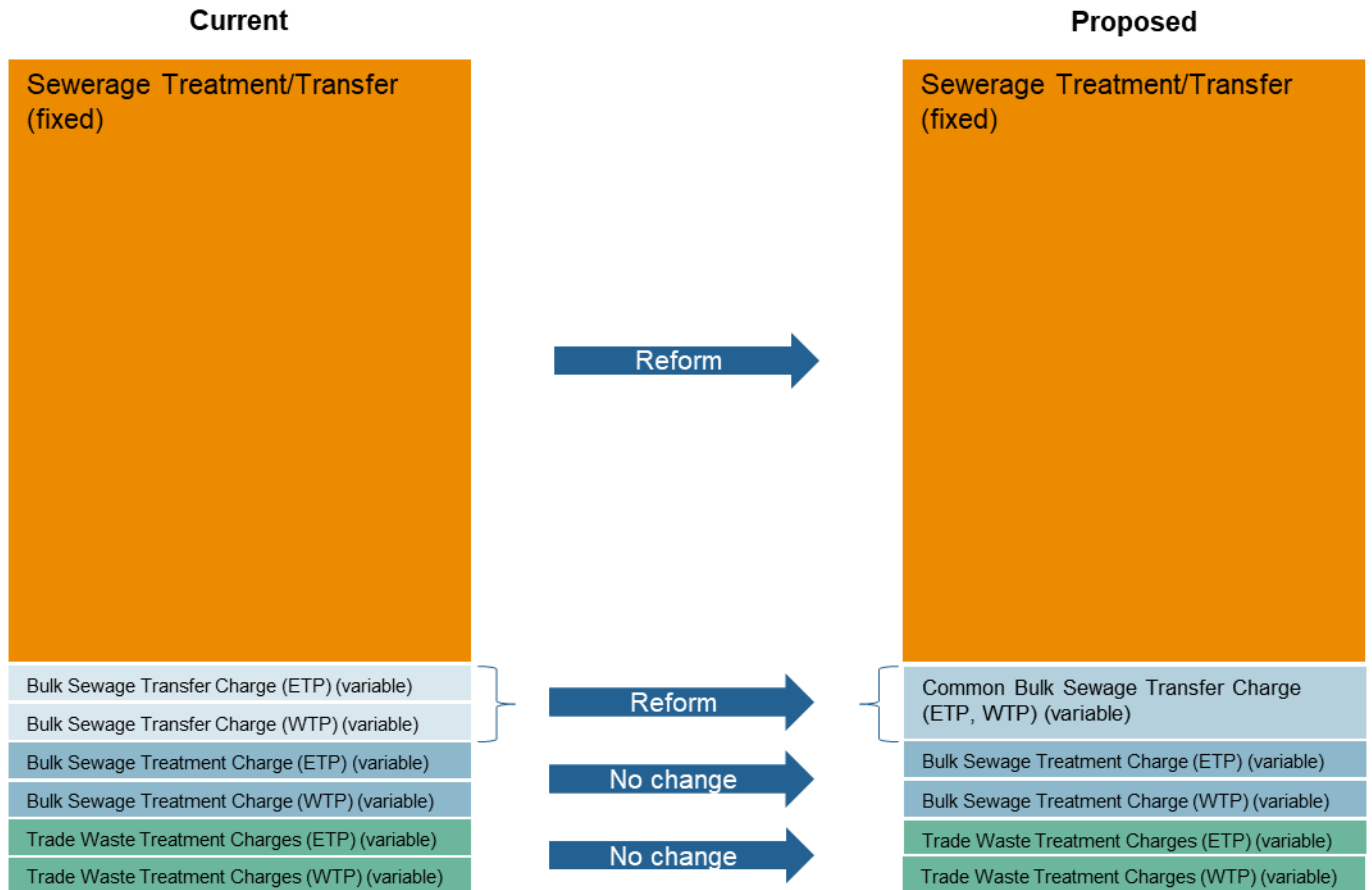
<sup>106</sup> Melbourne Water 2025, 2026 price submission, September, p. 207.

<sup>107</sup> Melbourne Water 2025, 2026 price submission, September, p. 207.

(See pages 210 to 213 of its price submission.)

Figure 7.2 shows the proposed bulk sewerage tariffs.

**Figure 7.2 Melbourne Water’s current and proposed bulk sewerage tariffs**



**Notes:** ETP means Eastern Treatment Plant and WTP means Western Treatment Plant.

Source: Essential Services Commission’s summary of Melbourne Water’s proposal.

Melbourne Water’s proposal, including the two reforms, is outlined below.

### 7.2.1. Melbourne Water’s proposed bulk sewage variable charges

Melbourne Water currently has the following separate variable charges for the Eastern and Western Treatment Plants:

- bulk sewage transfer
- treatment charges (\$/ML)
- trade waste load charges for disposal of biological oxygen demand, total suspended solids, total kjeldahl nitrogen and inorganic total dissolved solids (\$/tonne).

## **Bulk sewage transfer charge (\$/ML)**

Melbourne Water proposed to replace its separate sewage transfer charges for the Eastern and Western Treatment Plants with a common sewage transfer charge for both the Eastern and Western Treatment Plants irrespective of the destination of the sewage transfer.

We assessed Melbourne Water's proposal and sought further information from Melbourne Water on the underlying cost structures. We found that the transfer costs for the two treatment plants are different and not converging, which suggests a common charge may not be cost reflective.

In its response to our request for information, Melbourne Water noted that:

- its proposed common transfer charge would recover the combined transfer costs of the Eastern and Western Treatment Plants
- different transfer prices do not provide an effective price signal to retailers as Melbourne Water has operational control over directing sewage to either treatment facility
- moving to a common charge would simplify the tariff structure
- the proposed tariffs are supported by the retail water businesses.

Our draft decision is to not accept Melbourne Water's proposed common sewage transfer charge because there is a lack of evidence to indicate that the proposed tariff structure reflects the underlying costs, which is a requirement of our guidance.<sup>108</sup>

In response to our draft decision, Melbourne Water must either:

- provide evidence that the underlying transfer costs for the two treatment plants are converging to support its proposal to move to a common sewage transfer charge
- revise its sewage transfer charge to align with the underlying costs associated with transferring sewage to each treatment plant.

## **Bulk sewage treatment charges (\$/ML), trade waste load charges (\$/tonne)**

Melbourne Water does not propose any changes to the tariff structure for its variable bulk sewage treatment charges or trade waste load charges. Melbourne Water states that these will continue to be set with regard to long-run marginal costs, consistent with our guidance.<sup>109</sup>

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<sup>108</sup> Essential Services Commission, *2026 Melbourne Water price review: Guidance paper*, 19 November 2024, pp. 60–61.

<sup>109</sup> Melbourne Water 2025, *2026 price submission*, September, p. 210; Water Industry Regulatory Order, cl. 11(d); Essential Services Commission, *2026 Melbourne Water price review: Guidance paper*, 19 November 2024, pp. 60, 75–76.

Our draft decision is to accept Melbourne Water’s proposed bulk sewage treatment charge and trade waste load charges as they reflect the underlying costs, provide reasonable pricing signals to retailers, and are consistent with our guidance criteria.

### **7.2.2. Melbourne Water’s proposed bulk sewerage fixed charges**

Melbourne Water currently sets sewerage treatment/transfer fixed charges for each retail water business based on the business’s relative forecast use of the system. Melbourne Water proposed to change the basis on which these charges are set, by using historical actual usage over the last 5 years at the time of price setting to set shares of fixed costs for each retail water business. Under the proposal, water business’s contributions to the fixed cost would be reviewed every 5 years. Melbourne Water extensively engaged with water retailers on its proposed approach.

We consider Melbourne Water’s proposal to rely on historical actual usage is simpler and better reflects the retail water business’s actual cost to the sewerage system. Our draft decision is to accept Melbourne Water’s proposal as it is consistent with the criteria set out in our guidance.<sup>110</sup>

### **7.3. Submissions**

Melbourne Water’s proposed bulk water and bulk sewerage charges will result in a modest increase to bills for end-use customers. For metropolitan water businesses’ household customers, the proposed prices will result in an average bill increase of 1.8 per cent across the next 5 years, or 0.4 per cent per year (before inflation).

Where Melbourne Water identified distributional impacts of its proposed reforms, it worked with water businesses through its Regulatory and Tariff Forum to tailor a price path for each individual business. A number of submissions from individuals expressed concern regarding the affordability of Melbourne Water’s proposed charges. Melbourne Water addressed affordability issues by ensuring that the individual price paths remain revenue neutral. The proposed price paths also include efforts to smooth prices to minimise impacts in the first year of the regulatory period and avoid bill shocks in subsequent years.<sup>111</sup>

We received several submissions noting the importance of balancing fair prices with appropriate investment. The Water Services Association of Australia supports Melbourne Water’s proposed capital expenditure and believes the business has been able to significantly manage the price impact flowing from this investment.<sup>112</sup> Financial Counselling Victoria noted the more modest price

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<sup>110</sup> Essential Services Commission, *2026 Melbourne Water price review: Guidance paper*, 19 November 2024, p. 61.

<sup>111</sup> Melbourne Water 2025, *2026 price submission*, September, pp. 203–212.

<sup>112</sup> Water Services Association of Australia, *Water in transition: submission to Essential Services Commission on Melbourne Water’s price review*, 11 December 2025, p. 2.

increases in Melbourne Water's final price submission compared to an earlier draft version, and submitted this demonstrated Melbourne Water's understanding of the impact its prices can have on end-use customers facing hardship.<sup>113</sup>

#### **7.4. Consequential amendments to South East Water's determination**

Melbourne Water's bulk water and sewerage tariffs are passed-through to end-use retail prices through mechanisms in retail water businesses' determinations. Most water retailers have specific mechanisms in their determinations that allow them to pass-through changes to all of Melbourne Water's bulk tariffs.

South East Water's determination does not include such a mechanism. Instead, it includes a specific ability for us to adjust some of its prices (through pass-through formulas), to account for the impact of Melbourne Water's tariffs.

South East Water made a submission to Melbourne Water's price review requesting we exercise our discretion under clause 6 of its current determination, to allow the pass-through of changes in Melbourne Water's bulk water tariffs.<sup>114</sup>

Clause 6 of South East Water's price determination provides that where the commission:

(a) makes a price determination for storage operator and bulk water services supplied by Melbourne Water Corporation for some or all of the period from 1 July 2021; and

(b) declares that such price determination provides for different prices to be charged to South East Water from those assumed in the making of this Determination;

the commission may decide to amend this Determination, specify a price adjustment and/or specify a mechanism for making a price adjustment, provided that it is satisfied that such amendment and/or price adjustment takes or will take into account the interests of customers.<sup>115</sup>

Melbourne Water's proposed bulk tariff reform involves significant changes to the prices it charges South East Water. If South East Water could not pass-through all of the changes to bulk costs, it would have a material impact on its revenue and prevent it from implementing cost-reflective

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<sup>113</sup> Financial Counselling Victoria, *Submission to the Essential Services Commission 2026 Water Price Review*, 12 December 2025, p. 2.

<sup>114</sup> South East Water, *Submission to the Essential Services Commission 2026 Water Price Review*, 12 December 2026, p. 1.

<sup>115</sup> Essential Services Commission, *South East Water 2023 Price Determination*, Clause 6.

end-use prices. As noted, other retailers will be able to pass-through all of these changes under their existing determinations.

South East Water estimated that if we did not amend its determination, it would face a \$100 million revenue shortfall. Our estimate is significantly lower than the \$100 million per year estimated by South East Water, as it incorrectly interpreted Clause 6.<sup>116</sup>

Table 7.1 shows our estimate of the impact on South East Water's revenue of Melbourne Water's proposed changes to its bulk tariffs:

- the impact of changes to bulk water to be about -\$13 million in 2026-27 and \$4 million in 2027-28 (which South East Water can pass on to prices when we invoke clause 6)
- the impact of changes to bulk sewerage to be about \$22 million in 2026-27 and \$29 million in 2027-28 (Clause 6 needs to be amended to allow South East Water to pass on to prices)
- the net impact (water and sewerage) to be about \$9 million in 2026-27 and \$33 million in 2027-28 (this amount may be lower depending on Melbourne Water's response to our draft decision on trade waste demand).

After considering Melbourne Water's proposed tariffs, the submission received, and the materiality of the impact on South East Water, we consider it appropriate to both:

- amend South East Water's determination, to ensure there is an available mechanism for the commission to consider all impacts of the Melbourne Water decision
- consider using such a mechanism to adjust pricing mechanisms under South East Water's determination, limited to the impact of Melbourne Water's proposed tariffs.

In making any adjustment, we will take into account the interests of South East Water's customers.

We will consult with South East Water about the form of this potential adjustment and its approach. We welcome other submissions about South East Water's approach to this issue through the process for Melbourne Water's 2026 price review.

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<sup>116</sup> South East Water, *Submission to the Essential Services Commission 2026 Water Price Review*, 12 December 2025, p. 1. In its estimation of its \$100 million shortfall, South East Water assumed that it was unable to pass on variable costs of water, which is around \$97 million in 2026-27 and \$98 million in 2027-28 however its determination allows for pass-through of total costs and does not distinguish between variable and fixed costs.

**Table 7.1 Impact of Melbourne Water’s proposed tariffs on South East Water**  
 \$ million 2025-26

Revenue item from South East Water	2025-26	2026-27	2027-28
Total water revenue	344.39	331.32	348.54
<b>Difference compared with 2025-26 (water)</b>		<b>-13.07</b>	<b>4.15</b>
Total sewerage revenue	227.73	250.04	256.53
<b>Difference compared with 2025-26 (sewerage)</b>		<b>22.31</b>	<b>28.80</b>
Total revenue (water + sewerage)	572.12	581.36	605.07
<b>Difference compared with 2025-26 (water + sewerage)</b>		<b>9.24</b>	<b>32.95</b>

## 8. Waterways and drainage, diversions and miscellaneous services

This chapter sets out our draft decision on Melbourne Water's proposed waterways and drainage tariff structures, diversions tariff structures and miscellaneous tariffs.

### 8.1. Waterways and drainage tariffs

Our draft decision is to accept Melbourne Water's proposed tariff structures for its core waterways and drainage services and special drainage area services for the Tidal Waterways, Quiet Lakes and Koo Wee Rup Longwarry end-use customer groups.

Melbourne Water provides drainage, waterways and floodplain management services in the Port Phillip and Westernport region. It administers programs to:

- improve the health of rivers and creeks
- improve stormwater quality
- maintain drainage infrastructure to service urban growth and provide flood protection.

It funds these services through waterways and drainage tariffs that are collected from all rateable residential and non-residential properties within Melbourne Water's Waterways Management District.

Melbourne Water proposed to largely maintain its existing tariff structure for its waterways and drainage services. This includes transitioning the remaining non-residential customers on a property value-based charge to a single fixed charge during 2025-26, as part of a process it began in 2016.<sup>117</sup> (See pages 215 to 219 of its price submission.)

Melbourne Water proposed to reduce its waterways and drainage charges for all end-use customer groups by between 0.8 per cent and 0.9 per cent (before inflation) in 2026-27, then adjust them for inflation only from 2027-28 to 2030-31.

#### Interested parties raised some concerns about Melbourne Water's proposals

We received public submissions on Melbourne Water's waterways and drainage tariff proposal from two environmental groups: Maribyrnong River and Waterways Association and the Concerned

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<sup>117</sup> Currently, the property value-based charge is applicable to over 35,000 non-residential customers. The fixed charge is set at 1.5 times the residential charge to reflect the relative impact of non-residential customers on the waterways and drainage system.

Waterways Alliance. Both groups expressed concern about the proposed price path, noting that a declining or flat charge in real terms is inconsistent with the community's willingness to fund greater waterway protection.<sup>118</sup> They questioned whether the proposed charge is set at a sufficient level to enable Melbourne Water to meet its statutory responsibilities under the Water Act. Both submissions expressed support for a charge that reflects increased investment in waterway health and environmental protection.<sup>119</sup> We note that Melbourne Water proposed significant investments in the waterways and drainage system to meet its proposed outcomes. We consider the waterways and drainage charges to be sufficient to deliver those outcomes (see section 4.2.2 on our draft decision on capital expenditure). Melbourne Water is continuing to closely engage with these interested parties to better understand and address the issues raised in their submissions.

### **Our draft decision on Melbourne Water's proposed waterways and drainage tariff structure**

Our draft decision is to accept Melbourne Water's proposed tariff structure for its waterways and drainage service. The proposal:

- is a continuation of its current tariff strategy
- reflects the relative costs of providing shared services to each end-use customer group
- is easy for customers to understand.

However, a flat charge is unlikely to be fully cost reflective and send appropriate price signals to end-use customers. As outlined in our 2021 draft decision, Melbourne Water should review its waterways and drainage tariffs for non-residential customers over 2026 – 31 and propose more cost reflective from 2031-32 onwards.<sup>120</sup> In line with our guidance, Melbourne Water should ensure that it conducts adequate end-use customer consultation over the next 5 years to inform any reform proposals.<sup>121</sup>

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<sup>118</sup> Maribyrnong River and Waterways Association, *Submission to the Essential Services Commission Melbourne Water 2026 Price Review – Waterways and Drainage Charge*, 10 December 2025, p. 1; Concerned Waterways Alliance, *Submission to the Essential Services Commission Melbourne Water Price Review 2026*, 12 December 2025, pp. 2-3.

<sup>119</sup> Maribyrnong River and Waterways Association, *Submission to the Essential Services Commission Melbourne Water 2026 Price Review – Waterways and Drainage Charge*, 10 December 2025, p. 1; Concerned Waterways Alliance, *Submission to the Essential Services Commission Melbourne Water Price Review 2026*, 12 December 2025, pp. 2-3.

<sup>120</sup> Essential Services Commission 2021, *Melbourne Water Draft Decision: 2021 water price review*, 17 March, pp. 66-67.

<sup>121</sup> Essential Services Commission, *2026 Melbourne Water price review: Guidance paper*, p. 59.

### 8.1.1. Patterson Lakes

For direct service customers in the Patterson Lakes special drainage area, Melbourne Water proposed to continue to provide the following services on a fee-for-service basis:

- ongoing maintenance and replacement of private jetties used by the Tidal Waterways community to gain recreational access to the waterways
- bore water flushing of two of the three Quiet Lakes (Lake Legana and Lake Illawong), and inspection of the water quality of these lakes.

Melbourne Water also proposed to extend its bore flushing service to Lake Carramar, the third lake in the Quiet Lakes.

Melbourne Water's engagement with end-use customers on the relevant tariff proposals is discussed in section 3.1.

#### **Tidal Waterways special drainage service area tariff**

Melbourne Water proposed to transition to a single maintenance and renewal charge for timber jetties (from 2031) and concrete jetties (from 2038) when the existing jetty infrastructure payments are completed. Currently there is a:

- charge for timber jetties, administered under a bespoke payment plan for each customer
- charge for concrete jetties, administered under a bespoke payment plan for each customer
- common maintenance charge for both types of jetties.

Under this proposal, new jetty-related capital and maintenance costs forecast over 2026–31 will be recovered via a single annual maintenance and renewal charge. The proposed tariff restructure will apply to timber jetty owners from 2031-32 onwards and to concrete jetty owners from 2038-39 onwards.

Melbourne Water also proposed to extend the repayment period for the initial cost of timber jetties by 2 years to 2030-31. This is in response to timber jetty owners' preference for a smoothed price path over the next 5 years.<sup>122</sup>

Under Melbourne Water's proposal:

- it will gradually replace the current charges with the single maintenance and renewal charge for construction of new jetties

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<sup>122</sup> Melbourne Water 2025, *Patterson Lakes community engagement summary*, 21 August, p. 1.

- repayments of the initial cost of infrastructure (which commenced in 2015-16) will be reduced by 38 per cent for timber jetties and 13 per cent for concrete jetties (before inflation) in 2026-27 followed by a decrease of 2.8 per cent (before inflation) per year from 2027-28 onwards.

Melbourne Water noted that the net impact of its proposal will avoid a bill shock for end-use customers.

We did not receive any submissions from customers in the Tidal Waterways community.

We accept Melbourne Water's proposal to commence a gradual transition of all Tidal Waterways customers to a single charge. The proposal reflects the collective cost of timber and concrete jetty services provided to them, is administratively simple and easy for customers to understand.

### **Quiet Lakes (Lake Legana, Lake Illawong and Lake Carramar)**

Melbourne Water proposed to maintain the current service level at Lake Legana and Lake Illawong, and extend the bore water flushing to Lake Carramar from 2026-27. This service is aimed at managing algal blooms and maintaining the lakes' water quality for recreational use by the community. Under Melbourne Water's proposal, costs will be shared equally across all residents bordering the Quiet Lakes through a single bore flushing charge. Melbourne Water proposed to adjust the bore flushing charge only by inflation in 2026-27, then increase it by 19 per cent (including inflation) each year from 2027-28 to 2030-31.

Melbourne Water noted that most residents who participated in its consultation process supported its proposal and the price increase.<sup>123</sup> However, we received a submission from the Patterson Lakes (Quiet Lakes) Owners and Residents Association opposing the proposed tariff and expressing dissatisfaction with Melbourne Water's service outcomes in relation to the water quality and amenity of the Quiet Lakes.<sup>124</sup> The same customer group appealed the commission's final decision on Melbourne Water's bore flushing tariff proposal in 2017, raising similar issues to that raised in its submission.<sup>125</sup> The appeal panel affirmed that our 2017 decision to approve a standalone tariff for Melbourne Water's proposed service offering to the Quiet Lakes residents was without bias.<sup>126</sup> We note that Melbourne Water proposed to maintain the same service quality outcomes as in 2017.

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<sup>123</sup> Melbourne Water 2025, *2026 price submission*, September, p. 54. Essential Services Commission 2017, *Melbourne Water – Quiet Lakes Bore Flushing Tariff Proposal – Final Decision*, June.

<sup>124</sup> Patterson Lakes (Quiet Lakes) Owners and Residents Association, *Submission to Essential Services Commission in response to Melbourne Water bore tariff proposal PS26*, 10 December 2025, pp. 1-3.

<sup>125</sup> Essential Services Commission 2017, *Melbourne Water – Quiet Lakes Bore Flushing Tariff Proposal – Final Decision*, June.

<sup>126</sup> Essential Services Commission Appeal Panel Order on Quiet Lakes Fees, 6 September 2017.

### *Our assessment of Melbourne Water's proposed tariff structure for its bore flushing service*

We approved Melbourne Water's proposal to continue applying a standalone tariff on Quiet Lake resident for bore flushing services in 2017 as it is consistent with the appeal panel's decision.

With regard to the price level, we reviewed Melbourne Water's forecast bore flushing costs and tariff revenue over the 2026–31 regulatory period and found that the proposed price path will transition towards full cost recovery by 2030-31. We acknowledge that there is a cross-subsidy by the broader waterways and drainage customers as the proposed charge does not yet reflect efficient energy and monitoring costs to undertake bore flushing. However, the charge will be closer to cost reflectivity by 2030-31.

### *Our draft decision on Melbourne Water's proposed tariff structure for its bore flushing service*

We consider that the Quiet Lakes residents who receive exclusive recreational benefits from the bore flushing service should pay for the cost of the service. This is consistent with our prior decisions.

Our draft decision is to accept Melbourne Water's proposed tariff structure for its bore flushing service, that is, a single fixed charge for all residents bordering the Quiet Lakes including Lake Carramar.

## **Koo Wee Rup – Longwarry Flood Protection District**

Melbourne Water charges the Koo Wee Rup–Longwarry customers in the Flood Protection District a special drainage rate. During the current regulatory period, Melbourne Water has transitioned these customers from a property value based charge to a single cost reflective charge. Melbourne Water proposed to maintain this charge at its current level in 2026-27 and increase it by 5.2 per cent (before inflation) per year from 2027-28 onwards.<sup>127</sup> This reflects Melbourne Water's proposal to deliver an uplift in the drainage maintenance and flood resilience services provided to this district in response to the community's feedback.

Melbourne Water noted that most property owners who participated in its consultation process preferred a modest price increase in support of a higher level of service.<sup>128</sup>

We did not receive any public submissions on Melbourne Water's proposal relating to the special drainage rate.

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<sup>127</sup> End-use customers in this district do not pay the core waterways and drainage charge applied elsewhere across Melbourne Water's Waterways Management District.

<sup>128</sup> Melbourne Water 2025, *Koo Wee Rup – Longwarry Flood Protection District community engagement summary*, 21 August, p. 1.

Our draft decision is to accept Melbourne Water’s proposed tariff structure for the Koo Wee Rup – Longwarry Flood Protection District as it is supported by relevant customers, and it reflects the cost of delivering the increased maintenance and flood protection service, consistent with our guidance.

## 8.2. Diversion services tariffs

Our draft decision is to accept Melbourne Water’s proposed diversion tariffs structures.

Melbourne Water provides diversion services to customers who access water from waterways such as rivers, streams and dams.<sup>129</sup> Diversion customers are generally charged a licence service fee and a volume charge. We regulate Melbourne Water’s tariffs according to the pricing principles in the Water Industry Regulatory Order 2014.<sup>130</sup>

Melbourne Water proposed to:

- retain its existing tariff structures for diversion services
- keep licence fees and volume charges by inflation only in 2026-27 and then increase by up to 0.2 per cent each year from 2027-28 to 2030-31 (before inflation)
- increase the licence application fee for stormwater harvesting charges by 10 per cent in 2026-27 (before inflation) and then increase by inflation only from 2027-28 to 2030-31
- keep other diversion-related application fees flat (before inflation).

We assessed Melbourne Water’s proposed tariffs for its diversion services and consider they are cost reflective and provide signals about the efficient costs of providing the services. On this basis, our draft decision is to accept Melbourne Water’s proposed diversion tariffs as they are consistent with the criteria set out in our guidance.

## 8.3. Miscellaneous service tariffs

Our draft decision is to accept Melbourne Water’s proposed miscellaneous service tariff structures.

Melbourne Water currently provides a range of miscellaneous services to retail water businesses, developers and the general public. Miscellaneous service tariffs must reflect the actual cost of providing the services.<sup>131</sup>

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<sup>129</sup> Diversion services account for about 0.1 per cent of Melbourne Water’s revenue.

<sup>130</sup> The pricing principles that we must have regard to are listed at cl. 11(d) of the Water Industry Regulatory Order 2014.

<sup>131</sup> Essential Services Commission, *2026 Melbourne Water price review: Guidance paper*, 19 November 2024, p. 63.

Melbourne Water did not propose any changes to the structure of its tariffs for miscellaneous services but proposed:

- to increase most miscellaneous service fees by inflation
- relatively small one-off increases and for some charges, small decreases
- to increase stormwater connection service fees by 10 per cent per year to partially correct historical under-recovering of costs.

Melbourne Water consulted with its customers on the proposed changes to tariff levels.<sup>132</sup>

We reviewed Melbourne Water's miscellaneous service fees and customer feedback, and consider they are cost reflective and supported by its customers.

Our draft decision is to accept Melbourne Water's proposed miscellaneous service fees on the basis that they are consistent with the criteria in our guidance.

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<sup>132</sup> Melbourne Water 2025, *2026 price submission*, September, p. 221.

## 9. Developer charges and large load connections

This chapter sets out our draft decision on Melbourne Water’s proposed developer charges. Developers pay Melbourne Water for the capital investment required to provide waterways and drainage services on undeveloped land (which is usually on the urban fringe).<sup>133</sup>

This chapter also sets out our response to an addendum to Melbourne Water’s price submission outlining the principles and charges it proposed to apply to large load and/or complex connections.<sup>134</sup>

### 9.1. Waterways and drainage developer charges

Melbourne Water’s proposal to charge for development service schemes (developer charges) is set out on pages 222 and 223 of its price submission.

Melbourne Water currently uses two sets of principles to determine its developer charges:

- principles around the establishment of individual development services schemes
- pricing principles that Melbourne Water uses to calculate scheme rates.

We do not have a role approving the principles around the establishment of individual development service schemes but we have a role in approving the pricing principles that Melbourne Water uses to calculate scheme rates. The pricing principles were approved in Melbourne Water’s 2021 price review.

#### Melbourne Water proposed minor amendments to its pricing principles

Our guidance sets out the following pricing principles to calculate developer charges:<sup>135</sup>

- identifying future capital expenditure for each year of the expected life of the scheme
- identifying forecast developable hectares for each year using an estimate of development density
- applying a pre-tax real discount rate (consistent with that determined by the commission) to convert future cash flows into present value terms

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<sup>133</sup> Developer charges are different to new customer contributions charged by retail water businesses, which are a financial payment made to a water business for works that are used or will be used directly or indirectly for the provision of services that will benefit the connecting property, and any fireplugs attached to those works.

<sup>134</sup> Melbourne Water 2026, *Addendum to Melbourne Water’s 2026 price submission – large and complex connections*, February, pp. 6–7.

<sup>135</sup> Essential Services Commission, *2026 Melbourne Water price review: Guidance paper*, 19 November 2024, pp. 65-66.

- setting the developer charge such that the present value of future income equals the present value of future costs, where future income is equal to the developable hectares in each year multiplied by the developer charge
- reviewing the financial assumptions relating to each scheme on an annual basis and reviewing engineering specifications every 5 years.

We noted in the guidance that if Melbourne Water proposed changes to the pricing principles to calculate developer charges, then we would assess the changes against the matters in clause 11 of the Water Industry Regulatory Order 2014.

Melbourne Water proposed to continue using its current pricing principles with the following changes to reflect its current practice:

- Refinements to the principles to reflect Melbourne Water's 2021 final decision. These refinements were omitted from the guidance for Melbourne Water's 2026 price review.<sup>136</sup>
- Minor amendments to better reflect the wording in sections 196 and 197 of the Water Act, which allow the recovery of an appropriate allocation of sunk costs, rather than being limited to future capital expenditure.
- The addition of an option to use a different density unit other than developable floor area where appropriate to calculate developer charges for urban renewal precincts.

These principles are similar to the principles we approved in our 2021 final decision with some minor amendments. We reviewed these amendments and consider the revised principles as proposed by Melbourne Water meet the requirements of the Water Industry Regulatory Order 2014.

On this basis, our draft decision is to approve Melbourne Water's proposed pricing principles to calculate development service scheme rates.

### **Interested parties raised concerns about Melbourne Water's application of its pricing principles**

Melbourne Water has 121 active drainage schemes with different pricing models for each.

Melbourne Water provided us a sample of models and reports for active drainage systems, to demonstrate how the pricing principles are applied. We have reviewed this sample to check that the current pricing principles have been correctly applied by Melbourne Water.

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<sup>136</sup> Essential Services Commission, *2026 Melbourne Water price review: Guidance paper*, 19 November 2024, pp. 65-66.

We found that Melbourne Water applied the pricing principles correctly in the samples we looked at. However, we received a submission from the Urban Development Institute of Australia and the Association of Land Development Engineers recommending as part of our review, that we:

- Scrutinise the use of averaged developer charges in Melbourne Water’s price submission, noting that these do not reflect the charges actually faced by many developments.
- Require clearer disclosure of the ranges of scheme-specific developer charges, including minimum, maximum and percentile outcomes, to accompany any presentation of average developer charges.
- Incorporate a regular, predetermined increase to developer charges which is reassessed when infrastructure requirements are reviewed, to avoid large step-changes when charges are eventually reset.
- Consider whether the degree of scheme-to-scheme variance is consistent with our objectives of transparency, fairness and efficient pricing signals, particularly in the context of housing affordability and supply.
- Seek further justification from Melbourne Water as to why large variances in scheme-to-scheme charges are acceptable, and whether alternative approaches to smoothing, rebalancing or risk sharing across schemes have been adequately considered.
- Consider opportunities to combine schemes where they serve a closely aligned development area to improve efficiency and reduce duplication of overheads.<sup>137</sup>

Our assessment of the sample of models and reports for active drainage systems provided by Melbourne Water showed that its assumptions underpinning the drainage services scheme costs and the corresponding developer charges were appropriate. Melbourne Water stated in its price submission that it will review the principles it uses to establish drainage services schemes together with representatives from the sector during the 2026–31 regulatory period.<sup>138</sup>

Melbourne Water provided a submission in response to the submission from the Urban Development Institute of Australia and the Association of Land Development Engineers, stating:

- Melbourne Water communicates scheme rates via price schedules and an interactive calculator on its website for developers, and the average rates were only included in the price submission which was written for the commission.
- The variances in developer charges reflect the unique characteristics and infrastructure needs of each scheme.

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<sup>137</sup> Urban Development Institute of Australia, Victoria and Association of Land Development Engineers, *Submission to the Essential Services Commission 2026 Water Price Review*, 30 January 2026, pp. 1–4.

<sup>138</sup> Melbourne Water 2025, *2026 price submission*, September, p. 223.

- Melbourne Water’s recent engagement with developers found developers preferred maintaining the current drainage services scheme model for its price submission and Melbourne Water making a commitment to review the principles used to establish schemes.
- Melbourne Water’s commitment to review the principles includes consideration of aggregating schemes and cost apportionment across schemes and Melbourne Water notes there are different views in the sector on this issue.
- Melbourne Water has established an industry working group to progress this work with the sector which is currently considering the issues raised in the submission by the Urban Development Institute of Australia and the Association of Land Development Engineers.<sup>139</sup>

The submission raised issues that relate to the application of the principles rather than the principles themselves and therefore fall outside the scope of our price review. Our preliminary view is that Melbourne Water’s proposed pricing principles are consistent with the requirements of our guidance. We note that Melbourne Water has committed to working with the industry in reviewing the principles it uses to establish drainage scheme areas. It should continue to address the issues raised in the submission as part of that review.

Our draft decision is to approve Melbourne Water’s proposed developer charges pricing principles.

## 9.2. Proposed pricing principles for large and/or complex connections

Melbourne Water submitted a late addendum to its 2026 price submission outlining the principles and charges it proposed to apply to large load connections.<sup>140</sup>

Melbourne Water identified the issue of large or complex connections through its ongoing engagement with us and interested parties from 2025. This engagement has informed the development of its current proposal, which looks to respond to emerging challenges associated with servicing these types of connections. We acknowledge Melbourne Water’s proactive approach in raising this issue with us and engaging constructively in what is a relatively new and evolving area of economic development. However, we consider that Melbourne Water was generally slow to respond to the issue of large load demand (particularly from data centres) – there are no estimates of the impact of large loads in its proposed forecast demand and expenditure, and interested

<sup>139</sup> Melbourne Water, *Submission to the Essential Services Commission 2026 Water Price Review*, 27 February 2026, p. 3.

<sup>140</sup> Melbourne Water 2026, *Addendum to Melbourne Water’s 2026 price submission – large and complex connections*, February, pp. 6–7.

parties were not consulted on its late addendum. We would have expected these issues to be addressed in the pricing proposal submitted in September 2025.

For the purposes of assessing the proposal, Melbourne Water has adopted a specific definition of 'large or complex connections', which are those that:

- have an instantaneous peak, annual demand, or trade waste load significantly higher or different to those of residential, domestic or light commercial use,<sup>141</sup> or
- require Melbourne Water to construct works to service the connection directly or indirectly via the water business's networks, or
- require Melbourne Water to construct works earlier and/or at a greater capacity than planned.<sup>142</sup>

We have applied this same definition in our consideration of Melbourne Water's proposal to ensure consistency and clarity in responding to the proposal. However, we seek interested parties' views on the proposed definition.

We also note that the framework we apply in regulating other connections and water and sewerage services is equally relevant in this context. This provides an established and consistent basis for assessment, ensuring that similar principles are applied across comparable services. While we are not yet in a position to accept the proposal as put forward, we recognise the value of Melbourne Water's engagement and the importance of continuing to work through these issues as the sector responds to changing demand and developments. Our preliminary view on Melbourne Water's proposal is outlined below.

### **9.2.1. Our guidance on large and/or complex connections**

The guidance we issue pursuant to the Water Industry Regulatory Order 2014 sets out our regulatory framework for large and/or complex connections. The guidance needs to capture the matters we expect water businesses to consider and provide clarity about the information they must provide us in support of their pricing proposals. Our guidance also needs to consider the binding requirements that the *Water Act 1989* imposes on water businesses in relation to new connections requiring payment of charges in relation to large or complex connections.

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<sup>141</sup> Melbourne Water notes that that 'light commercial use' will be set out in its connection policy and those of other water businesses – Melbourne Water 2026, *Addendum to Melbourne Water's 2026 price submission – large and complex connections*, February, p. 6.

<sup>142</sup> Melbourne Water 2026, *Addendum to Melbourne Water's 2026 price submission – large and complex connections*, February, pp. 6–7.

Our guidance on large and/or complex connections was provided to Melbourne Water through a series of discussions and reviews of its late proposal in relation to large or complex connections.<sup>143</sup>

### 9.2.2. Melbourne Water's proposed pricing principles for large and/or complex connections

Melbourne Water proposed pricing principles to charge for:

- large and/or complex connections to water, sewerage and recycled water services
- sewer mining, which it defines as the practice of extracting sewage from a sewer and treating the sewage to recover a desired resource (for example, recycled water). Sewer mining may also involve the management of waste byproducts (for example, by way of disposal back to the source sewer, or another sewer).<sup>144</sup>

Melbourne Water's proposal included:

- back-to-back arrangements between Melbourne Water and connected water businesses so that all costs that are incurred as a result of the connection are recovered
- miscellaneous fees to recover:
  - investigation and application costs
  - ongoing fixed, usage and reservation costs
  - disconnection costs
  - any other up-front or ongoing operating costs incurred by Melbourne Water to service the new connection
- a capital contribution, which:
  - is calculated for each application
  - recovers the costs of constructing – or bringing forward – infrastructure required for the new connection
  - is charged:
    - to the water business to which an applicant seeks to connect and subsequently passed-through to the applicant via a negotiated new customer contribution
    - or in the case of a direct connection to Melbourne Water's works, from the applicant.

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<sup>143</sup> Clause 13(b) of the Water Industry Regulatory Order 2014 sets out that 'The Commission may at any time vary or add to the guidance provided to the relevant regulated entity following consultation, including with the regulated entity'.

<sup>144</sup> Melbourne Water 2026, *Addendum to Melbourne Water's 2026 price submission – large and complex connections*, February, p. 10.

Melbourne Water noted that a negotiating framework, connections policy, and tripartite agreements will be developed during the 2026–31 regulatory period in collaboration with water businesses, the Department of Energy, Environment and Climate Action, and the commission. Under its connections policy and negotiating framework, customers would have review rights to the Victorian Civil and Administrative Tribunal.

Melbourne Water proposed to charge for large and/or complex connections and sewer mining under section 264(1) of the *Water Act 1989*, which provides:

An Authority may, by by-law or otherwise, set charges for anything it does in the performance of its functions, including any function delegated to it.

### **9.2.3. Melbourne Water proposed miscellaneous charges relating to large and/or complex connections**

Melbourne Water proposed using its existing miscellaneous charging principles in its determination to recover:<sup>145</sup>

- investigation and application costs
- ongoing fixed, usage and reservation costs
- disconnection costs
- any other up-front or ongoing operating costs incurred by Melbourne Water to service the new connection.

#### **Investigation and application costs**

In its proposal, Melbourne Water provided further detail on the components of investigation costs. However, it also noted that an ‘application’ will be subject to special charges, which it set out will be calculated not using miscellaneous pricing principles but net incremental cost pricing principles (discussed below in ‘Connection charges’).<sup>146</sup> Hence, Melbourne Water’s proposal is unclear on the pricing principles it proposes to use to recover investigation and application costs.

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<sup>145</sup> Pricing principles for miscellaneous services not included in Schedule 2 are set out in Schedule 4.5 of the Melbourne Water Determination: Essential Services Commission, *Melbourne Water Determination: 1 July 2021 – 30 June 2026*, 16 June 2021, p. 32.

<sup>146</sup> Melbourne Water 2026, *Addendum to Melbourne Water’s 2026 price submission – large and complex connections*, February, p. 6.

## Ongoing charges

Melbourne Water proposed the following ongoing charges to be paid by water businesses or, in the case of any direct connection, the customer:

- Fixed charges – may include annual service charges that reflect any ongoing metering, monitoring and other costs incurred directly or indirectly by Melbourne Water with the connection
- Usage charges
- Reservation charges – may apply if the new connection requires supplementary or intermittent back-up supply

Melbourne Water also set out that these charges will be set in accordance with Melbourne Water's cost allocation methodology.<sup>147</sup> It is unclear to us whether this means consistent with the miscellaneous pricing principles or refers to an additional set of pricing principles as the proposal does not set out the cost allocation methodology. Also, it is unclear why Melbourne Water did not propose using the pricing principles for setting water business's fixed and variable usage charges, as set out in the guidance, or why these principles should not be applied to estimate reservation charges.

## Disconnection charges

Melbourne Water proposed that disconnection charges would apply when a large and/or complex customer that has connected to a water business, or Melbourne Water's water, sewerage or recycled water services:

- removes the physical connections to the water business and/or Melbourne Water's system, and
- has paid a connection contribution charge to Melbourne Water via its water business.

Melbourne Water proposed that disconnection charges must be set to have regard to works constructed to serve the large and/or complex customer, the forecast utilisation of the works constructed by the wider customer base, and consider any contribution customers of made by the large and/or complex loads.

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<sup>147</sup> Melbourne Water, *Addendum to Melbourne Water's 2026 price submission – large and complex connections*, 21 February 2026, p. 8.

## **Our preliminary view on Melbourne Water’s proposed miscellaneous charges for large or complex connections**

Our preliminary view is that it is unclear:

- if Melbourne Water has provided sufficient detail for connected parties to understand the underlying cost components, as it appears to us that more detail would be required.

Our preliminary assessment of Melbourne Water’s miscellaneous charges for large and/or complex connections suggests they are likely to be very large. However, Melbourne Water’s proposal has not yet provided sufficient detail or clarity on the underlying cost components to enable a robust assessment. We also seek feedback from interested parties on Melbourne Water’s proposal on miscellaneous charges. As a result, we are not yet able to accept the proposed miscellaneous charges.

In response to our draft decision, Melbourne Water should provide more comprehensive information on the cost components of these miscellaneous charges. This should include a clear breakdown of the activities underpinning each of the cost categories.

### **9.2.4. Connection charges (special charges)**

Melbourne Water proposed capital contributions called ‘special charges’ which are calculated for each application to recover the costs of constructing or bringing forward infrastructure required for the new connection. Special charges are charged to the water business to which an applicant seeks to connect and are subsequently passed through to the applicant via a negotiated new customer contribution, or in the case of a direct connection to Melbourne Water’s works, to the applicant.

Melbourne Water proposed that special charges will be calculated by applying the following pricing principles:

- incremental infrastructure and associated costs in one or more of Melbourne Water’s statutory cost categories attributable to the given connection, which must be greater than the avoidable cost of not servicing the connection and less than the standalone cost of servicing that connection (incremental cost)
- incremental future benefits that will be earned by Melbourne Water from customers at that connection.

Our preliminary assessment is that we support the setting of the special charge based on costs less benefits because Melbourne Water’s proposed approach is consistent with the approach set out in the commission’s framework for setting new customer contributions charges through pricing

principles.<sup>148</sup> The new customer contributions pricing principles have worked well in the past. We also support Melbourne Water's transparent approach to ensuring these principles are clearly set out prior to charges being calculated. However, in response to our draft decision, Melbourne Water must consider whether it will charge for water commodity costs. For example, the incremental costs for water entitlement, recycled water and desalinated water capacity.

### 9.2.5. Sewer mining

Melbourne Water proposed charges relating to sewer mining to have regard to connection costs, monitoring costs, metering costs, administrative costs, extraction costs and benefits and discharge costs based on existing miscellaneous charging pricing principles and pricing principles where scheduled prices do not apply in its determination.<sup>149</sup> Melbourne Water stated it will undertake further engagement and consultation on its charges relating to sewer mining ahead of implementation.

Melbourne Water outlined in its proposal more detail on the cost components for sewer mining and noted that the prices for sewer mining will be set out in a tripartite agreement with the relevant water business. We note that all pricing principles for large and complex connections, including sewer mining will be set out in Melbourne Water's determination.

Our preliminary assessment is that:

- it is not yet clear to us that Melbourne Water has provided interested parties with enough detail to understand the underlying costs for sewer mining given that these charges are expected to be in the tens to hundreds of thousands of dollars
- there is no consideration of inclusion of resource costs in sewer mining charges
- it is not clear why Melbourne Water has not proposed using the trade waste pricing principles to set charges to recover the costs of discharging back into the sewer.

Our preliminary view is that we are not yet able to accept the proposed sewer mining charges as there is insufficient detail provided in Melbourne Water's proposal.

In response to our draft decision, Melbourne Water must clearly set out:

- interested parties' feedback on the level of detail on the cost components underlying sewer mining charges
- its consideration of trade waste charges for sewer mining

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<sup>148</sup> Essential Services Commission, *New Customer Contributions Framework*, 22 January 2026, p. v.

<sup>149</sup> Pricing principles for miscellaneous services not included in Schedule 2 are set out in Schedule 4.5 of the Melbourne Water Determination. Pricing principles where scheduled prices do not apply are set out in Schedule 4.2 of the Melbourne Water Determination: Essential Services Commission, *Melbourne Water Determination: 1 July 2021 – 30 June 2026*, 16 June 2021, pp. 30–32.

- consultation feedback on a resource cost for inclusion in its proposed sewer mining charges.

### 9.2.6. Incremental financing costs

Melbourne Water proposed how it would calculate incremental financing costs (to cover brought forward capital spends) based on existing formulas set out in water business's determinations.<sup>150</sup>

Our preliminary assessment is to accept the proposed approach to calculating incremental financing costs because it is consistent with our guidance and has worked well in the past.

### 9.2.7. Other issues

Melbourne Water proposed a high-level dispute resolution process and noted it will develop:

- A connection policy that clearly outlines when a referral is needed to Melbourne Water that may result in a contribution for upgrades or bring-forward of bulk assets.
- A negotiating framework that would outline the steps and processes which Melbourne Water would take and how it would fit in the water business's negotiating framework. This would include dispute resolution processes.
- A standard tripartite agreement to be used as a template for future connections that would be subject to a contribution for bulk assets managed by Melbourne Water.

Under our new customer contributions framework, retail water businesses must prepare a connection policy and negotiating framework. We consider these documents to be well suited to Melbourne Water. Our preliminary assessment is we support the development of the above policies. Melbourne Water should consider including in its connection policy the type of information specified in our new customer contributions framework where it is relevant to Melbourne Water's proposed principles.<sup>151</sup> In addition, Melbourne Water should set out in its connection policy how it intends to manage stranded assets arising from a mismatch between the asset life used to service a data centre and the asset life of a data centre.

The connection policy (setting out a dispute resolution process in more detail) and negotiating framework should be submitted to us for approval. We expect Melbourne Water to finalise these policies in consultation with affected water businesses by December 2026.

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<sup>150</sup> For example, see: *Essential Services Commission, Greater Western Water Determination: 1 July 2024 – 30 June 2028*, 12 June 2024, p. 33.

<sup>151</sup> Essential Services Commission, *New Customer Contributions Framework*, 22 January 2026, pp. 27–29.

### 9.2.8. Draft decision

Our preliminary view is that Melbourne Water has not yet provided us with adequate information or justification for us to be satisfied that its proposed pricing principles for large and/or complex connections are compliant with our guidance. Also, given the lateness of the proposal, water retailers and other interested parties have not had an opportunity to comment or provide feedback on Melbourne Water's proposal. Therefore, we are not yet able to accept the proposal.

In addition, given the limited time we had to assess Melbourne Water's proposal, a full assessment is not set out in this draft decision, but will be included in our final decision.

## 10. Financial position

We have reviewed key indicators of Melbourne Water's financial performance, and our preliminary view is that Melbourne Water will generate sufficient cash flow from the revenue requirement adopted in our draft decision to deliver on its service commitments.

In approving prices, we must have regard to the financial viability of the water industry.<sup>152</sup> We interpret the financial viability requirements under the *Essential Services Commission Act 2001* and the *Water Industry Regulatory Order 2014* to mean that the prices we approve should provide a high level of certainty that each water business can generate sufficient cash flow to deliver on its service commitments. This includes financing costs arising from investments to meet service expectations.

We provided Melbourne Water with a financial model template to help our assessment of its financial position in the context of the prices proposed in its price submission. This template calculated estimates for key financial indicators based on Melbourne Water's assumptions about revenue and expenditure in its price submission. As our draft decision requires Melbourne Water to make some adjustments to its revenue and expenditure forecasts, we have recalculated these financial indicators based on the revenue and expenditure forecasts in our draft decision. We have then compared the results with the benchmarks we set for each indicator in our guidance to assess Melbourne Water's financeability under our draft decision.<sup>153</sup>

For the 2026 Water Price Review, we have applied both actual and notional tests for each of the indicators:

- Table 10.1 calculates the indicators based on Melbourne Water's assumptions. This is an actual test of whether Melbourne Water would raise sufficient finance and remain financeable throughout the regulatory period – based on Melbourne Water's proposal and our draft decision.
- Table 10.2 calculates the indicators based on a 'notional efficient business', which may have different inputs (like the level of gearing or cost of debt) to Melbourne Water. This notional test allows us to assess whether an efficient business would raise sufficient funds to remain financeable throughout the regulatory period – based on Melbourne Water's proposal and our draft decision.

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<sup>152</sup> *Water Industry Regulatory Order 2014*, cl. 8(b)(ii) and *Essential Services Commission Act 2001*, s. 8A(1)(b).

<sup>153</sup> See our guidance for more information about the financial indicators, including descriptions and definitions. *Essential Services Commission, 2026 Melbourne Water price review: Guidance paper*, 19 November 2024, pp. 66–68.

**Table 10.1 Actual financial indicator scores calculated from Melbourne Water’s proposal and our draft decision compared to our benchmarks**

		2026-27	2027-28	2028-29	2029-30	2030-31
<b>Ratio for funds from operations interest cover (times)</b>	<b>Commission benchmark</b>	<b>&gt;1.5</b>	<b>&gt;1.5</b>	<b>&gt;1.5</b>	<b>&gt;1.5</b>	<b>&gt;1.5</b>
	Melbourne Water’s proposal	2.0	2.0	1.9	1.9	2.0
	Draft decision	2.0	2.0	2.0	2.0	2.0
<b>Funds from operations / Net debt</b>	<b>Commission benchmark</b>	<b>&gt;6%</b>	<b>&gt;6%</b>	<b>&gt;6%</b>	<b>&gt;6%</b>	<b>&gt;6%</b>
	Melbourne Water’s proposal	6.7%	6.7%	6.6%	6.6%	6.6%
	Draft decision	6.8%	6.8%	6.9%	7.0%	7.1%
<b>Net debt / Regulatory asset value (Gearing)</b>	<b>Commission benchmark</b>	<b>&lt;80%</b>	<b>&lt;80%</b>	<b>&lt;80%</b>	<b>&lt;80%</b>	<b>&lt;80%</b>
	Melbourne Water’s proposal	54.4%	54.4%	54.3%	54.1%	53.7%
	Draft decision	55.2%	54.9%	54.6%	54.0%	53.3%
<b>Retained cash flow / Net debt</b>	<b>Commission benchmark</b>	<b>&gt;4%</b>	<b>&gt;4%</b>	<b>&gt;4%</b>	<b>&gt;4%</b>	<b>&gt;4%</b>
	Melbourne Water’s proposal	6.1%	6.0%	6.3%	6.3%	6.4%
	Draft decision	6.0%	6.0%	6.4%	6.6%	6.7%
<b>Internal financing ratio</b>	<b>Commission benchmark</b>	<b>&gt;35%</b>	<b>&gt;35%</b>	<b>&gt;35%</b>	<b>&gt;35%</b>	<b>&gt;35%</b>
	Melbourne Water’s proposal	48.7%	46.5%	47.2%	48.4%	52.6%
	Draft decision	52.7%	51.2%	53.1%	54.2%	58.6%

**Notes:** Funds from operations interest cover measures the extent of the cash flow buffer a water business has to meet its debt obligations. Funds from operations/Net debt measures the extent to which the serviceability of debt is improving, remaining stable, or declining. Internal financing ratio measures the extent to which an entity has cash remaining to finance a prudent portion of capital expenditure after making dividends. Gearing measures how much of the water business’s operations is funded by debt versus equity. Retained cash flow is calculated by subtracting dividends from funds from operations. Retained cash flow/Net debt measures the extent to which the serviceability of debt is improving, remaining stable, or declining once cash extracted from the business is considered.

**Table 10.2 Notional financial indicator scores calculated from Melbourne Water’s proposal and our draft decision, compared to our benchmarks**

		2026-27	2027-28	2028-29	2029-30	2030-31
<b>Ratio for funds from operations interest cover (times)</b>	<b>Commission benchmark</b>	<b>&gt;1.5</b>	<b>&gt;1.5</b>	<b>&gt;1.5</b>	<b>&gt;1.5</b>	<b>&gt;1.5</b>
	Melbourne Water’s proposal	2.2	2.2	2.1	2.0	1.9
	Draft decision	2.2	2.2	2.2	2.1	2.0
<b>Funds from operations / Net debt</b>	<b>Commission benchmark</b>	<b>&gt;6</b>	<b>&gt;6</b>	<b>&gt;6</b>	<b>&gt;6</b>	<b>&gt;6</b>
	Melbourne Water’s proposal	5.7%	6.0%	5.6%	5.5%	5.2%
	Draft decision	5.9%	6.2%	6.0%	5.9%	5.6%
<b>Internal financing ratio (%)</b>	<b>Commission benchmark</b>	<b>&gt;35%</b>	<b>&gt;35%</b>	<b>&gt;35%</b>	<b>&gt;35%</b>	<b>&gt;35%</b>
	Melbourne Water’s proposal	47.9%	47.3%	45.2%	44.8%	46.2%
	Draft decision	53.4%	53.4%	52.5%	51.9%	53.5%

**Notes:** Funds from operations interest cover measures the extent of the cash flow buffer a water business has to meet its debt obligations. Funds from operations/Net debt measures the extent to which the serviceability of debt is improving, remaining stable, or declining. Internal financing ratio measures the extent to which an entity has cash remaining to finance a prudent portion of capital expenditure after making dividends.

The two primary financial indicators we look at in our assessment are ‘Funds from operations interest cover’ and ‘Funds from operations divided by Net debt’. Using the actual test, these two key indicators are forecast to remain above the benchmarks we set in our guidance throughout the regulatory period. This indicates that, based on the assumptions underpinning our draft decision, Melbourne Water would remain financeable.

We will recalculate the financial indicators based on updated information and undertake a further assessment of Melbourne Water’s financeability before making our final decision.

Businesses are primarily responsible for managing their financial performance. If there is a material change in circumstances and deviation from the assumptions underpinning the forecasts during the regulatory period, we expect Melbourne Water will explore avenues to address any concerns about its financeability. While a financial viability adjustment to its maximum prices can be made during the regulatory period, this should be seen as a last resort safeguard available in the pricing framework.

## 11. PREMO rating

We use the PREMO water pricing framework – Performance, Risk, Engagement, Management and Outcomes – to review pricing proposals. PREMO is an incentive mechanism that links the return on equity used to calculate a water business’s revenue requirement to that business’s level of ambition expressed in its price submission and its delivery on commitments made as part of its last price review. Our guidance required Melbourne Water to self-assess and rate its price submission for each element of the PREMO mechanism and arrive at an overall self-rating. We required Melbourne Water to self-rate its price submission as either ‘Leading’, ‘Advanced’, ‘Standard’ or ‘Basic’, with ‘Leading’ being the most ambitious and ‘Basic’ the least.

The assessment tool included in our guidance directed Melbourne Water to consider its level of ambition in relation to matters covered in its price submission, such as proposals related to operating and capital expenditure, the form of price control and tariffs.

We also assessed and rated Melbourne Water’s price submission. As outlined in our guidance, the combination of Melbourne Water’s self-rating and our preliminary rating has determined the return on equity we have adopted to calculate Melbourne Water’s revenue requirement in our draft decision.

For future price reviews, we intend to update our guidance in relation to First Nations rights and interests, consistent with the principle of self-determination. We plan to include additional matters that water businesses will need to demonstrate across the different elements of the PREMO framework. This may impact how we assess whether a price submission has met our expectations for achieving ‘Standard’, ‘Advanced’ or ‘Leading’ PREMO ratings in the future.

### 11.1. Our PREMO assessment of Melbourne Water’s price submission

Our draft decision is to rate Melbourne Water’s price submission overall as ‘Standard’ under PREMO, which is the same as Melbourne Water’s overall self-rating.

Our draft decision is to rate each of the five PREMO elements as shown in Table 11.1, with our preliminary rating of ‘Basic’ for the Performance element of PREMO being lower than Melbourne Water’s self-rating of Standard.

Melbourne Water’s self-rating for each of the PREMO elements and its overall self-rating are shown in Table 11.1. This table also includes our proposed ratings following our assessment of Melbourne Water’s price submission.

**Table 11.1**    **PREMO rating – draft decision**

	Overall PREMO rating	Performance	Risk	Engagement	Management	Outcomes
Melbourne Water’s self-rating	Standard	Standard	Standard	Standard	Standard	Standard
Commission’s preliminary rating	Standard	Basic	Standard	Standard	Standard	Standard

Our preliminary view is that we agree with Melbourne Water’s overall PREMO self-rating of its price submission as ‘Standard’. This is reflected in our draft decision on Melbourne Water’s return on equity (see section 4.4.2). We have formed this preliminary view after reviewing Melbourne Water’s price submission and its self-rating for each of the five PREMO elements, with a summary of our assessment provided below.

### 11.1.1. Performance

For its 2026 price review, Melbourne Water’s rating for the Performance element of PREMO is considered relative to its overall PREMO rating of ‘Standard’ at its most recent price review in 2021. Its rating must consider delivery against its commitments across the current regulatory period, including meeting its outcomes targets, customer sentiment, and performance against expenditure benchmarks set at the previous price review.<sup>154</sup>

As noted in section 3.2, we agree with Melbourne Water’s self-assessment that it has met most of its outcome commitments for the period to date. It met four of its five outcome commitments and demonstrated accountability and transparency in its performance reporting. Although, Melbourne Water did not meet its targets for its four customer satisfaction measures, it acknowledged that these were ambitious and survey methodology issues impacted their measurement.<sup>155</sup> Melbourne Water developed improved methodologies for measuring customer satisfaction with its services, and the retail water businesses have agreed to apply these new approaches going forward.

Melbourne Water’s controllable operating expenditure in 2024-25 was \$51 million (11 per cent) above the benchmark of \$467.4 million set at the 2021 price review. Our preliminary view is that \$40 million of this increase is efficient recurring expenditure but our draft decision is to remove

<sup>154</sup> As set out in Essential Services Commission, *2026 Melbourne Water price review: Guidance paper*, 19 November 2024, pp. 80–83, with guiding questions included on page 52.

<sup>155</sup> Melbourne Water, as a bulk service provider, is not included in our quarterly customer perception surveys, which we use to compare each business with the rest of the sector. Melbourne Water developed its own survey measures for the 2021–26 regulatory period, but considers those survey questions and the approach are not fit-for-purpose, especially with a small sample size.

\$11 million that was not sufficiently justified. Much of the increase was associated with 234 additional full-time equivalent positions that were not included in its approved benchmark (see section 4.1.2).

We also note that part of the increase reflects cost pressures arising during the pandemic. The expenditure forecasts proposed by Melbourne Water as part of its 2021 price review were developed prior to the pandemic. Melbourne Water chose not to update these before our final decision in 2021 and instead carried the risk of variances to its actual expenditure.

Melbourne Water's capital expenditure for the current regulatory period was \$463 million (10.6 per cent) above the benchmark adopted for the 2021 price review.<sup>156</sup> Our final decision for Melbourne Water's 2021 price review removed a notional \$50 million per year to balance delivery uncertainty risk in favour of customers. This \$250 million adjustment translates to \$302 million in \$2025-26, which means Melbourne Water's capital overspend was effectively \$161 million (3.7 per cent) compared with its unadjusted benchmark allowance (see section 4.2.1).

There was significant variation in Melbourne Water's delivery of major projects, including deferred, delayed and cancelled projects. Around half of Melbourne Water's major projects were delayed, with only five projects completed on time or ahead of schedule by 2024-25. This is reflected in the trend of Melbourne Water's actual capital delivery, which shows annual gross expenditure below annual benchmarks in the first 2 years of the regulatory period and above annual benchmarks in the last 3 years of the period.

In making our draft decision we have accepted that:

- Melbourne Water's self-assessment that it has largely met its outcome commitments to date, noting its challenges in measuring performance against its customer satisfaction targets.
- Melbourne Water developed improved methodologies for measuring customer satisfaction with its services, in agreement with the retail water businesses. These alternative measures consistently show strong satisfaction with its services among its customers (including the water businesses, developers and customers interacting with its customer contact centre).
- Melbourne Water's was able to demonstrate that almost 80 per cent of the variance above its controllable operating expenditure benchmark is efficient recurring expenditure.
- all of its actual capital expenditure overspend above its benchmark was reasonable and Melbourne Water satisfactorily explained the cost variances in its major projects.
- Melbourne Water was able to ramp up its delivery of projects in the last 3 years of the period so that it made up the capital expenditure underspend in the first 2 years of the regulatory period

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<sup>156</sup> In net terms (after contributions and asset disposal are accounted for) Melbourne Water exceeded the benchmark used to set maximum prices by \$35.1 million (1.0 per cent).

- Melbourne Water was able to explain the delays to the major projects it committed to deliver in the last regulatory period and that it identified several lessons that it has applied to improve its capital planning and delivery for the 2026–31 regulatory period.

While we accept that some costs have increased in the current regulatory period, we consider that businesses should still seek to closely manage and reprioritise costs having regard to their price review benchmarks. The PREMO framework (and the Water Industry Regulatory Order 2014 itself) is built on a sharp focus on efficiency, and base year costs for 2024-25 are critical to assessing the efficient operating costs to be reflected in benchmarks adopted for setting prices in the 2026–31 period. Melbourne Water’s 2024-25 controllable operating expenditure variance of \$51 million is significant and we only verified \$40 million of the overspend as being prudent and efficient.

In addition, the delays in capital expenditure, that was not incurred in the early years of the regulatory period, meant Melbourne Water was able to keep the forecast costs of the planned capital (depreciation and return on) in those years, at customers’ expense.

On these basis, our draft decision is to rate Melbourne Water’s price submission as ‘Basic’ for the Performance element of PREMO. This is a lower rating than Melbourne Water’s self-rating of its price submission as ‘Standard’ for this element.

### 11.1.2. Risk

The Risk element of PREMO is assessed against guiding questions focused on the appropriate allocation of risk (so that customers don’t pay more than they need to), and the business’s proposed Guaranteed Service Level scheme (including that it provides incentives for the business to deliver valued services efficiently).<sup>157</sup>

In support of the self-rating of its price submission as ‘Standard’ for the Risk element of PREMO, Melbourne Water provided an overview of key regulatory risk categories and the allocation of these risks between the business and its customers, based on its internal risk management framework.<sup>158</sup>

Key factors we identified that support Melbourne Water’s self-rating include:

- It proposed increasing the share of revenue recovered through variable charges, reducing its reliance on fixed charges and taking on a greater share of demand risk.
- It proposed an efficiency improvement rate of 2 per cent, which is an ambitious target and places greater delivery risk on the business.

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<sup>157</sup> Essential Services Commission, *2026 Melbourne Water price review: Guidance paper*, 19 November 2024, pp. 84–85, with guiding questions included on page 52.

<sup>158</sup> Melbourne Water 2025, *2026 price submission*, September, pp. 95–98.

- It has taken steps to manage the risk associated with the timing and delivery of its large capital program by excluding costs associated with ‘priority 4’ projects from its capital expenditure forecasts and including only development costs for ‘priority 2’ projects. However, our draft decision removes funding for ‘priority 3’ projects and applies a further 10 per cent reduction to the remaining water and sewerage capital expenditure forecast to better address the uncertainty and deliverability risks associated with the proposed program.
- It proposed price adjustment mechanisms for uncertain or unforeseen events that largely continue current arrangements. These mechanisms provide an established framework for managing certain risks that may arise during the regulatory period.
- It proposed a new Guaranteed Service Level for drinking water quality that matches the rebate a water retailer must pay to its customers when Melbourne Water, or a failure in Melbourne Water’s system, causes non-compliance with drinking water quality standards.

We note that Melbourne Water’s proposed operating expenditure growth rate appears likely to be overstated. However, this risk is largely offset by the efficiency improvement rate proposed by Melbourne Water, which places the onus on the business to deliver efficiencies over the regulatory period.

On balance, we consider Melbourne Water’s proposal reflects a reasonable allocation of risk between Melbourne Water and its customers. Our draft decision is to agree with Melbourne Water’s self-rating of its price submission as ‘Standard’ for the Risk element of PREMO.

### **11.1.3. Engagement**

The Engagement element of PREMO is assessed against guiding questions such as the form, timing, and nature of matters engaged on by the water business, and the influence of engagement on the business’s proposals. We also consider the extent to which a business has undertaken inclusive engagement, including with First Nations peoples and those experiencing vulnerability.

Our draft decision is to agree with Melbourne Water’s self-rating of its price submission as ‘Standard’ for the Engagement element of PREMO on the basis of the overall quality of its engagement program and the level of influence it afforded its stakeholders (see section 3.1).

Many elements of Melbourne Water’s engagement program demonstrate sound engagement practice. Its engagement started early and was designed to inform and test key elements of its proposal with customers, including First Nations peoples. Melbourne Water used a range of engagement methods to reach different customer groups. Through these activities it gathered feedback from around 8,200 customers and interested parties.

In addition, Melbourne Water undertook extensive engagement with the development industry, including initiatives to address backlogs in the processing of drainage scheme applications.

Melbourne Water's engagement focussed on matters that were material to prices and outcomes for each customer group. These included customer outcomes and service priorities, investment priorities for waterways and drainage services, transparency and collaboration with partners, affordability, bill impacts and equity considerations like support for customers experiencing vulnerability.

Its submission also demonstrated how customer feedback informed and shaped elements of its proposal, for example by:

- prioritising affordability in its proposed price changes
- proposing funding programs to support customers experiencing financial difficulties
- proposing a new Guaranteed Service Level for drinking water quality
- proposing improved service levels through more responsive and consistent communications
- prioritising vegetation for the environment, wildlife and biodiversity.

However, we received submissions from end-use waterways and drainage customers highlighting the need for improved transparency around the costs of services and the outcomes customers receive. Melbourne Water identified this as a contributing factor to relatively low participation rates in some voting activities among this customer group. While this does not detract from the overall quality of the engagement program, it suggests opportunities remain for Melbourne Water to strengthen how it communicates information to support customer participation and understanding.

We also note that Melbourne Water submitted a late proposal on pricing principles for large and/or complex loads (February 2026) for us to make a draft decision. We understand that Melbourne Water has been engaging with affected water businesses but that it did not consult on the proposal prior to its submission to us. We support Melbourne Water's efforts to address the issues raised by large and/or complex connections but would expect it to have engaged with retailers on its proposal before submission. We note that Melbourne Water has indicated it will consult with water businesses on its proposal.

On balance, given the overall quality and influence of its engagement program, our draft decision is to agree with Melbourne Water's self-rating of its price submission as 'Standard' for the Engagement element of PREMO.

#### **11.1.4. Management**

The Management element of PREMO is assessed against guiding questions that cover matters such as:

- The efficiency of proposed expenditure and prices.
- The quality of the business's price submission and supporting information to justify its proposals.

- Evidence of senior-level ownership and commitment to the proposals contained in the price submission.

A key requirement for a 'Standard' price submission rating for the Management element of PREMO is that proposed expenditure changes can be clearly justified by the business as prudent and efficient. Consistent with our draft decision on its forecast operating and capital expenditure, our preliminary view is that Melbourne Water was able to sufficiently justify that elements of its forecasts were prudent and efficient.

Melbourne Water proposed a total of \$7,856.1 million in capital expenditure over the 2026–31 regulatory period, which is 62 per cent above the expenditure it delivered over the 2021–26 regulatory period (using the latest forecast for 2025-26). We were able to verify the prudence and efficiency of some elements of Melbourne Water's proposed capital expenditure. Melbourne Water was able to provide sufficient evidence to satisfy us of its project prioritisation in support of the significant uplift in capital spending it proposed. However, we have some remaining concerns over the deliverability of the proposed program. To address these concerns associated with the large scale of Melbourne Water's proposed investment program our draft decision is to:

- remove \$82.7 million associated with 'priority 3' projects
- apply a further 10 per cent reduction to the remaining water and sewerage capital expenditure forecast.

Melbourne Water proposed an operating expenditure efficiency improvement rate that matched its proposed expenditure growth rate, effectively committing to absorb growth costs incurred over the regulatory period. However, we note that Melbourne Water also proposed 19 additional cost step increases to its baseline forecasts when some of these costs should be covered by its growth allowance or are immaterial and could be funded from its higher baseline expenditure allowance. Our draft decision is to accept only \$154 million of the \$201 million in proposed step changes.

Melbourne Water submitted an addendum to its pricing submission setting out how it proposed to deal with large and/or complex connections during the regulatory period. While we support Melbourne Water's proactive approach in raising the issue with us, and engaging constructively in what is a relatively new and evolving area of economic development. We consider that Melbourne Water was generally slow to respond to the issue of large load demand (particularly from data centres) – there are no estimates of the impact of large loads in its proposed demand and expenditure forecasts. The addendum was submitted quite late in our price review process. This limited the time we had to assess the proposal prior to our draft decision. We also note that other water businesses and interested parties have not had the opportunity to comment or provide feedback on Melbourne Water's proposal.

Our preliminary view is that Melbourne Water has not yet provided us with adequate information or justification for us to be satisfied that its proposed pricing principles for large and/or complex connections are compliant with our guidance.

Melbourne Water's price submission was generally well written and presented. Melbourne Water provided sufficient supporting evidence for most of its proposals. Its financial model was largely complete and consistent with its price submission, and its demand forecasts were based on reasonable assumptions. Through its price submission, Melbourne Water demonstrated that:

- Its board and senior leadership team were involved in the development of its proposals and its customer engagement strategy.
- It managed the implementation of the South-Central Pool Bulk Entitlements reform smoothly with affected water businesses and gained support for its proposed tariff reforms.
- It managed the interests of developers, water businesses, end-use customers and First Nations people to ensure their feedback was incorporated into the price submission and informed its proposals.

Melbourne Water's board also attested to the accuracy of the information contained in its price submission, as required by our guidance.

On balance, our draft decision is to agree with Melbourne Water's self-rating of its price submission as 'Standard' for the Management element of PREMO.

#### **11.1.5. Outcomes**

The Outcomes element of PREMO is assessed against guiding questions focused on:

- whether the proposed outcomes align with customer priorities and expenditure forecasts
- whether the proposed outcomes are measurable
- the processes established to measure performance and report to customers.

Melbourne Water proposed a new set of outcomes developed through consultation with customers and aligned with the delivery of its core services and customer priorities. It also proposed a largely new set of measures and targets that are simpler and easier for customers to understand compared with the current framework. Melbourne Water proposed a set of 19 measures and annual targets for each measure that it will use to report on performance across its 5 outcomes.

To deliver on its proposed outcomes, Melbourne Water proposed key investments in:

- drinking water security and quality
- water transfer networks and storage capacity
- treatment plant compliance and emissions reduction
- waterway management

- flood mitigation and modelling
- urban land development
- stormwater harvesting.<sup>159</sup>

Melbourne Water proposed to partner with metropolitan water businesses to support customers experiencing financial hardship through a new waterways and drainage hardship grant, funding a water efficiency program, and delivering a sector uplift program.<sup>160</sup>

As noted in section 3.2, our preliminary view is that Melbourne Water has provided evidence that demonstrated its outcome measures and targets were developed in consultation with customers and align with customer priorities.

Generally, we consider Melbourne Water's measures provide a sound basis to track performance and delivery against each outcome, subject to some minor wording clarifications. We are working with Melbourne Water to ensure its final set of measures is consistent with our guidance. Our preliminary view is that while Melbourne Water's outcome initiatives represent improvements in transparency, accountability and customer support, the proposed measures and targets largely reflect the continuation of current service levels. Proposing to maintain existing levels of service is consistent with a 'Standard' rating under our PREMO framework.

Melbourne Water will report twice annually to customers on its performance via its website and will also take its annual outcomes performance report to water business customers and its ongoing customer forum for feedback before submitting the report to the commission.

On balance, our draft decision is to rate Melbourne Water's price submission as 'Standard' for the Outcomes element of PREMO, which is the same as Melbourne Water's self-rating.

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<sup>159</sup> Melbourne Water 2025, *2026 price submission*, September, pp. 72–79.

<sup>160</sup> Melbourne Water 2025, *2026 price submission*, September, p. 85. The water efficiency program involves Melbourne Water providing water saving solutions to reduce bills for customers experiencing financial hardship. The sector uplift program involves Melbourne Water providing support to and partnering with community sector organisations, increasing marketing and education campaigns in collaboration with metropolitan water businesses, and contributing to the Financial Counselling Industry Fund.

## Appendix A – Submissions received

Name or organisation	Date received
The Aquatic Diviners and Dowser's Guild of Victoria	10 October 2025
Chrisentiae Sait-Piaf	11 October 2025
Anonymous	9 December 2025
Patterson Lakes Quiet Lakes Owners and Residents Association	10 December 2025
Water Services Association of Australia	11 December 2025
Maribyrnong River and Waterways Association	11 December 2025
Concerned Waterways Alliance	12 December 2025
South East Water	12 December 2025
Financial Counselling Victoria	12 December 2025
Urban Development Institute of Australia and the Association of Land Development Engineers	30 January 2026
Melbourne Water	27 February 2026

# Appendix B – Commission’s consideration of legal requirements

Clause 11 of the Water Industry Regulatory Order 2014 (WIRO) specifies the mandatory factors we must have regard to when making a price determination. The WIRO covers matters that are included in the *Water Industry Act 1994* (WI Act) and the *Essential Services Commission Act 2001* (ESC Act).

The following sections describe how we apply the mandatory factors and where we have done so in our draft decision for Melbourne Water.

In addition to the mandatory factors set out below, clause 11 of the WIRO requires the commission to have regard to the matters specified in the commission’s guidance.<sup>161</sup> We have had regard to the matters specified in our guidance in reaching our preliminary view. Our draft decision provides further information on where we have considered our guidance, and Melbourne Water’s compliance with our guidance, in reaching our preliminary view.

Note: all chapter and section numbers referenced below refer to our draft decision for Melbourne Water.

## **Economic efficiency and viability matters**

**WIRO clause 8(b)(i) requires us to have regard to the ‘promotion of efficient use of prescribed services by customers’.**

We consider that the efficient use of prescribed services by customers is promoted when a tariff is applied to customers benefiting from the service covered by the tariff, and tariffs send appropriate signals about efficient costs.

The following chapters and sections of our draft decision involved consideration of this factor:

- Our consideration of customer engagement (section 3.1).
- Our assessment of the revenue requirement (chapter 4).
- Our assessment of efficient operating expenditure (section 4.1) and capital expenditure (section 4.2).
- Our assessment of tariffs (section 5.3).

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<sup>161</sup> Essential Services Commission, *2026 Melbourne Water price review: Guidance paper*, 19 November 2024.

**WIRO clause 8(b)(ii) requires us to have regard to the ‘promotion of efficiency in regulated entities as well as efficiency in, and financial viability of, the regulated water industry’.**

We consider that the delivery of outcomes which reflect customer service priorities at an efficient cost promotes efficiency in regulated entities and the water industry. Our draft decision has therefore had regard to the extent that Melbourne Water has demonstrated its proposed outcomes reflect customer service priorities, and whether its tariffs and forecast costs reflect efficient levels of expenditure.

The following chapters and sections of our draft decision involved consideration of this factor:

- Our consideration of customer engagement (section 3.1).
- Our assessment of the revenue requirement (chapter 4).
- Our assessment of efficient operating expenditure (section 4.1) and capital expenditure (section 4.2).
- Our assessment of tariffs (section 5.3).
- Our assessment of financial viability (chapter 6).

**WIRO clause 8(b)(iii) requires us to have regard to the ‘provision to regulated entities of incentives to pursue efficiency improvements’.**

We consider that the delivery of outcomes which reflect customer service priorities at an efficient cost provides regulated entities incentives to pursue efficiency improvements. The following chapters and sections of our draft decision involved consideration of this factor:

- Our consideration of customer engagement (section 3.1).
- Our consideration of outcomes (section 3.2).
- Our assessment of the revenue requirement (chapter 4).
- Our assessment of efficient operating expenditure (section 4.1) and capital expenditure (section 4.2).
- Our assessment of tariffs (section 5.3).

Additionally, our pricing approach allows a water business to retain the benefits of any cost efficiencies it generates until the end of its regulatory period. In other words, a water business has an incentive to outperform the operating and capital expenditure benchmarks we adopt for the purpose of estimating its revenue requirement and prices. This is consistent with providing incentives for water businesses to pursue efficiency improvements.

**ESC Act section 8A(1)(a) requires us to have regard to ‘efficiency in the industry and incentives for long-term investment’.**

We consider that adopting forecasts of efficient expenditure that reflect the service priorities of the customers of each water business promotes efficiency in the water industry.

The following chapters and sections of our draft decision involved consideration of this factor:

- Our consideration of customer engagement (section 3.1).
- Our consideration of outcomes (section 3.2).
- Our assessment of the revenue requirement (chapter 4).
- Our assessment of efficient operating expenditure (section 4.1) and capital expenditure (section 4.2).
- Our assessment of tariffs (section 5.3).

We have had regard to incentives for long-term investment by adopting:

- A 10-year trailing average approach to estimating the benchmark cost of debt (see section 4.4.1).
- A regulatory rate of return that we consider will enable Melbourne Water to recover borrowing costs associated with its investment in services, and generate a return on assets.<sup>162</sup>

**ESC Act section 8A(1)(b) requires us to have regard to the ‘financial viability of the industry’.**

We consider that the financial viability of the industry is secured by approving prices that provide a high degree of certainty that each water business can maintain an investment grade credit rating. Further, prices should enable each business to generate cash flow to service financing costs arising from investments to meet service expectations.

We have had regard to this matter in chapter 5.

**ESC Act section 33(3)(b) requires us to have regard to the ‘efficient costs of producing or supplying regulated goods or services and of complying with relevant legislation and relevant health, safety, environmental and social legislation applying to the regulated industry’.**

In preparing our draft decision, we have had regard to the extent Melbourne Water has demonstrated its forecasts reflect efficient costs to deliver services valued by customers, and to deliver on relevant legislation and relevant health, safety, environmental and social obligations.

The following chapters and sections of our draft decision involved consideration of this factor:

- Our consideration of customer engagement (section 3.1).
- Our assessment of the revenue requirement (chapter 4).
- Our assessment of efficient operating expenditure (section 4.1) and capital expenditure (section 4.2).

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<sup>162</sup> The regulatory rate of return is comprised of the cost of debt and the return on equity.

- Our assessment of tariffs (chapters 7 and 8).

## **Industry specific matters**

**ESC Act section 33(3)(a) requires us to have regard to the ‘particular circumstances of the regulated industry and the prescribed goods and services for which the determination is being made’.**

Our pricing approach allows each water business to propose outcomes, tariff structures and expenditure that reflect its particular circumstances. We consider that taking into account the particular circumstances of each water business is consistent with taking into account the particular circumstances of the water industry.

The following chapters and sections of our draft decision involved consideration of this factor:

- Our consideration of customer engagement (section 3.1).
- Our consideration of outcomes (section 3.2).
- Our assessment of the revenue requirement (chapter 4).
- Our assessment of efficient operating expenditure (section 4.1) and capital expenditure (section 4.2).
- Our assessment of tariffs (chapters 7 and 8).

We have had regard to the prescribed services listed in the WIRO in making our decision. This includes adopting operating and capital expenditure benchmarks that we consider will allow Melbourne Water to deliver services that are covered by the prescribed services listed in the WIRO.

**ESC Act section 33(3)(c) requires us to have regard to the ‘return on assets in the regulated industry’.**

Our draft decision provides for Melbourne Water to generate a return on assets through:

- Our consideration of the regulatory asset base (section 4.3).
- Our consideration of the cost of debt (section 4.4.1).
- Our consideration of the return on equity (section 4.4.2).

**ESC Act section 33(3)(d) requires us to have regard to ‘any relevant interstate and international benchmarks for prices, costs and return on assets in comparable industries’.**

In assessing costs, prices and return on assets we have had regard to relevant interstate benchmarks:

- indicative bills paid by customers in other jurisdictions in Australia<sup>163</sup>
- operating and capital expenditure per connection throughout Australia<sup>164</sup>
- tariff structures applied by water businesses throughout Australia<sup>165</sup>
- the regulatory rate of return set by other regulators.<sup>166</sup>

We are not aware of any international benchmarks that are relevant to our decision.

**WI Act section 4C(b) requires us to ‘ensure that regulatory decision-making and regulatory processes have regard to any differences between the operating environments of regulated entities’.**

Our pricing approach allows each water business to propose outcomes, a revenue requirement, expenditure and tariffs that reflect its particular circumstances and operating environment.

The following chapters and sections of our draft decision involved consideration of this factor:

- Our consideration of customer engagement (section 3.1).
- Our consideration of outcomes (section 3.2).
- Our assessment of the revenue requirement (chapter 4).
- Our assessment of efficient operating expenditure (section 4.1) and capital expenditure (section 4.2).
- Our assessment of tariffs (chapters 7 and 8).

Our price review also considers the views of stakeholders affected by Melbourne Water’s proposals, including through submissions and public meetings.

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<sup>163</sup> Bureau of Meteorology, *National performance report 2022-23: urban water utilities, Part A*, March 2024.

<sup>164</sup> Bureau of Meteorology, *National performance report 2022-23: urban water utilities, Part A*, March 2024.

<sup>165</sup> Includes Icon Water, Sydney Water, Hunter Water, Central Coast Council, Power and Water Corporation, Urban Utilities, Unity Water, SA Water and TasWater.

<sup>166</sup> Independent Pricing and Regulatory Tribunal NSW, *Final Report – Review of prices for WaterNSW-Rural Valleys from 1 July 2025 – June 2025*; Independent Pricing and Regulatory Tribunal NSW, *Final Report – Sydney Water prices 2025-2030*, September 2025; Essential Services Commission of South Australia, *SA Water’s water and sewerage retail services: 1 July 2024 – 30 June 2028*, SA Water Regulatory Determination, 1 July 2024; Queensland Competition Authority, *Final report – Seqwater bulk water price review 2022–26*, March 2022; Queensland Competition Authority, *Final report – Rural irrigation price review 2025–29*, Seqwater, January 2025; Office of the Tasmanian Economic Regulator, *Final report – Investigation into TasWater’s prices and services for the period 1 July 2022 to 30 June 2026*, May 2022.

## Customer matters

**ESC Act section 8(1) requires us to have regard to the fact that the ‘objective of the Commission is to promote the long-term interests of Victorian consumers’.**

We consider that promoting efficiency in delivering outcomes that align to service priorities of customers is consistent with promoting the long term interests of Victorian consumers.

The following chapters and sections of our draft decision involved consideration of this factor:

- Our consideration of customer engagement (section 3.1).
- Our consideration of outcomes (section 3.2).
- Our assessment of the revenue requirement (chapter 4).
- Our assessment of efficient operating expenditure (section 4.1) and capital expenditure (section 4.2).
- Our assessment of tariffs (chapters 7 and 8).

**ESC Act section 8(2) requires us to ‘have regard to the price, quality and reliability of essential services’ in seeking to achieve the objective in section 8(1) of the ESC Act.**

We consider that promoting efficiency in delivering outcomes that align to service priorities of customers, and allowing businesses to meet regulatory and policy obligations is consistent with this objective.

In terms of prices, the following chapters and sections of our draft decision involved consideration of this factor:

- Our consideration of the revenue requirement (chapter 4).
- Our assessment of efficient operating expenditure (section 4.1) and capital expenditure (section 4.2).
- Our consideration of demand (chapter 5).
- Our consideration of tariffs (chapters 7 and 8).

In terms of the quality and reliability of services, the following sections of our draft decision involved consideration of this factor:

- Our consideration of customer engagement (section 3.1).
- Our consideration of outcomes (section 3.2).

**WIRO clause 11(d)(i) requires us to have regard to whether Melbourne Water’s prices ‘enable customers or potential customers of the regulated entity to easily understand prices charged by the regulated entity for prescribed services or the manner in which such prices are calculated, determined or otherwise regulated’.**

We consider that the following matters are relevant when considering whether Melbourne Water’s prices enable customers or potential customers to easily understand prices, or the manner in which prices are calculated, determined or otherwise regulated:

- feedback from customers during a water business’s engagement
- the structure of individual tariffs
- the proposed form of price control
- any changes to tariffs and how water businesses explain them to customers.

The following sections of our draft decision involved consideration of this factor:

- Our consideration of tariffs and the form of price control (chapters 7, 8 and 10).

**WIRO clause 11(d)(ii) requires us to have regard to whether Melbourne Water’s prices ‘provide signals about the efficient costs of providing prescribed services to customers while avoiding price shocks where possible’.**

We consider prices can provide signals about efficient costs when a tariff is applied to customers benefiting from the service covered by the tariff, and tariffs send appropriate signals about efficient costs.

The following chapters and sections of our draft decision involved consideration of this factor:

- Our consideration of customer engagement (section 3.1).
- Our assessment of the revenue requirement (chapter 4).
- Our assessment of efficient operating expenditure (section 4.1) and capital expenditure (section 4.2).
- Our assessment of tariffs (section 5.3).

**WIRO clause 11(d)(iii) requires us to have regard to whether Melbourne Water’s prices ‘take into account the interests of customers of the regulated entity, including low income and vulnerable customers’.**

We consider that customer value established through prices and customer outcomes, as well as tariff structures, assistance available to customers having difficulty paying bills is relevant to this objective.

The following chapters and sections of our draft decision involved consideration of this factor:

- Our consideration of customer engagement (section 3.1).

- Our consideration of outcomes (section 3.2).
- Our consideration of guaranteed service levels (section 3.4).
- Our assessment of tariff structure and prices (chapters 7 and 8).

## **Health, safety, environmental and social obligations**

**ESC Act section 8A(1)(d) requires us to have regard to ‘the relevant health, safety, environmental and social legislation applying to the industry’.**

Our draft decision proposes to approve a revenue requirement that will enable Melbourne Water to deliver the outcomes valued by customers, and on its legal and regulatory obligations.

The following chapters and sections of our draft decision involved consideration of this factor:

- Our assessment of the revenue requirement (chapter 4).
- Our assessment of efficient operating expenditure (section 4.1) and capital expenditure (section 4.2).
- Our assessment of the form of price control (chapter 10).

**WI Act section 4C(c) requires us to ‘ensure that regulatory decision-making has regard to the health, safety, environmental sustainability (including water conservation) and social obligations of regulated entities’.**

Our draft decision proposes to approve a revenue requirement that will enable Melbourne Water to deliver the outcomes valued by customers, and on its health, safety, environmental sustainability and social obligations.

The following chapters and sections of our draft decision involved consideration of this factor:

- Our assessment of the revenue requirement (chapter 4).
- Our assessment of efficient operating expenditure (section 4.1) and capital expenditure (section 4.2).
- Our assessment of tariffs (chapters 7 and 8).

## **Other matters**

**ESC Act section 8A(1)(c) requires us to have regard to ‘the degree of, and scope for, competition within the industry, including countervailing market power and information asymmetries’.**

In relation to the above, Melbourne Water does not face any competition in the delivery of its prescribed services within its region. Our draft decision takes this into account through our consideration of forecast efficient costs, and considering the service priorities of customers as revealed through a business’s customer engagement.

The following sections of our draft decision involved consideration of this factor:

- Our assessment of engagement (section 3.1)
- Our assessment of outcomes (section 3.2)
- Our assessment of efficient operating expenditure (section 4.1) and capital expenditure (section 4.2).

We consider that our pricing approach helps to address market power and information asymmetries relating to the water businesses. Our PREMO water pricing approach provides incentives for a water business to provide its “best offer” to customers in its price submission. This is described in further detail in a report we released in 2016.<sup>167</sup>

**ESC Act section 8A(1)(e) requires us to have regard to the ‘benefits and costs of regulation (including externalities and gains from competition and efficiency) for: (i) consumers and users of products or services (including low income and vulnerable consumers); and (ii) regulated entities’.**

We have had regard to benefits and costs of regulation by:

- Focusing our assessments of price submissions on the materiality of proposals to customer interests (including low income and vulnerable services), including in terms of price, bill and service impacts.
- Designing our guidance so we minimise the compliance costs for water businesses. Our guidance noted that much of the information required in price submissions should be readily available to water businesses as it would be relevant for other purposes such as corporate planning and project prioritisation and justification.<sup>168</sup>

**ESC Act section 8A(1)(f) requires us to have regard to ‘consistency in regulation between States and on a national basis’.**

Similar to other state and national regulators, our economic regulatory approach:

- uses the building block method to estimate a water business’s revenue requirement
- allows water businesses to implement various forms of price control, including price caps and revenue caps
- allows for consultation with key stakeholders during a price review, including through the release of a draft decision.

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<sup>167</sup> Essential Services Commission, *Water Pricing Framework and Approach, Implementing PREMO from 2018*, October 2016, pp. 11–13.

<sup>168</sup> Essential Services Commission, *2026 Melbourne Water price review: Guidance paper*, 19 November 2024, p. 2.

**WI Act section 4C(a) requires us to ‘ensure that the costs of regulation do not exceed the benefits’.**

We have sought to ensure that the costs of regulation do not exceed the benefits by:

- Focusing our assessments of price submissions on the materiality of proposals to customer interests (including low income customers and customers experiencing vulnerability), including in terms of price, bill and service impacts.
- Designing our guidance so we minimise the compliance costs for water businesses. Our guidance noted that much of the information required in price submissions should be readily available to water businesses as it would be relevant for other purposes such as corporate planning and project prioritisation and justification.<sup>169</sup>

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<sup>169</sup> Essential Services Commission, *2026 Melbourne Water price review: Guidance paper*, 19 November 2024, p. 2.

# Appendix C – Melbourne Water’s proposed Guaranteed Service Levels

## Melbourne Water’s proposed Guaranteed Service Levels for Greater Western Water

Guaranteed Service Level	Rebate
Unplanned water quality issue	<ul style="list-style-type: none"> <li>• If a precautionary drinking water advisory is issued due to a potential issue with drinking water supplied by Melbourne Water:               <ul style="list-style-type: none"> <li>– Bottled water reimbursement to metropolitan water business customers (on application)</li> <li>– Reimbursement of metropolitan water business incident administration costs</li> </ul> </li> <li>• Matching metropolitan water business Guaranteed Service Level rebate, up to \$75 rebate per property if drinking water supplied does not meet the microbial characteristics of health-based drinking water quality standards, and Melbourne Water, or a failure in Melbourne Water’s system, caused the non-compliance<sup>170</sup></li> </ul>
Unplanned water service interruption	<ul style="list-style-type: none"> <li>• \$250 rebate for more than 5 unplanned interruptions per year, \$125 for more than 3 unplanned interruptions per year</li> <li>• \$125 water service unplanned disruption not resolved within 5 hours of notification</li> </ul>
Unplanned sewer service interruption	<ul style="list-style-type: none"> <li>• \$125 more than 3 sewer blockages in a year</li> <li>• \$100 sewer blockage not resolved within 5 hours of notification</li> </ul>
Sewer spill (caused by system failure)	<ul style="list-style-type: none"> <li>• \$1,200 sewer spill in house</li> <li>• \$3,500 sewer spill in house not contained within 1 hour</li> <li>• \$100 sewer spill in property not contained within 5 hours of notification</li> </ul>

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<sup>170</sup> Clause 16(2) of the Safe Drinking Water Regulations (2025); Excludes events that are beyond the reasonable control of Melbourne Water, including acts of God, lightning, storm, flood, fire, earthquake or any other natural disaster, explosion, pandemic or epidemic.

**Melbourne Water’s proposed Guaranteed Service Levels for Greater Western Water (continued)**

<b>Guaranteed Service Level</b>	<b>Rebate</b>
Planned event – non-emergency – breach of minimum notice period to metropolitan water business	Match Greater Western Water payment of \$100 to household customer
Unplanned event or planned event (minimum notice period not met), additional management of customer calls/complaints <sup>171</sup>	Average calls/day = 140 Greater than 35 calls/day increase per event caused by Melbourne Water or greater than 10 calls/hour per event caused by Melbourne Water  Compensation of \$5,000 per incident to retail water business
Significant unplanned water or sewerage service disruption/event	Melbourne Water would make payments at its discretion to Greater Western Water based on an assessment of the impact
Pressure deviations above tolerances	Actual cost where >\$10,000 per incident to Greater Western Water

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<sup>171</sup> Minimum notice periods for planned interruptions, for full details see Melbourne Water 2025, 2026 price submission, September, pp. 266–267.

## Melbourne Water’s Guaranteed Service Levels for South East Water

Guaranteed Service Level	Rebate
Unplanned water quality issue	<ul style="list-style-type: none"> <li>• If a precautionary drinking water advisory is issued due to a potential issue with drinking water supplied by Melbourne Water: <ul style="list-style-type: none"> <li>– Bottled water reimbursement to metropolitan water business customers (on application)</li> <li>– Reimbursement of metropolitan water business incident administration costs</li> </ul> </li> <li>• Matching metropolitan water business Guaranteed Service Level rebate, up to \$75 rebate per property if drinking water supplied does not meet the microbial characteristics of health-based drinking water quality standards, and Melbourne Water, or a failure in Melbourne Water’s system, caused the non-compliance<sup>172</sup></li> </ul>
Unplanned water service interruption	\$60 rebate for more than 5 interruptions (water, sewer and water quality) per year, or unplanned interruption longer than 5 hours to resolve
Unplanned sewer service interruption	\$60 rebate for more than 2 interruptions per year, or unplanned interruption longer than 4 hours to resolve
Sewer spill (caused by system failure)	<ul style="list-style-type: none"> <li>• \$1,000 rebate when sewer spill on property takes more than 5 hours to contain</li> <li>• \$3,000 rebate for sewer spill within the house</li> </ul>
Unplanned event or planned event (minimum notice period not met), additional management of customer calls/complaints <sup>173</sup>	<p>Average calls/day = 400</p> <p>Greater than 100 calls/day increase per event caused by Melbourne Water or greater than 10 calls/hour per event caused by Melbourne Water</p> <p>Compensation of \$5,000 per incident to retail water business</p>

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<sup>172</sup> Clause 16(2) of the *Safe Drinking Water Regulations (2025)*; Excludes events that are beyond the reasonable control of Melbourne Water, including acts of God, lightning, storm, flood, fire, earthquake or any other natural disaster, explosion, pandemic or epidemic.

<sup>173</sup> Minimum notice periods for planned interruptions, for full details see *Melbourne Water 2025, 2026 price submission*, September, pp. 266–267.

## Melbourne Water’s Guaranteed Service Levels for South East Water (continued)

Guaranteed Service Level	Rebate
Significant unplanned water or sewerage service disruption/event	Melbourne Water would make payments at its discretion to South East Water based on an assessment of the impact
Pressure deviations above tolerances	Actual cost where >\$10,000 per incident to South East Water

## Melbourne Water’s Guaranteed Service Levels for Yarra Valley Water

Guaranteed Service Level	Rebate
Unplanned water quality issue	<ul style="list-style-type: none"> <li>• If a precautionary drinking water advisory is issued due to a potential issue with drinking water supplied by Melbourne Water: <ul style="list-style-type: none"> <li>– Bottled water reimbursement to metropolitan water business customers (on application)</li> <li>– Reimbursement of metropolitan water business incident administration costs</li> </ul> </li> <li>• Matching metropolitan water business Guaranteed Service Level rebate, up to \$75 rebate per property if drinking water supplied does not meet the microbial characteristics of health-based drinking water quality standards, and Melbourne Water, or a failure in Melbourne Water’s system, caused the non-compliance<sup>174</sup></li> </ul>
Unplanned water service interruption	<ul style="list-style-type: none"> <li>• \$50 for more than 4 hours unplanned event</li> <li>• \$100 for more than 12 hours unplanned event</li> <li>• \$50 for 3 or more unplanned events 12 months (rolling 12 months)</li> </ul>
Unplanned sewer service interruption	<ul style="list-style-type: none"> <li>• \$50 interruption more than 4 hours</li> <li>• \$100 interruption more than 12 hours</li> <li>• \$50 for 3 or more interruptions last 12 months (rolling 12 months)</li> </ul>

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<sup>174</sup> Clause 16(2) of the *Safe Drinking Water Regulations (2025)*; Excludes events that are beyond the reasonable control of Melbourne Water, including acts of God, lightning, storm, flood, fire, earthquake or any other natural disaster, explosion, pandemic or epidemic.

## Melbourne Water’s Guaranteed Service Levels for Yarra Valley Water (continued)

Guaranteed Service Level	Rebate
Sewer spill (caused by system failure)	<ul style="list-style-type: none"> <li>• \$1,000 spill inside property for over one hour</li> <li>• \$2,000 subsequent spill inside property last 12 months for over 1 hour</li> <li>• \$1,000 uncontained spill on property more than 4 hours</li> <li>• \$2,000 subsequent uncontained spill on property for over 4 hours last 12 months</li> </ul>
Planned event – non-emergency – breach of minimum notice period to metropolitan water business	Match Yarra Valley Water payment of \$50 to household customer
Recurring aesthetic water quality customer complaints	\$50 to household customers for the third and subsequent contact/complaint about separate water quality issues in a rolling 12-month period
Unplanned event or planned event (minimum notice period not met), additional management of customer calls/complaints <sup>175</sup>	<p>Average calls/day = 400</p> <p>Greater than 100 calls/day increase per event caused by Melbourne Water or greater than 10 calls/hour per event caused by Melbourne Water</p> <p>Compensation of \$5,000 per incident to retail water business</p>
Significant unplanned water or sewerage service disruption/event	Melbourne Water would make payments at its discretion to Yarra Valley Water based on an assessment of the impact
Pressure deviations above tolerances	Actual cost where >\$10,000 per incident to Yarra Valley Water

<sup>175</sup> Minimum notice periods for planned interruptions, for full details see Melbourne Water 2025, 2026 price submission, September, pp. 266–267.

## Melbourne Water’s Guaranteed Service Levels for other connected water businesses

Guaranteed Service Level	Rebate
Unplanned water quality issue	<ul style="list-style-type: none"> <li>• If a precautionary drinking water advisory is issued due to a potential issue with drinking water supplied by Melbourne Water:               <ul style="list-style-type: none"> <li>– Bottled water reimbursement to metropolitan water business customers (on application)</li> <li>– Reimbursement of metropolitan water business incident administration costs</li> </ul> </li> <li>• Matching metropolitan water business Guaranteed Service Level rebate, up to \$75 rebate per property if drinking water supplied does not meet the microbial characteristics of health-based drinking water quality standards, and Melbourne Water, or a failure in Melbourne Water’s system, caused the non-compliance<sup>176</sup></li> </ul>
Unplanned water service interruption	As per water business Guaranteed Service Level Scheme
Planned event – non-emergency – breach of minimum notice period to metropolitan water business	As per water business Guaranteed Service Level Scheme

<sup>176</sup> Clause 16(2) of the Safe Drinking Water Regulations (2025); Excludes events that are beyond the reasonable control of Melbourne Water, including acts of God, lightning, storm, flood, fire, earthquake or any other natural disaster, explosion, pandemic or epidemic.