Yarra Valley Water

10 March 2023

Marcus Crudden
Executive Director, Price Monitoring and Regulation
Essential Services Commission
Level 8, 570 Bourke Street
Melbourne VIC 3000

Dear Marcus

RESPONSE TO OUR 2023-28 WATER PRICE REVIEW DRAFT DECISION

We welcome the Commission's draft decision on our 2023-28 Price Submission, covering the period 1 July 2023 to 30 June 2028.

As requested in the Draft Decision we have provided additional information on the following issues:

- guaranteed service levels - particularly in reference to protocols for a new service level and community rebate for water quality events
- new customer contributions (also known as developer charges)
- demand forecasts
- measures and targets.

Guaranteed service levels

We're committed to providing high standards of service. Our Guaranteed Service Levels (GSL) have evolved over time with customer input. We have a range of service levels and rebates for a number of aspects of our services, such as, planned and unplanned water and sewerage service interruptions and issues, responsiveness to customer contact and debt recovery. For individual customers who experience a level of service below the defined GSLs, we provide an automatic rebate on their next bill.

Our 2023-28 price submission (and subsequent information we provided), proposed:

- no change to existing GSLs with individual rebates paid to affected customers
- a new GSL for water quality events, with an associated community rebate.

Further, in relation to water quality events and any associated service levels and rebates, we committed to:

- implement an easy bottled water refund process
- develop a transparent metropolitan sector approach as to how rebates will be allocated to community projects

- develop protocols on the value and application process for refunds for system-wide events that consider the type of advisory, the cause of the water quality issue, the response and recovery plans in place, and the duration of the advisory.

- review the rebate model following consultation with customers and communities undertaken as part of Greater Western Water and Melbourne Waters' price review processes.

The Commission proposed to accept the proposed guaranteed service levels – albeit noting *"Final guaranteed service levels and rebates will be subject to our consideration of any feedback following the release of our draft decision, and further information on Yarra Valley Water's proposal for a new guaranteed service level focused on water quality and protocols for when rebates would apply."* (Page 17).

We play our role in protecting public health within a large, integrated Melbourne water supply system, and we consider it appropriate that any rebate we introduce for water quality events should be consistent with the other metropolitan water corporations. Ultimately, we need to ensure any rebate appropriately balances acknowledgment of the impacts to customers and communities when a water quality advisory is issued; and that it does not inadvertently compromise the complex, risk-based decision-making processes that underpin issuing a water quality advisory.

From 1 July 2023, we propose to introduce a bottled water refund process and water quality community rebate. The associated protocols and processes are influenced by the number of customers impacted and the extent of the impacted area.

At a high level, for the bottled water refund we propose:

- customers will be able to claim up to $30 for the purchase of bottled water following being issued a water quality advisory notice
- claims will not require evidence, with customers receiving immediate confirmation of claim
- all refunds will be credited on customers' next bill.

In relation to a community rebate, the following table summarises our proposed approach for any water quality event where a water quality advisory is issued to one or more customers.

Customers (per event)	<50 of our customers	>50 of our customers	>50 customers – covered by more than one retail water retailer
Rebate value (per event)	$5000 per Local Government Area	$10000 per postcode affected	$10000 per postcode impacted
When will the rebate apply?	Whenever an advisory notice is issued (covers a precautionary boil water advisory, do not drink or do not use advisory)		
Timing	As part of the recovery phase of any water quality event, we'll identify the total value of the rebate payable and work with the local Council(s) to identify water conservation and biodiversity value creation opportunities as supported by our customers during our price submission engagement process. Our process will include: • contact Councils within a month of being identified • make payment within 3-6 months • communicate to customers and the wider community annually about the value of rebates paid and the value created.		
Review	As part of Melbourne Water's 2026 price review process we'll jointly engage customers on the community rebate to ensure we continue to meet their expectations.		

In addition, if during any water quality event it is determined that we've failed to meet safe drinking water standards, we'll return $1.8 million to our customers as part of our ongoing commitment to deliver on the outcomes proposed in our submission.

New Customer Contributions (NCCs)

New customer contributions (NCCs) are contributions made by developers towards the cost of providing major sewerage, water and recycled water infrastructure for new connections.

The draft decision (p 41-42) proposes not to accept our proposed NCCs (standard), citing the intention to continue the review of the proposal and reasonableness to use sunk costs including renewals – as below:

"We will undertake a further review of Yarra Valley Water's proposed new customer contributions prior to our final decision. As part of that review, we will assess the reasonableness of Yarra Valley Water's proposed inclusion of sunk costs, including for renewals, in its proposed new customer contributions. Based on the information to date, it is unclear whether the inclusion of sunk costs, including asset renewal costs, complies with our guidance."

We consider the proposed NCC estimates are consistent with s.268 of the Water Act. Specifically, it is consistent with s.268 (1), as the proposed NCC estimates apply to customers which benefit from services being provided, and takes into account the present cost of any works that are used or will be used directly or indirectly for the provision of those services.

Consistent with this, NCCs should reflect the cost of providing infrastructure for new connections and not be set so low that the existing customer base is subsidising development costs. Neither should it be set so high that the total revenue received from new connections subsidises the existing customer base.

The approach used to develop NCC estimates for the new growth areas is consistent with the modelling used to support the proposed NCCs in our 2013 and 2018 price submissions. This includes the allocation of forecast growth costs to specific growth areas and actual growth (sunk) costs, after adjusting for NCCs received and regulatory depreciation from 2013-14 related to each growth area. Inclusion of these growth assets is consistent with the ESC's NCC principles, and its definition of incremental cost included in its 2013 Guidance on New Customer Contributions principles. This is on the basis that these long-term assets are intentionally designed and built to cater for future growth and new customers benefit from the capacity created. The inclusion of sunk costs[1] was also accepted by the ESC's consultant, SKM, in its 2012 review of metropolitan NCC estimates.

The introduction of the ESC's Performance, Risk, Engagement, Management and Outcomes (PREMO) framework in 2017 encourages businesses to consider the appropriate sharing of risk with customers, especially where there is uncertainty in relation to costs and timing. On this basis our 2018 price submission identified $257.11 million of potential, but uncertain, 'at risk' capital expenditure. This includes expenditure related to growth and renewals.

The higher NCC estimates, particularly for the Urban Growth Boundary (UGB) growth region, compared with the 2013 and 2018 modelling is largely driven by:

- actual growth costs over the 2018-23 regulatory period being $180 million higher than 2018 model estimates
- increased forecast capital expenditure for the UGB area for the 2023-28 regulatory period of $584.7 million compared to 2018 model estimates

[1] Sinclair Knight Merz, Draft Expenditure Assessment Report – Metropolitan Water Businesses, April 2013 Page 7 that "... acknowledges the ESC's August 2012 NCC Guidance Paper (Appendix C), which sets the beginning of Water Plan 2 as the threshold for past growth infrastructure that can be included in the NCC calculations".

- including an additional 10 years of forecast capital expenditure ($1604.5 million) in the UGB area from 2028-29 to 2038.

The inclusion of sunk costs and allocating the capacity allowed for growth at the time existing assets are renewed appropriately distributes the costs of these assets between existing customers and new customers. We are proposing increases in NCCs for both the UGB growth area and infill areas (existing suburbs). For existing customers this also captures some of the benefit of the additional capacity in the existing network they have created by significantly reducing their consumption over the last 20 years.

To assess the impact of sunk costs, we've undertaken further analysis that shows:

- modelled charges for the new urban growth boundary increase significantly regardless of the extent that sunk costs are included. The lowest 2022 modelled charge only included forward looking costs and is $21,552 compared to the current charge of $6,327.78.
- recycled water NCCs for infill areas (including Epping North and Greenvale) increase significantly under all sunk cost scenarios – with the lowest 2022 modelled charge of $3,377 compared to current charges of $775.08.
- under the approach that includes sunk costs from 2013-14 and a 14% share of renewal costs based on the proportion of new customers to existing customers, the 2022 modelled price for water and sewerage NCCs for infill areas is $4,260 compared to the current charge of $1,550.16.

We have updated the NCC model estimates with the release of the Victorian Government population and dwelling growth estimates (VIF2022). This has resulted in a reduction in the modelled charge for all NCCs . Adopting a consistent approach with that used for our 2023-28 submission, the net incremental cost to service each new lot has reduced marginally but is still in-excess of the current new contributions received for each lot in the urban growth boundary (UGB) and infill areas. A comparison of the current charges with the modelled charges is provided in the table below.

	Current charge 2022-23	2022 modelled charge (Sep' 2022 – VIF2021)	2022 modelled charge (Mar' 2023 – VIF 2022)[2]
Standard (per lot), incorporating current Epping and Greenvale special charging areas			
Water and sewerage	$1,550.16	$4,260[3]	$2,959
Recycled water	$775.08	$5,927	$4,034
Special charging area – new urban growth boundary (per lot)			
Water, sewerage and recycled water	$6,327.78	$39,867	$31,417

As shown, there is potential for movements over time in NCC estimates – driven by factors including both actual and forecast capital costs, as well as changes in connection growth in size and timing. Given NCC estimates in future regulatory periods will vary from the current estimates, we propose to transition price changes over time.

Our initial proposal was a 5% per annum price increase (capped at 10% nominal per annum if inflation is higher than 5% in any given year) over the 2023-28 regulatory period. The decision to cap prices was made considering:

[2] Reflects updated population and dwelling growth estimates (VIF2022) and includes sunk assets from 2013-14 net of NCC's received and regulatory depreciation.

[3] Overestimated in our 2023 submission as $5,577.

- commitments made in our 2018 price review in relation to the annual rate of transition towards cost reflective NCC prices
- the potential for price shock - noting that for the purposes of the 2018 price review, price shock was defined by the ESC as an increase of greater than 10% in any year for any individual tariff.

In February 2023, we discussed the ESC's draft decision with representatives of the Urban Development Institute of Australia (UDIA), including the methodology used to model charges and the issues of rate capping and time to achieve cost recovery.

Considering the ESC's draft decision, we subsequently proposed to UDIA staff a nominal 10% annual price increase. This approach provides price certainty to developers for the next 5 years and should shorten the time before NCCs are fully cost reflective.

The UDIA subsequently provided a letter responding to this revised proposal. A copy is attached

Demand forecasts

The draft decision accepts our demand forecasts for the purpose of approving maximum prices – having been developed consistent with guidance and reflecting latest available Victoria in Future estimates issued by the Victorian Government (VIF 2021).

Since lodgement of our submission, updated Victorian Government population and dwelling growth estimates have been made available to us (VIF2022). The draft decision expects our response to "… demonstrate how it has considered these updated estimates and if required, identify and justify any changes to its demand forecasts" (page 36), and further that "… updates must also be included in its pricing model submitted in response to our draft decision".

The new data series shows the impact of the pandemic, with reduced population compared to the 2021 projections. This shift is reflected in actual customer and property numbers up to 2021-22. Overall the VIF 2022 projections from 2023-24 for population and dwellings show accelerated annual growth in the number of dwellings partially offset with lower population per dwelling.

Our revenue cap adjusts to cater for small movements in customers and demands from year to year, ensuring that we only collect the revenue required from customers over the regulatory period. Modelling impacts of VIF 2022 show that there is an additional P0 reduction in 2023-24 of 0.5% in customer prices. As a result we propose to update customer and demand projections and resubmit a revised financial template that reforecasts from 2022-23:

- customer numbers and associated incremental operating costs to service new customers
- customer demand and associated bulk charge volumes from Melbourne Water
- revenue not received
- new customer contributions.

We've also assessed impacts of VIF2022 on other cost inputs. Following this analysis we do not propose to update:

- minor product volumes, revenues or associated costs as the analysis shows the change in price to be immaterial
- forecast growth capital expenditure as it's the location of the development and fast tracking of precinct structure plans that is predominantly driving the program rather than the rate of growth
- other capital expenditure that is not impacted by the rate of growth or customer demand.

Measures and Targets

The draft submission accepts 6 proposed outcomes and 17 underpinning measures and targets, however notes *"... we have identified that 10 of 17 measures are considered ambiguous or not clearly defined"* (page 15). In addition the draft outlines *"We will provide Yarra Valley Water with our standard Outcomes Submission Template to complete and submit with its response to this draft decision. We will work with the business to ensure the final set of measures addresses the above matters and complies with our guidance requirements."* (page 15).

The completed Outcomes Submission Template is attached to this letter, noting the intention to revise the target for compliance with Safe Drinking Water Regulations (2015) from 100 per cent compliance to the number of safe drinking water related non-compliances with a target (for all 5 years) of 0.

We've also clarified the calculation and description of measures identified in the draft decision including:

- where measures and targets are based on customer perception, stating clearly the percentage is of customers surveyed, the survey question and specific responses counted
- specific reference to planned and unplanned interruptions where appropriate
- defining terms such as 'designated area' and 'material impact'
- outlining how the measure is calculated to avoid misinterpretation or miscalculation
- reconfirming targets.

Refer to the attached Appendix for a full list of the outcomes, measures and targets proposed.

Other matters

We note that our final revenue requirement and prices will be based on latest available information and that the Determination will adjust for:

- any changes due to feedback received in response to the draft decision
- cost of debt and inflation
- forecast licence fees, environmental contribution and Melbourne Water's bulk charges
- any change in forecast energy costs.

Please find attached to this letter an updated financial template with revised inputs associated with:

- additional products and services to correct differences between our original financial template submitted on 29 September 2022 and our written submission (section 8.3, page 115). For completeness please note the information provided in the written submission was correct.
- revenue requirement associated with adjustments from the last period
- revised customer growth and demand projections reflecting VIF 2022, together with associated updates to bulk charges, controllable operating costs and NCCs
- revised prices.

If you require further information, please contact Brett Mathieson, Manager Regulation, Planning and Performance.

Yours sincerely

[redacted]

Pat McCafferty
Managing Director

Contact us

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For language assistance

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For all other languages call our translation service on **03 9046 4173**

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Appendix – Outcomes, Measures and Targets

			Target				
Outcome	**Measure**	**Unit**	**2023-24**	**2024-25**	**2025-26**	**2026-27**	**2027-28**
Safe and pleasant drinking water	Compliance with Safe Drinking Water Regulations (2015) (water sampling health parameters and regulatory audit)	Number of non-compliances	0 non-compliances	0 non-compliances	0 non-compliances	0 non-compliances	0 non-compliances
	Customers who agree we provide great drinking water (survey respondents answering 'strongly agree' or 'somewhat agree')	% of customers surveyed	≥91%	≥91%	≥91%	≥91%	≥91%
Reliable water and sewerage services	Customers who experience three or more unplanned interruptions	Number of customers	<7,000 customers	<7,000 customers	<7,000 customers	<7,000 customers	<7,000 customers
	Customers who experienced five or more unplanned interruptions in the last three years, and any interruptions this year	Number of customers	<3,572 customers	<3,572 customers	<3,572 customers	<3,572 customers	<3,572 customers
Timely response and repair	Customers' satisfaction with the restoration of their services (planned and unplanned interruptions) (Survey respondents answering 'very satisfied' or 'satisfied')	% of customers surveyed	≥91%	≥91%	≥91%	≥91%	≥91%
	Customers whose water or sewerage service wasn't restored within four hours (planned and unplanned interruptions)	% of customers	≤4.85%	≤4.85%	≤4.85%	≤4.85%	≤4.85%
	Customers whose water or sewerage service wasn't restored within 12 hours (planned and unplanned interruptions)	% of customers	≤0.35%	≤0.35%	≤0.35%	≤0.35%	≤0.35%
Service that meets everyone's needs	Customers' satisfaction with their most recent interaction with us (survey respondents answering 'very satisfied' or 'satisfied')	% of customers surveyed	≥86%	≥86%	≥86%	≥86%	≥86%
	Customers, who accessed our support services, believe Yarra Valley Water helped them with their bills (survey respondents answering 'strongly believe' or 'somewhat believe')	% of customers surveyed	≥92%	≥92%	≥92%	≥92%	≥92%

Outcome	Measure	Unit	Target 2023-24	2024-25	2025-26	2026-27	2027-28
Saving water for the future	Water lost in Yarra Valley Water's supply system	% of water not sold to customers	≤7.8%	≤7.5%	≤7.3%	≤7.3%	≤7.3%
	Recycled water used where it's available	% of total water used in areas where its available, that is recycled water	≥4.0%	≥4.6%	≥4.6%	≥4.7%	≥11.8%
	Average household water use (litres per property per day)	Average litres used by households each day	≤402	≤402	≤401	≤400	≤396
	Business customers who use more than 100ML (100 million litres) of water a year, who have an active water efficiency plan	% of customers	100%	100%	100%	100%	100%
Looking after our natural environment	Hectares of land we actively manage to preserve and restore biodiversity and natural habitats	Hectares of land	9 hectares	11 hectares	13 hectares	45 hectares	47 hectares
	Volume of sewage spills reported to the EPA as having a material impact to the environment	Kilolitres	≤5,000 kilolitres	≤5,000 kilolitres	≤5,000 kilolitres	≤5,000 kilolitres	≤5,000 kilolitres
	Number of customers who were on septic tanks and are now connected to the sewerage network	Number	>200	>200	>200	>200	>200
	Percentage of energy requirements met from renewables	% of all energy	85%	95%	100%	100%	100%

9 March 2023

Mr Chris Brace

General Manager, Growth Futures

Yarra Valley Water

Dear Chris,

The Urban Development Institute of Australia, Victoria (UDIA Victoria) thanks Yarra Valley Water (YVW) for engaging with us and our membership throughout the preparation of its submission to the Essential Services Commission (ESC). We are also pleased to be able to provide invaluable insight regarding the foreseeable impacts of the proposed New Customer Contributions (NCC), and provide comment on contributions made by other organisations, during the review process.

UDIA Victoria is the peak-body representing the urban development industry. We are a not-for-profit advocacy, research and educational organisation supported by a membership of land-use and urban development entities, across the private sector and Victoria's public service. We are committed to working with industry and government to deliver housing, infrastructure, and liveable communities for all Victorians.

UDIA Victoria welcomes the opportunity to respond to the ESC's draft decision on YVW's NCC submission and YVW's revised proposal.

While UDIA Victoria appreciates the fundamental principle of a cost-reflective mechanism, we encourage decision-makers to consider its execution in the context of increasing economic uncertainty and pay due consideration to the impacts its implementation will have on development feasibility and housing affordability.

The urban development industry is one of the biggest contributors to the Victorian economy and one of the State's largest employers.

Average combined taxes and charges on greenfield development are approximately $2.5 million per hectare. This equates to $146,100 per lot, or 44 per cent of the median greenfield lot price. In established areas, combined taxes and charges already equate to approximately $178,000 per dwelling, or 30 per cent of the average dwelling price.

As outlined in your original submission, the difference between the current charge for 2022-23 and the modelled charge for 2022 (based on ESC's approved modelling) constitutes a five-fold increase.

We are also aware of a response to YVW's submission by the Consumer Action Law Centre (CALC), advocating for the implementation of a cost-reflective NCC. The implementation of a cost-reflective mechanism has the potential to impact the deliverability of development in growth areas, during a major housing availability and affordability crisis.

The ESC's previously held position recognises that there is a significant risk of price shock associated with incremental increases beyond 10 per cent per annum. Advice UDIA Victoria has received from our membership is that this would be untenable.

By all accounts, such a significant increase would severely impact the feasibility of projects currently underway and in planning, leading to costs being passed through to homeowners.

The development industry demonstrated remarkable resilience throughout the pandemic, though it was not immune to its impact – nor prevailing economic conditions. Construction cost escalation, skilled labour shortages, statutory planning delays, successive rate hikes and market volatility are among the raft of challenges currently plaguing the industry. We have already seen these result in numerous projects being rendered unviable.

UDIA Victoria cannot support a proposed five-fold increase to existing NCCs on this basis, however we are pleased that YVW have undertaken to revise their position to balance their expenditure demands, and account for the significant pressures already impacting growth area development.

If you would like to discuss this further, please don't hesitate to contact me at [redacted]

Regards,

[redacted]

Matthew Kandelaars, CEO,

UDIA Victoria