



2013-2018 Water Plan New Customer Contributions

**Supplementary Submission
December 7, 2012**



Background

Western Water submitted the 2013-2018 Water Plan in October 2012. Due to the development of an alternative principled-based New Customer Contributions (NCC's) framework by the Essential Services Commission (ESC), Western Water is required to submit supplementary information by 7 December 2012.

Abbreviations

Essential Services Commission	(ESC)
New Customer Contributions	(NCC's)
Weighted Average Cost of Capital	(WACC)
Urban Development Institute of Australia	(UDIA)
Growth Areas Authority	(GAA)
Department of Sustainability and Environment	(DSE)
Office of Living Victoria	(OLV)



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1. Introduction

As a result of the significant growth predicted to occur within the region serviced by Western Water in the next two decades it is imperative a fair and reasonable approach be taken as to how this growth is funded. Feedback from the extensive consultation for the 2013-2018 Water Plan, Western Water current customer base expressed dissatisfaction of bearing the cost of growth. Given growth predictions in excess of 5% per annum over the next 10 years, the cross subsidy to fund growth by existing customers is only assumed to remain if the current NCC regime was to continue.

Western Water has been actively involved in the development of an alternative principles-based NCC framework. The new NCC framework will see the adoption of a transparent, cost reflective pricing principles approach. The ESC worked closely with key stakeholders including Vicwater (water industry representation), the Urban Development Institute of Australia (UDIA), the Growth Areas Authority (GAA) and the Department of Sustainability and Environment (DSE) in developing the framework, guidance paper and NCC estimator.

2. Assumptions

2.1 Model Assumptions

2.1.1 Lot Growth

Growth projections underpinning Western Water's 2013-2018 Water Plan submission have been applied within NCC modelling.

2.1.2 Capital Expenditure

Capital figures applied align with the figures reflected in Western Water's Water Plan submission.

For NCC modelling purposes only the 'growth' projects were utilised.

- Growth capital for periods 2013-2018 Water Plan (WP3) and 2018-2023 Water Plan (WP4)
- Some growth projects from 2008-2013 Water Plan (WP2) were included (at closing Written Down Value as at 30 June 2013)

2.1.3 Depreciation

Average depreciation rate of 3% applied uniformly for purpose of calculating tax.

2.1.4 Gifted Assets

Total value of gifted assets calculated based on weighted average costs.

2.1.5 Operating costs

Incremental operating costs (both fixed and variable) attributable to growth and new capital expenditure have been included in NCC modelling across all services.

2.1.6 Revenue

Estimated incremental revenues derived from the new growth lots for each service, calculated applying the same tariffs proposed in the Western Water 2013-2018 Water Plan submission.

2.1.7 Tax

Treatment of Tax is consistent with 'Estimator New Customer Contributions' paper whereby, tax effects of all revenues (including gifted assets and NCC revenues) and costs are included in the model.

Tax rate assumed at 30%.

2.1.8 Discount and Inflation rates

As set out in the ESC Estimator model, a nominal post WACC of 7.73% and inflation rate of 2.5% pa have been incorporated.

2.1.9 Water Demand

Differential water demand figures are assumed dependant on supply type and development area. These assumptions are captured in Appendix A section 3.3.9.

2.2 General Assumptions

2.2.1 NCC indexaton

Annual indexation using CPI be applied to the NCC charge.

3. Stakeholder consultation

Vicwater on behalf of the water industry formed a working group with representatives from Water Corporations both Metropolitan and Regional to assist with developing a revised methodology for NCC's. The working group has already conducted various consultations with the development sector and key stakeholders regarding the proposed changes. Further meetings and consultation is planned over the coming months with the next scheduled meeting with UDIA 10 December 2012.

Western Water conducted a NCC forum with the development industry which it services. This forum was held on the 12 November 2012. A total of 32 invitations were sent out with 10 industry representatives attending including representatives from key developments within the Western Water region including;

- Victoria Investments and Properties (Rockbank North),
- Lendlease (Atherstone – Toolern), and
- Investa (Diggers Rest).

The key points from the forum were as follows;

- Developers want certainty (for future planning)
- Impacts of changes significant due to budgeting constraints
- Phasing of NCC increases preferred – certainty is important

- VCAT is last resort due to time delay and cost
- Disputes are inevitable, but negotiation with flexibility is preferred over VCAT
- Lot sizes are shrinking, lot sizes above 1350m² will be rare
- Price gap between lot sizes should be small or nothing – commonly the house size is the same regardless of lot size
- A standard rate for all lot sizes is also easier for the industry to model
- Developers consider NCC should not be used as a proxy for planning lot size
- Generally speaking, infill and greenfield development should be charged consistently
- Bring forward principle – transparency is essential – need to know what Western Water development schedule, so developers know what is out of sequence.

In addition to the above Western Water has undertaken consultation with it's customers on the Water Plan – details of which have previously been provided. An important issue in our customer consultation was how funding of new growth should be provided. Western Water customers in this consultation were very clear that developers should fund this growth with consideration of an "offset" for future tariff reductions.

3.1 Negotiation Framework

Work is currently "under way" on developing a negotiation framework which considers the 'ESC guidance Appendix B', industry feedback and business requirements. It is proposed that this will be completed prior to the new regulatory period commencing on 1 July 2013.

4. Industry involvement

Western Water has been extensively involved in an industry group coordinated by Vicwater focused on development of an alternative principles-based NCC framework, estimator and guidance paper. Representatives from Western Water were involved with the Working Group including Chairing the group.

5. Modelling

Western Water engaged Marsden Jacob Associates to develop extensive modelling of a suite of New Customer Contributions (NCC's) based on the pricing principles established by the Essential Services Commission (ESC).

In developing this modelling, reliance was placed on the following papers released by ESC;

- Estimator, New Customer Contributions, August 2012
- Guidance Paper, New Customer Contributions, August 2012
- New Customer Contributions – Commission Staff framework and approach paper May 2012

The key pricing principles require developers to pay the net of incremental costs of the connection and incremental revenues earned from the new customers. During this exercise modelling was developed down to a disaggregated level for each service provided by Western Water. This enabled Western Water to understand impacts of development in particular areas. However, in response to consultation with the development industry it was decided in the interests of simplicity and to provide certainty to developers to recommend one aggregated NCC charge per service.

Refer appendix A – Marsden Jacob Associates 'New Customer Contributions (NCCs) Modelling approach and outputs'

6. Western Water proposal

After consideration of results from feedback from customers as part of 2013-2018 Water Plan consultation, development industry consultation and modelling Western Water Board have approved the submission of the following NCC charges;

(2012/13 \$ - full charge)

Water Supply	\$3,100 per lot (50% where Class A provided = \$1,550)*
Sewerage	\$3,700 per lot
Class A Recycled Water	\$2,400 per lot

*As part of the ongoing support of Class A development, the Board have also recommended the continuation of a 50% reduction to Water where Class A Recycled Water is provided.

The proposed water supply NCC varies slightly from the modelled figure (as per Appendix A). This is due the continuation of the 50% reduction to Water Supply NCC where Class A Recycled Water is provided. In order to achieve full cost recovery for water and provide the 50% reduction the overall Water Supply NCC needed to increase slightly.

6.1 Tariff Impacts

Modelling of the impacts on tariffs provide for no change to current Water Plan 2013-2018 tariffs. This is due to the following revenue requirement impacts almost "netting off".

As a result of the NCC changes the total building block items will change for Water Plan 2013-2018 as follows;

Tax Payable increases by \$6.59M
Return on new assets decreases by \$4.95M
Regulatory depreciation on new assets decrease by \$1.49M
Net change to revenue requirement \$0.15M

6.2 Transition Plan

In consideration of consultation with developers it is proposed to implement new NCC charges from 1 July 2013 at 70% of the full calculation and implement a smoothed increase over the next 5 years to achieve 100% by 2017/18, eg 70% 2013/14, 77.5% 2014/15, 85% 2015/16, 92.5% 2016/17, 100% 2017/18).

This will provide certainty to developers of the charges applicable on an annual basis, moving towards reducing the impact of growth on existing customers and ultimately achieve a full cost recovery approach to growth going forward.

6.3 Aggregation

In reviewing the level of aggregation to apply to NCC charges consideration was given to developer feedback and results of assessment of disaggregated results. The disaggregated results produced

variability across the Western Water region in particular in low growth areas where the timeframe for calculation of NCC produced NCC "spikes". The results produced in the new growth (high growth) areas remained fairly constant. Due to weighted averaging of these costs the lower growth area spikes are absorbed.

In addition all new growth across Western Water's region will be supported by additional water from Melbourne assisted by the interconnection of Western Waters water supply system. NCC's for water across Western Water will therefore result in a "pro rata" calculation which supports a common charge. The majority of lots predicted within the Western Water region are much smaller (around 400m²) than in the past, distorting what was previously the average size lot. Developer feedback suggested they didn't want NCC's to drive their lot sizes. In conclusion it was considered simpler to communicate, administer and accept as well as providing greater certainty to our developers to apply one charge per service across all areas.

6.4 Board Recommendations

The Western Water Board met on the 21 November 2012 and approved the following recommendations in regards to the proposed NCC changes;

1. Single NCC for each service – water supply, sewerage and Class a recycled water apply across Western water's region
2. A uniform NCC be applied independent of lot size. It is recommended that a 50% discount be continued (as exists in the current Water Plan) for water NCC where lots are provided with Class A recycled water.
3. NCC charges for Water Plan 2013-2018 of;
 - Water Supply \$3,100
 - Sewerage \$3,700
 - Class A recycled water \$2,400and annual indexation using CPI be applied
4. A transition period commencing at 70% to 100% of the calculated NCC over the 5 year Water Plan period.
5. NCC for multi-unit development be provided with a "credit" for the existing lot and then a standard NCC per unit. For larger unit developments for example retirement villages that a revised NCC be calculated based on either a pro-rata approach and/or "fixture unit".

Appendices

Appendix A - New Customer Contributions Modelling approach and outputs – Marsden Jacob Assoc.

Appendix B – summary of Growth Capital Expenditure

Appendix C - Copy of planned infrastructure