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SUMMARY OF METROPOLITAN BUSINESSES WATER PLANS

WATER PRICE REVIEW 2013-18
PRICING PERIOD COMMENCING 1 JULY 2013

NOVEMBER 2012

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Essential Services Commission 2012, *Summary of metropolitan businesses water plans Water Price Review 2013-18, November*

INTRODUCTION

City West Water, Melbourne Water, South East Water, Western Water and Yarra Valley Water (metropolitan water businesses) have submitted final Water Plans to the Essential Services Commission for assessment.

The Water Plans set out the prices each of the businesses propose to charge for their water, sewerage and other related services for the five year price period commencing 1 July 2013 (next price period). The Water Plans also include information about service outcomes and expenditure proposed by the water businesses.

This is the third major review of water prices we have undertaken since we became the economic regulator of the Victorian water industry in 2004.

Our role is to assess Water Plans against principles set out in the Water Industry Regulatory Order (WIRO). We will approve the prices proposed by the water businesses if they meet the requirements of the WIRO. Only where a business does not meet the WIRO requirements can we specify the prices to apply.

This paper provides an overview of the key aspects of the metropolitan water businesses' Water Plans and some of the issues likely to be relevant in our assessment process. This paper does not cover all aspects of the businesses' proposals or identify all relevant issues that will be considered. Rather, it is intended to assist customers to understand the broad nature of the proposals and to facilitate public comment and debate.

We have also published a summary sheet for each business that provides more information about the key components of each business' Water Plan.

Copies of this paper, summary sheets for each business, detailed Water Plans submitted by each business, and the WIRO, are available on our website www.esc.vic.gov.au.

RESPONDING TO THE WATER PLANS

We encourage customers and representative groups to provide comment on the Water Plans. Consultation with customers and representative groups is an important part of our decision making process. This feedback will assist us in deciding whether or not to authorise the businesses' price proposals.

Provide feedback via submission

You can send a written submission or comments on the businesses' Water Plans to the Commission by 25 January 2013.

Submissions can be sent by email to water@esc.vic.gov.au or by post to:

*Water Division
Essential Services Commission
Level 2, 35 Spring St
Melbourne VIC 3000*

We normally publish submissions on our website. We may choose not to publish a submission where it contains confidential or commercially sensitive information. If there is information that you do not want published you should discuss the matter with us prior to making your submission. We can be contacted by phone on 03 9651 0206.

Attend a public forum

We will hold two public forums to provide customers with an opportunity to hear the businesses explain their Water Plans, and ask the businesses questions:

- 3 December 2012 for Melbourne Water, City West Water, South East Water and Yarra Valley Water; and
- 4 December 2013 for Western Water.

The forums will also provide us with an opportunity to hear the views of customers and representative groups on the businesses' proposals and their impact.

The location and timing of these public forums are provided on our website www.esc.vic.gov.au. We will also advertise details about the time and location of the forums in newspapers. You can register your attendance by email water@esc.vic.gov.au or by phone on 03 9651 0206.

TIMELINES

We will keep customers and representative groups informed of the progress and opportunities for consultation through regular updates to our website and our newsletter—Essential Water News. You can subscribe to Essential Water News by emailing water@esc.vic.gov.au. Key dates for our price review are summarised below.

Price review timeline

3 December 2012	Public forum on Water Plans (Melbourne Water and the three retailers)
4 December 2013	Public forum on Water Plan (Western Water)
25 January 2013	Closing date for public submissions to the Commission on the businesses' Water Plans
March 2013	Commission releases its draft decision on water prices, invites submissions on draft decision
March-April 2013	Public forums on draft decision
April 2013	Closing date for public submissions to the Commission on our draft decision
June 2013	Final decision

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1 | OVERVIEW OF WATER BUSINESS PROPOSALS

This paper provides a high level overview of the Water Plan proposals for City West Water, Melbourne Water, South East Water, Western Water and Yarra Valley Water. It focusses on proposed price changes, bill impacts, service standards, expenditure and major projects to be delivered over the five year price period commencing 1 July 2013.

Note: All dollar figures in this report are in real 2012-13 terms (that is, they do not account for the effect of inflation in future years).

1.1 Proposed prices and impact on customer bills

Three retail water businesses (City West Water, South East Water and Yarra Valley Water) have proposed a steep increase in water and sewerage prices in the first year, followed by zero real increase over the remainder of the regulatory period. In contrast, Western Water proposed a smooth price path with increases of a little over 6 per cent each year over the period.

Based on the prices proposed by the retail water businesses, we have estimated annual water and sewerage bills for an indicative residential owner occupier and tenant, using 2011-12 average consumption for each business. The estimates of average consumption vary for each business as their customers use different amounts of water.

The actual impact on an individual customer's bills will vary depending on each customer's actual consumption pattern and our final decision on the prices that will apply for the next price period.

Table 1 **Estimated household water and sewerage bill – indicative owner occupier**
(\$2012-13)

	<i>Consumption used for estimating bill (kilolitres)</i>	2012-13 \$	2013-14 \$	2017-18 \$	\$ change from 2012-13 to 2017-18
City West Water	143	\$793	\$1,060	\$1,060	\$269
South East Water	139	\$829	\$1,118	\$1,118	\$289
Yarra Valley Water	144	\$910	\$1,220	\$1,220	\$310
Western Water	169	\$956	\$1,014	\$1,299	\$343

Note: The indicative bills are calculated using 2011-12 average consumption for each water business—estimates of average consumption vary for each business as their customers use different amounts of water. Businesses may have used different assumptions for average consumption in their Water Plan. Estimated bills do not include waterways and drainage charges, which is applied to each customer's bill separately.

Over the period from 2012-13 to 2017-18, the annual water and sewerage bill for an indicative residential owner occupier increases for all retail businesses.

Table 1 shows that in 2017-18, we estimate the annual water and sewerage bill for an indicative residential owner occupier will be highest for Western Water. Western Water also forecasts the largest bill increase over the period 2012-13 to 2017-18 (35.8 per cent). The indicative bill is lowest for City West Water and is also the lowest bill increase over the period of the metropolitan businesses (33.9 per cent).

As shown in table 2, we estimate that in 2017-18, the annual water and sewerage bill for an indicative residential tenant would be highest for Yarra Valley Water (\$645), followed by South East Water (\$577) and City West Water (\$571). Western Water has the lowest indicative residential tenant bill (\$379). While Yarra Valley Water has the highest tenant bill, it has the lowest percentage increase for tenant bills of the retailers.

Over the period from 2012-13 to 2017-18, the annual water and sewerage bill for an indicative residential tenant would increase by similar amounts for all businesses. The annual tenant bill rises by \$177 for customers of Yarra Valley Water, and the least for customers of Western Water (\$134).

Table 2 **Estimated household water and sewerage bill – indicative tenant**
(\$2012-13)

	<i>Consumption used for estimating bill (kilolitres)</i>	2012-13 \$	2013-14 \$	2017-18 \$	\$ change from 2012-13 to 2017-18
City West Water	143	\$405	\$569	\$571	\$166
South East Water	139	\$411	\$576	\$577	\$166
Yarra Valley Water	144	\$468	\$645	\$645	\$177
Western Water	169	\$244	\$266	\$379	\$134

Note: The indicative bills are calculated using 2011-12 average consumption for each water business—estimates of average consumption vary for each business as their customers use different amounts of water. Businesses may have used different assumptions for average consumption in their Water Plan.

The estimates of typical bill increases published by the water businesses in their Water Plans are set out at table 3a. For the retail businesses, it is an estimate of the bill changes facing an average or typical customer and reflects proposed tariff structure changes and different price increases applied to different products. For Melbourne Water¹, their estimates are based on a bundled water and sewerage increase.

There is a range of ways to calculate the average price change proposed by the water businesses. We have used a different method to estimate the average annual price change to what businesses used for their Water Plans.

We have estimated an average price change by weighting the change in each tariff proposed by its relative share of forecast revenue for 2013-14. The businesses have used an approach that is an average increase across all prices, keeping 2013-14 demand constant. Our estimates therefore differ from those in the Water Plans of the businesses as a result of the differing approach, not error in calculation.

Based on our approach, under the proposals of the businesses Melbourne Water's water and sewerage prices rise by 65.7 per cent in real terms over the next price

¹ Melbourne Water provides bulk water and sewerage services to the Melbourne retail businesses and to a lesser extent Western Water. Melbourne Water charges these businesses for those services and they in turn pass through those costs to customers.

period (table 3b). Increases for the retailers range from nearly 31.7 per cent (City West Water) to 35.9 per cent (Yarra Valley Water).

All the retail water businesses have proposed higher price rises for water compared to sewerage over the next regulatory period. Recycled water prices are proposed to rise in line with potable water prices. Trade waste prices are proposed to increase in the first year for half the retail businesses, and then rise in line with changes in the Consumer Price Index (CPI). The other retailers proposed no real increase to trade waste prices over the next price period.

Table 3a Water Plan estimates – price impacts (real %)

	2013-14	2014-15	2015-16	2016-17	2017-18
Melbourne Water: water and sewerage	60.4%	-0.5%	-0.5%	-0.5%	-0.5%
City West Water*	33.9%	0.0%	0.0%	0.0%	0.0%
South East Water*	33.6%	0.0%	0.0%	0.0%	0.0%
Yarra Valley Water*	33.7%	0.0%	0.0%	0.0%	0.0%
Western Water*	6.1%	6.2%	6.3%	6.3%	6.3%

**Table 3b Estimated annual (real %) price changes –
ESC weighted-average across all tariff categories**

	2013-14	2014-15	2015-16	2016-17	2017-18
Melbourne Water: water and sewerage	69.0%	-0.5%	-0.5%	-0.5%	-0.5%
City West Water	31.7%	0.0%*	0.0%*	0.0%	0.0%
South East Water	34.9%	0.0%*	0.0%*	0.0%	0.0%
Yarra Valley Water	35.9%	0.0%*	0.0%*	0.0%	0.0%
Western Water	6.3%	6.1%	6.2%	6.3%	6.4%

Note: the approach to estimate prices uses a weighted average using forecast 2013-14 revenue across all tariffs. We have applied the approach consistently across all businesses. Businesses may have used a different approach to estimate average price changes in their Water Plans.

a Please note the figures in 2014-15 and 2015-16 marked with *s. For a small proportion of new customers, the retailers are putting transitional arrangements in place for connection fees. If these arrangements are not included in the calculation of the weighted average, the 2014-15 and 2015-16 figures equal 0.0 per cent.

1.2 Proposed tariff structures

Tariff structures are important as they provide signals to customers about the cost of delivering water and sewerage services and influence the level of water use by customers. The retail water businesses have not proposed significant changes to existing tariff structures over the next price period from 1 July 2013.

There are some relative changes among the different tariffs:

- All retail water businesses are proposing higher price rises for water services relative to sewerage and trade waste charges. This is mainly because they are passing on most of the desalination plant costs through water charges rather than averaging the costs between water and sewerage services.
- Trade waste charges will see only minor real increases over the next regulatory period.

1.3 Water services

Three of the retail businesses have proposed large price rises for water services in 2013-14, followed by CPI rises in the remaining years of the period. The businesses proposed price increases (weighted average of residential and non-residential water prices) for the first year of the next price period of:

- 50 per cent increase – South East Water
- 49.8 per cent increase – Yarra Valley Water, and
- 47.5 per cent increase – City West Water.

Western Water has proposed a (weighted average of residential and non-residential water) price rise of 8.9 per cent in the first year, followed by increases of around 8.5 per cent each year until 2017-18.

The retail water businesses are proposing to maintain existing tariff structures for water services, including a fixed service charge and a variable usage charge.

All businesses propose to maintain three tier inclining block tariffs (IBTs) for variable water use by residential customers, meaning that customers are charged higher prices as their water usage exceeds certain defined thresholds (known as tiers or blocks).

For non-residential customers, the retail water businesses are proposing to retain single variable charges.

The metropolitan retail businesses propose to shift from the fixed water and sewerage charge based on property title to a charge based on tenements (or residences/businesses). This will mean that if there are more than one residence or business on one title, each will pay a separate fixed service charge. To lessen the initial impact of this change, 50 per cent of the charge will apply in 2014-15 followed by the full charge in 2015-16.

1.3.1 D factor

The retail water businesses are also proposing an annual variable charge to account for desalination water costs if water from the desalination plant is needed. This has been referred to as a “d factor”.

The proposed d factor would enable metropolitan water businesses to pass-through the volumetric cost of any water provided by the Victorian desalination plant. Having a d factor means that water usage prices would be adjusted upwards in any year if desalination water is ordered.

For example, if the Victorian Government ordered 50 GL for City West Water, South East Water or Yarra Valley Water, an average customer bill for that business would increase between \$9 and \$12.

1.3.2 Sewerage services

Similar to water services, three of the retail businesses have proposed large price rises for sewerage services in 2013-14, followed by CPI rises in the remaining years of the period. The businesses proposed price increases (weighted average of residential and non-residential sewerage prices) for the first year of the next price period of:

- 22.8 per cent increase – Yarra Valley Water
- 21.3 per cent increase – South East Water, and
- 7.5 per cent increase – City West Water.

Western Water has proposed a (weighted average of residential and non-residential water) price rise of 3.5 per cent in each year of the period.

All retail businesses propose that a fixed sewerage service charge apply for residential and non-residential customers. City West Water, South East Water and Yarra Valley Water also proposed to maintain a variable charge for sewerage disposal charge (SDC) for both residential and non-residential sewerage customers. Western Water proposes to maintain only a fixed charge.

City West Water, South East Water and Yarra Valley Water propose to modify their SDC for residential customers. While South East Water proposes to simplify the SDC by removing the seasonal adjustment, Yarra Valley Water proposes to alter its seasonal adjustment factor to reflect a forecast bounce back in outdoor water use. In contrast, City West Water proposed to alter their SDC decreased the assumed level of outdoor use, which leads to a higher proportion of indoor use.

For non-residential customers, South East Water will continue to apply the SDC to reflect each customer’s proportion of water discharged or apply an industry average. Yarra Valley Water proposes to apply a flat discharge factor (no seasonal variation) to the SDC.

1.3.3 Trade waste services

City West Water and Yarra Valley Water have proposed increased trade waste service prices in the first year (5.0 per cent and 4.3 per cent respectively) followed by CPI increases in the following four years. South East Water has proposed a price rise of 0.1 per cent in the first year, followed by CPI rises in the remaining years of the period. Western Water has proposed no real price rises for trade waste during the regulatory period.

The retail water businesses proposed the following changes to trade waste tariffs:

- South East Water proposed a fixed charge based on a risk ranking for each trade waste customer in place of the volumetric based charge in the current period.
- Yarra Valley Water proposed a fixed charge based on the risk ranking of each customer, and a variable charge. The risk ranking replaces the current volume based annual fees. The variable charge will be based on volume and pollutant load.
- Western Water proposed to maintain a fixed fee for minor trade waste; and for major trade waste, a fixed and variable fee based on load.
- City West Water proposed to maintain variable charges for volume and pollutant load.

1.3.4 Recycled water services

As for water and sewerage services, three of the retail businesses have proposed large price rises for sewerage services in the first year, followed by CPI rises in the remaining years of the period. The businesses proposed price increases (weighted average of residential and non-residential recycled prices) for the first year of the next price period of:

- 67.2 per cent² – City West Water.
- 49.5 per cent increase – Yarra Valley Water, and
- 28.3 per cent increase – South East Water.

Western Water has proposed to continue to apply a (weighted average of residential and non-residential water) price rise of 7.7 per cent in the first year followed by increases between 5.7 and 6.7 per cent in subsequent years.

Melbourne Water proposed to maintain a volumetric component to its charges for recycled water and proposes to recover the revenue shortfall through wholesale sewerage prices on a ‘polluter pays’ basis.

² This figure refers only to non-residential customers because City West Water will not have a residential recycled water service until 2014-15 when the West Werribee scheme becomes operational.

The other metropolitan water businesses proposed to link their recycled water tariffs to the standard variable water price. For residential customers:

- City West Water and Yarra Valley Water proposed to continue charging a fixed charge and a variable charge based on the first tier potable water price.
- South East Water proposed to set its recycled water usage charge at 85 per cent of the first tier for potable water.
- Western Water proposed to set a fixed charge and a variable charge for recycled water. The fixed charge is differentiated by meter size and the variable charge (for class A residential customers) is set at the first tier of potable water.
- For non-residential customers, prices for recycled water services are set according to the pricing principles in the Commission's Final Decision of the 2008 Price Review. These principles allow for negotiation of contracts between the water business and non-residential customers.

1.3.5 Bulk water charges

Melbourne Water proposes to maintain its current system of separate bulk water, headworks and transfer prices, with each having a variable and a fixed component. There is one variable headworks price for all water retailers. There are different variable transfer prices for each water retailer based on the costs of the transfer network in the various supply areas.

1.3.6 Bulk sewerage charges

Melbourne Water proposes to maintain its current sewerage pricing structure. There are separate variable sewerage prices for its Eastern and Western sewerage systems. Melbourne Water also has separate variable prices for the major trade waste parameters for the Eastern and Western systems.

1.3.7 Waterways and drainage charges

Melbourne Water proposes a real 2.7 per cent increase for all waterways and drainage charges for each year of the regulatory period (table 4). Melbourne Water proposes that on 1 July 2013, the waterways and drainage charge for residential customers will be \$87.32.

For residential and non-residential customers within the Urban Growth Boundary, proposed waterways and drainage charges are as follows:

- Residential customers would be charged a flat, occupancy-based fee.
- Non-residential customers pay a rate based on property value subject to a minimum fee.
- A flat fee is paid by: all non-residential properties included in the waterway management district as a result of extending Melbourne Water's service area in November 2005; and non-residential properties as a result of the extension of the Urban Growth Boundary since 2010 and lifting of farm exemptions.

- There are special drainage area charges in the Koo Wee Rup - Longwarry Flood Protection District, and extra fees at Patterson Lakes.

Table 4 Estimated annual (real %) price changes for waterways and drainage - Melbourne Water

2013-14	2014-15	2015-16	2016-17	2017-18
2.7%	2.7%	2.7%	2.7%	2.7%

Melbourne Water has proposed some minor changes to the pricing structure for the waterways and drainage charge. It proposes:

- to apply the new urban growth boundary as the boundary between urban and rural rates and
- to remove the historical farm exemption from paying waterways and drainage charges.

1.3.8 Developer charges

Melbourne Water proposed to continue the current pricing principles and methodology for setting developer charges.

City West Water has proposed a single standard developer charge of \$6 500 to apply to all lots connecting to the business's assets in the urban growth zone, subject to a transition plan. The business has proposed to assess non-standard development applications on a case-by-case basis using the Commission's New Customer Contributions estimator. City West Water is not proposing to levy a standard developer charge in Brownfields areas.

The other retailers indicated in their Water Plans that they will submit proposals to the Commission by 7 December 2012.

1.3.9 Form of price control

During the previous regulatory period, all metropolitan water businesses had a price cap as their form of price control. For the next price period, each of the retail businesses proposed some change to their form of price control, except Western Water, which proposed to retain individual price caps.

- City West Water proposes to retain individual price caps with the option to apply to move to a tariff basket approach during the regulatory period.
- South East Water proposes its prices be set via a weighted average price cap (or tariff basket) with a 3 per cent constraint on upward price movements.
- Yarra Valley Water proposes a revenue cap with a 2 per cent constraint on upward price movements.

South East Water and Yarra Valley Water's proposed prices are therefore only indicative because under their proposed forms of price control, we would not explicitly approve the individual prices (as is done under an individual price cap approach). This is because:

- under a tariff basket approach, as proposed by South East Water, we would approve an overall percentage price change for each year of the regulatory period. The business must ensure that the weighted average price change across all the business's tariffs does not exceed this.
- under a revenue cap approach, as proposed by Yarra Valley Water, we would approve the amount of revenue that the business is allowed to collect in each year of the regulatory period. If the business collects too much revenue, it must alter its prices to ensure that this revenue is passed back to customers.

1.3.10 Customer tariff choice

Yarra Valley Water is the only water retail business to propose optional tariffs for customers in its Water Plan. It proposes to conduct an 'opt-in' trial of a 100 per cent variable water and sewerage tariff comprising approximately 1 000 eligible customers in 2013-14.

1.4 Service standards

The businesses are required to propose targets for a core set of service standards for each year of the price period. The core service standards reflect the key issues of concern to customers and key cost drivers for businesses. The core service standards cover:

- planned and unplanned water supply interruptions
- sewer blockages and spills
- unaccounted for water and
- other customer service measures.

In our 2013 Water Price Review – Guidance on Water Plans³ we asked the businesses to consider a number of factors when setting targets for core service standard including an average of the last five years actual performance, trade-offs between price and service levels, and customer views.

³ Essential Services Commission 2011, *2013 Water Price Review – Guidance on Water Plans*, October.

Below are details of where the water businesses have proposed targets that deviate from the average of the last five years performance. Further detail on the service proposals of each water business is provided in the separate summary sheet prepared for each business.

Table 5 Proposed service standards varying from five year average level of service

<i>Service standard</i>	
City West Water	
Average time to attend priority 3 bursts and leaks	The target is based on the average time over the period 2006-07 to 2010-11. Performance in 2011-12 has been excluded due to the unusually low number of bursts that year due to exceptionally wet weather
Number of customers experiencing more than five unplanned water supply interruptions	The target for the in a year has been set to zero to reflect the past four year's average
South East Water	
Percentage of unplanned water supply interruptions restored within five hours	Proposed to reduce the target slightly. The business reported that changes in safety and traffic management regulations would necessitate additional expense to meet current performance South East Water believes that this investment is not justifiable given customer preferences
Number of complaints (per 1 000 customers) to EWOV	Proposed to increase the target relative to average performance over the past five years. The business expects an increase in customer complaints following the proposed price increase in 2013-14.
Percentage telephone calls for account and faults answered within 30 seconds	Proposed to notably reduce the target. The business reported that maintaining current levels of service would require additional staff and associated costs.

Continued next page

Table 5 (cont)

<i>Service standard</i>		
Western Water		
n/a		Generally proposing to maintain current levels of service.
Yarra Valley Water		
Times to respond to water and sewerage faults	Proposed to base targets on the average of the last three years performance to reflect current traffic conditions and congestion.	
Unplanned water supply interruptions frequency and duration	Proposed to base targets on the three year average performance reflecting the business' current practice of turning off the water supply.	
Unaccounted for water	Proposed to improve performance reflecting increased efforts by the business to reduce water losses from the network	

We will assess the justification for the proposed targets of the water businesses, particularly where they reflect a lower standard relative to recent performance.

1.5 Guaranteed service levels

A guaranteed service level (GSL) scheme is a financial mechanism for providing incentives for businesses to meet defined service standards without compromising efficiency. GSL schemes involve businesses providing payments or rebates to customers when they experience certain supply problems or do not receive defined levels of performance.

Metropolitan water businesses have between five and 12 GSLs in place. GSL payment values ranged from \$50 for GSLs related to interruptions to \$1 000 for sewage spills within a house.

None of the metropolitan water businesses proposed changes in their GSL schemes for the next regulatory period except for Yarra Valley Water, which increased increase the payment amount for 'no more than 3 sewerage interruptions within any 12 month period' and 'sewerage interruption restored within 4 hours' from \$50 to \$100.

1.6 Proposed revenue and expenditure requirements

The businesses' proposed price changes reflect their views about the revenue they need in order to deliver services to customers. Melbourne Water estimates that it will need to collect around \$8.6 billion in revenue over the period from 2013-14 to 2017-18, while collectively the other metropolitan water businesses estimate they will require \$13 billion in revenue over the same period. A large proportion of the retail businesses' costs will be paid to Melbourne Water, and therefore only a proportion of the \$21.6 billion is recovered from customers.

We have engaged PricewaterhouseCoopers to assist with our review of proposed expenditure. A key focus for the expenditure consultants in this price review is to also identify where businesses have opportunity to reduce costs (both operating and capital) and/or defer capital expenditure into the next price period. This is especially important in light of the proposed material customer impact of costs associated with the Victorian Desalination Plant.

Some of the key projects proposed by the metropolitan water businesses over the period from 2013-14 to 2017-18 include:

- Melbourne Water proposes to increase treatment capacity of the Western Treatment Plant (\$187 million)
- South East Water proposes to deliver sewerage services in Dromana – Portsea (\$186 million)
- City West Water proposes to build infrastructure for the second stage of the Altona recycled water project, including a salt reduction plant, a transfer main, a distribution network, and a storage tank (\$80 million), and
- Western Water proposes to increase capacity at the Sunbury Recycled Water Plant (\$33 million).

Table 6 provides more detail on the key capital projects proposed by each business.

Table 6 Key capital expenditure projects for each water business

<i>Proposed capital expenditure project/program</i>	<i>Reason</i>	<i>Cost \$m</i>
Melbourne Water		
Western Treatment Plant - treatment capacity augmentation	Growth	187
Flood mitigation program	Compliance	106
St Albans to Werribee Pipeline Stage 2	Growth	96
Eastern Treatment Plant – mechanical and electrical Renewals renewals program		79
Preston water mains renewals	Renewal	47
City West Water		
Network renewals program	Renewals	205
Growth areas – water, 3 rd pipe (recycled water) and sewerage	Growth	203
Altona recycled water stage 2	Compliance	80
Growth areas - sewerage	Growth	51
Program Arrow	Efficiency	51
South East Water		
Dromana – Portsea sewer backlog	Compliance	186
Water and sewer mains renewals programs	Renewals	121
Construction and fit out of new office	Efficiency	78
Three sewage treatment plant upgrades	Growth/Compliance	82
Cranbourne recycled water tank	Growth	12

Continued next page

Table 6 (cont)

<i>Proposed capital expenditure project/program</i>	<i>Reason</i>	<i>Cost \$m</i>
Yarra Valley Water		
Water, sewer and House Connections Branch renewals programs	Renewals	332
Sewer hydraulic improvement program	Compliance	109
Sewer expansion projects	Growth	99
Western Water		
Sunbury Recycled Water Plant capacity upgrade	Growth	33
Melton stormwater harvesting	Compliance	19
IT Systems improvement	Efficiency/improvement	17
Recycled water facility upgrades	Growth	11
Sewer spills prevention strategy	Compliance	9
Surbiton Park Recycled Water Plant upgrade	Growth	9

1.6.1 Capital expenditure

In total, the metropolitan water businesses proposed to spend around \$5.1 billion on capital projects over the next price period, \$1.4 billion (or 21.4 per cent) lower than in the current price period (note that these figures are in net terms, that is, they exclude any project costs covered by government or customer contributions). Collectively, businesses expect investment over the next five years will deliver:

- renewal of infrastructure to maintain/improve service
- projects to meet greater forecast demand and growth and
- compliance with government standards

Forecasts for net capital expenditure by individual businesses over the period from 2013-14 to 2017-18 range from \$204 million for Western Water to \$2 168 million for Melbourne Water (table 7).

Only Melbourne Water and Yarra Valley Water forecast falls in net capital expenditure, but these falls outweigh the increased capital expenditure of the other metropolitan businesses. The falls largely reflect a reduced need for water supply augmentation (which was a large contributor to higher capital expenditure in the current price period). Proposed increases in capital expenditure for the other metropolitan businesses are largely due to customer growth.

Table 7 Net Capital expenditure (\$m 2012-13)
Total forecast compared to current price period

	Total forecast compared to current price period	2013-14 to 2017-18	Change (%)
City West Water	626.9	663.9	5.6%
South East Water	828.8	999.2	20.6%
Yarra Valley Water	1 129.4	1 036.4	-8.2%
Western Water	136.7	203.8	49.1%
<i>Total retail businesses</i>	<i>2 721.8</i>	<i>2 903.3</i>	<i>6.7%</i>
 Melbourne Water	 3 728.6	 2 167.8	 -41.9%

1.6.2 Operating expenditure

Melbourne Water has proposed operating expenditure of \$5.1 billion for the next price period, \$3.0 billion (150 per cent) higher than the current regulatory period (table 8), mainly due to the costs associated with the Victorian Desalination Plant (box 1.1).

Excluding bulk water costs (because these are captured above in Melbourne Water's costs), the retailers have collectively proposed operating expenditure of \$2.4 billion for the next price period, 13.2 per cent higher than the current price period.

The main drivers of operating expenditure growth are:

- costs associated with the Victorian Desalination Plant
- environmental contributions
- forecast increases in input costs (particularly energy and labour)

BOX 1.1 VICTORIAN DESALINATION PLANT

The main reason for the increase in prices proposed by the water businesses in the price period from 1 July 2013 is the Victorian Desalination Plant. Melbourne Water has estimated that the desalination plant accounts for almost 90 per cent of its proposed increase in wholesale water and sewerage prices.

The metropolitan retailers have estimated that the desalination plant explains around two-thirds of their proposed increase in prices.

Table 9 itemises Melbourne Water's operating expenses, including forecast desalination plant "security of supply" fixed costs, which excludes any costs associated with the purchase of water.

Melbourne Water forecasts total desalination plant security costs of just over \$3 billion in the five years from 1 July 2013, with annual costs falling from around \$644 million in 2013-14 to \$568 million in 2017-18⁴ (this excludes proposed desalination project management costs of around \$8 million per year starting in 2016-17).

⁴ In real terms (\$2012-13).

Table 8

Operating expenditure (\$m 2012-13)

Total forecast compared to current price period

	<i>2008-09 to 2012-13</i>	<i>2013-14 to 2017-18</i>	<i>Change (%)</i>
City West Water	510.6	627.9	23.0%
South East Water	710.9	752.0	5.8%
Yarra Valley Water	736.9	820.1	11.3%
Western Water	157.3	194.6	23.7%
<i>Total retail businesses</i>	<i>2 115.8</i>	<i>2 394.6</i>	<i>13.2%</i>
 Melbourne Water	 2 012.8	 5 052.3	 151.0%

Note: bulk charges are excluded from the figures for the retailers

Excluding the cost of desalination, licence fees and increasing environmental contributions, growth in the proposed operating expenditure directly controllable by the water businesses varies:

- 0.01 per cent per year for South East Water
- 0.4 per cent per year for Yarra Valley Water
- 3.2 per cent per year for Western Water
- 3.9 per cent per year for Melbourne Water
- 4.2 per cent per year for City West Water

Melbourne Water proposed that directly controllable operating expenditure would increase from \$331 million in 2011-12 (the last full year for which actual data is available) to \$409 million by 2017-18 (table 9).

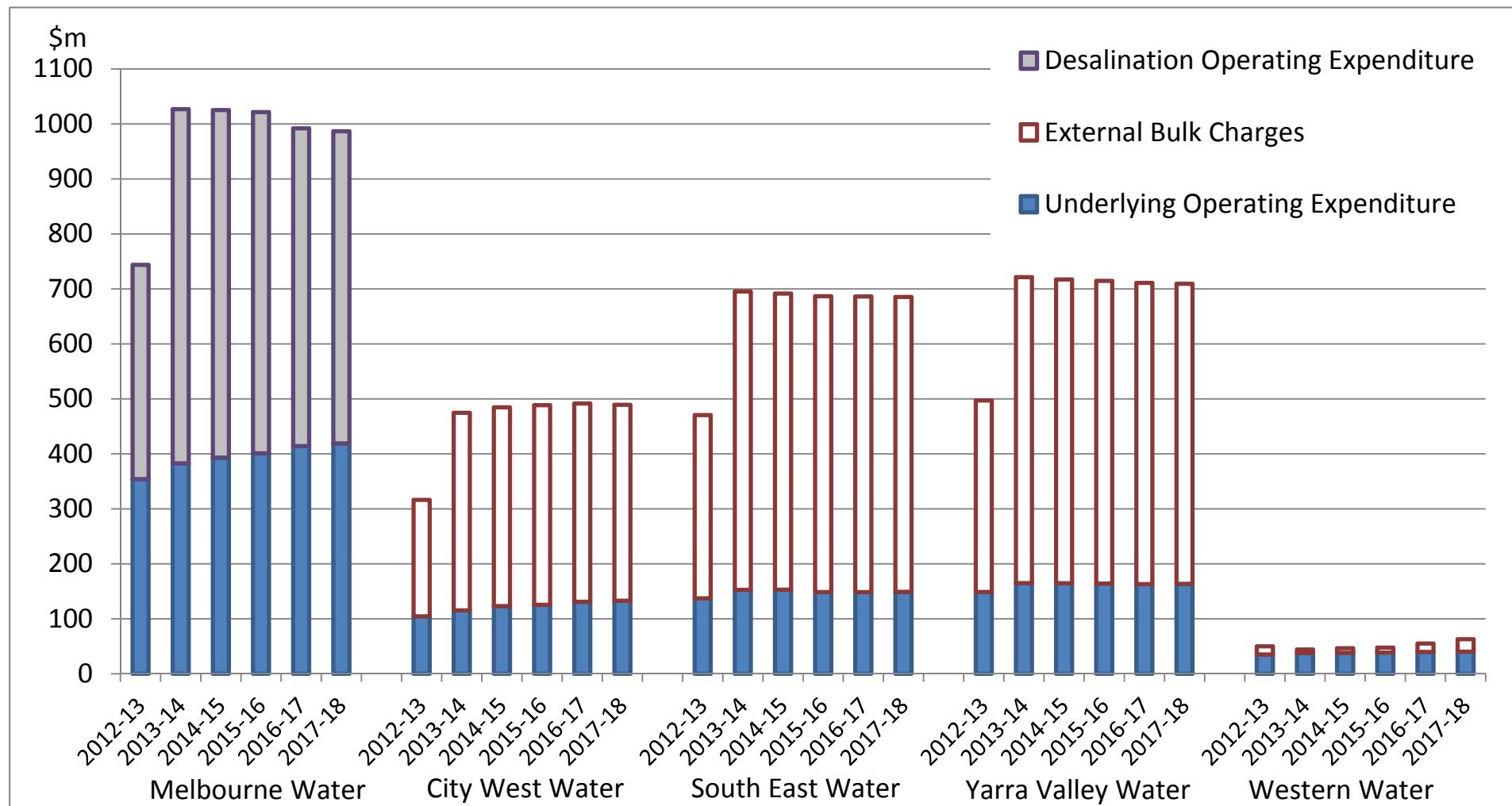
Collectively, directly controllable operating expenditure for the metropolitan retail water businesses is proposed to increase from \$375 million in 2011-12 to \$411 million by 2017-18.

We have engaged independent consultants (PricewaterhouseCoopers) to conduct a thorough assessment of the businesses' proposed expenditure plans to ensure they are prudent and efficient. We will publish the PricewaterhouseCoopers review when we release our draft decision on the prices for regional water businesses in March 2013.

Table 9 Breakdown of forecast operating expenditure (\$m)

	2011-12	2012-13	2013-14	2014-15	2015-16	2016-17	2017-18
Melbourne Water							
Directly controllable	330.7	351.7	380.7	391.1	398.9	403.9	408.6
Desalination contract costs	-	389.7	644.2	632.2	620.6	578.0	567.7
Desalination project management	-	-	-	-	-	8.2	8.0
Licence fees	2.1	2.4	2.0	1.9	1.9	2.0	2.3
<i>Total</i>	<i>332.8</i>	<i>743.8</i>	<i>1,026.9</i>	<i>1,025.3</i>	<i>1,021.4</i>	<i>992.0</i>	<i>986.6</i>
City West Water							
Directly controllable	90.7	93.1	96.6	105.0	107.8	113.9	116.1
Bulk charges	229.1	211.7	359.3	361.5	363.0	360.5	356.4
Environmental Contribution	11.0	10.8	18.1	17.6	17.1	16.7	16.2
Licence fees	0.6	0.5	0.8	0.5	0.5	0.5	0.5
<i>Total</i>	<i>331.4</i>	<i>316.2</i>	<i>474.7</i>	<i>484.6</i>	<i>488.4</i>	<i>491.6</i>	<i>489.2</i>
South East Water							
Directly controllable	120.1	120.2	123.9	123.9	119.7	119.7	120.2
Bulk charges	341.9	333.3	542.4	538.6	538.1	537.5	536.1
Environmental Contribution	16.6	16.7	27.9	27.9	27.9	27.9	27.9
Licence fees	1.0	1.0	1.1	1.1	1.1	1.1	1.1
<i>Total</i>	<i>479.6</i>	<i>471.1</i>	<i>695.2</i>	<i>691.5</i>	<i>686.7</i>	<i>686.1</i>	<i>685.2</i>
Yarra Valley Water							
Directly controllable	133.3	130.4	134.8	135.4	135.5	135.2	136.4
Bulk charges	352.4	348.2	556.5	552.4	550.4	547.9	545.7
Environmental Contribution	17.8	17.5	29.1	28.3	27.5	26.8	26.1
Licence fees	1.0	1.0	1.0	1.0	1.0	1.0	1.0
<i>Total</i>	<i>504.6</i>	<i>497.1</i>	<i>721.4</i>	<i>717.1</i>	<i>714.5</i>	<i>711.0</i>	<i>709.2</i>
Western Water							
Directly controllable	31.3	33.9	35.0	35.7	36.3	37.4	37.9
Bulk charges	11.4	14.6	6.5	8.2	8.9	15.3	22.7
Environmental Contribution	1.6	1.6	2.4	2.3	2.3	2.2	2.2
Licence fees	0.1	0.2	0.2	0.1	0.1	0.1	0.2
<i>Total</i>	<i>44.5</i>	<i>50.3</i>	<i>44.1</i>	<i>46.5</i>	<i>47.6</i>	<i>55.1</i>	<i>62.9</i>

Chart 1

Directly controllable operating expenditure (\$m 2012-13)

1.7 Demand forecasts

Demand forecasts play a key role in determining customer prices. Where businesses propose conservative demand forecasts, everything else being equal, prices will be higher than if they proposed more optimistic demand forecasts.

In our 2013 Guidance on Water Plans we outlined several key issues to be the focus of our assessment of demand forecasts for the next price period. These include:

- the extent and timing of any bounce back in water demand following the move from restrictions to Permanent Water Saving Rules in most areas,
- the impacts of changes in price on demand, and
- consistency between demand forecasts and the businesses' proposals about the extent and nature of operating and capital expenditure and revenue forecasts.

Our initial observations about the demand forecasts in the retail water businesses' Water Plans are:

- Businesses have generally forecast moderate growth in their number of connections.
- Generally, businesses have made modest assumptions about bounce back in consumption per connection following the move from water restrictions to Permanent Water Use Rules.
- Most businesses have forecast increases in total residential sales volumes, however this is largely driven by growth in connections.
- Most businesses have forecast conservative or declining non-residential sales volumes.

Table 10 shows that the retail water businesses collectively expect total customer connections to rise by 15.1 per cent in the period from 2011-12 (the last year of actual data available) to 2017-18. The strongest growth is forecast by Western Water and City West Water. Yarra Valley Water projects relatively low growth in connections.

Total water consumption is forecast to rise by 2.6 per cent over the period from 2011-12 to 2017-18. The strongest growth is forecast by Western Water. Despite forecasting high growth in connections, City West Water projects total consumption to remain steady over the period. This could be related to their assumptions about increase demand for recycled water as a substitute for potable water.

Stage 1 water restrictions will end in Melbourne by 1 December 2012, and will revert back to Permanent Water Use Rules.

Table 10 Forecast connections and consumption

	Connections (no.)			Consumption (Kilolitres)		
	2011-12 (actual)	2017-18 (forecast)	Change (%)	2011-12 (actual)	2017-18 (forecast)	Change (%)
City West Water	360 277	424 561	17.8%	86 614	86 727	0.1%
South East Water	648 098	736 573	13.7%	116 051	118 054	1.7%
Yarra Valley Water	647 110	736 760	13.9%	119 994	124 554	3.8%
Western Water	53,191	69 110	27.0%	10,060	11 882	18.1%
Total	1 709 898	1 937 005	13.3%	332 160	341 217	2.7%

All metropolitan water businesses except South East Water have forecast stronger growth in residential water sales volumes than non-residential sales volumes over the period. Some of the larger differences between residential and non-residential water sales volumes include (see table 11):

- Western Water has forecast a 42.6 per cent increase for total residential sales compared to a 28.0 per cent decrease in non-residential
- City West Water has forecast a 13.2 per cent increase for total residential sales compared to a 17.1 per cent decrease in non-residential
- Yarra Valley Water has forecast a 5.1 per cent increase for total residential sales compared to a 0.9 per cent decrease in non-residential.

Table 11 Forecast consumption residential and non-residential (Kilolitres)

	Residential			Non-residential		
	2011-12 (actual)	2017-18 (forecast)	Change (%)	2011-12 (actual)	2017-18 (forecast)	Change (%)
City West Water	49 159	55 668	13.2%	37 455	31 059	-17.1%
South East Water	88 359	89 570	1.4%	27 692	28 484	2.9%
Yarra Valley Water	94 598	99 385	5.1%	25 396	25 169	-0.9%
Western Water	7 143	10 183	42.6%	2 358	1 669	-28.0%
Total	239 259	254 806	6.5%	92 901	86 411	-7.0%

The metropolitan water businesses have proposed significant expenditure for recycled water, and have all forecast strong growth in residential customer connection over the period (table 12). We will review the businesses' performance against previous proposals for recycled water, levels of expenditure, and the reasonableness of the demand forecasts.

Table 12 Forecast recycled water connections and consumption

	<i>Residential connections</i>		<i>Consumption volume</i>	
	<i>2011-12 (actual)</i>	<i>2017-18 (forecast)</i>	<i>2011-12 (actual)</i>	<i>2017-18 (forecast)</i>
City West Water	-	15 148	-	473 830
South East Water	3 852	19 112	92 697	1 202 271
Yarra Valley Water	2 613	19 577	154 958	1 139 753

The Commission has engaged Frontier Economics to review the demand forecasts of the water businesses. The results of the Frontier Economics review will be published when we release our draft decision on water prices in March 2013.

2 | NEXT STEPS

We encourage customers and representative groups to respond to the issues in their water businesses' Water Plans and to identify any further issues that they consider should be addressed in assessing the businesses' Water Plans. The responses received through the public consultation process will assist us to assess the businesses' Water Plans. The due date for submissions in response to the Water Plans is 25 January 2013.

We will hold two public forums to provide further opportunity to understand the key features of the businesses' proposals and to identify any issues or views that customers and representative groups may have about the proposals and their impact. The forums will be held:

- 3 December 2012 for Melbourne Water, City West Water, South East Water and Yarra Valley Water; and
- 4 February 2013 for Western Water.

Further details of the location and timing of these public forums are provided on our website www.esc.vic.gov.au. If you would like to attend public forums or have any queries, please advise via email water@esc.vic.gov.au or by phone 03 9651 0206.

We will release a draft decision on water prices in March 2013. The draft decision will provide our preliminary views on the maximum prices to apply from 1 July 2013.

The draft decision will take into account our assessment of the Water Plans, issues raised in the consultation process, and comments on the Water Plans from customers, their representatives and interest groups. The draft decision will form the basis for further consultation before the Commission makes its final decision in June 2013. The new prices authorised through the final decision will take effect from 1 July 2013.

The indicative timeline for the water price review is outlined below:

Price review timeline

November-December 2012	Public forums on Water Plans
25 January 2013	Closing date for public submissions to the Commission on the businesses' Water Plans
March 2013	Commission releases its draft decision on water prices, invites submissions on draft decision
March-April 2013	Public forums on draft decision
April 2013	Closing date for public submissions to the Commission on our draft decision
June 2013	Final decision
