

Date 9 May 2023  
Our Ref: 641/005/003



Marcus Crudden  
Executive Director, Price Monitoring and Regulation  
Essential Services Commission  
Level 37, 2 Lonsdale Street  
MELBOURNE VIC 3000

Dear Marcus,

**RE: Response to Price Review 2023: South Gippsland Water Draft Determination**

We welcome the Essential Services Commissions (ESC) draft decision on our Water Price Review 2023 and acknowledge the ESC found our price submission and supporting model were generally of a high quality.

The ESC requested we respond to the following:

1. **Outcomes** - completion of the standard Outcomes Reporting Template. We note you will continue to work with us to ensure the final set of measures complies with your guidance requirements.
2. **Revenue Requirement** - an updated price schedule, revenue requirement and prices to reflect the updates to the cost of debt and inflation estimates.
3. **Changes in laws or government policy** – to our knowledge, there are no changes in laws or Government policy that would impact the price determination. We have not recognised any material changes that may impact our forecast costs, revenue requirement or prices.
4. **Demand** – consideration to the latest Victoria in Future estimates
5. **Prices** – confirmation of how we intend to address the impacts of relatively high inflation on proposed prices and customer bills for 2023-24.
6. **Impacts of Inflation** – consideration of the impacts of inflation on our forecast expenditure in 2023-24. Recognising the balance across expenditure items such as chemicals, electricity, insurance, and construction costs increasing well above CPI.

Following the release of the draft determination a review process has been completed considering:

- 1) The release of:

SGW Price Review Model	14 April 2023
FTI Capex for NCC's Preliminary Observations	14 April 2023
Inflation and Cost of Debt updates	3 May 2023
Analysis of Customer Outcomes and template	3 May 2023
FTI Consulting Draft NCC report	8 May 2023
- 2) New Customer Contribution (NCC) considerations. A response to the FTI Capex for NCC's Preliminary Observations has been provided to the Essential Services Commission on 21 April 2023. We are developing a further response to the FTI Consulting Draft NCC report, which will be provided to the ESC by Friday 12 May 2023.

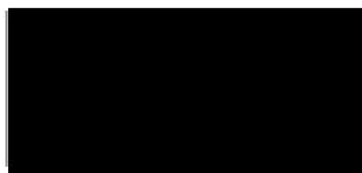
- 3) Feedback from the Essential Services Commission Customer Outcome analysis has been considered and a number of Outcomes and measures were updated in response. The Customer Outcome Template is attached and we welcome further conversation.
- 4) Community and Stakeholder feedback received at the Essential Services Commission Community Engagement session held on 28 April 2023.

We accept the key elements of the draft determination, recognising a final decision with respect to New Customer Contributions is pending. The attached response provides further clarification to the items identified within the draft determination.

We accept that the ESC draft determination will provide the pricing relief necessary to meet our customers' expectations. We will continue to work with our customers and stakeholders to ensure we remain vigilant to the needs of customers, with a focus on those who may be experiencing payment difficulties.

Should you require any further information, please do not hesitate to contact me on [REDACTED]

Yours sincerely,



Robert Murphy  
**Managing Director**

*Attachments:*

*SGW response to the Water Price Review 2023 Draft Determination*  
*SGW financial model 2023 – 2028*  
*SGW NCC model*  
*SGW Customer Outcome Template*

## South Gippsland Water Response to PS2023 Draft Determination

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ESC determination	SGW response
<b>Customer outcomes</b>	
<p>Generally, we consider South Gippsland Water’s intentions are clear, and its measures and targets will provide a sound basis to track performance and delivery against each outcome. We identified some matters for follow up that we consider South Gippsland Water will need to address in its response to our draft decision. These relate to clarifying measures and targets.</p>	<p>We reviewed the comments in the draft determination and amended the Customer Outcome table (Appendix B) to address the ESCs request to clarify certain measures and targets. The Outcome areas clarified include:</p> <p><b>Reliability:</b> We have generally achieved our performance targets for water and sewer spills over Regulatory Period 4. However, achieving reliability targets is becoming increasingly challenging due to infrastructure age and travel times to areas such as the Poowong, Loch, and Nyora pressure sewerage systems. For this reason, we are proposing the reliability measures to remain consistent.</p> <p><b>Water:</b> clarification of measure completed</p> <p><b>Wastewater:</b> clarification of measure completed</p> <p><b>Environment:</b> amended measure wording from compliance % to non-compliance number</p> <p><b>Integrity:</b> clarification of measure completed</p> <p>Our updated Customer Outcomes are provided as an attachment to this response titled ‘SGW Outcome Reporting 2023 – 2028’.</p>
<b>Revenue Requirement and Operating expenditure</b>	
<p>Our draft decision adopts a revenue requirement of \$198.2 million, lower than the \$199.9 million proposed by South Gippsland Water.</p> <p>Our draft decision is to not accept South Gippsland Water’s forecast operating expenditure of \$128.1 million and instead propose a benchmark of \$127.9 million.</p> <p>The ESC also requested we provide an updated price schedule and update our revenue requirement and prices to reflect the ESCs updates to estimates for the cost of debt and inflation advised in April 2023.</p>	<p>We accept the ESCs draft decision to reduce our revenue requirement for Regulatory Period 5 to \$198.2M and operating expenditure to \$127.9M.</p> <p>We acknowledge the ESC’s observation that it is likely inflation will remain relatively high and that the Victorian Public Sector Executive Reforms and associated remuneration costs should be funded via the CPI increase.</p> <p>We acknowledge and accept the reduction in return on assets and regulatory depreciation.</p> <p>We are not proposing any changes to our price schedule as we proposed a revenue shortfall in our price submission in recognition of affordability for customers. This revenue shortfall has not diminished with the proposed reduction in our revenue requirement.</p> <p>An updated financial model is attached to this response.</p> <p>To our knowledge, there are no further material changes to laws or government policy that may impact our updated Price Model or information.</p>

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### ESC determination

### SGW response

#### Closing regulatory asset base

Our draft decision is to adopt a closing regulatory asset base of \$211.9 million at 30 June 2022, which is lower than the \$213.9 million proposed by South Gippsland Water.

We accept the ESCs draft decision to adopt a closing regulatory asset base of \$211.9 million at 30 June 2022 to align with our approved 2021-22 regulatory accounts.

We also note finalisation of the forecast regulatory asset base is dependent on the approval of our New Customer Contributions. We will continue to work with the ESC to complete this process.

#### Forecast regulatory asset base - New Customer Contributions

Our draft decision is to not accept South Gippsland Water's forecasts for revenue from customer contributions.

South Gippsland Water must update and justify its customer contribution forecasts in response to our draft decision. South Gippsland Water must also ensure that the forecast customer contributions in the financial model and new customer contributions model can be reconciled.

We have provided a detailed response to the ESC on the 21<sup>st</sup> of April 2023 addressing the methodology used to calculate our proposed NCCs. Key areas of the response include:

- We have adopted a consistent approach to the process for the allocation of capital expenditure to new customer contributions since 2013.
- Our processes were reviewed and approved by our Board and the ESC in the 2018 and 2020 Price Submissions
- We have an established, considered process for the allocation of capital investment as growth driven

An updated NCC model that reconciles with our financial model has been provided as an attachment to this response.

We note that the impact of this reconciliation process has recognised the updated growth capital expenditure included in our financial model and has identified an NCC charge of \$7,568 each for water and sewer connection. We are proposing we adopt the NCC charge proposed in our submission of \$2,971 recognising we have engaged with developers on the proposed charge and the impact of adopting the higher NCC charge on developers.

We note the ESC provided FTI Consulting's draft final report on our New Customer Contribution methodology on the 8<sup>th</sup> of May and will provide a detailed response to the ESC by the 12<sup>th</sup> of May 2023, as requested.

#### Regulatory Depreciation

Our draft decision is to not accept South Gippsland Water's forecast regulatory depreciation.

We accept the ESCs draft decision to not accept our forecast regulatory depreciation and the adjustment to the average asset life for water entitlements held by South Gippsland Water.

The draft decision has also noted the final decision may make further adjustments to our forecast regulatory asset base and depreciation as a result of the decision on New Customer Contributions. We believe our methodology of calculating NCCs is a sound and previously tested methodology. We consulted on our proposed

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	charges with developers with no concerns raised. We do not believe it fair and equitable to pass costs borne as a result of new customers to our wider customer base, some of whom are experiencing financial hardship.
<b>Demand</b>	
<p>Our draft decision is to accept South Gippsland Water's demand forecasts.</p> <p>In its response to our draft decision, South Gippsland Water must demonstrate how it has considered these updated estimates and, if required, identify and justify any changes to its demand forecasts</p>	<p>We welcome the ESCs draft decision to accept the demand forecasts we proposed.</p> <p>We have completed a review of our demand forecasts against the Victorian in Future (VIF) September 2022 updated projections. For the South Gippsland region, there is minimal shift in growth, primarily with respect to the timing of the population increase. Our recent experience has also demonstrated that regional growth often performs above the VIF forecasts. We do not believe an update is required.</p>
<b>Tariff Structures and Prices</b>	
<p>Our draft decision is to accept South Gippsland Water's proposed tariff structures.</p> <p>As part of its response, South Gippsland Water must demonstrate how it has considered the impacts of inflation on its forecast expenditure in 2023-24, and whether they are reasonable taking into account that some of its key costs are unlikely to increase as much as near-term inflation.</p> <p>South Gippsland Water proposed capital expenditure for the Venus Bay Outfall upgrade. The main beneficiaries of the upgrade are two major trade waste customers and FTI Consulting's report states that South Gippsland Water is</p>	<p>We welcome the ESC's draft decision to accept the tariff structure and price path we proposed and recognised that we are addressing customer affordability by proposing to charge prices that are lower on average than the amount we could have charged under our proposed revenue requirement.</p> <p>In this high inflation environment, South Gippsland Water's price submission has been developed to minimise the cost-of-living pressures on all our customers and, in particular, our customers experiencing financial hardship. Specific ways in which we are addressing the interests of vulnerable and low-income customers in 2023/24 and beyond are:</p> <ul style="list-style-type: none"><li>• Tariffs that collect less than our proposed revenue requirement</li><li>• Tariffs that have been informed by extensive customer engagement</li><li>• A 2 per cent increase up front with a gradual approach to further price increases that have been tested with customers experiencing vulnerability</li><li>• Implementation of a targeted co-payment program designed to re-engage with customers with outstanding payments and assist in reducing their debt</li><li>• Extending customer supports to non-residential customers</li><li>• Continuing to provide additional funds to the state government-funded Community Rebate Scheme, to allow additional customers to access the scheme and receive repairs or plumbing upgrades with the aim to reduce their water use or bills.</li></ul>

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ESC determination	SGW response
negotiating contracts with the two customers to recover the capital and operating expenses associated with this project. We require South Gippsland Water, in response to our draft decision, to explain and justify how it proposes to recover the costs associated with the project.	<p>Like our customers, we are also seeing significant increases in the cost-of-doing-business. For instance, in 2023 chemical prices have increased by 10% and are expected to increase by another 7.5% in 2024, electricity prices are forecast to increase by a 45% in coming years, and insurance costs have increased by approximately 35% over the past five years and predicted to increase a further 20% for 2023–24. In addition, we have seen huge increases of around 18% in construction prices for our capital projects. While some of our cost increases are below CPI, our analysis shows that this is offset by expenditure areas increasing well above CPI.</p> <p>We will always remain vigilant to the needs of our customers, with a focus on customers experiencing payment difficulties. For instance, in 2020 we delayed the implementation of our approved price increase as customers were experiencing financial hardship at the start of the Covid-19 pandemic. We will continue to consider similar interventions for the benefit of our customers, as the needs arise and we see fit.</p> <p>We proposed to recover expenditure on with the Venus Bay Outfall upgrade from the beneficiaries of that asset only via new trade waste agreements that are currently under negotiation, in line with the ESCs pricing principles for unique services. The forecast revenue is ringfenced as listed as a non-scheduled tariff revenue/ contract revenue, captured within the financial model worksheet titled “RevenuePriceCap_FO”, identified as row 45, Trade Waste Contract Revenue.</p> <p>Finalisation of the trade waste agreements is currently underway, and the process is subject to commercial-in-confidence negotiations.</p>
Provide proposed updated prices that reflect the draft decision and updates to revenue requirements	An updated price schedule is included in the Financial model.