

The Essential Services Commission

We are the independent economic regulator of the Victorian water industry. The Commission periodically assesses prices put forward by water businesses in a three to five year Water Plan.

Commission review of Water Plans

Last year, all metropolitan water businesses submitted their Water Plans to the Commission for the third regulatory period (2013-18). Their Water Plans set out the costs they will be facing and the prices they proposed to charge customers over the next regulatory period to recover those costs. In authorising prices for the water businesses, the Commission assessed whether the proposed operating and capital expenditure forecasts were prudent and efficient, and assessed the required revenue to operate the businesses and to meet obligations from the Minister of Water and other regulatory bodies. The Commission engaged PwC to assist with the assessment of metropolitan businesses' proposed expenditure.

Operating expenditure – draft decision

Total operating expenditure is a significant component of water businesses' total revenue requirements, ranging from 50 per cent to 80 per cent for metropolitan water businesses for the next regulatory period.

Melbourne Water forecast total operating expenditure of \$5.1 billion for the next regulatory period. Of this, \$2.0 billion is directly controllable by the business while the remaining amount accounts for payments for the Victorian Desalination Plant (VDP accounting around \$3.0 billion) and regulatory charges such as environmental contributions and licence fees.

The other metropolitan water businesses forecast a total operating expenditure of \$9.7 billion. Of this, \$2 billion is directly controllable by the businesses and around \$7.0 billion accounts for bulk water charges and regulatory charges. The Melbourne Water's desalination payments are recovered from customers through the greater metropolitan water businesses' bulk water charges. Of the metropolitan water businesses, only South East Water forecast controllable operating expenditure which is lower (\$16.3 million) than that of the second regulatory period.

The metropolitan water businesses identified the key drivers of proposed increases to operating expenditure as:

- higher labour, energy and (for some businesses) chemical costs
- defined benefits superannuation payments due to a shortfall in the funds
- increase in the environmental contribution from 2013-14 and
- additional expenditure associated with new facilities such as treatment plants.

The Commission proposes to approve \$4850.7 million of operating expenditure for Melbourne Water over the next five years. This is \$201.6 million (or 4.0 per cent) lower than that proposed by the business. Key areas of adjustment made by the Commission include: lower financing costs; operating expenditure reductions, e.g., labour, energy, revisions to regulatory and other costs; and productivity improvements.

For the other greater metropolitan water businesses (City West Water, South East Water, Yarra Valley Water and Western Water), the Commission proposes to approve \$9.2 billion over the same period. This is \$481.7 million (or 5 per cent) lower than that proposed by the businesses.

Capital expenditure – draft decision

Capital expenditure is another key component of the water businesses' revenue requirements. It increased significantly in the metropolitan water businesses, reflecting the significant one-off investment projects aimed at augmenting water supply in response to the drought. For the third regulatory period, businesses forecast capital expenditure of around \$5.8 billion. For the third regulatory period, businesses forecast capital expenditure of \$252 million for Western Water, to \$2.5 billion for Melbourne Water. Their lower forecasts reflect a reduced need for water supply augmentation which was a large contributor to higher capital expenditure in the second regulatory period. South East Water, City West Water and Western Water forecast increases due largely to customer growth.

The metropolitan water businesses identified the key drivers of proposed capital expenditure as:

- projects to meet forecast increases in demand
- compliance with government standards and
- renewal of infrastructure to maintain or improve service.

The Commission proposes to approve \$2409.1 million of capital expenditure for Melbourne Water over the next five years. This is \$48.0 million (or 2.0 per cent) lower than proposed. The Commission's revised capital expenditure allowance reflects its proposed changes to the timing of delivery of projects and the removal of some projects.

For the other four businesses, the Commission proposes to approve \$3192.2 million. This is \$136.4 million (or 4.1 per cent) lower than that proposed by the businesses.

Examples of the water businesses' key projects and programs are highlighted below. For most businesses, a small group of projects account for a significant proportion of their total capital expenditure. We will continue to monitor the delivery of key projects through the next regulatory period, via our annual water performance reporting.

Renewals/replacements/refurbishments

The Commission's draft decision provides for water businesses' proposed renewals, replacements and refurbishments of capital projects and programs. These are undertaken to improve or maintain existing levels of service, to reduce corporate operating costs and to address operational and safety concerns. Examples of key projects or programs for which expenditure has been allowed:

- Melbourne Water: Eastern Treatment Plant (mechanical and electrical renewals program), Preston water mains renewals.
- City West Water: network renewals program.
- South East Water: water and sewer mains renewals program.
- Yarra Valley Water: water, sewer and house connections branch renewals programs.

Compliance

The Commission's draft decision provides for capital expenditure to meet the obligations imposed by the Victorian Government, including technical regulations such as Department of Health and the Environmental Protection Authority. Examples of key capital projects:

- Melbourne Water: flood mitigation program.
- South East Water: Dromana-Portsea sewer backlog.
- Yarra Valley Water: sewer hydraulic improvement program.
- Western Water: Melton stormwater harvesting and sewer spills prevention strategy.

Efficiency

- City West Water: Program Arrow business efficiency initiative.
- South East Water: construction and fit out of new office.
- Western Water: IT systems improvement.

Growth

The Commission's draft decision allows for capital expenditure to meet forecast customer growth and increases in demand for some of the water business service areas. Examples of key projects for which expenditure has been allowed are:

- Melbourne Water: Western Treatment Plant (treatment capacity augmentation stage 2), St. Albans to Werribee pipeline (stage 2).
- City West Water: integrated water and 3rd pipe (recycles water), sewerage system upgrades.
- South East Water: three sewage treatment plant upgrades and Cranbourne recycled water tank.
- Yarra Valley Water: sewer expansion projects.
- Western Water: Sunbury recycled water plant capacity upgrade, recycled water facility and Surbiton recycled water plant upgrades.

Where to get details of the Commission's expenditure assessment

We publicly released our draft decision for metropolitan water businesses on 23 April 2013. This draft decision also contains our findings and draft decision on forecast expenditure. Further details are also contained in PwC's expenditure review reports which have been released together with the draft decision.

Next stage of the process

Businesses and customers are invited to provide their views on the Commission's recommendations and analysis in response to the draft decision.

How to get involved

We invite the public to comment on our draft decision until 20 May 2013. Public forums will be held in April and May. Written submissions can be sent by email to water@esc.vic.gov.au or posted to Water Price Review, Essential Services Commission, Level 37, 2 Lonsdale Street, Melbourne 3000. More information, including material from past price reviews can be found on the website www.esc.vic.gov.au.

Figure 4. Water Businesses' Capital Expenditure 2008 to 2018 (\$m 2012-13)

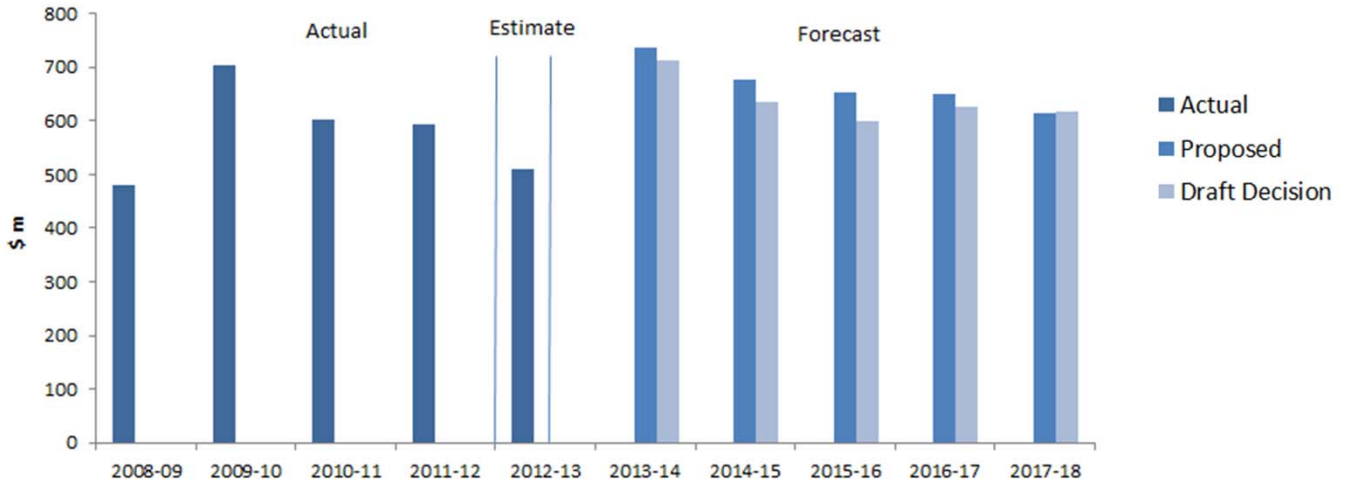


Figure 5. Water Businesses' Total Capital Expenditure 2013 to 2018 (\$m 2012-13)

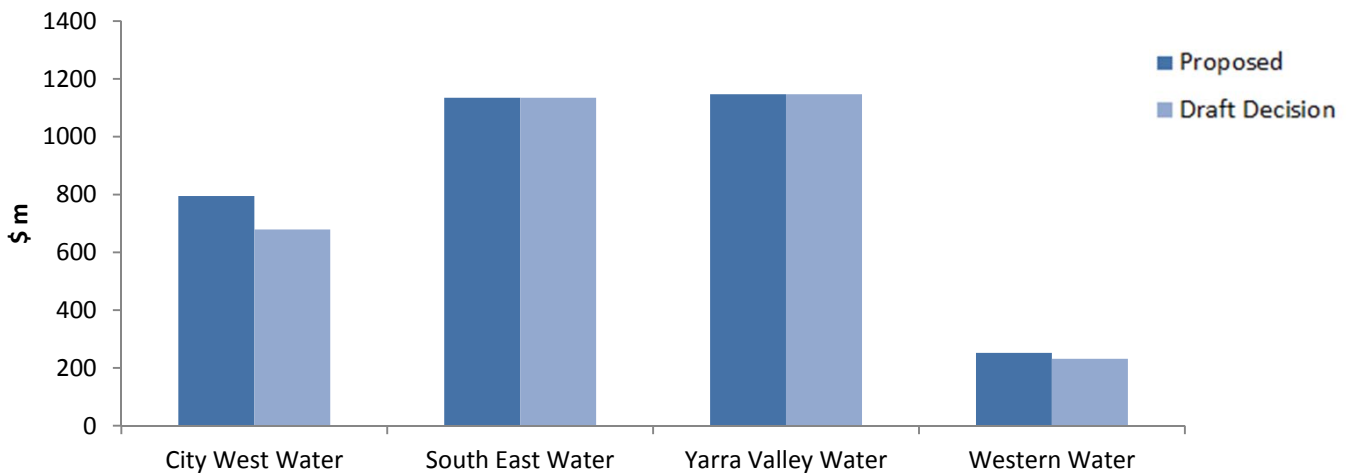


Figure 6. Melbourne Water's Total Capital Expenditure 2013 to 2018 (\$m 2012-13)

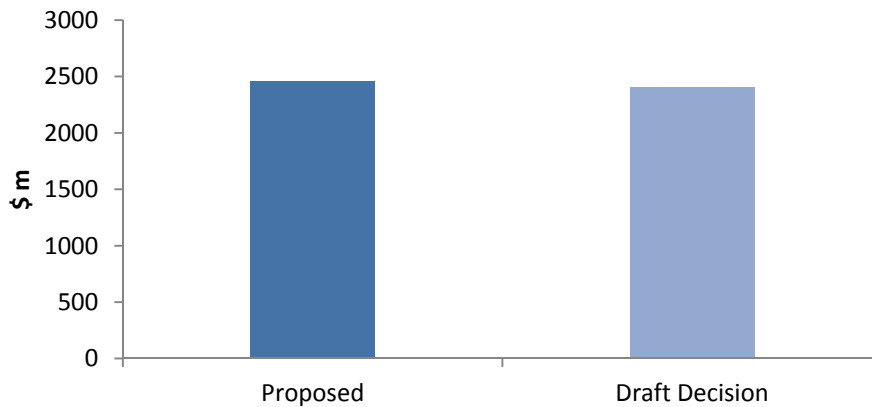
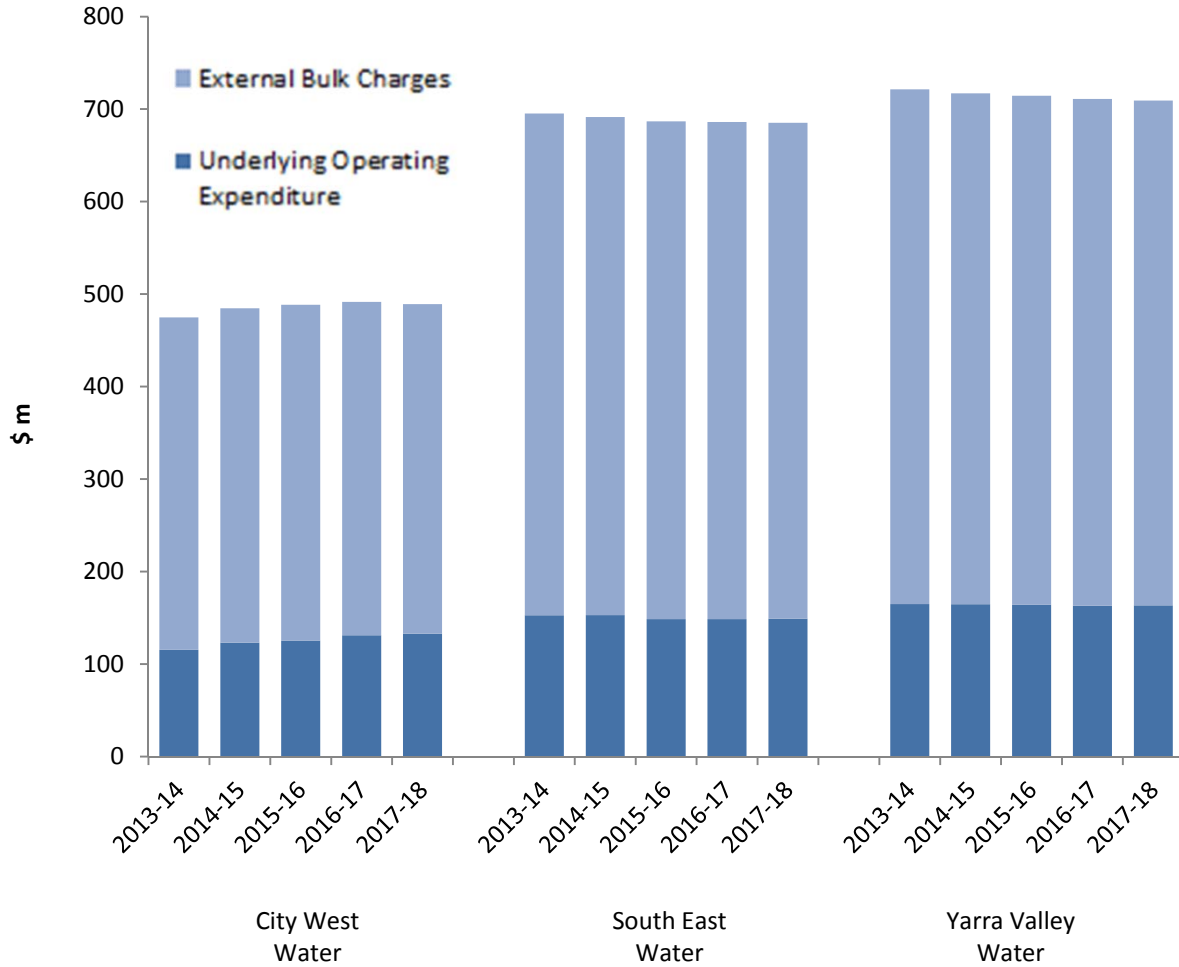


Figure 1. Water Businesses' Operating Expenditure 2013 to 2018 (\$m 2012-13)



Note: Desalination is not a key cost for Western Water.

Figure 2. Melbourne Water's Operating Expenditure 2013 to 2018 (\$m 2012-13)

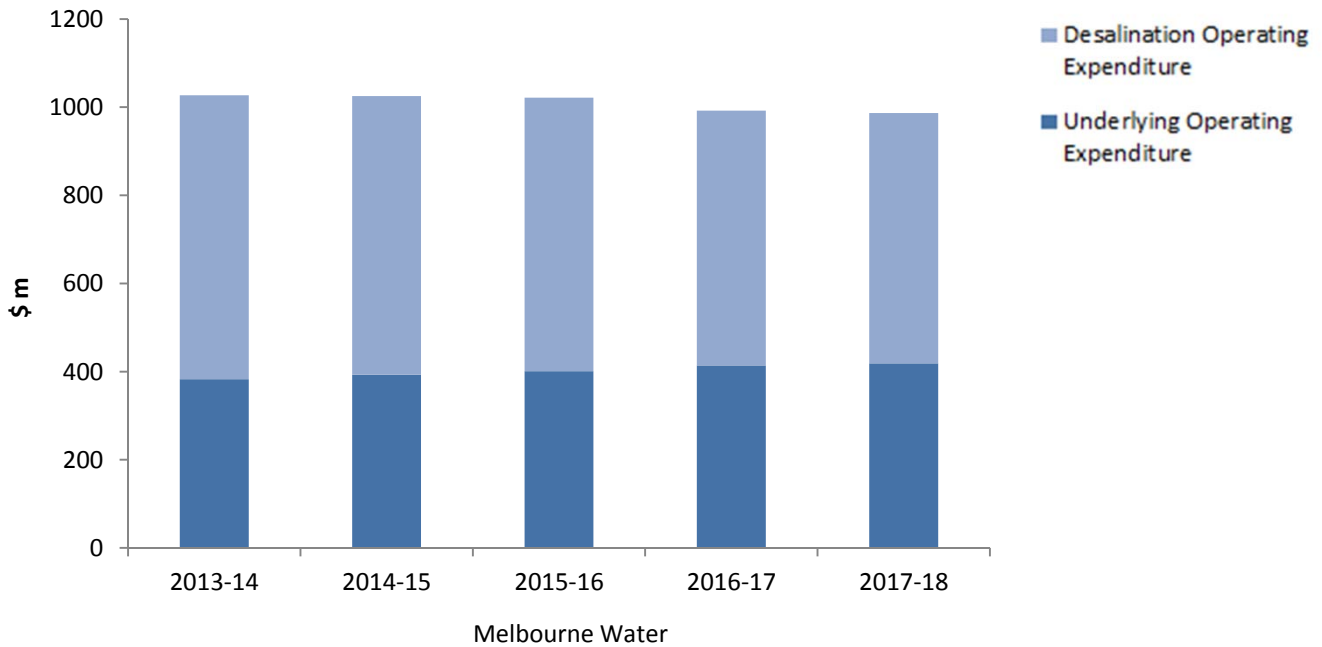


Figure 3. Melbourne Water's Capital Expenditure 2008 to 2018 (\$m 2012-13)

