



**Essential Services Commission 2018,  
*GWMWater draft decision:2018 Water  
Price Review, 28 March***

**GWMWater Response**

**8 May 2018**

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## 1. Executive Summary

GWMWater has considered the draft decision of the Essential Services Concession which supports the revenue requirement proposed by GWMWater. Since releasing its draft decision the Victorian Government has released its 2018/19 Budget and the ESC has requested that water businesses articulate the impact of any budget initiatives that were announced by the Treasurer.

The updated trailing average cost of debt for 2017/18 has also been advised by the ESC and is included in the updated financial model provided with this response.

### 1.1 Summary of GWMWater Response

In its Draft decision, the Essential Services Commission did take a different view on some elements of the submission. The GWMWater response to the material elements of ESC Draft Decision are summarised below.

*Table 1-1 Summary of Position on Significant Adjustments*

	<b>ESC Draft Decision</b>	<b>GWMWater Response</b>
Operations Maintenance and Administration	Reduced Operations Maintenance and Administration Expenditure by \$3.61 million.	GWMWater accept on the basis that this is consistent with the 2.5% productivity target that the GWMWater Board aspire to achieve in the 2013-2018 regulatory period.
Asset Renewal Expenditure	Reduced proposed renewal expenditure by \$9.3 million.	GWMWater accept and are prepared to take a greater level of risk on expenditure specific to asset renewal and this be reconciled upon transition to the regulatory period beyond 2023.
Regulatory Depreciation	Decreased regulatory depreciation by \$4.56 million.	GWMWater accept in part and have proposed a moderated reduction of \$1.6 million. See 2.1.17 for further details.

GWMWater accept that the ESC do not have a role in setting prices for environmental water held by the Victorian Environmental Water. With the clearer guidance that has been provided subsequent to the lodgement of the GWMWater Price Submission, adjustments have been made to the classification of revenues and the attribution of cost.

GWMWater has also provided further clarity on the cost base and reliability of the irrigation water product held by the Commonwealth. GWMWater is also proposing a more transitioned price path to mitigate any potential price shocks to the Commonwealth.

GWMWater has also proposed a more progressive price path from \$20 per ML (2017/18 tariff) for the recreation lakes water product.

**1.2 Issues arising from the 2018/19 Victorian State Budget.**

The commercial principles of the East Grampians Rural Water Supply Project have been articulated in this submission but have not been reflected in the supporting financial outlook. These projects are funded and planned on the basis that they will not add to the costs of existing customers of GWMWater.

## 2. Introduction

GWMWater submitted its 2018-2023 Water Price Submission on 29 September 2017 and whilst this was its fourth price submission since the introduction of independent price regulation in 2004, it was the first that was not dominated by the Wimmera Mallee Pipeline.

The 2018-2023 Water Price Submission was the first under the Essential Services Commission Performance Risk Engagement Management and Output (PREMO) Model. GWMWater embraced the PREMO model and built on its strong model of engagement by establishing a Deliberative Panel to consider issues that were very much the central theme of the GWMWater Price Submission.

The ESC has generally supported the new compliance related initiatives of the GWMWater Price Submission. The ESC has however modified some of 'business as usual' elements of the Price Submission.

In the period since the ESC handed down its draft determination, the Victorian Government has delivered the 2018/19 State Budget. The ESC has requested that water businesses reflect the impact of these in their response to the draft decision to the extent that they will impact on the business outlook in the 2018-2023 period.

Also in the period since the ESC have advised of the updated trailing average cost of debt for 2017/18. The update cost of debt is included in updated financial model provided with this response.

### 2.1 Specific Responses to the Draft Decision

The following provides some specific commentary in response to the issues and observations of the ESC Draft Decision on the GWMWater 2018-2023 Water Price Submission.

#### 2.1.1. *PREMO Rating*

The ESC agreed with all GWMWater ratings with the exception of Management.

The Management rating downgrade from Leading to Standard was attributed to the less ambitious productivity targets relative to other water businesses. GWMWater had an aspiration of 2.5% productivity but priced a 1.5% productivity gain. The more cautious approach to productivity was reflective of the aggressive productivity achieved in the 2013-2018 regulatory period.

As discussed at 2.1.15 GWMWater will accept the ESC decision on Operations Maintenance and Administration. This effectively 'codifies' the 2.5% productivity aspiration that was implicit in the GWMWater Price Submission.

This will not give rise to an uplift of the Management Rating under PREMO by application of the ESC guidance and does not change the overall rating as the aggregate score as assessed by GWMWater was at the higher end of 'Advanced'.

### 2.1.2. *Regulatory period*

GWMWater sought a regulatory period of five years and this has been supported by the ESC.

In the context of the outcome of the Draft Decision GWMWater does not see any reason to vary the duration of the regulatory period sought.

### 2.1.3. *Guaranteed Service Levels*

The ESC supported the GWMWater proposal to introduce an additional GSL of \$100 for drinking water quality excursions.

The proposed introduction of a drinking water quality GSL was sought by the Deliberative Panel and was driven also by our recent challenges with water quality in Nhill.

GWMWater welcomes the ESC endorsement of the proposed drinking water quality GSL and will proceed with its implementation from 1 July 2018.

### 2.1.4. *Revenue Requirement and Tariff Structures*

Despite some differences in the way it is derived, the ESC has supported the overall revenue requirement of GWMWater and the tariff structures that will apply to its determination.

These differences are outlined in more detail in the specific responses to reductions in operating expenditure, reductions in capital expenditure and adjustments to regulatory depreciation.

The reduced revenue requirement resulting from subsequent reductions in the trailing average cost of debt and the 2018/19 State Budget reduction in the regional payroll tax rate have been proportionally applied across Urban Water, Sewerage, Trade Waste, Domestic and Stock (Pipeline), Headworks, Environment and Recreation Lake Water tariffs.

### 2.1.5. *Customer Contributions*

GWMWater continues to apply the ESC principles based approach to the determination of New Customer Contributions.

The cost of new development is very much locality specific with disparate networks of infrastructure in rural water, urban water and wastewater. The low rates of growth provide GWMWater with the capacity to assess each proposal on a case by case basis to ensure the optimum utilisation of infrastructure.

The more significant application of the new customer contribution approach is specific to the large scale rural pipeline extensions. These contributions are considered in the context of the benefit to the landowner relative to the broader benefit to the Victorian and/or national economy and to GWMWater. This is discussed in more detail in the Section 2.2.1 that articulates the commercial principles of the East Grampians Rural Pipeline Business Case.

#### 2.1.6. *Cost of Debt and Inflation*

GWMWater acknowledges that in the context of the building block and price paths the ESC will make an annual global determination on the cost of debt and the index to support price paths. The update to the cost of debt for 2017/18, as advised by the ESC, is included in the revised price adjustment formulas.

#### 2.1.7. *Tax Allowance*

The ESC has acknowledged that there will be no tax obligations arising in the 2018-2023 regulatory period or for the foreseeable period beyond.

The Victorian budget commitments that affect GWMWater do not give rise to any change in this position with any government contributions being treated as equity.

#### 2.1.8. *Demand forecasts*

The ESC expressed support for the basis of GWMWater demand forecasts in its draft determination.

GWMWater growth water forecasts are relatively ambitious and assume that there will be further rural pipeline extensions in the planning outlook. These will need to be reconciled in the context of the Victorian Government commitment to the East Grampians Water Supply Project.

#### 2.1.9. *Form of Price Control*

The ESC supports the GWMWater proposed price cap as the form of price control.

#### 2.1.10. *Adjusting Price Mechanism*

GWMWater has developed a proposed price adjustment mechanism to apply to changes in the cost of debt.

GWMWater anticipates that the application of government policy specific to environmental water pricing will be clarified in the window of the 2018-2023 water price review. GWMWater also seek to have an adjusting mechanism in the event that this reverts to a prescribed service as implied by Water for Victoria.

#### 2.1.11. *Urban Remote Metering*

The ESC has supported GWMWater's proposal to introduce Urban Remote Metering as represented in the business case that complemented the Price Submission.

GWMWater is well advanced in the development of a procurement strategy and anticipates to commence delivery of the project in the first year of the regulatory period.

#### 2.1.12. *Goroke Sewerage*

The proposed introduction of sewerage in Goroke was strongly supported by the Deliberative Panel as well as the ESC.

The proposed technical solution is well advanced and with delivery anticipated early in the regulatory period.

*2.1.13. Drinking Water Upgrades – Kaniwa, Moyston, Ultima and Elmhurst*

The water quality upgrades being proposed in these four towns were all supported by the Deliberative Panel and the ESC.

All solutions are assumed to be pipeline solutions connecting to the nearest town as the base technical solution.

*2.1.14. Decommissioning Redundant Assets*

The proposed program of decommissioning of redundant assets has been supported by the ESC.

GWMWater carries significant redundant assets as a consequence of the significant reengineering that has occurred over the past two decades and the proposed program applies a risk based approach to the determination of priorities relative to other infrastructure priorities.

*2.1.15. Operations Maintenance and Administration Expenditure*

The Draft Decision of the ESC gave rise to some adjustments to GWMWater's proposed Operations, Maintenance and Administration expenditure. These adjustments are summarised in Table 2-1 below.



Table 2-1 Summary of Operations Maintenance and Administration Expenditure

		<b>2018-2023 Real 1/1/18, \$m</b>
GWMWater Price Submission		173.2
<b>Deloitte Expenditure Review</b>		-3.61
<b>ESC Adjustments</b>		
State environmental water (based on revenue, not proxy of cost)	-2.3	
Licence fees (ESC, DHS, EPA)	0.021	
Environmental Contributions	0.131	-2.148
<b>Draft Decision - total operating expenditure</b>		<b>167.5</b>

The price paths of the GWMWater Price Submission was inclusive of a 1.5% productivity target. The GWMWater Price Submission did however acknowledge an aspiration to achieve a 2.5% productivity improvement.

The conservative approach was influenced by the very strong achievement in this 2013-2018 Price Review period where a 4% productivity aspiration has been achieved.

The Draft Decision of the ESC effectively ‘prices in’ the GWMWater Boards productivity aspiration of 2.5% after excluding electricity and environmental water revenue. A labour adjustment has been applied to all businesses based on 2.3% nominal (0% Real increase).

GWMWater can attribute its productivity improvements to the efficiency arising from the application of the asset and works management system with a focus on continuous improvement in the operational and works management program. The process of review of life cycle outcomes and service performance is ongoing and continues to mature and inform the resources required to maintain service levels.

GWMWater accepts the Draft Decision on the basis that effectively mandates the 2.5% productivity aspiration. GWMWater note that in accepting this it is forgoing any adjustments to the representation of electricity prices based on the outcome of contracts presently being negotiated.

#### 2.1.16. Capital Expenditure

In its Draft Decision the ESC has adjusted the renewals or ‘business as usual’ capital expenditure. Table 2-2 below summarises this expenditure adjustment proposed by the ESC.

*Table 2-2 Summary of Capital Expenditure Adjustments*

	<b>2018-2023 Real 1/1/18, \$m</b>
GWMWater Price Submission	97.5
<b>Deloitte Expenditure Review</b>	-9.3
<b>Draft Decision - total capital expenditure</b>	<b>88.2</b>

GWMWater’s lift in renewal expenditure was strongly linked to asset infrastructure performance. Since 2004, GWMWater has maintained priority over water projects that have secured water supply to the region whilst building a better understanding of the capability of its existing infrastructure with its asset management systems.

The 2016/17 ESC Water Industry Performance Report released in March 2018 shows that in measures of service reliability that can be attributed to asset performance, GWMWater performs poorly on all reported measures relative to the rest of the water industry. The performance measures that were highlighted in the performance report were the interruptions to water supply and sewer blockages and sewer spills.

The GWMWater Deliberative Panel had a particular focus on GWMWater asset management practices and expressed a view that GWMWater should ensure that expenditure had the capability to maintain service levels.

GWMWater accepts the ESC Draft Decision on the understanding that it is still improving the application of its asset management information to support good long term strategic asset investment decisions. The renewals program is based on a combination of condition (year 1-2) and predictive modelling based on life. As a result, there is an inherent level of uncertainty and this will continue to be informed based on actual performance and condition assessments.

GWMWater will continue to improve its asset management capability. Further improvements in asset planning and works management and continuous focus to proactively manage the overall program. The process of review of life cycle outcomes and service performance is ongoing and continues to mature and inform the level of resources required.

With an overall desirability of maintaining customer affordability, GWMWater will assume greater risk on asset performance. Any outcomes that may require a greater level of expenditure will be the subject of reconciliation and review in the preparation of the water price submission beyond 2023.

#### 2.1.17. *Regulatory Depreciation*

GWMWater accept in part the ESC adjustment to regulatory depreciation on existing assets and provide the following information to support the basis of this response.

The proposed reduction in the draft decision is not reflective of asset consumption and does not provide for price stability. Regulatory depreciation in the final year of the previous regulatory period is \$13.23m (2017/18). Proposed depreciation of \$11.05m in 2018/19 in the draft decision represents 16% reduction in depreciation. This contrasts to a 19% increase in the Regulatory Asset Base (RAB) from 2012/13 to 2017/18.

GWMWater response however does support a moderated reduction in regulatory depreciation from an average annual depreciation of \$12.08 million in the third regulatory period to \$11.48 million over the 2018-2023 water price review period. This represents a 5% reduction notwithstanding the additional embedded reduction achieved from negating increases in depreciation arising from the increase in the RAB.

Regulatory depreciation will be the subject of further reconciliation and review in the preparation of the water price submission beyond 2023.

#### 2.1.18. *Recreational Water Pricing*

Recreation water pricing policy was a key initiative of GWMWater in the 2013-2018 Water Price Submission.

The policy delivered a subsidy for water supplied to recreation lakes and a discount for water used by sporting clubs and other not for profit organisations.

The Deliberative Panel supported the proposed extension of the sporting club recreation water discount to schools that receive a water supply from GWMWater.

The \$20 per ML supply charge for recreation water that has been maintained in nominal terms, was set to reflect community concern about the capacity to meet the cost of water whilst they were re-establishing amenity at the recreation lakes. The millennium drought gave rise to a period of approximately 10 years where the recreation lakes of the region that were formerly part of the channel delivery system. The subsidised price of \$20 per ML is lower than the subsidised price under channel supply that was \$48 per ML (2004 dollars).

GWMWater does however acknowledge that Buloke Shire is still establishing capability to support its portfolio of recreation lakes and as a result is proposing to transition the proposed price increases over the five years of the 2018-2023 regulatory period.

Table 2-3 Revised Recreation Lake Water Prices and Tariffs

Usage Charge <sup>^</sup>	Unit	2017/18	2018/19	2019/20	2020/21	2021/22	2022/23	2022/23
Price Submission	ML	\$20.00	10.0%	10.0%	3.0%	0.0%	0.0%	\$25.00
Revised Submission	ML	\$20.00	4.1%	4.1%	4.1%	4.1%	4.1%	\$24.30

<sup>^</sup> Tariff Category - Recreation Lake Water

2.1.19. *Environmental Water Pricing – Victorian Environmental Water Holder*

Since lodging the 2018-2023 Water Price Submission, greater clarity has been provided on how the current revenue and any notional cost attributed to environmental water held by the Victorian Environmental Water Holder should be treated from a regulatory perspective.

GWMWater has adjusted the representation of environmental water revenue to reflect this as non-prescribed revenue. The representation of revenue is independent of any underlying tariff and reflects the historic revenue attributed to environmental water since the policy was first changed in 2014. The revenue has been used as the deemed notional cost of providing an environmental water service.

Water for Victoria reiterated the policy expectation that the environment will meet the cost of water supply. In the period 2018-2023, it is expected that the application of the policy will be clarified and that GWMWater will seek to review prices when the application of the Water for Victoria Environmental water pricing policy is clarified.

2.1.20. *Irrigation Water Pricing – Commonwealth Environmental Water Holder*

In 2013, the Commonwealth government secured the collective water holding of the Wimmera Irrigation System under the Commonwealth Irrigator Led Group Proposal (ILGP) Program.

The decision by the Wimmera Irrigators Association (WIA) to offer the water for sale was based on a lack of reliability combined with the future cost of water by application of the pricing principles of the National Water Initiative.

The investment by the Commonwealth secured the water at source and agreement was reached in relation to the funding for the removal of the delivery infrastructure. By virtue of this the only obligation attributable to the Commonwealth is the relative share of headworks cost.

Our Water Our Future established the policy framework for the transition of water pricing to independent price regulation by the ESC. This framework required the establishment of an opening Regulatory Asset Base to underpin prices moving forward. The policy also provided for the rural opening RAB to be zero unless investment had been undertaken that would be justified to be included in the opening RAB. In the period leading up to 2004, GWMWater undertook two major dam safety projects on Lake Wartook and Lake Bellfield. Whilst substantially funded by the Victorian government, GWMWater through its predecessor entities contributed to the costs of these projects that secured water supply to all users and this

has been attributed to the opening RAB which for GWMWater was \$77 million across the business.

The high opening RAB of \$77 million for GWMWater was also based on the need to maintain price stability. With the funding concepts being worked up for the Wimmera Mallee Pipeline assuming that GWMWater contributions would be ‘back ended’, the high opening RAB avoided the need for price reductions followed by future price shocks.

The Commonwealth irrigation water holding has also had an unintended commensurate uplift in reliability as a consequence of the investments in water savings. The following table provides an overview of the improvement in reliability arising from the adjustments to the Wimmera Glenelg Bulk Entitlement Order as water savings have been progressively reflected in the water sharing instruments.

Table 2-4 Progressive changes in Irrigation Product Water Reliability

Irrigation Entitlement Reliability (%)	Comment
71	Stated reliability in 2004 Bulk Entitlement Conversion
75	WMPP Business Case estimation of irrigation reliability post pipeline
81	Stated reliability in 2010 (post pipeline) Bulk Entitlement Order
83	Change in reliability when 2011 Storage Management Rules were configured in REALM Model
90	Irrigation reliability in 'CP15' - accredited 'post irrigation' REALM model for Murray Darling Basin Diversion Compliance
90	Modelled Irrigation reliability following 2014 Bulk Entitlement review

GWMWater does however acknowledge the price shocks associated with the 2018-2023 Water Price Submission as was proposed. GWMWater is proposing a more moderate price path above CPI that reflects the cost of the irrigation water product held by the Commonwealth.

Table 2-5 Revised Irrigation/Environment Prices and Tariffs

Tariff Category <sup>^</sup>	Unit	2017/18	2018/19	2019/20	2020/21	2021/22	2022/23	2022/23
<b>Price Submission</b>								
Allocation Charge	ML	\$6.92	10.0%	9.0%	0.0%	0.0%	0.0%	\$8.31
Usage Charge	ML	\$13.88	10.0%	9.0%	0.0%	0.0%	0.0%	\$16.69
<b>Revised Submission</b>								
Allocation Charge	ML	\$6.92	3.1%	3.1%	3.1%	3.1%	3.1%	\$8.08
Usage Charge	ML	\$13.88	3.1%	3.1%	3.1%	3.1%	3.1%	\$16.22

<sup>^</sup> Tariff Category - Environment

## 2.2 Impact of the 2018/19 Victorian State Budget

### 2.2.1. East Grampians Rural Pipeline Project

The Victorian government budget provided a budget allocation of \$32 million for the East Grampians Rural Pipeline Project. The \$32 million is unconditional but consistent with the principles of the Business Case, it is expected that the Victorian contribution will be matched by the Commonwealth government.

The project funding was based on the business case that was submitted to the Victorian government in October 2017. The overall project estimate is assumed to be \$85.2 million and within the full scope of the project, GWMWater was committed to fund \$15 million with the remaining expenditure to be met from new customer contributions. GWMWater is reviewing the procurement and delivery strategy to ascertain the extent that the project could be staged to maximise landowner coverage. This will include a review of the capacity of GWMWater to fund part of the project.

All policies for the East Grampians Project are consistent with those applied for the South West Loddon Project that has been funded since the 2013-2018 Water Price submission. The following summarises the policies that apply to rural pipeline extension projects.

- Land Owner and GWMWater contribution applies the New Customer Contribution (NCC) Negotiating Framework
- Growth Water will need to be acquired by landowners to meet their water requirement. This payment is in addition to the NCC and growth water acquired becomes a tradeable water product.
- Tariffs will be the same as the rates and charges of existing domestic and stock customers.
- Service standards will be the same as existing domestic and stock service standards.
- The financial commitment of GWMWater will not increase prices to existing customers of GWMWater.

### 2.2.2. Payroll Tax

The Victorian State Budget provided for payroll tax relief to businesses in regional Victoria.

The rate of payroll tax for GWMWater will reduce from 3.65% to 2.43%, reducing payroll Tax operating expenditure by \$180,000 per annum.

## 3. Summary

This is fourth Water Price Submission prepared by GWMWater but the first under PREMO.

GWMWater applaud the initiative of the ESC in challenging water businesses to develop pricing submissions under the PREMO model. GWMWater has responded to the challenge but acknowledge that with respect to Management, the reluctance to provide customers the full

benefit of the 2.5% productivity to which GWMWater aspired led to a downgrade of the Management rating under PREMO.

GWMWater will also take on more risk in relation to urban asset performance. By reducing anticipated renewal spend in line with proposed adjustments by the ESC, we can ensure prices are maintained at or below CPI.

GWMWater is also proposing more progressive price increases for water supplied to recreational lakes and irrigation water held by the Commonwealth Environmental Water Holder to mitigate the concerns raised about price shocks.

To the extent they can be reliably quantified GWMWater has also included the impact of budget initiatives included in the Victorian State budget that impact on water businesses over the course of the regulatory period.

The price outcomes that arise from the adjustments are summarised below.

Table 3-1 Revised Real Price Paths 2018-2023

Line of Business	Real % increase/(decrease)				
	Year 1	Year 2-5	Year 3	Year 4	Year 5
Urban Water	(2.3%)	0	0	0	0
Urban Wastewater	(2.4%)	0	0	0	0
Rural Pipeline	(1.8%)	0	0	0	0
Groundwater	0	0	0	0	0
Unregulated licences - surface water	0	0	0	0	0
Environment	3.1%	3.1%	3.1%	3.1%	3.1%
Bulk Water	(2.8%)	0	0	0	0
Recreation Lake Water	4.1%	4.1%	4.1%	4.1%	4.1%
Minor Trade Waste	0	0	0	0	0