

Draft Water Plan 3 for Central Highlands Water Comments from John Barnes (Brown Hill resident) -January 2013

CHW's draft WP3 doubtless follows a format and direction spelt out by the ESC and through Ministerial guidelines and directions. However, to lay readers, there are a number of issues that are either not covered, or only partially covered, and which provide an incomplete picture of where CHW will be at the end of the five-year regulatory period. It would be better for CHW and the ESC if the Plan was more transparent to the public, who will be footing the costs and who might reasonably expect to have a clear understanding of the rationale used to justify them.

The draft WP3 clearly explains what it intends to do regarding tariffs (both amounts and structure), but does not explain why convincingly, or in the case of the full 8.5% increase for WP3 being borne by customers in year 1 of the five-year plan, it fails to justify it at all; it outlines its operating and capital program for the period, but does not provide an easy comparison with WP2, especially wrt the Country Town Sewerage Program, nor does it provide justification for its sewer strategy for Ballarat to accommodate future urban growth during and well beyond WP3; it outlines the key performance measures, though less comprehensively than it ought; and it fails to give a clear picture to readers of the long term financial position of the corporation, especially regarding debt and debt management.

Operating and Capital Expenditure

These are the key drivers for determining the Revenue Requirement for CHW during WP3, though they are not the only drivers. I will touch on borrowing as a third and important determinant later in this paper.

WP2 identified projects under the Country Towns Sewerage Program as capital projects. During WP2 these projects were reclassified as operational items due to them being covered by a contract with the private sector to design, build and operate these facilities over a number of years, and for CHW to make annual payments for these services and facilities. WP3 shows them as an annual operating expense of \$1.4m, and does not show them in the capital program. This is standard accounting procedure, though it is confusing insofar as the Blackwood/Barry's Reef sewerage scheme will not be delivered (or indeed even started) during WP2, and the flat \$1.4m figure could be expected to go up during WP3 when this project is delivered, though there is no apparent accounting for the \$1.4m figure increasing beyond CPI during WP3. It is understood that the likely capital costs of the Blackwood/Barry's Reef Country Town Sewerage Project could be in excess of \$20m, with local contributions amounting to a minuscule proportion of these costs (as contributions are capped by the government). What are the cost impacts of the Country Towns Sewerage Program and how are they proposed to be paid for?

Indeed the works for Blackwood/Barry's Reef are problematic and result from an ill-considered public announcement by the earlier Bracks government, which successive Labor and Liberal governments have seen fit to honour. There appear to be very few local champions for this project, which will result in small blocks being developed throughout Blackwood and Barry's Reef and thus destroying the very character that attracts current residents to the area; a general ambivalence by the Shire of Moorabool which would far prefer to see sewerage investment into existing growth areas, and a hefty cost penalty to all CHW customers. The Country Town Sewerage Project comes to CHW as a direction from the Victorian government and is a direct pass through on costing within the Water Plan. However, the project needs to be questioned at a political level, and aborted. The

CHW Board needs to redouble its efforts in this regard. If the failure to account beyond the \$1.4m operating cost p.a. is indicative of the intent of CHW not to build Blackwood/Barry's Reef, during WP3, or any future water plan for that matter, then it has my full support.

Ballarat South Wastewater Treatment Plant Augmentation Works are justified on the basis of CHW having,

“recently developed a strategy to augment the capacity of the BSWWTP to accommodate predicted 2035 flows and loads, and an increased level of service to match industry standards.” (p.23 WP3)

This strategy is not in the public domain, nor is there any information (not even an outline of what is proposed) on the CHW website. The relationship of this work to the Ballarat Sewer Flow Containment Project – Ballarat South Outfall Sewer is not at all clear. Enquiries to CHW indicate that the works are mainly needed for EPA compliance reasons, rather than to fulfil a vision for 2035.

In view of the projected growth of Ballarat in the future, especially the residential and industrial growth projected for Ballarat West, is a commitment to directing so much sewage (and infiltrated stormwater) through Ballarat South WWTP smart? Is it the best investment for the future? How does it relate to the \$10.1m capital spend on Ballarat West Urban Growth Zone Future? Does this commit us irrevocably to the Ballarat South WWTP solution? What are the long-term risks and benefits of this decision and how are they superior to alternatives? (Ballarat South WWTP is going to be a massive facility within the middle of urban Ballarat -odour, terrorist attack, discharge to the Yarrowee River of high salinity waste water under extended drought/climate change conditions, sewer plant overflows to the environment under intense storms -with downstream impacts, and other risks -compared with decentralised facilities servicing the development to the west.) What of the stormwater infiltration already experienced and exacerbated at Ballarat South WWTP by the recent completion of the Ballarat Sewer Renewal (along Canadian Valley and through central Ballarat), and the prospect of further infiltration from new sites in Ballarat West in future? How do the relative costs (public and private) of the rainwater covenant on Ballarat West -Lucas (p.33 WP3) compare with systems like those developed by Wannon Water in greenfields sites in Warrnambool? Is such a covenant approach preferred for the rest of the Ballarat West Growth Precinct? What gives the most efficient and effective long-term integrated water management strategy for Ballarat West (including impacts of stormwater infiltration on Ballarat South WWTP)?

Long-term Financial Viability of CHW

WP3 fails to account for debt levels during the five-year Plan period. It also does not provide any details on interest payments for each of those years. The Plan tells us this:

“CHW’s debt level has grown from zero in 2005-06 to approx. \$140M in 2011-12. This in turn has contributed to an increase in costs to service this debt.” (p28 WP3)

but little more. It does not give the projected gross borrowing figures for 2012-13, nor for any of the five years of WP3. Does it go up, down, or is it the same? How much is being spent on debt servicing, and is this interest only, or does it include down-payment of principal? In the past the ESC has rarely allowed prices which reduce debt levels. Is this still the case? If so, when is it deemed that a water corporation has enough debt to warrant it being paid down? Does the ESC policy give precedence to debt reduction by water corporations over the payment of dividends to Treasury?

It is noted that there were operational shortfalls in revenue during WP2, anticipated to be \$22m.

“While CHW has implemented strategies to mitigate the financial impact by delivering

capital and operational expenditure below WP2 allowances, there remains a cash shortfall of approximately \$22M. To ensure CHW's financial stability is maintained and to avoid a material impact on prices this shortfall has been capitalised in the Regulatory Asset Base to allow recovery over future Water Plans at modest rates."p.28 WP3

Is WP3 subject to the same risk on revenue as WP2? If so, can these losses be sustained should they continue to occur? WP3 fails to give any explanation as to why it is a better estimate than its predecessor. I am unsure as to the appropriateness of operating losses being capitalised as part of the RAB, though in the case of the Country Town Sewerage Projects, I can appreciate the shift caused by this being a PPP, rather than in-house capex, as being part of the rationale.

Performance Measures

Generally, the performance measures in CHW's WP3 are comprehensive. However, Figure 5: Additional Service Standard Targets might be improved by a figure of CO2 equivalent emissions. Whilst it is understood that CHW is not monitored by the Commonwealth government as a major polluter, and like all Australian householders, simply pays more for its energy costs, it would be instructive to look at CHW's annual energy consumption to and from the grid, with an estimate of the CO2 equivalents that this translates to. It would also be instructive for CHW to account for fugitive emissions for its operations, especially from its WWT Plants. Reporting on these aspects of CHW's operations would fulfil a useful public accountability role and also provide the Board with information useful for looking at costs and opportunities associated with energy use, cogeneration and pollution management.

Figure 11: Regulatory Asset Valuations is a confusing table as the RAB seems to bear little relationship, if any, to the accounting asset base shown in the audited financial statements of CHW, and the line Return on RAB lacks context insofar as the reader has little idea what the benchmark is used for, and whether this is high or low for this type and size of water corporation.

Tariffs

Tariff Structures

1. Postage stamp pricing

WP3 continues the practice of postage stamp pricing across the entire region. In other words, everyone pays pretty much the same price for the same level of service. Whilst simple to understand and apparently an equitable arrangement for all, it belies the fact that services cost significantly different amounts to provide to different communities. Postage stamp pricing hides the real costs of building and operating infrastructure, and fails to send a message to communities and their developers of where the most cost-effective investments can be made. In reality it means that Ballarat customers cross-subsidise all other CHW customers within the region, now and into the future. WP3 has not canvassed the opportunities CHW has to send a clearer message about the real costs of infrastructure and operations, thus discouraging investments in the least cost-effective areas, nor has it considered how it might reduce the burden on Ballarat customers.

For example, considerable capital investments are planned for Maryborough and Blackwood/Barry's Reef during WP3. In the case of Maryborough, this comes on top of heavy investments during the period covered by WP2. The question of just how much cross-subsidy from Ballarat to Maryborough is enough has not been raised. There is no doubt that the quality of water CHW supplies to Maryborough has often been extremely poor, though security of supply has been

bolstered in recent years. There is also no doubt that Maryborough is an economically poor community by comparison to Ballarat. The capacity of Maryborough customers to pay full price for infrastructure and operating costs is limited. This however, should not stop CHW from considering ways in which Maryborough might be assisted, but at the same time making it clear that the costs associated with provision of these services is higher than for Ballarat. So too with Blackwood/Barry's Reef. The anticipated cost of providing sewerage services to this one project is considerably higher than the original total cost for the entire Country Town Sewerage Project, covering Smythesdale, Waubra, Gordon and Blackwood/Barry's Reef. Again, the question should reasonably be addressed of how much cross-subsidy to these towns is enough for Ballarat customers to sustain.

Perhaps CHW could consider a policy of volumetric rates for similar quality water being universal across the region. The fixed components of costs for water and sewerage infrastructure could be varied, perhaps in three categories that give a nod to the asset valuations within each system and the return rates represent on these assets. The Ballarat system fixed charges might provide for its share of 100% coverage of region-wide asset depreciation, Maryborough at say 10% above Ballarat, and smaller systems at 20% more. In the event that the mix between volumetric and fixed costs might be varied in future, so that fixed costs do not approximate 100% coverage of asset value, the relative positions of the suggested three category fixed tariffs, should be maintained. Some discussion on the considerable difference between balance sheet asset values and the regulatory asset value used by the ESC for price setting is warranted in any future discussion along these lines.

2. Stepped tariffs

Government and regulators tend to change their views on whether more or less steps in tariffs is a good thing. This WP cycle sees the inclining block tariff out of favour and headed for oblivion in WP4, and a Ministerial Direction that tariffs will be reduced to two blocks for WP3. I am a layman, and have never made sense of the arguments of economists on the undesirability of inclining block tariffs, especially when prices are fully regulated more than five years in advance, and are not subject to variation in a market, even during times of considerable scarcity, as was evident during the recent thirteen consecutive years of below average rainfall. Whilst water corporations and government continue to rely on a regime of water restrictions to manage consumption during times of water scarcity, I see inclining block tariffs as putting a permanent shot across the bows of heavy consumers, reminding them that they are water wallys who should mend their ways to prepare for the dry times ahead, and in the meantime pay for their profligate behaviour. I do not believe the rationale of equity being used to justify reducing tariff blocks to be sound, nor do I believe that moving to higher trigger levels between blocks improves equity. I do believe it allows those wealthier households with a high water habit to purchase abundant water at reduced costs. This brings me to my next point.

3. Trigger levels between block tariffs

WP3 proposes to lift the volume of water consumed before triggering a higher tariff from 150kL/annum under WP2 to 175kL/annum for 2013-18. The assertion is made that this and reducing from three tariff blocks in WP2 to two in WP3 will be more equitable and advantage larger families. It may do the latter, but it is not more equitable for the majority of CHW consumers. The reasons are as follows. Current average water consumption by CHW customers is less than 150kL/annum/household. Many of the below average users, who probably constitute more than half of CHW's customers, are small households of one or two people. Numbers of them are using significantly less than the average, and are already cross-subsidising heavier users by virtue of high fixed water costs and low volumetric charges. Increasing the trigger level even further beyond average consumption, means that these small users will be making an even greater contribution

toward the costs of heavier users. Not all heavy users are big families, yet the raising of the trigger level is justified on the grounds that they will be assisted. Nor are all large families financially strapped. A much more effective and fairer way of achieving assistance to large, low income families would be to provide rebates on volumetric water charges for these big families on low incomes, and keeping the trigger levels lower. WP3 provides no modelling of who will be the winners and losers of the proposed tariff changes. This is a serious omission and should be addressed in the ESC's draft determination.

4. Volumetric versus fixed charges

CHW talks about a greater than 25% increase in volumetric charges as being too high to introduce without considerable community debate and preparation, and opts to remain with the current arrangements for water charges, both fixed and volumetric. It indicates there will be work done during WP3 to increase awareness of this issue and to come to WP4 with any new thinking as a result of consultation. This is squibbing it for two reasons. First, CHW has had the breathing space during the last three years since the drought broke to conduct community consultation on water volumetric and fixed charges. The fact that they held no public meeting at all in Ballarat in the lead-up to this draft WP3 being prepared is indicative of their lack of effort. Second, the emphasis on a greater than 25% increase on volumetric charges fails to acknowledge that this is but one aspect of the issue. People need to be helped to understand the likely total costs of water under a new tariff structure. Substantial increases in volumetric tariffs is what sends the message about curbing consumption, and is the very point about changing the mix. It is acknowledged that it is now too late to bring the community along with changes for WP3, but this reflects poorly on CHW's leadership role.

Tariff Amounts

I have taken some trouble to raise questions about a number of operating and capital expenditures that could potentially reduce the need for revenue. I have also raised the issue of repayment of debt, which could increase the need for revenue, but that WP3 gives too little information to know whether this is true or not. The ESC has the opportunity to clarify these matters with CHW over the coming months.

Even if the revenue requirement for CHW is correct in this draft of WP3, there is no justification provided within the document for the proposed 8.5% increase in the first year. As noted above, the \$22m loss has nothing to do with it. To the best of my knowledge, there has been no public consultation about such an increase. For WP2 an up-front increase occurred after lengthy and exhaustive consultations with customers across the region. CHW should be required to justify why it is in the best interests of customers to have an 8.5% (+CPI) increase in year 1 of a five-year strategy, with only CPI to follow. Is part of the explanation as simple as the Victorian government's environmental contribution being raised by 60% in one year (2013-14), and CHW being too polite to point out the fact? If this is a substantial contributing factor, then I think CHW have shown considerable moderation and restraint in putting together a budget with such a modest overall rise. I take no issue about the amount proposed for tariff increases during 2013-18. Questions remain about its timing and whether revenues are really directed to the key strategic capital investments for the long-term benefit of the CHW customers.

New Customer Contributions

“When factoring in all associated costs and benefits, CHW’s modelling returns a net \$0 / lot NCC charge. This means that for the 2013-2018 regulatory period, the standard NCC charge

will be set at \$0 / lot for both sewer and water services.” (Section 4.2 NCC Framework Paper to ESC)

I can understand that this might be the overall net contribution from NCC charges over the WP3 period, but I struggle with the idea that the default charge to developers is \$0/lot for sewer and water extensions. The Paper goes on to explain that it will make charges under certain circumstances and it will follow the Negotiating Framework to process and determine the amounts to be charged, suggested by the ESC. This seems pretty innocuous, except that it does raise questions about when this Framework will be applied, who makes the decision that it will be applied, and on what basis such decisions are made.

“CHW intends to adopt the ESC’s negotiating framework, as outlined in the ESC guidance paper, as the standard framework by which NCC’s will be negotiated with connection applicants. CHW will apply the framework to ‘Greenfield’ and significant in-fill developments within CHW’s area of operations. “ (Section 3.1)

How will this be practically applied?

This implies that an initial decision will be made by officers as to whether the ESC endorsed methodology will be applied. How will officers do this? What information will they make such decisions upon? What paper trail will be left if decisions are subsequently challenged internally (via an audit process or similar)? Would it be prudent to say that all applicants will make application according to the methodology of the ESC, and that the water corporation has at its discretion to advise the applicant at any time that they have concluded that the NCC will be \$0, but should it be greater than \$0, the entire process will be exhausted (subject to either party withdrawing as outlined). The reasons for determining the \$0 contribution need to be documented as much as the reasons for making a charge. There needs to be a process and complementary policy to guide decisions. This will protect officers from special pleading by developers that they should be exempt from the Framework, or from internal audit or management challenges against frontline staff, and it would provide the Board with some comfort that they have in place a system that is unlikely to be abused.

I look forward to the publication of the ESC's draft determination and its consideration of the matters I have raised.

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