

In reply please quote: D2018/022672

8 May 2018

Mr Marcus Crudden
Director Water
Essential Service Commission
Level 37 / 2 Lonsdale Street
Melbourne Victoria 3000

By email: water@esc.vic.gov.au

Dear Marcus,

WATER PRICE REVIEW 2018 - RESPONSE TO DRAFT PRICE DECISION

Thank you for the Commission's draft decision (dated 28 March 2018) on Wannon Water's 2018-2023 Pricing Submission as a part of the 2018 Water Price Review.

Wannon Water recognises that both the Commission and Wannon Water have a mutual objective to ensure excellent value for water customers and communities in the south-west Victoria. As such, we appreciate the preliminary views and insights the Commission has made in its draft decision and equally appreciate the opportunity to respond.

As a matter of process, we have also reviewed the public submissions listed on the Commission's website as they relate to Wannon Water.

Attached to this letter are specific responses to the matters the Commission raised in its draft decision.

In parallel with the Commission's 2018 Water Price Review, the Minister for Water, in Wannon Water's 2018/19 Letter of Expectations and Corporate Plan Guidelines, expressed a desire to see progress in the implementation of priority policy areas of *Water for Victoria*. The Minister also expressed an expectation that Wannon Water's average customer experiences affordable bills that are stable, or preferably falling, through the next price period.

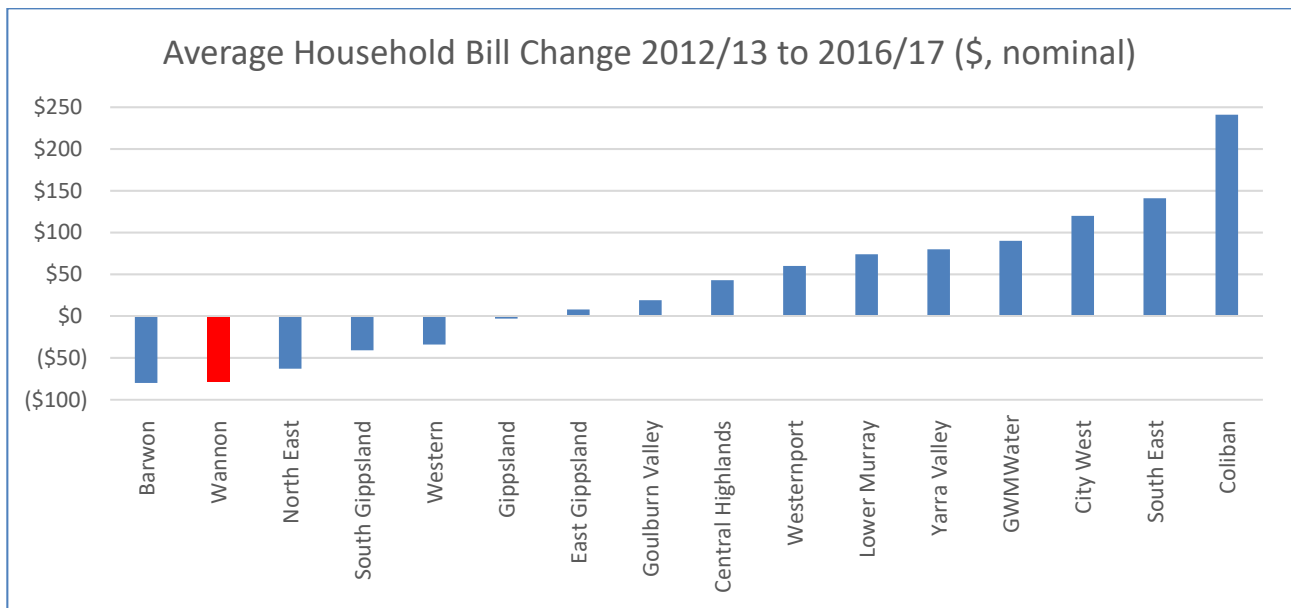
With the benefit of the Commission's draft decision together with the Minister's household bill expectations, Wannon Water has reconsidered both its proposed operational and capital expenditure forecasts as well as overall Price Submission outcomes.

In the attachment, you will notice that Wannon Water has critically examined and accepted a significant portion of the Commission's cost amendments, which will result in lower prices for our customers. These changes will allow Wannon Water to maintain household bills steady at \$1,100 (plus CPI) for 2018/19, effectively transitioning the \$70 rebate into lower prices for 2018/19 and subsequent years.

This outcome is likely to be received favourably by our customers, particularly as it equates to a real 11.1% household bill reduction over the six-year period from 2013/14 to 2018/19 with average household bills declining from \$1,238 to \$1,100 (stated in 2018 dollars).



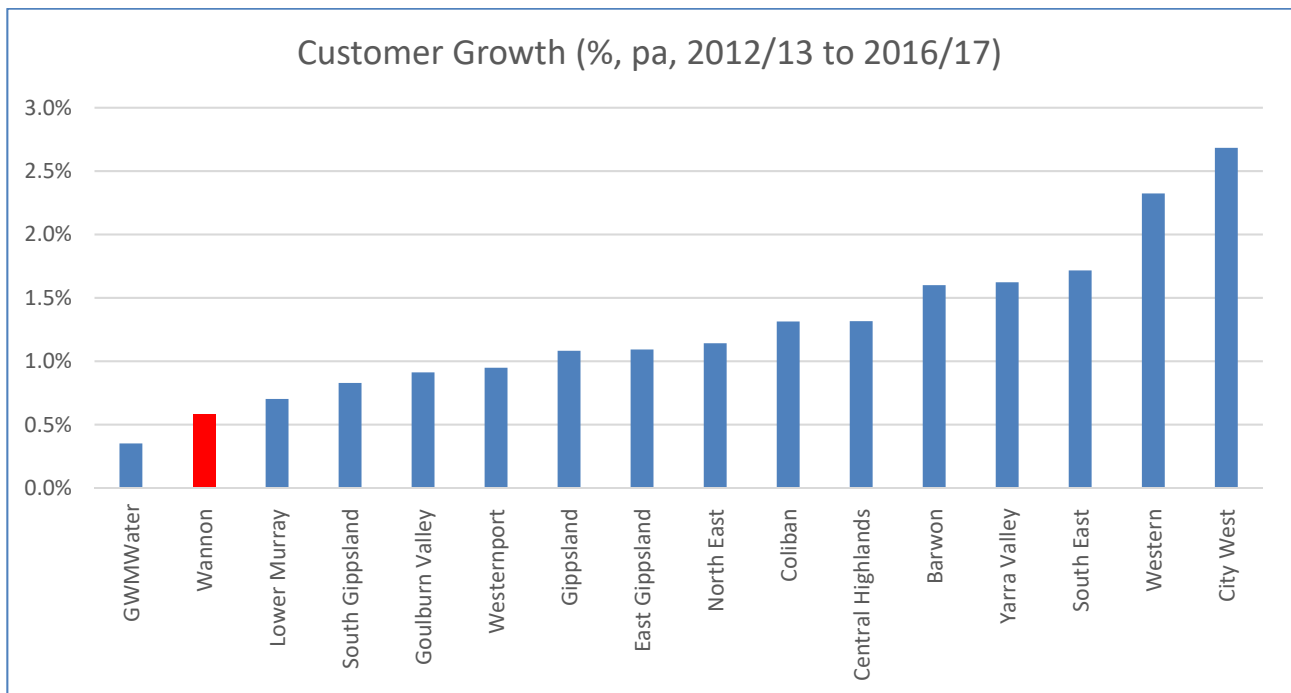
In comparison to urban water corporations in Victoria, the Commission itself reports the reduction in Wannon Water’s average household bill as being within \$1 of the highest over the five-year period from 2012/13 to 2016/17 (as shown in the chart below).



Source: Water Performance Report 2016-17, Essential Service Commission, 1 March 2018

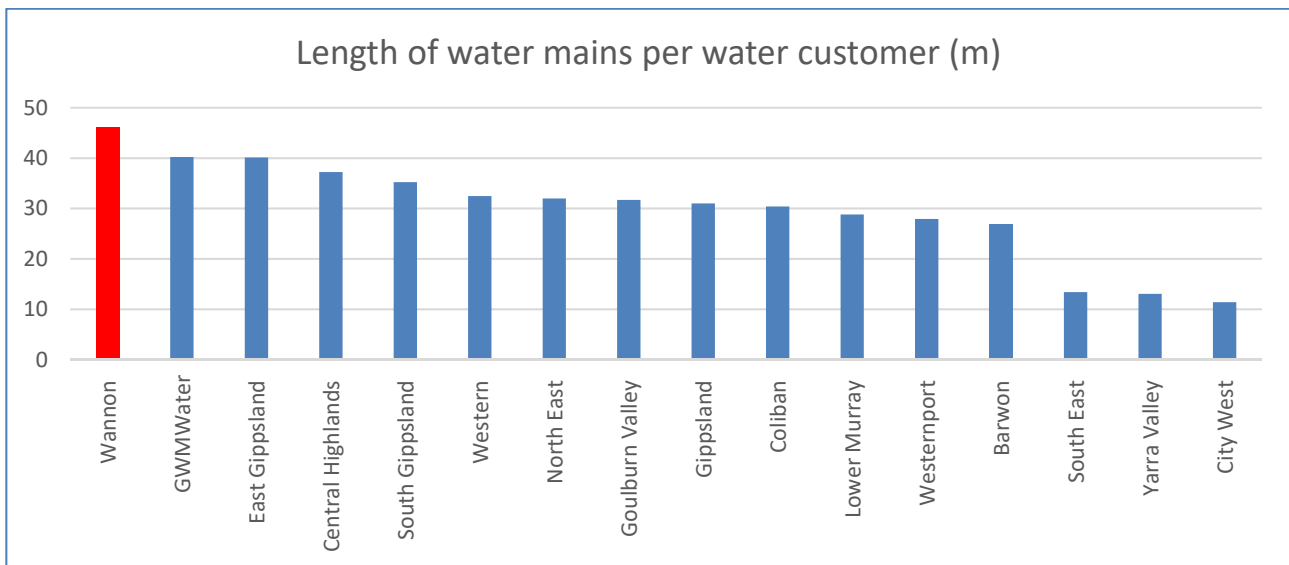
Wannon Water believes maintaining stable household bills for 2018/19 and subsequent years will be challenging to achieve, particularly due to the following:

1. Our region has had, and is forecast to experience, very low growth rates in comparison to other Victorian water corporations, meaning our ability to absorb cost increases via revenue associated with new customers is limited. The chart below shows Wannon Water has the second lowest customer growth rate of Victorian urban water corporations.



Source: Water Performance Report 2016-17, Essential Service Commission, 1 March 2018

- Wannon Water has the second largest operating area of Victorian urban water corporations, and pumps water significant distances within our region to provide water services. We have 46 metres of water mains per customer, which is the highest of all Victorian water corporations, placing greater upward pressure on operating costs and asset renewal costs compared to other water corporations for those services.



Source: Water Performance Report 2016-17, Essential Service Commission, 1 March 2018

- Over the past five years, Wannon Water has taken an aggressive approach to cost reductions to deliver an 11.1% household bill reduction. These cost reductions included ongoing savings as well as deferral of expenditure. Given the aggressive past approach, there are fewer new opportunities to offset cost increases associated with energy costs, employment costs, environmental contribution levy costs and new costs associated with delivering the policy objectives of *Water for Victoria*.

The Commission's draft decision in Figure 2.1 shows that Wannon Water's controllable operating costs per water connection (Index 2016/17=100) would decrease by 11% over the 10-year period 2013-23, which is more than double the average reduction by water corporations (5%). This reduction in controllable costs has been proposed despite economy of scale challenges and geographic challenges.

- The planned \$38 million major expenditure to upgrade the Warrnambool Sewage Treatment Plant is the first major upgrade since its commissioning in 1996. The project is necessary to support industrial expansion, necessary for regional development, and to provide capacity for modest residential growth in Warrnambool, Allansford and Koroit. The investment is vital and results in an unusually large capital works program, placing upwards pressure on prices.

Lower than planned expenditure is needed to deliver the stable household bill outcome and this has been achieved by committing to a higher efficiency improvement rate (increased from 1%pa to 2%pa) and reductions in a number of proposed expenditure programs.

Since launching our '*Beyond water for strong communities*' vision and '*Partnering for stronger communities*' strategy in 2016, Wannon Water has received positive feedback from customers and stakeholders and 83% of customers said they were satisfied or very satisfied with our proposals relating to strengthening communities.

Nevertheless, minor amendments to Outcome 6 – *Partnering with communities and helping our region flourish* and Outcome 7 – *Ensure we provide great value* are proposed and reflect the rebalancing of priorities.

Indicator	Measure	Current Performance	2023 Target	Revised 2023 Target
“We will maintain our strategic community partnerships and strengthen our communities” (previously “We will expand our strategic community partnerships and strengthen our communities”)				
Customer satisfaction with our performance partnering with communities to help our region flourish	Percentage of customers satisfied with our performance partnering with communities to help our region flourish	N/A	Improving Trend	Maintain 2018 performance
Regional stakeholder satisfaction with our performance partnering on areas of regional priority.	Percentage of regional stakeholders satisfied with our performance partnering on areas of regional priority.	N/A	Improving Trend	Maintain 2018 performance
“We will build on our relationships with our customers and other stakeholders to keep the conversation open about our planning and decision-making”.				
There is ongoing engagement with our customers and community to build capacity, strengthen relationships and inform decision making.	Number of instances of two-way engagement to inform the development of each annual corporate plan	Varies year on year	At least 500 instances of two-way engagement per annum	No change
	Percentage of customers who engaged with Wannon Water satisfied with the engagement process	N/A	Improving Trend	Maintain 2018 performance
“Maintain customer satisfaction levels” (previously “Further improve in customer satisfaction levels”)				
Customer overall satisfaction	Customer satisfaction with value for money	84% satisfied or very satisfied	Improving trend	Maintain current performance

As you can see, Wannon Water has critically examined and responded to the views and insights within the Commission’s draft decision and has proposed prices and customer outcomes that align with the Minister for Water’s expectation for stable or falling average household bills.

In analysing our response to the draft decision we request the Commission recognise our:

- Genuine consideration of the views and matters raised in the draft decision;
- Previous strong performance in cost reduction and household bill reduction;
- Voluntary reduction of an additional 2% of tariffs in 2016/17, as this was judged to be in the best interest of customers at that time;
- Unique challenges in managing increasing costs in a low customer growth environment; and
- Proposal to absorb the \$70 rebate and keep household bills stable, which will be favourably received by customers and meets Ministerial expectations.

We look forward to discussing any aspect of the Commission's draft decision and this response.

Yours sincerely

A handwritten signature in blue ink, appearing to read 'A Jc/L' followed by a long horizontal stroke.

ANDREW JEFFERS
Managing Director

Wannon Water Draft Decision – 2018 Water Price Review

Revised proposal to Essential Services Commission

Customer bill impacts

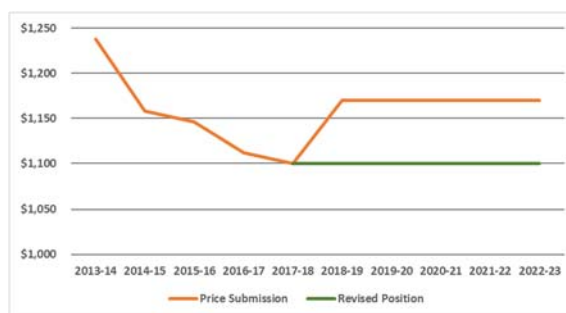
Wannon Water has carefully considered the Draft Decision, and has recently benefited from the Minister for Water clarifying expectations regarding affordability outcomes. This proposal includes tariffs that are more favourable for our customers compared to our Price Submission.

Average residential customer – owner

(Projected average water consumption 2013-2023: 146 kL per annum)

A residential household customer - owner using an average amount of water can expect to pay the same amount for their services in 2022/23 as they did in 2017/18.

Since 2012/13 their bill will have decreased by \$138 (11%) to \$1,100.



Average residential customer – tenant

(Projected average water consumption 2013-2023: 146 kL per annum)

A residential household customer - tenant using an average amount of water can expect to pay the same amount for their services in 2022/23 as they did in 2017/18.

Since 2012/13 their bill will have decreased by \$79 (28%) to \$201.

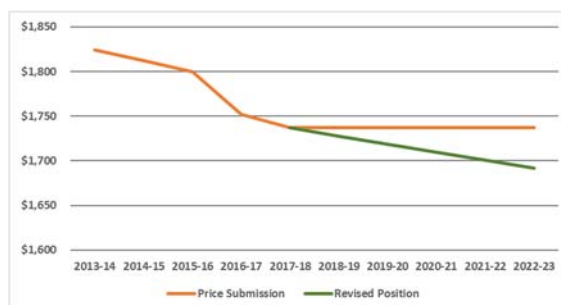


Average non-residential customer

(Projected average water consumption 2013-2023: 376 kL per annum)

A non-residential customer using an average amount of water can expect to pay \$45 less for their services in 2022/23 as they did in 2017/18.

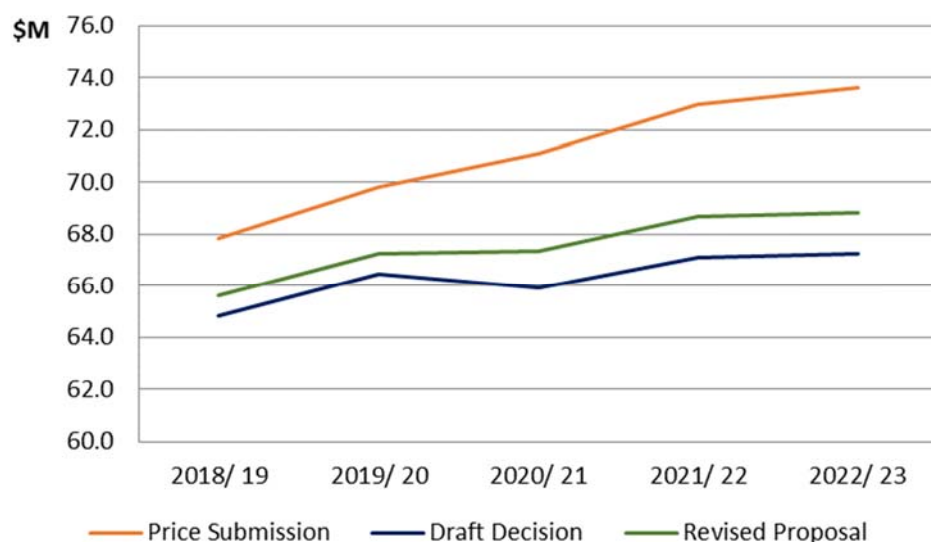
Since 2012/13 their bill will have decreased by \$132 (7%) to \$1,692.



Revenue requirement

Wannon Water proposes a revenue requirement of \$337.6 million compared to \$355.3 million in our Price Submission.

Revenue requirement



Revenue requirement, \$million 2017-18

	2018-19	2019-20	2020-21	2021-22	2022-23	Total
Price Submission	67.8	69.8	71.1	73.0	73.6	355.3
Draft Decision	64.8	66.4	65.9	67.1	67.2	331.5
Revised Proposal	65.6	67.2	67.3	68.7	68.8	337.6

The revised revenue requirement is \$6.1 million more compared to the Draft Decision.

Revised proposal revenue requirement, \$million 2017-18

	2018-19	2019-20	2020-21	2021-22	2022-23	Total
Operating expenditure	42.3	42.7	40.9	40.0	39.8	205.8
Return on assets	13.3	14.0	15.2	16.0	16.2	74.7
Regulatory depreciation	9.9	10.4	11.1	12.4	12.7	56.5
Adjustment from last period	0.1	0.1	0.1	0.1	0.1	0.7
Revenue requirement	65.6	67.2	67.3	68.7	68.8	337.6

Change to revenue requirement, \$million 2017-18

	2018-19	2019-20	2020-21	2021-22	2022-23	Total
Operating expenditure	+0.2	+0.2	+0.7	+0.4	+0.6	+2.3
Return on assets	+0.6	+0.6	+0.7	+0.6	+0.8	+3.6
Regulatory depreciation	-	+0.1	-	+0.2	+0.2	+0.4
Adjustment from last period	-	-	-	-	-	-
Revenue requirement	+0.8	+0.9	+1.4	+1.2	+1.6	+6.1

Operating expenditure

“The benchmark operating expenditure that we propose to adopt for Wannon Water does not represent the amount that Wannon Water is required to spend or allocate to particular operational, maintenance and administrative activities. Rather, it represents assumptions about the overall level of operating expenditure (to be recovered through prices) that we consider sufficient to operate the business efficiently and to maintain services over the regulatory period.”¹

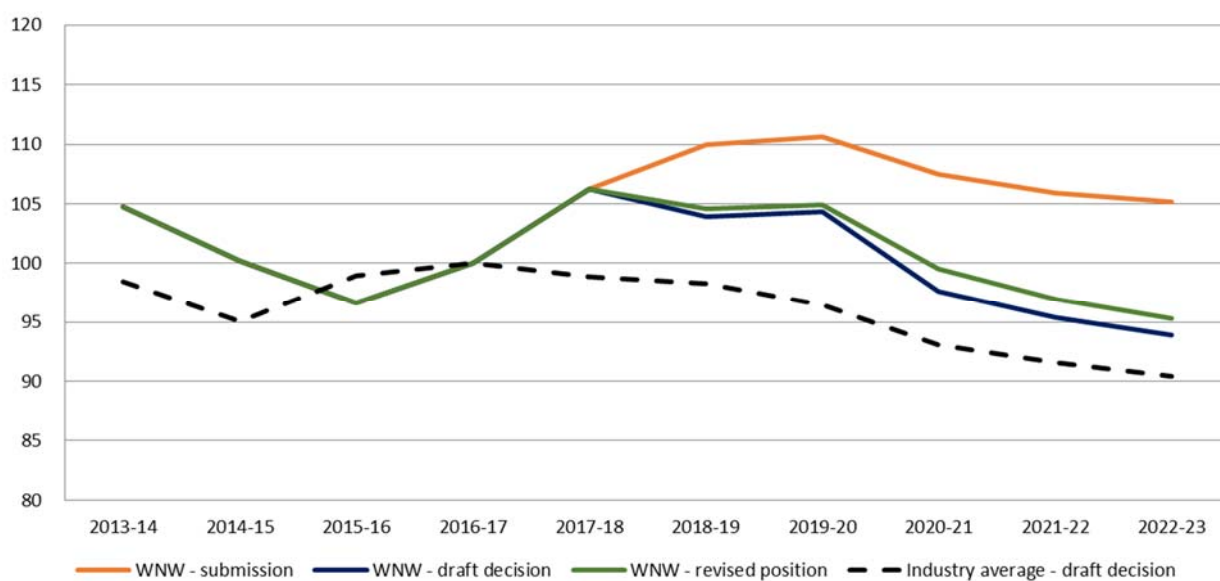
Controllable operating expenditure

Wannon Water proposes to reduce controllable operating expenditure by \$14.2 million to \$187.6 million compared to our Price Submission. The effect on operating expenditure per water connection is a 5% reduction compared to the baseline year (2016/17). It also represents a 9% reduction since 2013/14, which is a higher reduction than the 8.2% industry average reduction recommended in draft decisions and 3.6% higher than the industry average of 4.8% for all price submissions.

We believe this is an appropriate level of controllable expenditure given the challenges we face with low customer growth and servicing a large geographic operating area.

Controllable operating expenditure per Water Connection

Index: 2016/17 = 100



Total operating expenditure

Wannon Water proposes to reduce total operating expenditure by \$14.9 million to \$205.8 million compared to our Price Submission.

The Draft Decision proposed total operating expenditure of \$203.5 million. Wannon Water’s proposal is \$2.3 million greater and explained below.

¹ Wannon Water Draft Decision – 2018 Water Price Review, page 10

Operating Expenditure, \$million 2017-18

	2018-19	2019-20	2020-21	2021-22	2022-23	Total
Draft decision operating expenditure	42.1	42.5	40.2	39.6	39.2	203.5
Labour	1.0	1.4	1.6	1.9	2.1	8.0
Electricity	(0.4)	(0.5)	0.1	-	0.1	(0.6)
Carbon neutrality	-	-	(0.1)	(0.1)	(0.1)	(0.2)
Biosolids management (operating cost from new capital works)	-	0.1	0.1	0.1	0.1	0.4
Efficiency improvement rate	(0.4)	(0.7)	(1.1)	(1.4)	(1.8)	(5.3)
Wannon Water total adjustments	0.3	0.2	0.7	0.6	0.5	2.3
Wannon Water revised operating expenditure	42.3	42.7	40.9	40.0	39.8	205.8

Growth & Efficiency improvement rate

The Draft Decision proposes reductions in operational expenditure in some cost categories and reasoned that increases in costs above inflation should be managed through efficiency improvements, or via increased revenue from growth.

“Wannon Water’s proposed efficiency improvement rate...is equivalent to our mandated 1 per cent efficiency rate from the last price review, and is the equal lowest improvement rate posted across all water corporations in their price submissions. It exceeds Wannon Water’s forecast connection growth rate of only 0.8 per cent per annum, which results in a slightly declining annual baseline operating cost.”²

Growth

In comparison to regional urban water Corporations, Wannon Water has very low customer connections growth. As a result, our revenue growth is much lower than other water Corporations and our ability to absorb cost increases via revenue associated with new customers is limited.

Wannon Water has experienced average annual customer growth since 2012/13 of 0.6% - the second lowest rate of growth in the state and half the average rate of growth experienced by all regional urban water Corporations.

Whilst Warrnambool is experiencing growth with residential development, other serviced towns are not. Despite this lack of growth, in most cases a decline in growth, Wannon Water provides the same level of services that these communities have been receiving historically. This requires investment in maintaining aging infrastructure. With a reducing customer base and subsequently reducing tariff revenue this is challenging from a cost perspective.

² Wannon Water Draft Decision – 2018 Water Price Review, page 12

We also note that the growth rate of 0.8% in our Price Submission, based on *Victoria in Future 2015*, is higher than that experienced over the past 5 years. Whilst this is a forecast, there is no clear indicator that growth in the region will exceed historic levels, as such our forecast of 0.8% provides a demand risk for Wannon Water.

Efficiency improvement rate

The Commission has drawn attention to our proposed efficiency improvement rate of 1% (\$1.6 million) and compared it to other water Corporations. In highlighting our efficiency improvement rate as the equal lowest improvement rate across all water Corporation's Price Submissions, Wannon Water puts forward that the Commission has not given due consideration to the \$1.3 million of 'identified efficiencies' within our Price Submission.

Combining the identified efficiencies and the \$1.6 million 'unidentified efficiencies', Wannon Water's efficiency improvement rate is higher than the mandated 1% efficiency rate and is not the equal lowest improvement rate across all water Corporation's Price Submissions.

Additionally, if our efficiency improvement rate is offset against our growth forecast, Wannon Water is one of only five regional urban water Corporations to include a negative net baseline opex growth in their Price Submission. Given our low growth rate, we believed proposing this outcome in our Price Submission to be appropriate.

The Commission recognised that "...significant efficiency gains were made by Wannon Water during the 2013-2018 period".³ Our baseline controllable operating expenditure was well below the benchmark allowed for in 2016/17 in the previous price determination. Whilst we do not consider the baseline level of operating expenditure as an efficient level of expenditure, it does include ongoing efficiencies that flow through the next regulatory period.

Our negative net baseline growth, our identification of specified efficiencies within our Price Submission and our performance in recent years to reduce operating costs highlight our commitment to improve efficiency and lower customer bills.

Within the Draft Decision the Commission states that proposed cost increases should be offset by gains in efficiency. Given there are not reasons provided as to why the proposed expenditure is not required, Wannon Water strongly believes that an increase in the efficiency improvement rate should be made to counter proposed increases in cost. This proposal therefore includes an increase to our efficiency improvement rate.

Baseline

*"Wannon Water has proposed downward adjustments of \$0.70 million to its actual 2016-17 baseline year controllable operating expenditure, producing a starting point for forecast annual operating expenditure. The resultant figure of \$35.61 million is 18 per cent below the benchmark of \$43.62 million allowed for 2016-17 in the previous price determination. This demonstrates significant efficiency gains made by Wannon Water during the 2013-18 period, and we consider this reflects an efficient baseline cost to forecast annual operating expenditure."*⁴

³ Wannon Water Draft Decision – 2018 Water Price Review, page 11

⁴ Wannon Water Draft Decision – 2018 Water Price Review, page 11

Wannon Water considers our baseline operating expenditure of \$35.61 million low in the context of recent years. The Commission states in the Draft Decision that they “...consider this reflects an efficient baseline cost to forecast annual operating expenditure”⁵. Wannon Water has a differing view to the Commission that the baseline operating expenditure was at an efficient level.

The baseline year, 2016/17, was a time when Wannon Water was mid-way through providing a \$70 rebate to residential water use customers. The rebate was possible through the implementation of efficiency related projects, which reduced operating costs, and by delaying a number of one-of projects until the 2018-2023 Price Submission period.

The reduction in operating costs is reflected in the baseline and carries through the Price Submission. The one-off projects were identified as new operating costs and in the Draft Decision have been removed on the basis that they can be absorbed by efficiencies and/or within revenue growth. These included our lagoon desludging program and information and technology system enhancements.

Wannon Water in its Price Submission treated these projects as new expenditure and the subsequent outcome provided for a bounce back to operating cost levels appropriate to undertake services and to implement Water for Victoria actions. Figure 2-1: Controllable opex – Wannon Water (\$2017-18)⁶ clearly shows the reduction in operating costs during the 2013-2017 period compared to approved operating costs for regulatory period 3. The graph highlights the bounce back in operating costs following this period.

Labour costs

The Draft Decision proposes to remove \$9.18 million for wage increases above inflation resulting from Wannon Water’s Enterprise Agreement (EA).

Wannon Water’s current EA is approved and in effect a contract, or obligation, to pay our employees ending 30 September 2020. Wannon Water submitted wage increases in the Price Submission based on the treatment in prior regulatory periods, where approved EA’s, including the recognition of efficiency initiatives, were considered prudent and efficient expenditure. The Draft Decision has approached this in a different manner during this price review period.

The EA includes approved increases of 3.25% per annum on the basis of implementing cost improvement initiatives to offset the costs of paying beyond the 2.5% government wage policy.

The cost efficiencies to fund the costs above 2.5% government wage policy are either included in the Price Submission baseline or identified as cost efficiencies within the Price Submission (i.e. Wind Energy Project). The Commission’s Draft Decision to remove labour costs does not consider these efficiencies in this context as the Draft Decision proposes to retain these efficiencies. Wannon Water proposes that by not allowing the ongoing effect of our EA’s 3.25% increases the net result within the Draft Decision is double-dipping (reducing operating costs twice by allowing for the cost efficiencies).

Wannon Water proposes that the costs and identified efficiencies associated with the 3.25% per annum wage increases in the EA for years 1 and 2 are prudent and efficient. We propose that costs associated with years 1 and 2 remain as an operating cost and that the efficiencies identified remain as an offset to operating costs.

⁵ Wannon Water Draft Decision – 2018 Water Price Review, page 11

⁶ Wannon Water Draft Decision – 2018 Water Price Review, page 14

A new EA will be effective from 1 October 2020 and Wannon Water acknowledges that forecasting wage increases beyond this period is difficult. History indicates that the likelihood of wage increases matching current wage policy is extremely low.

Wannon Water also recognises that any wage increases approved beyond wages policy will require efficiencies to be implemented. To this end, Wannon Water believes that a portion of the 'unidentified efficiencies' to meet the 1% efficiency improvement rate target should be acknowledged as a mechanism to cover these increases.

Wannon Water's revised proposal provides for forecast wage increases to remain in the price review model as stated in the Price Submission (3% per annum for years 3 – 5), and that the efficiency improvement rate be increased. Increasing the efficiency improvement rate results in a decrease in costs equating to the difference between CPI and the assumed 3% wage increases for years 3, 4 and 5. In effect, Wannon Water proposes to absorb the costs associated with assumed wage increases beyond CPI for years 3 to 5, and therefore accepts a \$5.3 million reduction in operating costs associated with labour costs.

Additionally, Wannon Water proposes amendments to labour costs be made which reflects a change in presentation of labour cost data. In investigating the Draft Decision recommendation, Wannon Water has reconstructed labour costs for the period. As a result:

Costs associated with vacancies for the whole of 2016/17 that were subsequently filled in 2017/18, have been removed from the line in the variations table referencing the EBA increases within the price review model, and included as an addition to the baseline costs (\$0.28M). The reference within the price review model 'EBA increases greater than CPI' included variations due to payroll tax, superannuation changes and projected banding changes for existing employees. We have endeavoured to provide greater clarity in the updated price review model.

We identified an error in the baseline calculations. In our modelling up until the actual 2016/17 baseline costs were able to be substituted for forecast costs, Wannon Water had included an annual baseline adjustment of \$0.31M, to allow for positions that were vacant for part of, or for the majority of the 2016/17 year. When our price review model was updated for actual costs, we inadvertently removed the baseline adjustment. We have therefore reinstated it in the updated price review model.

Labour costs have been updated in this proposal to reflect the reduction in payroll tax for regional businesses announced in the 2018-19 Victorian state budget. This equates to a decrease of \$1.2 million over the period.

Electricity

The Draft Decision proposes to remove electricity cost increases relating to assumed price increases above CPI (\$3.2 million) and usage increases as a result of new infrastructure (\$0.1 million).

At the time of writing the Price Submission, assumptions for electricity prices for five years of the regulatory period were made. As the Draft Decision suggests, Wannon Water will enter into a new electricity supply agreement in the near future providing certainty around electricity prices for years 1 & 2 of the five year period. Electricity cost forecasts have been updated in this proposal to reflect the proposed new contract. The proposed new contract results in lower electricity costs than the forecast in both the Price Submission and Draft Decision.

Wannon Water recognises the uncertainty regarding electricity pricing in years 3, 4 and 5. The Draft Decision proposes to remove the entire allowance of \$3.2 million under the assumption that the energy market will return to 2016/17 levels by 2020/21. Wannon Water believes that the likelihood of this occurring is very unlikely.

Electricity costs in the 2016/17 baseline are based on Wannon Water's contract price, which was significantly lower (61.5%) than the average market price for the year. Given that the likelihood of Wannon Water receiving favourable electricity contract prices at better than market rates in 2020/21, this proposal includes electricity prices at the midpoint between Wannon Water's 2016/17 contract price and the 2016/17 market price as our forecast beyond 2019/20. The outcome of this assumption is a \$0.41 million increase above the baseline for the three year period. We believe this to be a prudent and reasonable approach given the volatility of electricity prices, the likelihood of receiving 2016/17 pricing four years later, our low rate of customer connection growth and revised efficiency improvement rate.

This proposal includes \$0.05 million in electricity costs for usage increases as a result of new infrastructure. In the context of low customer connection growth and a significant increase to our efficiency improvement rate, we consider this cost appropriate.

As recognised in the Draft Decision, changes to electricity pricing has a negative effect on forecast cost savings. A number of initiatives that result in lower electricity use were included in our Price Submission. As a result of the favourable electricity contract outcome, cost savings for these initiatives reduce, resulting in an increase to forecast operating expenditure compared to the Price Submission.

The net effect of the above responses is provided in the table below:

Electricity costs, \$million 2017-18

	2018-19	2019-20	2020-21	2021-22	2022-23	Total
Price Submission	4.2	3.7	3.7	3.8	3.8	19.1
Amendments	(0.5)	(0.5)	(1.0)	(1.0)	(1.0)	(3.9)
Carbon neutrality effect	-	-	(0.1)	(0.1)	(0.1)	(0.2)
Revised proposal	3.7	3.2	2.8	2.9	2.9	15.4
Draft Decision costs	4.2	3.7	2.7	2.8	2.8	16.2
Variance to Draft Decision	(0.5)	(0.5)	+0.1	+0.1	+0.1	(0.8)

Water for community

The Draft Decision proposes moving the Water for Community program to revenue not collected, as opposed to an operating expenditure.

Wannon Water recognises that the net effect on customer bills of this change is nil. This proposal includes the Draft Decision amendment.

Tenant rebate

The Draft Decision removes the proposed rebate to tenant customers from the Price Submission.

Wannon Water recognises that the net effect of the Draft Decision and this proposal changes proposed tariff outcomes for all customers.

Our revised proposal includes a rebate to residential owner and tenant customers.

The price review model reflects the revised rebate represented as revenue not collected.

Refer to Tariff structures section on page 14 for further information.

New operating costs

The Draft Decision proposes to remove \$2.49 million in new costs and that these costs should be absorbed within the growth-adjusted baseline or funded through efficiency gains from these new initiatives.

Again, Wannon Water highlights that our ability to absorb new costs through the growth-adjusted baseline is hampered by low growth and that this proposal contains a significant increase in the efficiency improvement rate. Whilst this proposal removes \$2.06 million in new operating costs from our Price Submission, Wannon Water notes that this adds to the level of operating risk assumed by the Corporation.

This proposal includes new costs of \$0.43 million relating to increased bio-solid management. Wannon Water disagrees with the recommendation within the Draft Decision to remove these costs. Wannon Water provides the following additional information in relation to the increased cost for bio-solid management:

The driver for the refurbished Camperdown facility, the new facility in Hamilton and increased transport costs is due largely to a change in waste from major customers, not due to customer growth alone. The project links directly to our customer outcome to provide sewerage services that protect public health and the environment.

There is no correlation between customer connection growth and the requirement to upsize this infrastructure. Major customers are planning growth at their current sites which will increase both the type and the volume of waste received at the Warrnambool WRP. This proposal maintains that the increase in cost should not be managed within the growth-adjusted baseline and be considered a step change in costs.

Non-controllable expenditure

We note the changes made by the Commission within the Draft Decision for an increase in the Commission's licence fee, and decreases in the Environment contribution and the EPA licence fee. This proposal incorporates those changes.

Capital expenditure

Wannon Water proposes to reduce capital expenditure by \$14.1 million to \$142.4 million compared to our Price Submission.

The Draft Decision proposes to remove \$18.2 million in capital works projects, reducing the gross capital expenditure for the period to \$138.3 million. The Commission states in the Draft Decision that this amount represents assumptions about the overall level of expenditure considered sufficient to operate the business.

Wannon Water notes that the level of capital expenditure excluding the Warrnambool WRP Upgrade project (\$38.0 million) is lower than previous regulatory period capital works programs. Wannon Water undertook a detailed assessment of the proposed capital investment program for deliverability. Given the significant one-of project within the program, the conclusion of the assessment was that a program of the size proposed in our Price Submission was achievable.

In the context of providing affordable outcomes for customers and on the basis of the compelling need for the Wangoom Road water tower project, this proposal includes a \$4.1 million addition to the Draft Decision capital investment program.

Gross Capital Expenditure, \$million 2017-18

	2018-19	2019-20	2020-21	2021-22	2022-23	Total
Draft decision gross capital expenditure	20.9	37.3	44.6	22.1	13.3	138.3
Warrnambool - Wangoom Road water tower	0.0	+0.5	+1.7	+1.9	0.0	+4.1
Wannon Water revised gross capital expenditure	20.9	37.8	46.3	24.0	13.3	142.4

Warrnambool WRP upgrade

Wannon Water notes the commentary on the Warrnambool WRP Upgrade project within the Draft Decision and notes that progress with project planning continues. The business case has been finalised and is undergoing review by the Department of Treasury & Finance (DTF) and Department of Environment, Land Water & Planning. Formal approval is required by DTF before the project proceeds to construction stage. Formal approval is not required for the purposes of this price review. Functional design work begins in the near future. The forecast cost of the project remains at \$38.0 million.

Renewals Program

Wannon Water acknowledges the Draft Decision to reduce the renewals program by \$11.7 million. Wannon Water believes the increase was well justified and a significant amount of information was provided reflecting this belief. The hurdle to satisfy justification for the increase is considered high given the size of the increase.

This proposal includes a reduction of \$11.7 million in renewals works and notes the risk of delaying renewal works has the potential to negatively impact service standards in the medium to long term and a number of customer outcomes as a result.

Water tower projects

The Draft Decision includes the removal of both Wangoom Road and Wollaston Road Water Tower capital works projects.

This proposal includes the Wangoom Road project on the basis that:

1. There is clear justification for the requirement and timing of the project; and,
2. Excluding both Wangoom Road and Wollaston Road Water Tower growth related projects, increases the risk of a reduction in service standards for current and future customers to highly likely.

Acknowledging the difficulties in providing assured timing assumptions for the Wollaston Road Water Tower project, this proposal does not include the Wollaston Road project from the capital investment program. If the project occurs, Wannon Water will recover associated costs at the end of the period.

Wannon Water also notes that a third growth related water tower project, Hopkins Road Water Tower, was not included in the capital investment program during the regulatory period. This project was not included on the basis that the requirement had a greater level of timing uncertainty than the other two and that including two of the three water tower projects minimised the service level risk to customers. In removing the Wollaston Road Water Tower project, Wannon Water is taking a further risk to the provision of services to customers regarding growth related water supply projects.

Wangoom Road water tower

The Draft Decision proposes that there was "...not clear justification for the timing of the project or a clear trigger for when the works were required." ⁷ Wannon Water believes it provided clear justification. Additional information was provided to Deloitte for this purpose, however it appears this has not been fully considered. In addition, the certainty around its timing has become even more evident since the summer of 2017-18. We believe there is strong justification to include the Wangoom Road water tower project in this proposal. The information set out in Appendix A supports this.

⁷ Wannon Water Draft Decision – 2018 Water Price Review, page 21

Regulatory depreciation

This proposal amends regulatory depreciation by \$0.6 million compared to our Price Submission.

The reduction in our capital investment program of \$14.1 million results in a reduction to regulatory depreciation from \$57.1 million to \$56.5 million.

Return on assets

Cost of debt

Price adjustment mechanism – trailing cost of debt

After consultation with the Commission, Wannon Water has the understanding that the Commission will provide a price adjustment mechanism in our Final Determination. This mechanism will allow prices to adjust on an annual basis to reflect movements in the trailing cost of debt. This is Wannon Water's preference as the mechanism should be consistent across the State.

This submission includes the recent cost of debt and inflation updates.

PREMO assessment

This proposal retains our 'Standard' PREMO assessment and as a result, this proposal's revenue requirement associated with the PREMO rating is \$3.7 million higher when compared to the Draft Decision.

Wannon Water acknowledges the Commission's assessment of our Price Submission as 'Basic' for the purposes of assessing the return on equity aspect of the revenue requirement. We also note with interest the weighting given towards the Management and Risk components of PREMO compared to the Engagement and Outcomes components, giving an impression that the PREMO rating was highly weighted to efficiency considerations

We do not believe the Draft Decision PREMO rating complied with the 2018 Water Price Review Guidance Paper⁸ as Wannon Water's Price Submission did not trigger any of the "Examples of a basic submission" criterion.

In addition to the information provided in our Price Submission regarding PREMO and the efficiency improvement made within this response, our belief that the Commission should reassess and agree that our 'Standard' assessment is appropriate based on the following:

- Our controllable operating costs reduce significantly in this proposal as a result of our commitment to double the efficiency improvement rate. As the Commission highlighted in the Draft Decision, we have a good track record of achieving cost reductions and we will continue to challenge ourselves to meet this stretch target.
- Our revised capital investment program increases the service level risk to our customers. We acknowledge the likelihood of this occurring and the mechanism in place to recoup costs beyond those costs forecast in the next regulatory period.

⁸ 2018 Water Price Review Guidance Paper November 2017, pages 81-83 and 86-87

- Our customer growth is very low and our costs of service are more than most other regional water Corporations due to the scale of our service region. In this context, the decrease in operating costs per water connection to achieve outcomes is challenging.
- Our negative net baseline growth of 1.2% (growth of 0.8% less efficiency improvement rate of 2%) is significantly higher than all water corporations Price Submissions and only lower than Goulburn Valley's 1.8%.
- Our baseline expenditure level is low, a reflection of the one-off nature of deferring expenditure in order to provide our customers with a government efficiency rebate.
- The \$70 government efficiency rebate is one of the highest in the State for regional urban water corporations. Our customers have received benefit from this rebate for the past four years. The Minister's expectation to absorb the rebate to achieve stable bills is challenging, however this proposal does achieve this.
- This proposal provides justification for cost increases beyond the Draft Decision.
- The proposed reductions in operating costs in the Draft Decision were not specifically stated as unjustified, but rather the result of differences of opinion regarding forecasting assumptions (i.e. labour costs consistent with government wage policy). The accuracy of assumptions and calculations is not in question. The reduction in operating costs were largely due to recommendations to absorb costs within customer growth or via efficiency means.
- This proposal reduces operating and capital expenditure which has the overall effect of Wannon Water taking further financial risk from customers.
- We remain committed to the Guaranteed Service Level's in our Price Submission despite the increase in service level risk resulting from the lower operational and capital expenditure.
- We remain committed to the Outcomes and targets within our Price Submission, with the exception of those measures where revised 2023 targets are stated in the preceding letter to this revised proposal.

Tariff structures

With an overarching objective to maintain current tariff structures, maintain stable bills for households (residential customers) and maintain tariff structural alignment for residential and non-residential customers, converting the \$70 government efficiency rebate into customer tariffs proved challenging.

To maintain stable bills reductions to water volumetric charges and a residential customer rebate are proposed.

Water volumetric charges

Proposed changes to water volumetric charges are:

- Residential Tier 1, and non-residential non-potable water volumetric charges, reduce by an average of 5.8% per annum.
- Residential Tier 2 and 3, and non-residential potable water volumetric charges, reduce by an average of 1.1% per annum.

The reduction in the Tier 1 water volumetric charge provides a positive outcome for all residential customers. With average residential use of 146kL per annum, more than half our customers consume, and therefore pay for water within Tier 1. Tier 2 water volumetric charges are effective after using 160kL per year.

Alignment between non-residential water volumetric charges for non-potable and potable water and Tiers 1 and 2 respectively are maintained under this proposal.

Residential rebate

This proposal includes a rebate for residential owner and tenant customers. The rebate is phased out over a four year period and is proposed to ensure affordability outcomes continue to be met for this customer group.

Residential customer rebate, \$2017-18

	2018/19	2019/20	2020/21	2021/22	2022/23
Maximum annual rebate	\$56	\$42	\$28	\$14	-

The proposed rebate will be applied equally to customers' four quarterly bills. For customers whose quarterly bill does not exceed the rebate amount, the rebate will be capped at the total quarterly bill amount.

In the context that residential owner and tenant customers' 2018/19 bill will have reduced by 11% and 28% respectively since 2013/14, Wannon Water considers the bill outcomes will be received favourably by our customers.

Given the complexity of tariff modelling, Wannon Water will engage with the Commission to finalise tariffs during the period leading up to the Final Determination.

Appendix A – Wangoom Road water tower project

The project is driven by the need to adequately secure the supply of water to one of the major growth corridors in Warrnambool. The project is not a new project but one that was extensively investigated as part of the current regulatory period (Water Plan 3).

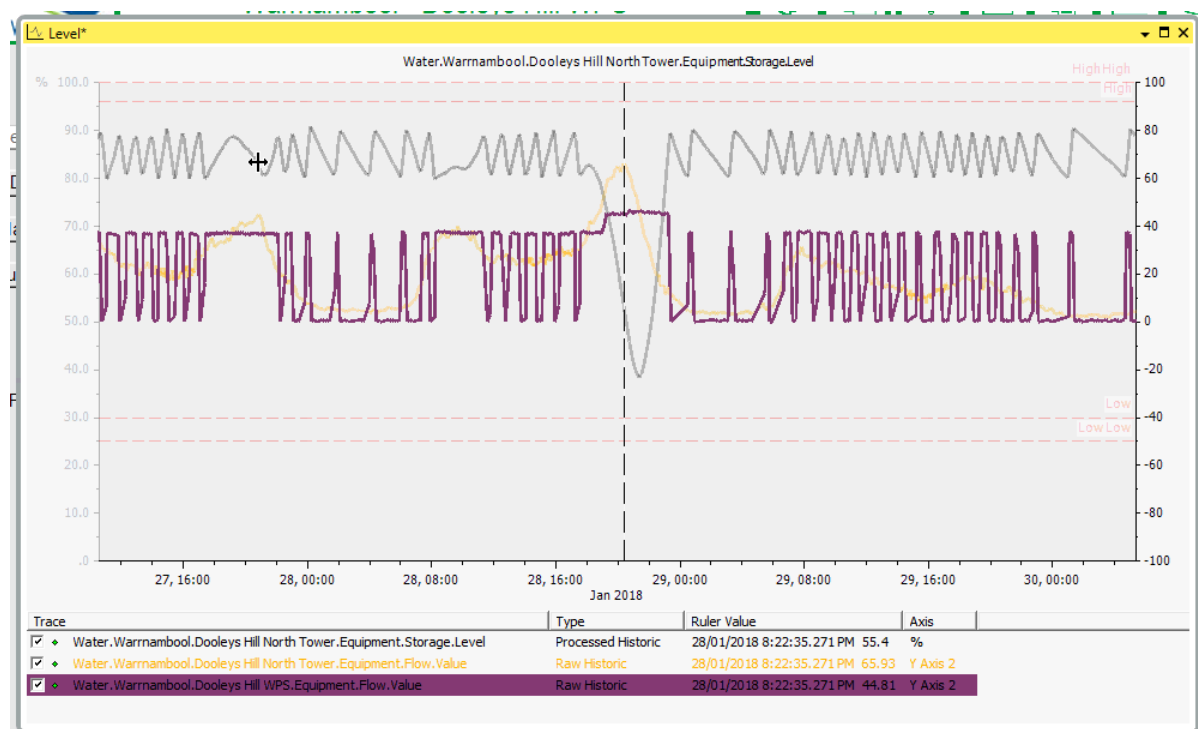
An extensive options evaluation was undertaken in 2012 identifying a preferred option whose infrastructure could be constructed in stages. The first stage was constructed in the current regulatory period (being 1400 m of 225 mm trunk pipelines) with the second stage (water tower, pump station and pipeline) and third stage (1 ML ground level tank) deferred due to slower than expected growth in this growth corridor and higher priority growth assets required elsewhere in Warrnambool.

In developing the Price Submission, the available options were reconsidered and no new options were identified. All options involved similar types of infrastructure meaning that the preferred option would be unchanged with the only changes since 2012 being cost changes. Rather than rewrite the 60 page 2012 business case, it was decided to reference this business case in the 2017 business case prepared for Price Submission 2018.

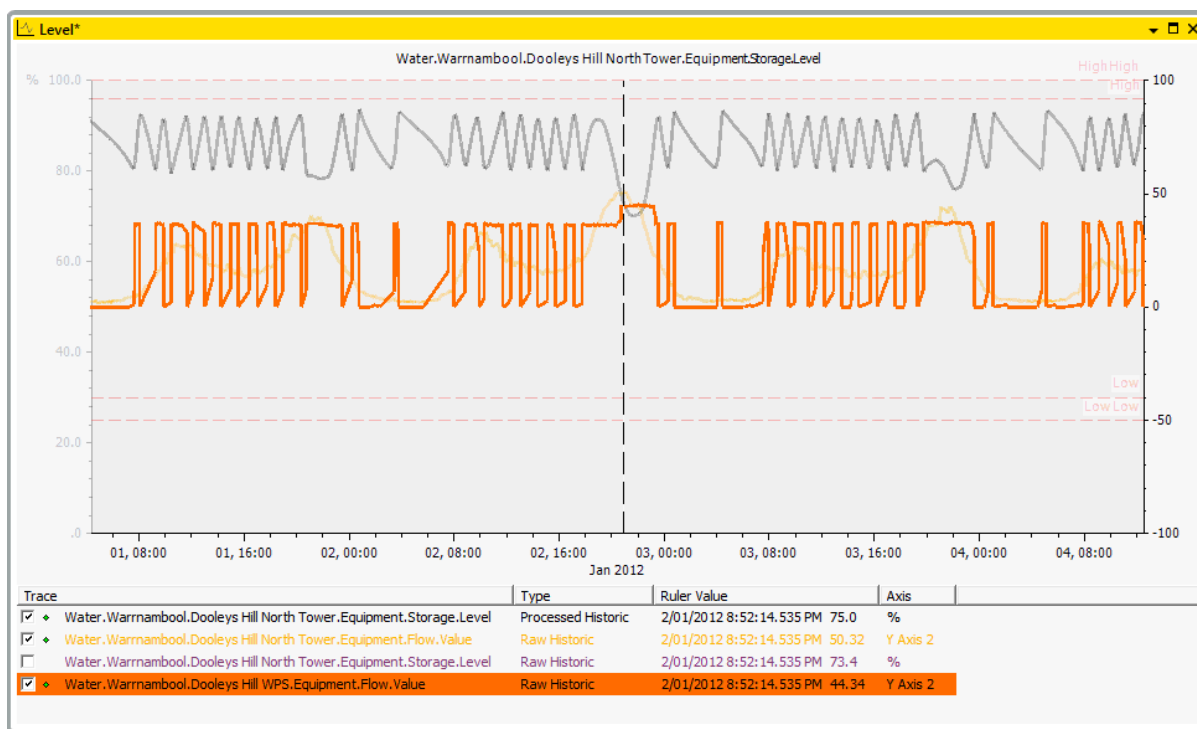
It is acknowledged that a clear trigger for the project is not specifically identified in 2017 business case other than the statement the additional 500 lots planned will “exceed the capacity of the existing elevated tower at Balmoral Road resulting in the need to construct a new water tower by 2022”. Further justification of the project was subsequently supplied to Deloitte, which revealed that hundreds of properties risk running out of water if the works are not undertaken – this information is provided below.

The current system is under stress.

The following graph shows the actual system performance on 28th January 2018 with the storage falling to under 40 % of depth (correlating to 22% of capacity) and the pumps operating at full capacity. The demand on the tower (orange line) is 66 l/sec with the pump only able to deliver 45l/sec (purple line). At this flow rate, the remaining water would have been used in 11 minutes following which customers would have been without water.



The same graph in 2012 shows the storage dropping to 70% full and maximum demand being 56 l/sec. At these rates water would last for 34 minutes – just enough time to get a genset to site.



The pumps would normally turn on at 72% full to maintain an emergency volume in storage in case of power failure, mechanical failure of pumps or a supply pipeline failure. Peak day demand has now increase such that the emergency volume would be consumed in 36 minutes with the demand that occurred in February this year. Hundreds of customers would then be without water. Such a short time is inadequate to respond to and undertake corrective actions. Three to five hours is a typical minimum time to repair a burst supply main.

The trigger for this project is to have sufficient water in reserve such that during emergencies, a supply to customers is maintained. The above indicates we have passed that trigger meaning that this project will be given the highest priority.

There has been substantial growth in the number of residences constructed and serviced by the Balmoral Road water tower over the last 3 calendar years as shown by the following table.

Growth in Wangoom Road water tower catchment

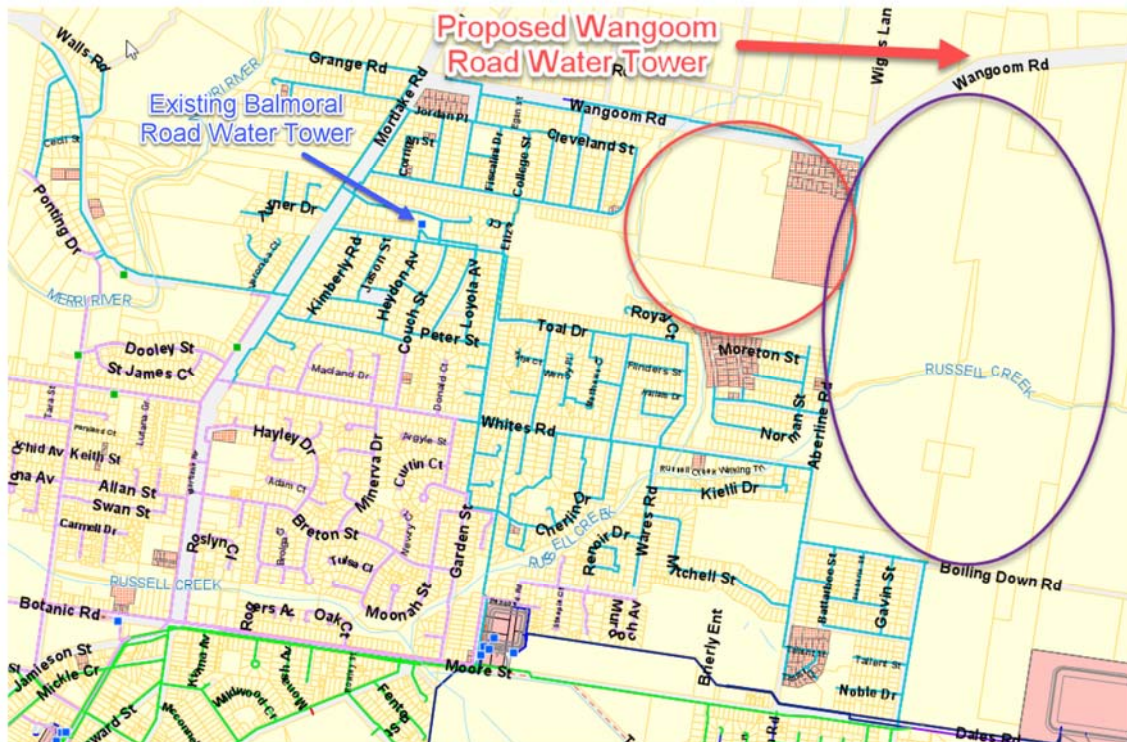
	2015	2016	2017
Number of new dwellings	77	102	91

It is anticipated that this level of growth will continue over the coming years with current vacant lots being built on and new lots being created through new subdivisions – see pink shaded areas in map below.

The blue pipe network below shows the areas serviced from the Balmoral Road tower – some of which will be transferred across to the Wangoom Road Tower when constructed thus relieving pressure on the existing tower.

The pink shaded land is land that is currently under development with water supply servicing plans approved and construction underway. The red circle is land that is currently undeveloped but is zoned for residential development and a development plan for around 500 lots has been approved by Council. The developer of this land has finalised servicing plans for the next stage of this development with construction underway. The purple circle is part of land that a structure plan is being prepared with the intention of rezoning the land for residential purposes within 2 years. This land will be supplied from the new water tower.

Wangoom Road water tower catchment area



The Draft Decision refers to “...inconsistent project costs in different documents...”⁹. The inconsistency identified in the 2012 business case is a typographical error in the executive summary where the recommended works are stated to be \$4.3 million instead of the \$5.0 million recommended in the body of the business case. It is not clear how this error was overlooked but the cost of all options assessed are correct and agree with the detailed estimates that were prepared. The NPV of each option is based on the estimated capital and operating cost of the various options – all amounts have been checked and there are no inconsistencies. The NPV of the preferred option is \$4.8 million compared to the other acceptable options of \$5.2 million and \$5.4 million respectively. The options were sensitivity tested in relation to power cost variation and the preferred option was still the lowest NPV in all cases.

The estimated cost for the second stage of the preferred option, being an elevated water tower, pump station and 3 km pipeline to the new tower has been updated in the 2017 business case to reflect current construction costs totalling \$4.24 million. The project has been correctly increased to \$4.33 million in the Price Submission template to reflect the conversion from \$2017 to \$2018. Stage 3 of the preferred option, being a 1 ML ground level tank has not been included in the Price Submission, as it is not expected to be

⁹ Wannon Water Draft Decision – 2018 Water Price Review, page 21

required until 2025. The updated cost of \$1.22 million for this stage has been included in the capital forecasts for years 6 to 10 of the Price Submission.