

8 May 2023

Marcus Crudden
Executive Director, Price Monitoring and Regulation
Level 8, 570 Bourke Street
Melbourne VIC 3000

Delivered via email: water@esc.vic.gov.au

Dear Marcus,

Re: Barwon Water's response to the 2023 Price Submission draft decision

We welcome the Commission's draft decision on our 2023 Price Submission, for the period 1 July 2023 to 30 June 2028.

In response to the draft decision, we have provided additional information on the following items:

- Impacts of high inflation for 2023-24
- Outcome commitments for 2023-28 – updated measures and targets
- Revenue requirement
- Adjustments to regulatory asset base
- Adjustment to regulatory depreciation
- Adjustment to tax allowance
- Growth and demand forecasts
- Adjusting prices – Melbourne Water bulk tariffs

Impacts of high inflation for 2023-24

In its draft decision, the Commission sought further information on how we intend to address impacts of relatively high inflation in 2023-24 on prices and customer bills. The draft decision paper also required Barwon Water to demonstrate how we have considered the impacts of inflation on our forecast expenditure for 2023-24, and whether our forecasts are reasonable, given some costs (e.g. labour) are not likely to increase in line with near term inflation.

Our enhanced customer support programs will help address impacts of inflation on customer bills.

As we have in the past, we will work closely with customers to mitigate bill pressure next financial year and into the future. Our initiatives include payment plan options such as one-off payment extensions, bill smoothing and our 'arrange and save' program, as well as extensive assistance accessing utility relief grants, and connections to free financial counselling services.

Additionally, we aim to be proactive on our delivery of these initiatives through our outbound calls program. We have already proposed to increase our customer assistance program to \$4.8M over the 2023-28 period, meaning more resources are available to help customers manage their 2023-24 bills, particularly through access to greater direct financial support from our enhanced 'arrange and save' program.

Our proposed real price decrease in 2023-24 will protect customers from the full impact of inflation in 2023-24.

Customer bills will increase by less than the consumer price index (CPI) for March 2022 - March 2023. From 1 July 2023, increases to typical bills for residents and businesses will be 1.0 per cent lower than inflation, after we apply our prescribed price movement (PPM) and regulatory Cost of Debt (CoD) adjustment to our core water and sewerage tariffs. That is, although March 2022 - March 2023 inflation was 7 per cent, nominal customer bills will typically increase by only 6 per cent in 2023-24. While our negative real price path provides modest relief from inflation on our customers' bills, this will occur in an environment where many utility bills are increasing more sharply.

Barwon Water has demonstrated a long-standing commitment to keeping customer bills affordable, consistently delivering real price decreases for customers over the last 10 years. Average bills for residential customers reduced by 15 per cent between their peak in 2012-13 and what we are proposing in 2023-24. Our commitment to affordable prices is set to continue throughout 2023-28, which will be the third price period in a row in which Barwon Water has delivered real price decreases for customers. Average annual household water bills will decrease from approximately \$1,076 this year to \$1,065 next financial year and will continue to go down by about \$10 each year to \$1,023 in 2027-28.

Relatively high inflation in 2023-24 will not provide Barwon Water with a revenue 'windfall'.

Our cost profile differs from the 'household basket of goods' measured by CPI. Following analysis of our key cost categories against relevant price inflation indices for March 2023, there is a strong indication that overall, we can expect our costs to increase by a rate higher than CPI on average. This analysis has considered all of our major cost categories (including building materials, labour, fuel, maintenance, chemicals, insurance, IT, consultants and electricity) with CPI rates ranging from 5per cent to 19 per cent.

We anticipate combined increases in operating and capital expenditure attributable to CPI will exceed corresponding increases in operating revenue i.e. we expect to be in deficit on a cash basis even when full CPI of 7per cent and Cost of Debt of 0.5 per cent are passed on to customers. We therefore propose to apply the full CPI of 7 per cent to our annual tariff adjustment process for 2023-24. With our customers in mind, we accept the risk of costs exceeding our revenue.

As we are proposing a price cap form of price control, our Board will have the opportunity to decide year by year to set prices in line with, or lower than the price cap determined by the

Commission. In the unlikely event that our revenue exceeds costs for 2023-24, our Board may elect to redress this through a subsequent annual tariff adjustment.

Outcome commitments for 2023-28 – updated measures and targets

Barwon Water continues to seek additional ways to connect with customers. We are proposing to report quarterly on relevant outcomes performance. We have taken on the ESC feedback on to improve the clarity and accountability of the targets. Any material changes to the wording of the measures or targets have been captured in the Outcomes Reporting Template (Attachment A) which reflects these recommendations and subsequent changes. Attachment A.

Revenue requirement

We accept the proposed adjustments the ESC has recommended to forecast operating expenditure which result in a 0.3 per cent lower revenue requirement. We have updated the revenue requirement and prices to reflect these adjustments and updates to estimates for the cost of debt and inflation. Please refer to Attachment B for the updated Price Schedule.

Adjustment to regulatory asset base

We accept the adjustments to prescribed capital expenditure for 2021-22 as identified as part of the regulatory accounts audit.

Adjustment to regulatory depreciation

We accept the proposed adjustment to regulatory depreciation resulting from the updated 2021-22 prescribed capital expenditure as identified as part of the regulatory accounts audit.

Adjustment to tax allowance

We have provided an adjusted tax allowance as part of the revenue requirement. This reflects the changes to the revenue requirement resulting from lower operating costs, regulatory depreciation updates and inflation.

Growth and demand forecasts

The Commission's draft decision required that we consider the latest Victoria in Future (ViF) estimates and if required, identify, and justify any changes to our demand forecasts. We have considered the latest ViF confidential release of 2022 Victorian Government Projections.

Through comparative analysis of our forecasts in our price submission, actuals to date and confidential ViF data, we note our forecasts and actual growth are closely aligned for both 2021-22 and extrapolations from year-to-date March for 2022-23, being 2.2% and 2.1% respectively. By contrast, the ViF data predictions for the same time periods are 2.8% and 2.7% respectively. The differences are apparent in the first three years and then all growth rate projections appear to align into the foreseeable future. The granularity of data used in our price submission forecasts from Forecast.id of 9,072 datapoints versus 234 for ViF and 5 yearly data may be also contributed to the closer alignment for our region.

We have not noted any changes in demand per property. Therefore, due to the closer alignment to our actual property growth we are proposing to continue to utilise our forecasts for growth and demand as per our price submission.

The more conservative growth predictions are supported by feedback received from developers which is suggesting depressed market conditions. One of our biggest development areas is down to single digit sales, build prices continue to rise and uncertainty with many builders and trades in the wake of the collapse of large building companies.

Adjusting prices – Melbourne Water bulk tariffs

We accept the ESC's proposal to maintain the current adjustment mechanism that allow prices to change in response to changes in Melbourne Water's bulk water charges. We note that we may choose not to pass the full impact of changes to costs through to customers if they result in higher customer prices.

We note that our final revenue requirement and prices will be based on latest available information and that the determination will adjust for:

- any changes due to feedback received in response to the draft decision
- forecast licence fees, environmental contribution and Melbourne Water bulk charges and for the latest inflation.

The updated Financial Model Template (Attachment C) reflects revised inputs due to:

- revenue requirement which reflects the draft decision and associated adjustments from the last period
- revised prices.

If you have any questions regarding our submission please contact Vicki Pinder, Manager Economic Regulation & Pricing on [REDACTED] or [REDACTED].

Yours sincerely,

[REDACTED]

Tracey Slatter

Managing Director

List of attachments:

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| Attachment A: | Outcomes Reporting Template |
| Attachment B: | 2023-28 Tariff Schedule |
| Attachment C: | BW 2023 Price Review Model - Draft Decision Response |