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Dear Angeline

Re: Consultation on the review of new customer contributions (NCCs) for PS28

Thank you for the opportunity to provide feedback on the Essential Services Commission (Commission) consultation in relation to NCCs for the 2028 water price review.

NCCs are an important component of our price submission, and it is important to get the balance right in terms of upfront recovery of costs from developers against those recovered from customers over time.

The impact of the Victorian Government's Housing Statement will differ between water corporations. For South East Water, the October 2024 Government announcements highlight that there is limited further greenfield development in our service area, where the focus will instead be on building denser homes and apartments in established suburbs ("infill") across Melbourne.

For the reasons set out in this submission, South East Water contends that:

- locational-based price signalling may remain appropriate for greenfield areas
- a single NCC may not be appropriate for infill areas
- flexibility is required in the regulatory regime to ensure water corporations can tailor NCCs to suit their unique circumstances
- a clear, transparent and flexible framework and model would assist water corporations in developing future NCCs.

We expand upon these points below, and have also responded to the consultation questions in Attachment A.

1. Locational-based price signalling remains most appropriate for greenfield areas

South East Water currently has two greenfield areas with standardised NCCs: Casey and Cardinia.

Excluding Pakenham West and Clyde South, there is limited greenfield land available for further housing development within the prevailing urban growth boundary.

Due to the long lead times for greenfield developments, developers in our region have informed us that they require a stable and transparent approach to pricing. As such, we believe our current methodology for calculating NCCs in these greenfield locations remains optimal, with a shift to a new model or new methodology providing little value.

South East Water also has an integrated NCC, which includes water, sewerage and recycled water for the Fishermans Bend development. This is an example of an infill development that has its own integrated NCC based on the uniqueness of the location and the available infrastructure assets.

2. A single NCC may not be appropriate for infill areas

South East Water will review its approach to setting NCCs for infill areas in preparation for the 2028-33 price submission ("PS28"). There are a range of matters that we will take into consideration when determining our NCCs for PS28. These include:

- **Impact of development on our network:** the ability of the existing network to cater for a single residential dwelling will differ from many multi-storey apartment complexes within a highly concentrated location. The Government announcements relating to the housing statements signal a greater number of high-rise residential apartment complexes along major public transport routes
- **Location-specific constraints in our network:** while there may be capacity available in our network to cater for a new multi-storey apartment building, there may not be if 10 such buildings are planned for a specific, densified area, such as in an activity centre near a railway station. A co-ordinated planning approach will be needed to increase water and sewerage main capacities. This will also impact our current planned renewals for old, deteriorated mains using "sliplining", which is our cost-effective process to reline the inside of existing mains, resulting in a reduction in the diameter and capacity of the sewer
- **Location-specific cost factors to augmenting or renewing our assets:** this may be ease of access to our assets, constraints around other utility's existing assets, and returning established streetscapes to their previous state, as well as geological differences that can drive significant cost variances. For example, some locations in our network are hilly and rocky, while others are low-lying and sandy. Additionally, we may consider the application of reticulation v shared assets in these areas to provide more equitable outcomes for developers
- **Promoting greater use of alternative water:** to reduce potable water demand, delay infrastructure augmentation, and for environmental reasons, we may wish to incentivise more new connections to utilise alternative water, particularly recycled water.

A different approach from a single flat-rate NCC in infill areas may very likely be required. There are several models and approaches we could consider for PS28, such as:

- specifying NCCs for connections that vary with the size and scale of a development. For example, it may vary within a defined range for water demand or sewerage flow, or by scale of the development (e.g., a charge for 1-9 dwellings, a different charge for 10-29 dwellings, or 30+ dwellings, etc.)
- specifying a flat rate per unit of water demand, water flow or sewage flow
- greater use of negotiated NCCs to reflect the costs specific to that connection

- a review of the current 'developer asset' funding arrangements, where a developer upgrades the size of an asset, but subsequent developers benefit from the upgrade.

There are pros and cons with each of these options. We will engage with our customers, community and stakeholders during the next two to three years to obtain their views on the best approach to address the unique challenges we are facing. We will also ensure our charges are fair and reasonable for new and existing customers.

3. Flexibility is required in the regulatory regime

We request that flexibility remains in the regulatory regime. While it can be useful for the Commission to be prescriptive in their requirements to calculate NCCs, this should not inhibit use of pricing options to address unique developments or circumstances.

With a likely focus on developments in and around activity centres and railway stations, and other infill sites, more work will be required to determine water and sewerage infrastructure needs. This may lead to greater complexity in pricing approaches to ensure ongoing fairness across our new and existing customer bases.

4. Clear, transparent and flexible framework and model needed

A clear, transparent and flexible framework is needed that can address the different challenges water corporations are facing from the housing statement. We request this is accompanied by a spreadsheet model that is updated to reflect current best practice, together with supporting instructional and explanatory documentation.

It would be beneficial if the updated spreadsheet model provides flexibility for water corporations to run different scenarios for a range of circumstances, as well as better enabling the calculation of NCCs for individual, negotiated connections.

We support the Commission's proposal to run workshops and training sessions for its new model. The workshops may result in further refinement to the supporting documentation. Overall, these will help to improve the quality of the retailers' models.

Should you have any queries in relation to this response, please contact Alen Allday, Regulatory Economist, at [REDACTED].

Regards



Elizabeth Carlile
Group Manager, Planning & Regulation
South East Water

ATTACHMENT A — RESPONSE TO COMMISSION QUESTIONS

1. What are your perspectives on the matters identified by the commission at the 2023 water price review (Ch 5). Are there other matters we should consider?

ESC concern relating to unjustified cost attribution

FTI Consulting was engaged by the Commission to review our NCCs for the purposes of PS23. While FTI made a range of findings, ultimately the Commission accepted our proposed charges.

The key issues that arose through the FTI Consulting process were:

- the use of sunk costs in modelling
- use of bottom-up versus top-down approaches to incremental cost
- complexity of calculating NCCs for infill locations where there are multiple cost drivers, notably growth (whether due to new or existing customers), renewals and compliance.

We would appreciate greater guidance from the Commission on its expectations for each of these issues in PS28.

ESC observed a preference for standard pricing by water corporations

South East Water intends to explore various NCC structures that reflect infrastructure servicing needs and costs in infill areas. Although standard pricing across large areas may be appropriate for some water corporations, this is less likely to be effective for the substantial infill developments expected in our service region over the coming price periods.

The National Water Initiative pricing principles makes clear that differential pricing should be considered only where there are benefits from doing so.¹ South East Water considers differential pricing beneficial for the broader customer base where costs vary between developments.

The extent to which developers respond to price signals from NCCs is not clear. It is likely that other factors, such as land availability, council requirements, or other policies will have a greater influence on development locations. Developers instead tend to incorporate charges from water corporations into the prices charged to house buyers. As such, there may not be clear benefits from using location-based pricing to drive developer investment decisions.

Standard pricing provides benefits through providing certainty to developers, who are able to quickly and easily estimate costs. This also provides administrative ease for water corporations, but only if costs are not substantially different across locations experiencing intensive development.

The use of negotiated NCCs may add complexity and time delays to the development approval process with water corporations. Also, negotiated NCCs may lead to additional developer queries if the charges are higher than the developer expects. On the flip side, it may increase fairness in the sharing of costs between developers and customers.

¹ Refer Department of Climate Change, Energy, the Environment and Water, [National Water Initiative pricing principles](#), 2004:

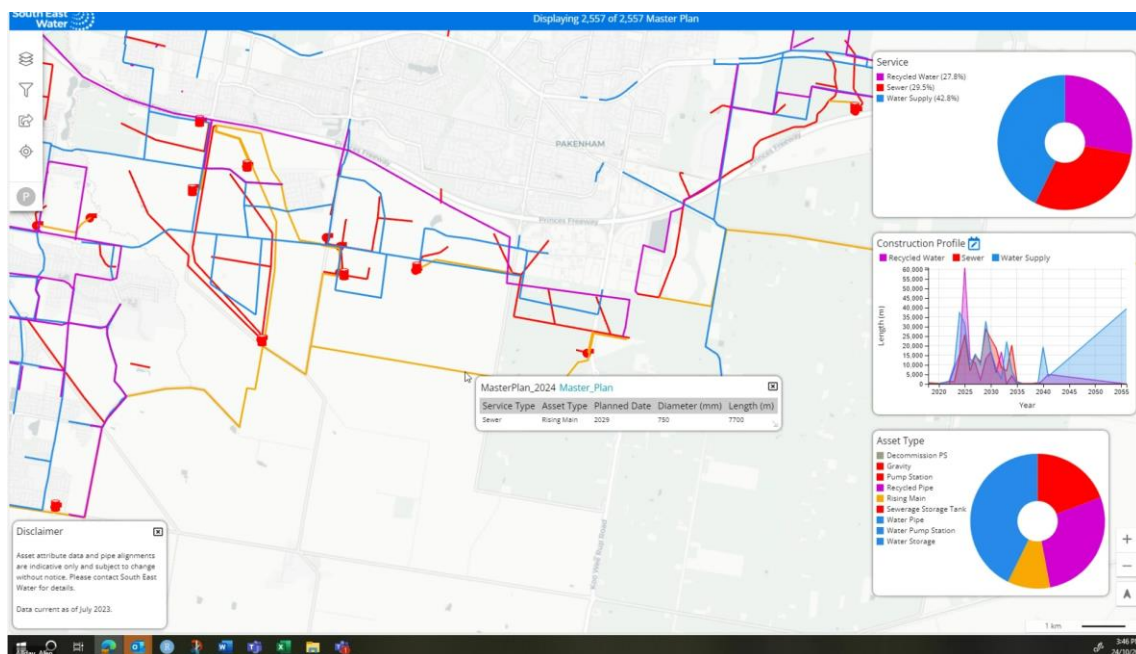
As set out in this submission, while we intend to continue to use standard pricing across different greenfield areas, we will further explore different NCC structures in infill areas for PS28.

Timing of development and development serving plans

Development servicing plans can assist developers to plan the timing and sequence of developments. This assists water businesses because out-of-sequence developments can be inefficient in terms of bringing forward capital investment needed at a future date where additional capacity is then under-utilised for some time, or if forecast volumes fail to materialise. Conversely, assets constructed out of sequence can bring forward the timing of other developments.

To assist developers, we provide a geospatial master plan on our website setting out the location of current and future assets, along with estimated year of construction, mains lengths, values, etc. A screenshot from our website is provided at Figure 1 below.

Figure 1 Screenshot from our Master Plan for Pakenham



Reference: [Master Plan](#)

2. What changes should the commission consider in terms of the guidance we provide water businesses on new customer contributions?

There are expected to be differences in the main types of developments across regional and metropolitan water retailer areas in future years in response to the Housing Statement. To the extent possible, we therefore request the Commission consider how the NCC framework can provide flexibility to cater for these different challenges facing water corporations, while also maintaining simplicity.

For example, South East Water expects about 70% of new dwellings to be in infill locations in our area in PS28, with only 30% being in greenfield locations. This is due to limited land available in greenfield locations in our region, with most development being infill. In contrast, it may be that new dwellings in regional locations are predominately going to be in greenfield locations.

Due to these major expected differences between the regional and metropolitan water retailers, different approaches to the structure of charges and calculations may be warranted. For example, a framework more suited to infill developments for metropolitan retailers could be implemented, and one that is more suited for greenfield developments.

Separately, we request the Commission makes clear its expectations in relation to documentation of water corporations for PS28. That is, articulation of the matters the Commission expects to be covered in written documentation to assist with developer queries. For example, in relation to cost allocation, we seek greater guidance from the Commission on its expectations in terms of:

- the use of sunk costs in modelling
- the use of bottom-up versus top-down approaches to incremental cost
- addressing the complexity of calculating NCCs for infill locations where there are multiple cost drivers, notably growth, renewals and compliance.

Other matters the Commission may seek to provide updated guidance on include:

- the negotiating framework, including any recommended enhancements or expectations on developers
- engagement expectations
- gifted assets, to assist water corporations and developers in driving consistent terminology across the sector; uplift understanding of how they impact the price submission cost model and ultimately the sharing of costs between developers and existing customers, as well as tax implications; and provide additional information and requirements around out-of-sequence developments.

3. How do you think the commission can support connection applicants and water businesses in their engagement on new customer contributions?

We support the Commission's proposal to conduct workshops and information sessions about NCCs for developers and industry groups (UDIA, etc.) as well as providing additional educational resources on its website.

By having better informed developers and industry groups, water retailers will be in a better position to explain how NCCs were calculated and how the charges are fair and reasonable. This may reduce the probability of costly and protracted disputes relating to these charges.

4. Are there other issues or information we should consider during our review, having regard to the commission's role in new customer contributions?

Please refer to our comments above.

5. What are your views on a change in terminology from our current use of 'new customer contributions' to an alternative such as 'developer charges'?

South East Water has a preference to retain NCCs. NCC is a well-established term used specifically within the water sector.