

Obj Ref: A6766497

Charles Millstead
Chief Executive Officer
Queensland Competition Authority
GPO Box 2257
Brisbane QLD 4001

12 August 2021

Dear Mr Millstead

Submission – South East Queensland Bulk Water Price Review 2023-26

Thank you for the opportunity to put forward a submission in relation to Seqwater Bulk Water Prices for 2023-26.

Unitywater welcomes the approach to provide transparency of Seqwater's plans to ensure bulk water is delivered in an efficient and low-cost way, whilst ensuring water security and water quality is not compromised.

Unitywater is of the view that it is appropriate for its customers to pay for expenditure where it can be clearly demonstrated that its customers will derive a benefit from that investment. Given changes to bulk water charges are required by legislation to be passed on directly to Unitywater customers, transparency of charges and benefit is important.

Bulk water is Unitywater's largest expense which in 2020-21 represented 55% of the median residential customer's water bill in the Sunshine Coast and Noosa region, and 51% in the Moreton Bay region respectively.

Since 2010-11, the bulk water component of the median Unitywater residential bill has increased from \$189 to \$428 in 2020-21, an increase of 126%. During this same period, Unitywater's component of the bill has increased from \$969 to \$1,074, an increase of 11%. Added to this, Unitywater's bills have been 'frozen' overall since 2015-16. Similarly, from 2011-12 to 2020-21, Unitywater's annual operating expenditure increased by \$118M, of which \$114M related to purchases of bulk water and \$4M in increases to Unitywater's other costs.

Given both price and cost increases, Unitywater requests the QCA to consider the following key matters when determining the bulk water price:

- a. The financial impact on end use customers and the necessity of expenditure in the context of end use customer's needs.
- b. The robustness and confidence of demand forecasts and its impact on the size and variability of the capital program.

- c. Capital program optimization and capacity of Seqwater to deliver the program efficiently.
- d. The need to pursue greater efficiencies in operating costs.
- e. The cumulative impact of the recovery of price path debt and drought tariffs on affordability for customers.

Unitywater notes that the drought tariff will be considered in a future submission and would like to highlight the criticality for stakeholder consultation due to the likely impact on customers, particularly given their expectation that water security was addressed through previous investments.

More specific detail on these items are contained below.

The financial impact on customers

Water and sewerage customers do not differentiate between Unitywater and Seqwater, therefore it is critical that consideration is given to the end use customer when setting bulk water prices.

In 2017 when a large increase in bulk water prices occurred, Unitywater saw its customer satisfaction metrics drop by 10%. As a result, Unitywater lost three years' worth of gains in customer sentiment. Customer sentiment is important in order to influence customer behaviour, particularly in relation to drought response and acceptance of future alternative water sources.

Central to Unitywater's strategy is to keep our prices affordable by reducing the total cost to serve our customers. To date, this has been achieved through a focus on continuous improvement and operational excellence resulting in the 'Unitywater' component of the median customer bill across both regions being frozen since 2015-16.

As noted above, the bulk water component of the median Unitywater residential bill has increased from \$189 in 2010-11 to \$428 in 2020-21, an increase of 126%. During this same period, Unitywater's component of the bill has increased from \$969 to \$1,074, an increase of 11%.

From a customer perspective, Unitywater questions the equity and transparency of charging water customers through the bulk water charge for items such as recreation management, flood mitigation and dam safety, which in many cases is investment brought about by either Seqwater or State Government for recreational activities in catchments and dams and urban planning decisions outside of the Unitywater catchment.

While such costs should be recovered from the community, the question is why should those costs be recovered through the bulk water charge? If so, we should be transparent on how much of the bulk water charge is for these purposes, i.e. recreational use, flood protection etc.

The robustness and confidence of demand forecasts and its impact on the size and variability of the capital program

Forecasting future demand for potable water is a fundamental building block of Seqwater's supply provision and thus pricing strategy. Seqwater's 2021 submission does not include a reference to the underpinning demand assumptions, instead referring to a document which will be published in 2022. Unitywater has not formally endorsed a demand target from Seqwater. Demand is assumed to comprise of population growth and consumption. Unitywater holds the view that population growth per medium level estimates from the Queensland Government Statistician's Office are reasonable and has endorsed this approach, however, without information about the consumption aspect of demand, Unitywater cannot comment further on specifics.

Seqwater has provided some detail on historical differences between estimated and actual demand (Figure 3.1, p. 39). It is assumed that this refers to both population growth and consumption. Unitywater recommends QCA consider not only the variance between historically forecast and actual demand by period, but also in aggregate: it appears that demand estimates were too high overall. Unitywater is concerned that setting the demand too high will feed into higher capital and operating cost projections, which will then be included in the price for end customers.

Capital Program Optimization and capacity to deliver efficiently

Seqwater's 2021 submission outlines the proposed capital expenditure for the next four years (Figure 5.1, p. 54 of Seqwater's Submission). Unitywater would like to raise the following:

- a. Unitywater requests consideration of reduction of non-revenue water investment including confirmation that the current and expected level of leakage does not warrant capital works to mitigate losses. This may involve confirmation of studies and level of confidence that Seqwater has in its present assessments.
- b. Unitywater understands that Seqwater is undertaking planning for rationalisation of its bulk water meters. Unitywater requests confirmation of the timing of completion this planning work and when the outcomes will be included in the capital and operational works programs.
- c. Outcomes reported from the previous period (2018-2021) show that Seqwater has not achieved the proposed capital expenditure, under spending by \$84M (18% of total approved capital expenditure). This expenditure was reflected in the price path over the previous period, therefore future charges should either be offset for the funding already provided or projects not delivered should not be included in future programs.



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- d. Further to the underspend on capital, the submission does not provide enough clarity as to what the underspend is comprised of:
 - i. Savings on projects.
 - ii. Deferment of projects (Unitywater notes that some deferred projects are included in the 2023–2026 proposal with an expectation that the original budget will need to be revised upwards).
 - iii. Overruns on projects.

Therefore, assessment of efficiency and capability to delivery is difficult to comment on.

- e. The proposed capital program is \$877M, approximately 180% of the 2018-2021 approved capital program.
- f. Unitywater recommends QCA examine the proposed capital program to determine the need for projects, timing of projects and robustness of the estimates within the referral period. Experiences of capital programs proposed by regulated water industries in other jurisdictions have shown that despite using investment decision gateway processes, there are multiple opportunities to optimise the profile of expenditure, achieve savings through procurement strategies, risks managed by those parties best to manage certain risks and efficient delivery.
- g. Unitywater recommends QCA evaluate the projects delivered and deferred from the 2018-2021 period to better understand what level of confidence the QCA has of Seqwater's ability to plan and deliver their significant capital program as compared to the previous period. Unitywater requests Seqwater's capacity to deliver be considered to ensure that forecast capital spend is not reflected in pricing and then not delivered in the period thereby resulting in customers paying for infrastructure that is not delivered as was the case in the prior period.

The need to pursue greater efficiencies in operating costs

Unitywater's view is that it is appropriate for 'end customers' to pay for expenditure where it can be clearly demonstrated that its customers will derive a benefit from that investment. For operating costs included in the Seqwater submission, Unitywater makes the following observations for consideration by QCA:

- a. Seqwater's submission proposes significant increases in operating costs beyond that previously approved by QCA. Unitywater is troubled by the number and the quantum of the proposed step increases. Furthermore, while an efficiency target exists, details of how that would be delivered are not outlined in the submission.
- b. There should be a focus on managing discretionary expenditure, innovating to reduce costs, risk-based and evidence-based asset management, and a focus on workforce productivity.
- c. Base year operating costs should not include drought related costs, as these costs should relate to the application of the drought tariff discussed in the referral notice.



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- i. After excluding one-off costs, one-off savings, capitalised costs and externally funded costs from 2019-20 actuals, the base falls to \$261.9M, which is \$8.2M higher than QCA's recommended forecast for 2019-20 of \$253.7M.
- h. The potential for over investment in response to new legislative requirements.
- i. A joint focus on decreasing 'end to end' water supply chain costs. For example: bulk water metering location, accuracy and system leakage are an opportunity.

Unitywater supports the following items included in the Seqwater submission:

- a. A review event mechanism for abnormal costs.
- b. Proactively managing drought and encourages Seqwater to continue to leverage the collective resources of SEQ Service Providers in terms of customer engagement.
- c. The long-term goal of net zero emissions by 2050, however this should not come through higher costs, but by looking for opportunities to both reduce energy consumption and costs and reduce emissions.

Price Path Debt impacts for customers

Unitywater notes that QCA has been requested to recommend prices for 1 July 2022 to 30 June 2026 to allow Seqwater sufficient revenue to recover the prudent and efficient costs of providing bulk water supply services and repay Price Path Debt by 2027-28. Price path debt is defined as the accumulated under-recovery arising from the bulk water price path and is estimated by Seqwater at \$2.4B as at 30 June 2022.

Unitywater expresses its concern over the time period in which this under-recovery would be recovered and that it would be further compounded by the addition of a drought levy. As reported in the National Performance Report 19-20: urban water utilities, South East Queensland (SEQ) has the highest typical water and sewerage bills amongst large retailers (those with more than 100,000 connections) across the east coast of Australia. A key driver of these bills is the high cost of bulk water relative to the cost of bulk water in southern States. Unitywater therefore suggests that QCA examine the economic impact on SEQ end use customers of a combined bulk water price reflecting recoverable price path debt, and a drought tariff and provide visibility in their determination on such impacts. Further, visibility of impacts should extend to the relative differences in the cost of bulk water in other jurisdictions across the country, as while input expenditure may be assessed as prudent and efficient the output price should also factor in settling the final price.

Drought tariffs

Seqwater have provided good opportunities over the past 12 months to bring retailer customers 'on the journey' to a potential drought tariff; however, Unitywater notes that no information has been provided as to the specifics of the tariff. Unitywater asks that QCA works with Seqwater and the State Government to ensure that 'end user' customers are informed early in the process about:



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- a. The potential size of the tariff.
- b. When the tariff would apply and its nature (volumetric or fixed charge).
- c. How long the tariff would apply (for example: whether it would operate for a defined period regardless of subsequent large increases in water storage levels).
- d. How the tariff would be communicated by all parties (noting that end customers do not readily distinguish between the retailer and the bulk water provider).
- e. How the tariff will be linked to the water security plan
- f. External oversight of tariff collection and allocation to drought initiatives

End customers are not likely to understand the necessity of a drought tariff, particularly given the bulk water price increases already experienced, which were to provide customers with significant drought-proofing.

Working together

Unitywater will continue to advocate for and support a model where Distributor Retailers and Seqwater work together to reduce overall customer bills. To do this, clear and transparent planning processes must exist between all South East Queensland retailers, and Seqwater.

Unitywater has appreciated the deeper levels of engagement with service providers since the last submission, including consultation on the drought tariff and water pricing principles, however, it is worrying that Seqwater have not had adequate time to consult with service providers around the submission for the 2023–2026 referral period. Unitywater recommends consideration also be given to the timing of announcements, including bulk price announcements, to better allow for planning and consultation.

Water Quality and Water Security

The availability of compliant water quality and water security are non-negotiables for Unitywater. The prudence and adequacy of demand forecasting and planned capital programs are major drivers of ensuring the adequacy of these non-negotiables. Unitywater has been consulted and is pleased to be working with Seqwater to improve these forecasts and modelling exercises.

Should you require any further information please contact Danny Power, Manager Corporate Performance on danny.power@unitywater.com or (07) 5431 8783.

Yours sincerely

George Theo
Chief Executive Officer