Urban Development Institute of Australia
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Mr Sebastian Roberts
General Manager, Network Regulation
Australian Energy Regulator
GPO Box 520
Melbourne VIC 3001

Via email: QLDelectricity2015@aer.gov.au

Dear Mr Roberts,

URBAN DEVELOPMENT INSTITUTE OF AUSTRALIA QUEENSLAND (CAIRNS BRANCH) SUBMISSION TO THE AER ON ERGON ENERGY'S REGLATORY PROPOSAL 2015-2020

The Urban Development Institute of Australia (the Institute) is a national not-for-profit organisation representing the property development industry. Established in 1971, the Queensland office is the largest of the state bodies. The Institute represents small, medium and large developers, construction companies, and consultants from a range of professions. The role of Institute is to assist our members to deliver thriving communities.

Queensland communities are entitled to a diverse range of land and housing choices that are affordable for Queenslanders at all income levels. With the right policy settings, a thriving and sustainable property development industry can create more jobs, more growth and more diverse and affordable housing for Queenslanders. Queensland's property development industry is the fourth largest contributor to Gross State Product (GSP) and jobs, therefore overall job creation and growth is dependent on this industry. Prior to the Global Financial Crisis the industry was the second largest contributor to GSP and jobs.

The Institute has twelve branches across Queensland. This strong structure informs our grass-roots knowledge of local areas. Six of our twelve branches operate in locations serviced by Ergon, including our Cairns Branch in Far North Queensland.

Power prices and the impact on local economies, industry and consumers

Far North Queensland is one of the key areas to assist with the Queensland State Governments plan for decentralization of the population[1]. One of the limiting factors to achieve this goal is the cost of living. Far North Queensland already endures higher prices for many commodities due to transport costs. Fuel costs are far higher than SEQ; insurance costs are out of control. Power costs, and in particular the large increases consumers have endured from increased network charges, has seen real cost increases despite householders and business making conscious changes to the way they use power. The costs have become a constraint to a range of businesses. This impacts on demand for labour in Far North Queensland and therefore demand for new property – the fourth largest contributor to the Queensland economy.

Northern Australia contains only 5% of Australia's population, but creates 55% of its Export GDP. Power is an integral part of daily life and is an economic facilitator to creating a wealthy country. In the Far North it is needed for cooling homes, businesses and produce - a cost not nearly as prevalent as in cooler parts of the state[2]. For the elderly, cooling homes is a necessity and failing to do so has been proven to lead to increased mortality rates.

[1] http://www.couriermail.com.au/news/queensland/campbell-newman-aims-to-move-public-servants-to-regions-under-decentralisation-plan/story-e6freoof-1226057770178

[2] https://www.ergon.com.au/__data/assets/pdf_file/0004/167755/Ergon-Energy-DM-Plan-2013_Final-Web.pdf (Figure 12 pp16)

Figure 6 below from Ergon's Demand Management Plan 2013/14 demonstrates how much growth is expected in the commercial and industrial sectors and therefore how much the Queensland economy stands to grow or be constrained by power costs[3]. While the UDIA (Qld) acknowledges that Ergon needs to behave commercially and pay a dividend to its shareholders (currently the State), we see considerable scope for reducing those dividends by addressing the issues outlined in this submission.

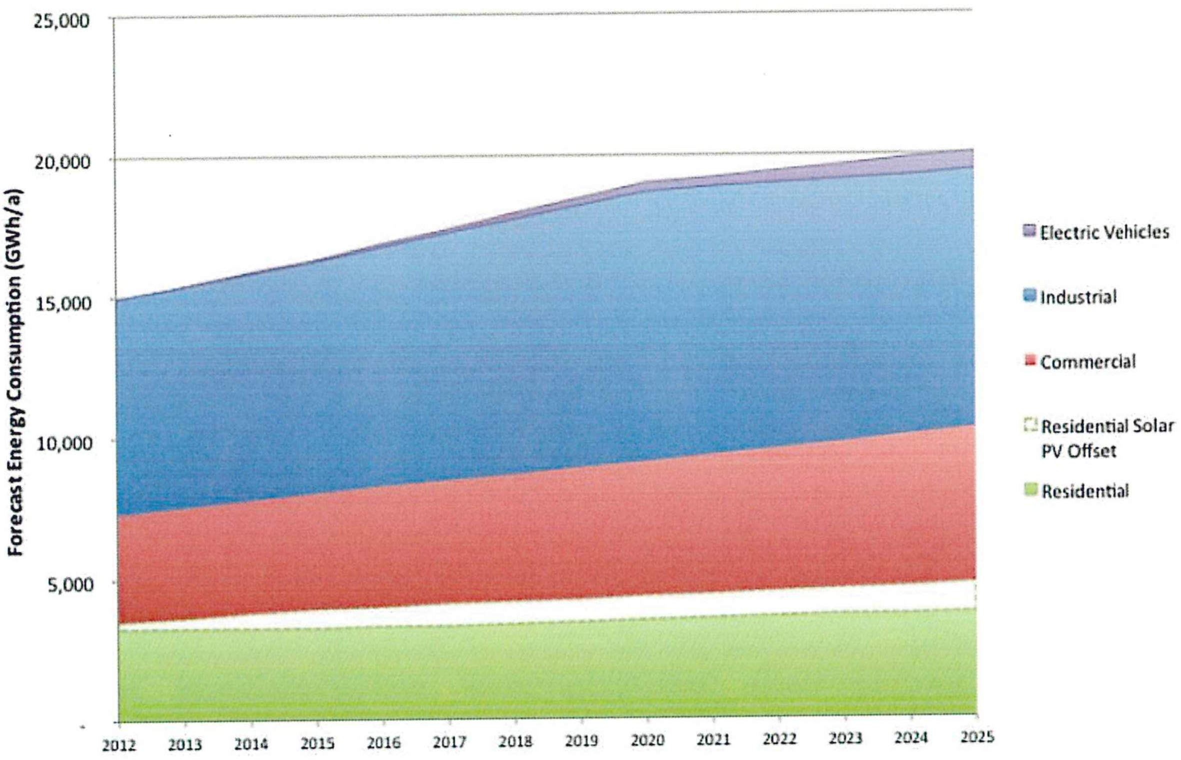

Figure 6: Ergon Energy system wide energy forecast – 2012 to 2025 (MMRF Model)

The AER review must look at the cost of power and its impact on the economy and consumers in a holistic manner. From a development industry perspective, the cost of the energy infrastructure developers are often required to fund as a condition and requirement of building a new development can significantly impact on the cost of new housing. Ergon's proposal is for stable network charges (Figure 1 in its submission) over the coming five years. This is not particularly comforting given the significant historic increases that have occurred. Ergon must seek to reduce its network charges and rectify the damage already done to Queensland's regional economy.

Specific Issues:

WACC (Weighted Average Cost of Capital)

Ergon's regulatory proposal suggests that they would reduce their WACC to 8.02%[4]. Whilst we recognise that the determination of an appropriate WACC is a complex issue, we would contest that given the nature of Ergon's business, market conditions and the current low interest environment (which is expected to continue into the foreseeable future) the WACC appears far too high to the outside observer. The AER must thoroughly interrogate the proposed WACC.

RAB (Regulatory Asset Base)

As a condition of property development, Institute members consistently fund, build and gift power assets to Ergon. It is not clear to the Institute whether such gifted assets form part of the RAB. It does not seem appropriate to us that an asset that was not paid for by Ergon can be treated in the same way as assets paid for by Ergon. Seeking to generate returns on gifted assets in the same way as returns are sought on assets paid for by Ergon would

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[3] https://www.ergon.com.au/__data/assets/pdf_file/0004/167755/Ergon-Energy-DM-Plan-2013_Final-Web.pdf

[4] https://www.aer.gov.au/sites/default/files/AER%20-%20Issues%20paper%20Qld%20electricity%20distribution%20regulatory%20proposals%20-%20December%202014_0.pdf (pp9)

appear to be a case of double dipping. The Institute urges the AER to investigate how Ergon treat gifted assets and the role they play in determining the RAB and network charges.

Last year around 35,000 new dwellings were commenced in Queensland. Delivering power to these dwellings cost the developer, and in-turn the consumer, around $6,500 per dwelling (on average), meaning the RAB was potentially increased by gifted assets in the order of $230m across Queensland (Ergon and Energex).

Other development industry matters

The development industry and Ergon have been working together over the past couple of years to ensure that Ergon improves the services it provides to the business community. For example, the creation of the Customer Initiated Capital Works (CICW) Developer Reference Group has led to some improvements in Ergon's practices and processes. There remains, however, a lot of work to do.

- Gold Plating of Infrastructure: The design and standard of service for infrastructure imposed by Ergon on developers continues to be excessive in many cases. For example, for residential subdivision designs, the network design is required to provide each home with 5kw capacity. Throughout the review process the issue of decreasing consumption leading to increasing unit charges is suggesting that, at least in the domestic situation, that 5kw capacity may be conservative. While the spare capacity created out of the 5kw load builds in some flexibility into the system; providing for future dual occupancy/ further subdivision; that should not be at the expense of the development industry and the buying public. This also begs the question of whether such spare capacity influences the RAB and WACC thereby increasing costs more than necessary.
- Contestability: Ergon has provided a significant level of contestability for the private delivery of new infrastructure such as in the development of new residential land subdivisions. The UDIA (Qld) would encourage that the process be extended, particularly to commercial and industrial subdivision. Further, the process of contestability should enable the development industry more certainty and control over the timing of delivery of services. This appears to 'fall down' once a subdivision has received Ergon Quality Assurance certificate. At this point, Ergon becomes responsible for energising the works, which can take up to 90 days under their rules. The industry expects Ergon will undertake its own quality assurance, however, once the works are accepted, we see no reason why private contractors cannot undertake the energising of subdivisions.
- Material costs: Currently private contractors engaged to install electrical subdivisional work must acquire materials from Ergon. This monopolistic behaviour is further exacerbated through bulk buying requirements – for instance if a job calls for 250m of low voltage cable that only comes in a 500m drum, the developer must buy the entire drum. Such practices push up the cost of housing.

In closing, please accept our thanks for this opportunity to provide feedback into the AER's review on Ergon Energy's 2015-20 Regulatory Proposal. We look forward to further discussion with yourself and your team and encourage you to contact Adam Gowlett should you have any questions about our submission.

Yours sincerely

Adam Gowlett

Branch President, UDIA (Qld) Cairns