Jemena Electricity Networks (Vic) Ltd

Fact Sheet

Our forecast operating and capital costs

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OUR FORECAST OPERATING AND CAPITAL COSTS

Jemena owns and manages the 6,000 km of distribution power lines that transport electricity to over 320,000 homes and businesses across North West Melbourne—from Mickleham to Footscray, and Gisborne South to Ivanhoe. We also own, maintain and read the meters that allow retailers to bill you for your electricity usage, and provide you with information to help you better manage this usage.

It's our job to make sure customers have electricity when they need it. To do this, we must design, operate and maintain our network so it can cope with extreme fluctuations in weather conditions and electricity demand and promptly restore power on the rare occasion when a severe storm or accident results in power outages. Increasingly, we must also manage the two-way flow of electricity between the network and those customers with solar photovoltaic units.

All of this involves expenditure of over $280m each year. Our customers told us that they want to know where their money goes—so this fact sheet explains exactly what our customers pay for.

ENSURING WE PROVIDE THE SERVICES OUR CUSTOMERS VALUE

Like many businesses, we need to make decisions on behalf of our customers. For example, we need to decide on what service levels we provide to meet our obligations, forecast the costs we will incur in providing our services, and work out how we price our services to recover these costs. Making these decisions inevitably involves trade-offs. For example, our customers consistently tell us they value a safe and reliable supply of electricity. However, they also tell us that rising energy prices have become a household or commercial concern, and they want us to put downward pressure on our costs and network prices. These priorities are potentially conflicting, as higher services levels often involve higher costs.

To help us develop our 2016 Plan, we engaged with a wide range of customer and stakeholder groups as well as the broad community. In particular, we sought customers' views on the key decisions we need to make for the next five years, to help us find the right balance between the long-term safety of our distribution network services, the service levels we provide to current and new customers, and the level and structure of the prices we charge.

Our proposal ensures we can continue to provide safe, reliable and responsive network and metering services that our customers value. It includes targeted investments to maintain our current service levels across the network—including in new growth areas, in established areas where assets are aging and in IT systems to support the services our customers told us they value.

At the same time, our proposal enables us to adapt our services and drive innovation in our changing energy market. For example, we will make it fast and easy for customers to connect solar photovoltaic units and other technologies to our network by utilising the benefits of our smart meters.

OUR OPERATING COSTS

Like most businesses, we incur two broad types of costs in providing our services—operating and capital costs.

Our operating costs include the costs of:

- Operating and maintaining our physical assets (such as poles, substations, meters and IT systems)
- Responding to outages or damage caused by storms and minimising the potential for trees and vegetation to damage our network
- Performing other functions like reading meters and providing billing information to retailers, and meeting legal and regulatory requirements.

These costs are generally recurrent, much like the costs of running a household (buying groceries, paying bills, general home maintenance) and we recover these costs on an annual basis.

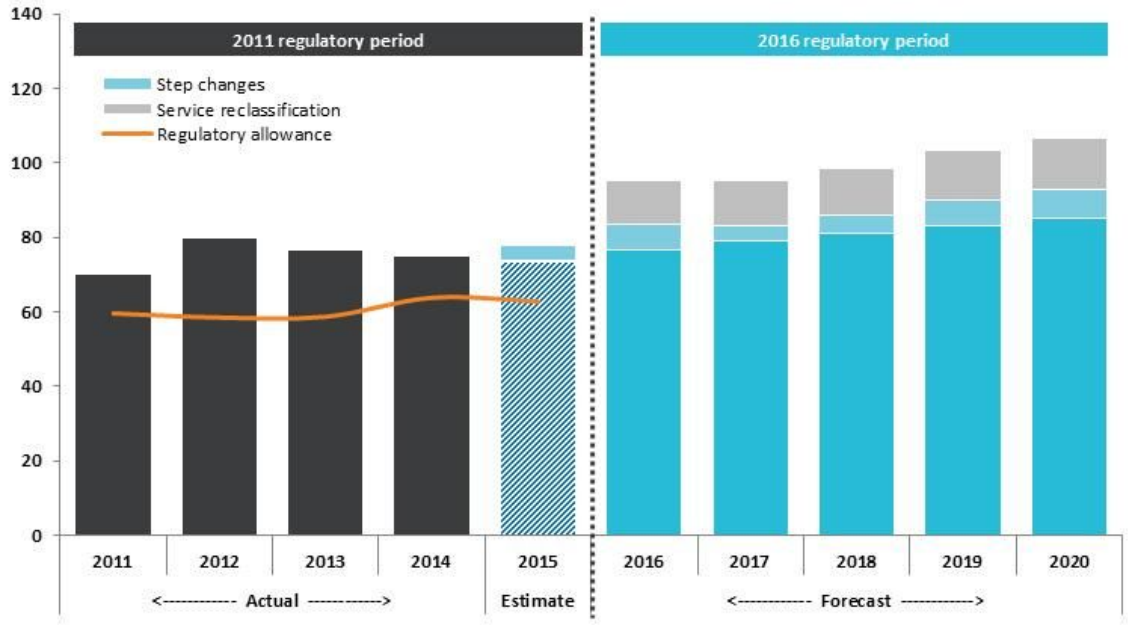
WE ARE FORECASTING AN INCREASE IN OUR OPERATING COSTS

We forecast our operating costs using the AER's preferred operating cost forecast method—'base, step, trend'.

We expect our operating costs for providing distribution services to increase to $499m over the 5-year period, an increase of 32% compared to the current period (excluding the impact of inflation). **(Figure 1)**

The reasons for this increase include the cost pressures of competing for skilled labour with other sectors in the economy and the costs involved in meeting new regulatory obligations (such as the new inspection and maintenance requirements for aging assets). This increase in our operating costs is partially offset by improvements in our efficiency (Box 1).

Figure 1: Comparison of actual and forecast operating expenditure for our distribution services over the 2011 and 2016 regulatory periods ($2015, $millions)



Box 1: Focusing on our operating cost efficiency

You told us that you want to see us continually striving to improve our efficiency so our services provide more value for money.

Currently, we are one of the lowest cost and most efficient electricity utilities in Australia. For example, a comparison of the total costs we incur to provide network services relative to other electricity utilities in Australia has found us to be among the most efficient of these businesses.

However, as markets change and knowledge and technologies improve, there are always opportunities for further improvements in efficiency. Improving our efficiency by being smarter and more innovative in how we plan and operate our network helps lower our prices over time.

That is why we are committed to pursuing more efficiency improvements—including improving our operating cost efficiency by over 4% over the next five years.

OUR CAPITAL COSTS

Our capital costs cover the investments we make to buy and build the physical assets required to deliver our services and meet our safety and service levels now and in the future.

Our capital works range from small standard projects (like installing a small length of wire and a meter to connect a new customer to the existing network) to large multi-million dollar projects (like installing new substations to ensure our network can accommodate growth in electricity usage or replacing aging poles and other assets to maintain the safety and reliability of our network).

These costs are generally funded through borrowings from debt and equity markets and paid back over the long term to ensure both current and future customers who benefit from the assets contribute to their costs (see *Fact Sheet – The costs of funding our investments).*

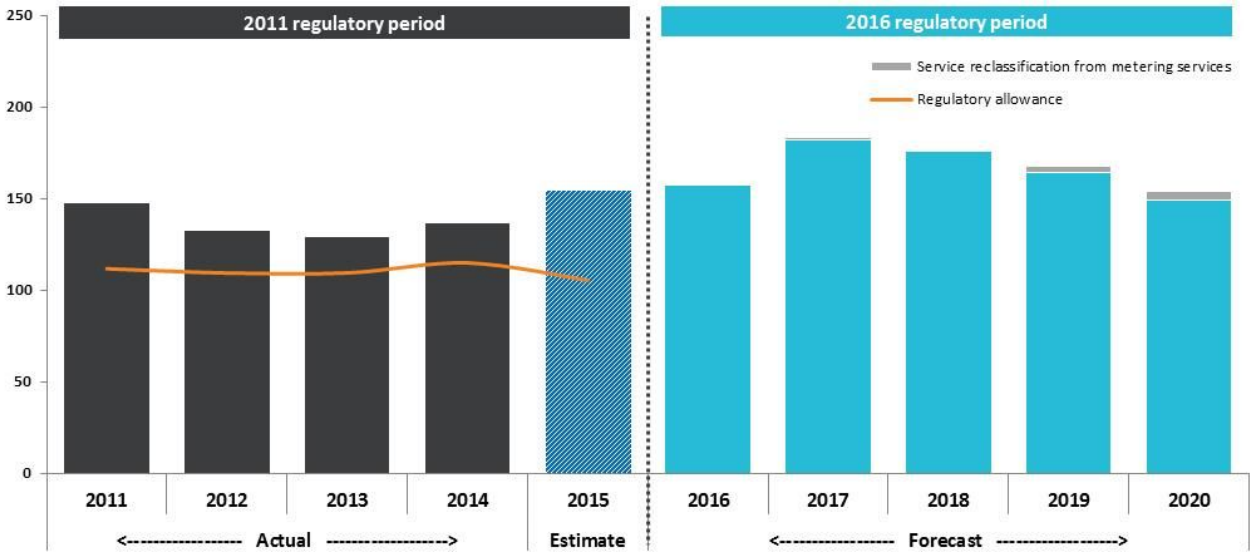
WE ARE FORECASTING AN INCREASE IN OUR CAPITAL COSTS

We expect our total capital costs for providing distribution services to increase to $841m over the next five-year period, an increase of 20% compared to the current period (excluding the impact of inflation). **(Figure 3)**

Some of the things that will influence our capital costs include:

- Addressing safety-related recommendations from the independent safety regulator, Energy Safe Victoria to replace the oldest and most failure-prone assets in our network and strengthening parts of the network exposed to higher bushfire risk (refer Box 2)
- Meeting the forecast increase in customer-initiated connections due to new housing developments and the redevelopment of some large industrial sites that are closing down
- Providing the incremental network capacity required to safely and reliably meet forecast growth in residential and business electricity demand within growth corridors of our network (refer Box 3)
- Replacing billing IT systems that have come to the end of their useful or economic life.

Figure 2: Comparison of actual and forecast capital expenditure for distribution services over the 2011 and 2016 regulatory periods ($2015, $millions)



We aim to ensure our capital costs are as prudent and efficient as they can be by planning smartly. This includes:

- Being long-term in our thinking, given the decisions we make today will affect our network charges and customer bills into the future
- Using our internationally-recognised governance process to ensure that our works program is planned, managed and delivered prudently and efficiently for the long-term benefit of our customers
- Testing our costs in the competitive market to ensure the investments are delivered in a value-for-money way.

Box 2: Expanding our inspection and maintenance programs to maintain safety and reliability

Some of our network assets were built 50 years ago or more. Just as an older car needs more frequent servicing, these ageing assets need greater inspection and maintenance.

To ensure we continue to meet safety requirements and provide the service levels you expect, our 2016 Plan will allow us to expand our inspection and maintenance programs in the aging parts of the network. This includes:

- Inspecting and testing the wires connecting houses to our street poles, in line with new safety and technical standards
- Inspecting and testing our poles and conducting a trial of a pole-top fire early detection system, to improve safety and maintain service reliability
- Testing high-voltage underground cables to improve reliability and allow us to identify the cables most in need of replacement
- Removing old street light wires that are not in use to improve safety
- Keeping our assets in service safely, and for as long as possible.

Box 3: Investing to meet forecast peak demand growth in the Craigieburn area

Our network must be built and maintained to meet our customers' total maximum demand for electricity from the network at any moment in time. Daily peaks in demand occur between 10am and 8pm on weekdays. The highest peaks occur on just a few days per year, during extremely hot weather when many households are using air conditioners. As these peaks increase, we must invest in the network to maintain the reliability of our services.

Over the 2016 regulatory period, we forecast growth in peak demand of 4.2% around Craigieburn—significantly higher than the forecast aggregate growth of 1.35% for the entire network. We forecast that this will result in some of our assets in the rapidly developing residential area to the north-west of Somerton in the Craigieburn, Roxburgh Park and Greenvale areas being under stress.

Our 2016 Plan proposes targeted investments—including a new zone substation to be built by November 2019—to manage this forecast growth and reduce the stress on our existing assets.