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Mr Adam Wilson
Chief Executive Officer
Essential Services Commission of South Australia
Level 1, 151 Pirie Street
ADELAIDE SA 5000
Via email: escosa@escosa.sa.gov.au

Dear Adam

RE: UDIA Submission on issues paper enquiry into regulatory arrangements for small-scale water, sewerage and energy services

Thank you for the opportunity to make submissions as part of this enquiry.

These submissions are made having regard to the scope of the Commission's power of enquiry under section 34 of the *Essential Services Commission Act* and the functions of the Commission under section 5 but having particular regard to the primary objective of the Commission in section 6 (a) of the act. Some of the matters addressed in these submissions may strictly extend beyond the scope of matters within the regulatory realm of the Commission and in certain instances might, if followed to their conclusion, result in legislative change. In making these submissions we nonetheless understand the limits of the Commissions jurisdiction but raise these matters for completeness and to provide a context.

About the UDIA

Established in 1971, the UDIA (SA) represents the interests of the urban development industry in South Australia in collaboration with all levels of government.

The UDIA represents around 200 businesses in South Australia and 4,000 on a national basis and is the peak body of the urban development industry.

As the fifth largest contributor to output in SA, the property development industry employs 56,000 people or 7% of the state's total workforce, and accounts for almost \$9 billion or 12% of Gross State Product.

Why small-scale water, sewerage and energy services are important to the development industry

Water, sewer and energy infrastructure and services are necessary for almost all end products of the endeavours of the development industry. This is generally the true for "products" such as residential development just as it is true for "products" in the nature of industrial development. While the importance of the service differs between the different end users and types of developments, all the three kinds of services are essential to the development industry.

Markets for land to develop and markets to sell the developed product

The market for the products of the development industry (residential land, industrial land, houses, offices, industrial estates etc.) is largely a free market in which competition is key. There is competition for land and buildings amongst developers as development sites just as there is competition in the market for the end product.

The market to buy land for development is affected by many things including the availability of service infrastructure and the cost of delivering or augmenting the necessary infrastructure. There are different costs for different sites affected by things such as distance, topography, the nature and extent of existing infrastructure etc. Greenfield sites and infill sites therefore have different infrastructure cost implications, just as two greenfield sites will potentially have different costs.

Developers need to bring products to market of appropriate type, quality, price and in a timely manner. The ability to compete is affected by the timeliness of the delivery of the product and price. Price is to some extent affected by delay (eg holding costs) but is also affected by the cost of inputs such as essential infrastructure and the related essential services.

With typically larger, monopoly type single provider environments, where infrastructure and services are delivered by a (typically) quasi government, single, monopoly service provider, there is little opportunity for the development industry to create any competitive advantage. The infrastructure is provided by the monopoly provider as and when (and if) it decides and the developer simply awaits the delivery of the infrastructure at a specified price. There is little opportunity in that environment for the development industry to find innovative solutions that might be cheaper, delivered faster or more effectively. To a large extent this circumstance applies across the industry meaning that there is no particular competitive advantage or disadvantage associated with the supply of infrastructure or services. However, it is an important element of potential improvement in the development industry and improvement in the price and potentially the product to the end consumer that is not able to be realised in a monopoly service environment.

Because of the desire to obtain a competitive advantage, and to potentially develop a further market in or associated with provision of services, developers have explored the use of the small-scale infrastructure schemes and service providers. Particularly in the case of sewerage infrastructure and services, they are almost always found to be more nimble, innovative and cheaper than the monopoly providers. The considerable existing competition in the market for development means that the benefits to the developer include the ability to -

- a. deploy the development more efficiently;
- b. bring the product to market in a timely manner; and
- c. offer a reduced price

all in order to compete in the crowded market for the various development products. Lower cost inputs are almost always passed on (or very largely passed on) in prices due to the inherent competition.

Appropriate regulatory environment to enable small scale service providers

A regulatory environment that enables new entrants to provide for dynamic, flexible and nimble service models is important to the development industry. Such an environment has considerable benefits to homebuyers and other beneficiaries of development products because it enables greater innovation and competition in the provision of infrastructure and services.

Consumer protection

Confidence in the regime is very important to the "consumers" of the products of the development industry. They too are the likely consumers of services for water, sewer and energy. Confidence is a key component in the activity of the development market. Confidence that basic consumer protections will be in place across all scales (large and small) of service delivery is therefore of considerable interest to the development industry. Likewise, consistency across the various scales is also important. For

example, it is critical to the success of small-scale providers that the protections to consumers are seen as no different to the protections afforded to those taking services from the large-scale providers.

Consumer confidence that an appropriate regime exists and in a manner that is understandable and consistent is therefore of considerable interest to the development industry. There does not appear to be any compelling reason to differentiate in the consumer protections that might apply to the different scales of service provision or across the different services. Indeed consistency in consumer protections across all scales and services will assist in general consumer understanding of rights and protections and also assist service providers and new entrants into the service industry to comprehend and adhere to those requirements.

The UDIA submits that a consistent suite of consumer protection measures, language and practices should be developed for all scales of services and across the different services offered.

Infrastructure and services both relevant

The development industry is involved in both the procurement and delivery of infrastructure for these essential services and in the provision of these services (to varying degrees). The submissions that follow are split into the matters relating to infrastructure and matters relating to services for water, sewerage and energy.

Water

Infrastructure

Water infrastructure is installed by developers as part of greenfield developments and on occasion it might be augmented for infill developments.

Within the metropolitan area, the delivery of water infrastructure by developers generally involves a negotiation with SA Water Corporation on the fees to be charged for connections or any augmentation of infrastructure. There is limited opportunity for alternative water supply arrangements and alternative infrastructure schemes within the metropolitan area because of the generally well-established reticulation system and limited benefits of sufficient scale in developing new mainline infrastructure for any particular project.

In greenfield areas beyond or towards the edge of the metropolitan area the situation is sometimes different. In those instances there is more often a need for larger extensions to water supply infrastructure or more substantial augmentation of such infrastructure. There is the potential for an alternative market for the delivery of the infrastructure by developers themselves. The difficulty though is that much of the headwork infrastructure to connect a new mainline to the existing main supply and deliver to a development site is subject to the connection fees and the attitude of the incumbent monopoly infrastructure provider. There is little opportunity for new infrastructure providers to enter that market and create any real competition because of the massive capital investment needed in most instances to link the main water sources to the location of development. The historical and geographical reality is that duplications of the main pipelines from the River Murray to the existing or developing settled areas is likely to be beyond the realm of any newcomer to the infrastructure market. This means that developers wishing to connect or augment existing infrastructure for a particular development have no other main infrastructure provider to negotiate with.

This is a fundamental problem with the present system. It is not cured by the recently amended third-party access provisions in the Water Industry Act which are still skewed in favour of the incumbent and do not provide any real balance to that considerable market power. This is not the place for a detailed submission on a proper third-party access regime. However, a proper third-party access regime would deliver more nimble infrastructure options at a lower cost in turn providing lower costs to consumers and opening up the market for infrastructure and water supply.

Water Supply services

Again, in the same way as infrastructure is almost inherently structurally linked to the existing system operated by the incumbent monopoly provider, it is very difficult for alternative service providers to provide a viable water supply service. The reality of the pricing by the incumbent of bulk water delivered to a particular point does not allow for real competition in the market for water supply services. This is

in part linked to the third-party access regime but is also a factor of the way in which the pricing of the delivery of water is set. There is almost certainly room for a competitor to obtain water rights at competitive rates on the open water market and provided that the delivery charges were set at a reasonable rate then the delivery of water to householders could be subject to more open competition. Again the complex issue of a proper regime for the pricing of delivery services is beyond scope of this enquiry or this submission. It is a matter that warrants further considerable investigation.

Sewerage

Infrastructure

Sewage infrastructure is particularly amenable to alternative service and supply arrangements. The nature of sewage infrastructure and the fact that it does not (unlike water) need to be linked to a fixed location of the source of supply means that the cost of delivering the infrastructure is within the realm of smaller operators without a government or quasi-government foundation (or a massive balance sheet). Sewerage infrastructure is also open to the various alternative engineering models ranging from CWMS schemes to vacuum sewer systems. At the treatment end of the system there is scope for variation, for instance between class A and class B levels of treatment. Linked to the quality of treated water is the further potential for the on sale of treated water or alternatively the disposal for no charge but with an associated benefit to another party (such as a golf course, Council reserves, irrigated horticulture etc).

This greater range in sewerage infrastructure means that it is a forum for new market entrants as a real alternative to the incumbent quasi-government service provider and to local government providers. Competition in the marketplace for the provision of infrastructure and sewerage services is therefore developing following the adoption of the water industry act. This is an exciting area for the development industry and for householders. It has the potential to deliver innovative solutions as well as lower prices.

An issue for the development industry is the lack of competitive neutrality with local government providers. Local government often has a competitive advantage over private commercial operators because of an existing network and existing plant which can be augmented. Local government often also has a market advantage of having a reputation of reliability (or at least the security that it will always be there as a provider of last resort) and a financial underpinning that the commercial operators need to overcome. While commercial entrant to the market for infrastructure and services may well have the same or superior reliability the perception in the community is not necessarily the same.

There are of course different attitudes to the delivery of infrastructure among different councils. Some charge connection fees at a flat rate along with flat rate augmentation fees. It is doubtful whether such flat rate connection or augmentation fees relate to the true cost of infrastructure. This again may well involve subsidisation by local government of the true cost or alternatively overcharging as the case may be. In cases where there is insufficient depth in market demand (say rural towns) for the infrastructure mean that local government providers will be the infrastructure provider of last resort and therefore this has little impact on competition in the marketplace. In some areas however local government is attempting to compete in the marketplace. For instance, in Mount Barker the council has more actively attempted to compete against private operators in order to win business for its sewer and CWMS schemes. It is important in those instances that competitive neutrality principles are adhered to so that new market entrants are not kept out of the market and new and innovative infrastructure solutions are not thereby impeded.

It is important that consumers have confidence in the quality of infrastructure. The regime of control over sewerage infrastructure is therefore of importance to the development industry for the reasons outlined above. Presently the regime involves the office of the technical regulator and the Department of Health both assessing proposals for sewerage infrastructure. The assessment even for small scale systems tends to be based heavily on the WASA code. The UDIA submits that the degree of reliance on this code for small-scale schemes has several adverse impacts. Firstly, the code is relatively outdated. Reliance on an outdated code means that new design and engineering solutions are impeded from adoption leading to greater cost and lower efficiency and in some instances reduced environmental performance in sewerage infrastructure. Secondly the code is skewed towards larger scale sewerage infrastructure schemes and is less suited to smaller scale systems. In effect this over engineering increases cost to providers and consumers.

The implementation of the regime and the resources of the office of the technical regulator and the Department of Health is limited. The office of the technical regulator and the Department of Health simply don't have the funding and resources to be able to develop a new code or method of assessment that encourages the adoption of new technology and innovative solutions. This is not a criticism of the people concerned but a factor of the limits to funding and resources to enable new approaches to be readily considered, and if appropriate adopted.

Electricity

Infrastructure

There are plainly limits imposed by the national scheme of regulation. Accepting those limits, maximal contestable infrastructure opportunities are important in allowing the development industry to procure electricity infrastructure at a competitive cost. There is scope within the market for alternative operators, but the opportunities have not to date been taken up to the extent that is apparently there.

Opportunities to enable newer technical solutions should be encouraged (such as where possible promoting a 'skinny grid' where there is a minimal shared grid connection for back up purposes but the majority of energy is supplied locally). This promotes an approach of innovation and cost reduction (within basic performance standards) which benefits consumers.

Confidence in the regulatory regime and technical standards is still critical.

Services

The market for services is reasonably mature and generally well-functioning.

Barriers to entry ought to be kept to a minimum to encourage new entrants and competition (eg licencing fee, bank guarantees etc).

Gas

Infrastructure

The provision of gas in the metropolitan area of Adelaide is mostly very cost effective to all new developments, as AGN is seeking to continue growth in their customer base. Small-scale off-grid systems are typically sought by developers in areas where the main natural gas system is absent or too far away. In these instances, developers may look to produce a localised reticulated LPG network to meet customer demand or distinguish themselves from competing developments.

A prime example is Mount Barker. We are aware that AGN has been seeking approval from the regulator to undertake an extension of its natural gas network to Mt Barker, but this has been knocked back. AGN may yet still pursue a business case to install such a network. In the absence of such a network, some developers are providing reticulated LPG networks to meet a clear customer demand (particularly relevant in the Hills).

The UDIA's view is that a natural gas network to Mt Barker is a fundamental piece of essential infrastructure that benefits the broad community and should have been approved by the regulator. It would have provided a more efficient solution, enabling the provision of natural gas to the whole of Mount Barker as opposed to the current situation where a select few in new developments have access to gas.

Summary

In summary, small-scale off-grid services provide a vital role in maintaining some cost competitiveness and efficiencies in the provision of essential services to developments in our largely monopolised regime in South Australia.

The UDIA also suggests that the standards, level of service and requirements of small-scale systems should not necessarily match those of the larger network, as the risks may not be as relevant.

Whilst the UDIA supports the need for clear up-front information and the protection of consumers, we would not like to see any impositions that add unnecessary costs to the provision of small-scale off-grid services as this may remove one of the few mechanisms available to developers to keep the costs of utilising monopolised service authorities in check.

Thank you again for the opportunity to comment and we would be happy to elaborate further on any of the above should you require.

Yours sincerely,

A handwritten signature in black ink, appearing to read "Pat Gerace".

Pat Gerace
Chief Executive Officer

30/9/2016