



Business SA Submission to ESCOSA on
SA Water Regulatory Proposal
2016-20
October 2015

Executive Summary

- SA Water’s focus on efficiencies to reduce prices for consumers is welcome but prices are still extremely high when viewed in a historical context and water usage rates are amongst the highest in Australia.
- SA Water’s total capital expenditure program across 2016-2020 is above its forecast depreciation and we are concerned about SA Water receiving value for money for specific projects.
- In relation to IT related capital expenditure, Business SA has some concerns that customer ‘willingness to pay’ research is being used to justify expenditure which may not otherwise occur within a benchmark commercial water utility business.
- Labour cost escalations above CPI are difficult to justify in light of South Australia’s current economic environment, particularly considering the State’s unemployment rate at 7.7 percent is the highest of all States and Territories.
- Business SA has previously adopted a position against any mandatory rollout of water smart meters and is encouraged that SA Water will follow this approach.
- SA Water looking to streamline service standards is in itself acceptable if efficiencies are passed back to consumers, however, Business SA cautions against any moves to reduce transparency in relation to service to business in both Adelaide and the regions.
- Business SA acknowledges an advised \$24.6 million upgrade to Bolivar’s wastewater treatment plant but it is unclear as to how this relates to the proposed Northern Adelaide Irrigation Scheme which SA Water’s regulatory proposal is silent on.
- There is not strong support from Business SA members for SA Water to spend additional money to improve its customer interfaces.

Why this matter is important to South Australian businesses

As South Australia's Chamber of Commerce and Industry, Business SA is the peak business membership organisation in the State. Our members are affected by this matter in the following ways:

- South Australian businesses, like other water consumers, have had to contend with significant water price rises over the past decade.*
- Operating the Adelaide Desalination Plant during the next drought is likely to be more expensive than existing water sources which places further pressure on SA Water to realise all possible efficiencies in its next regulatory proposal.*
- South Australia's volume and load based trade waste customers have been particularly hard hit by rising SA water charges in recent years with further substantial increases forecast.*
- Water, sewerage and trade waste charges are a significant cost for many of South Australia's largest employers, particularly food and beverage manufacturers which the State Government is relying on to drive economic growth.*

For further information, please contact Tyson Gherghetta at Business SA on (08) 8300 0088

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Key Policy Points

1. Recent price path for SA Water business customers

After taking into account the plateau in water usage and supply charges from 2012/13 to 2015/16, the tier one commercial water usage rate has still increased by 763 percent since 2004/5 and the tier two rate by 543 percent over the same period¹. The vast majority of these increases have occurred since 2008/9, predicated on the basis of SA Water having to fund the Adelaide Desalination Plant and to a lesser extent, the North South Interconnection System project.

Furthermore, comparable trade waste charges on average have increased by at least 200 percent over the same period without even factoring in new charges added since 2004/5, which makes historical comparisons problematic². However we do know that for some individual businesses, trade waste cost increases have been in excess of 1000 percent over the past decade and SA Water is still planning to levy 9.5 percent per annum increases from 2017/18 in a move towards cost reflectivity.

The CPI index for South Australia has only increased by 29.1 percent since 2004/5³. Business SA acknowledges that any business which tried to pass on cost increases of several hundred percent to consumers over the past decade would no longer be in business.

SA Water's 2016-20 regulatory proposal at least provides some long overdue price relief to business and other SA Water consumers with a 0.7 percent drop in water prices and a 9.0 percent drop in sewerage prices scheduled for 2016/17. We also welcome the average price rises for both water and sewerage being less than forecast CPI over the entire 2016-20 regulatory period. Notwithstanding, there needs to be some perspective around the relativity of water and sewerage price growth when viewed in a historical context. SA Water consumers, including businesses, are still paying substantially more for water than a decade ago even after adjusting for inflation. We acknowledge there are drivers outside SA Water's control such as the Government's decision to build the Adelaide Desalination Plant, however the reality for business is that the cost is considerably higher for essentially what is the same service. Consequently, ESCOSA should not view the overall acceptability or otherwise of any aspect of SA Water's 2016-20 regulatory proposal just through the lens of total forecast price rises being less than CPI as setting a satisfactory benchmark.

2. Rate of Return

Business SA previously made a submission to ESCOSA on setting SA Water's Rate of Return for the 2016-20 regulatory period. We did not support moving to a ten year trailing average for the cost of debt, however, we acknowledge that ESCOSA has since adopted this approach. The Australian Energy Regulator (AER) recently made final determinations on the regulatory proposals of electricity distribution networks in New South Wales and adopted a transitional approach to the ten year trailing average for the cost of debt. Likewise, if ESCOSA is to adopt the ten year trailing average approach, it should not adopt SA Water's proposal to transition immediately which captures the high interest cost period of the global financial crisis.

While Business SA does not take issue with SA Water's proposed rate of return beyond the cost of debt approach, we reiterate that SA Water's assets are not subject to independent valuation.

¹ These calculations do not allow for the discount which was previously provided for commercial water use in which case the effective price rise for commercial water use would be even higher. Sourced from South Australian Government Transparency and Regulatory Statements (2004/5 to 2012/13) and SA Water 2015/16 Water Prices

² This calculation does not allow for transitional discounts previously provided to trade waste customers. South Australian Government Transparency and Regulatory Statements (2004/5 to 2012/13) and SA Water 2015/16 Water Prices

³ Australian Bureau of Statistics, Consumer Price Index Australia, Tables 5 Index Numbers ; All groups CPI ; Adelaide June 2015

Considering the largest component of SA Water's revenues relates to returns and depreciation on its regulated asset base, it is important for there to be transparency regarding the valuation of SA Water's assets. In principle Business SA supports cost reflective pricing but only on the basis that there is an adequate level of disclosure regarding what are the key cost drivers.

3. Capital Expenditure Program

Business SA acknowledges that SA Water's capital expenditure program over 2016-20 totals \$1.27 billion (after allowing for a 5 percent efficiency dividend) which compares against forecast depreciation of \$1.12 billion. We recognise that SA Water needs to continue to replace depreciating assets but question whether all the forecast expenditure is necessary in the next regulatory period. Furthermore, what is the test for whether or not SA Water is getting acceptable value for money for each major capital investment? Business SA has been made aware of several instances where this may not be the case and suggest ESCOSA review comparative costs for privately delivered water related infrastructure in South Australia against projects which have been delivered by SA Water.

IT infrastructure is the largest single capital expenditure item for SA Water with a forecast spend of \$115 million over the next regulatory period. There is no argument that SA Water needs to continue investing in IT related infrastructure to improve the efficiency of its business and deliver adequate service to customers, including business. Notwithstanding, SA Waters' own customer survey conducted through Deloitte concluded that customers were generally happy with the level of service SA Water provides and were not willing to pay more for a better level of service or less for a lower level of service.⁴

Business SA accepts that, according to the same survey, the majority of SA Water's customers supported SA Water enhancing digital services to improve the customer experience but this feedback needs to be taken in the broader context of customers being generally satisfied with SA Water's level of service. As such, we would support IT spending on measures which improve the efficiency of SA Water's operations, such as better coordination of crews to attend and remediate leaks and bursts but request ESCOSA to carefully scrutinise IT spending which is not targeted at reducing SA Water's costs, which are ultimately paid for by customers, including businesses.

SA Water has already spent \$29.1 million on the Kangaroo Creek Dam safety project and is forecast to spend another \$54.8 million on this project in the next regulatory period. ESCOSA originally allowed SA Water to spend \$72.7 million in the 2013-16 regulatory period and now SA Water advises the dam upgrade is forecast to cost \$83.9 million, a further \$11.2 million. Business SA accepts that initial investigations identified a need for additional measures to reinforce dam structures against seismic events but considering the relatively high value of this project, it should be a particular focus for ESCOSA in terms of ensuring project completion occurs at the lowest possible cost.

4. Labour Costs

The State Government advised in its 2015/16 budget that it will continue to limit future wage growth to 2.5 percent per annum⁵ and SA Water has adopted its own future inflation forecast of 2.5 percent per annum. Notwithstanding, SA Water forecasts its labour price costs to be above inflation over the next regulatory period which will cost customers \$5.4 million.

SA Water has justified its decision to budget for above CPI labour costs based on analysis commissioned through BIS Shrapnel. Business SA raises the following concerns with that analysis:

⁴ Deloitte, SA Water Customer Engagement Program, Stage 3 Report, p22

⁵ South Australia Government, 2015/16 Budget Statement, p26

- BIS argues that 'the combination of high levels of utility engineering construction and overall construction in the state, particularly with the planned expansion of the Olympic Dam project from 2018/19, means increased competition for 'similarly' skilled labour and wage pressures in the South Australian utilities sector over the three years to 2019/20.⁶ However, it is far from clear that BHP is in fact planning to commence its Olympic Dam expansion project in 2018/19 and as such this should not be considered a factor in determining SA Water's future labour costs.
- Again, BIS argues that 'the \$2 billion Carrapateena copper project (scheduled to begin in 2016/17) should provide a boost' to the South Australian economy but this project is only at the pre-feasibility stage and should not be used to justify above CPI wage increases for SA Water employees.

Business SA reminds ESCOSA that the national minimum wage increase for 2015/16 was only 2.5 percent which has been used to set the wage increases of all employees on awards. Furthermore, South Australia's current unemployment rate is 7.7 percent, 1.5 percentage points above the national average of 6.2 percent⁷, and unfortunately further pressure is likely to come on the South Australian labour market once Holden ceases auto production in 2017. The latest economic growth data for South Australia shows that State final demand for the June quarter decreased 0.2% following a 0.7% rise in the March quarter⁸ which indicates the economy is barely growing, and we expect South Australia's final Gross State Product result for 2015 to be even softer considering exports were down 8.2% over 2014/15.⁹

Wage growth across SA Water's next regulatory proposal period should be no greater than 2.5 percent per annum. There have been a number of major job losses in South Australia over 2015 including at BHP, Santos, ASC, Arrium, Atlinta Energy and Holden to name just a few of the high profile announcements, not to mention the smaller businesses which typically 'fly under the radar'. Accordingly, the underlying drivers of labour price growth in South Australia are for the most part non-existent and there is definitely no validity to SA Water's claim of unavoidable above CPI labour cost increases over the next regulatory period.

5. Results of Business SA member survey on water costs

As part of our consultation process relating to this submission, Business SA surveyed members on various issues pertaining to SA Water costs, performance and infrastructure. While we acknowledge the survey only attracted 40 respondents, it still provided a reasonable indicator of the types of concerns businesses have in relation to water. Water is not typically the largest input cost for most businesses, but the rising impact of prices over the past decade has made a disproportionate impact on the competitiveness of local businesses with many pointing to difficulties in passing those costs back onto consumers. Export focused businesses also commented on the difficulty in competing in global markets where other countries were not exposed to the same rising costs. Businesses also experienced a lack of control over cost increases and commented on the cumulative burden rising water costs had when combined with other costs of doing business in South Australia.

More specifically, businesses provided the following feedback:

- When asked if there was an opportunity to use recycled water if it costs less than potable water, 42.4 percent said yes, 33.3 percent said no while 24.2 percent were unsure.

⁶ BIS Shrapnel, Attachment I - Labour Escalation, pii

⁷ ABS, Labour Force September 2015, Tables 1 and 7

⁸ ABS, Australian National Accounts June 2015, Main Features State Final Demand Chain Volume Measures

⁹ ABS, International Trade in Goods and Services (Australia) August 2015, Table 36 D - South Australia Merchandise Exports

- When asked if the existing level of reliability provided by SA Water was satisfactory, 75.8 percent said yes, 12.1 percent said no and 12.1 percent were unsure.
- When asked if the existing level of customer service provided by SA Water was satisfactory, 45.5 percent said yes, 18.2 percent said no and 36.4 percent were unsure.
- When asked whether SA Water should spend more money improving its customer interfaces, for example, billing or how they respond to bursts, 42.4 percent said yes, 30.3 percent said no and 27.3 percent were unsure.

Business SA also asked businesses questions related to SA Water infrastructure including the Adelaide De-salination Plant (ADP) and the proposed Northern Adelaide Irrigation Scheme (NAIS):

- When asked if they agreed to the ADP being used support irrigators during the next drought provided Adelaide's water security is assured, 21.9 percent agreed outright while another 65.6 percent agreed as long as costs are appropriately shared. Only 9.4 percent of businesses were against this proposal outright and 3.1 percent were unsure.
- When asked if they supported the proposed NAIS to provide additional recycled water for agriculture, 31.4 percent agreed outright and a further 56.3 percent agreed as long as costs are appropriately shared. Only 3.1 percent were outright opposed and another 6.3 percent unsure.

Business SA did ask survey questions in relation to trade waste but the relative number of customers is quite small and there is no statistical inference from these results despite to say that for such customers, trade waste costs remains a significant concern.

In other feedback, businesses argued that levying water charges based on property values was outdated and needed to be based on a user pays system and that furthermore, supply charges were not viewed as being cost reflective.

Businesses also had concern over the manner in which asset values supported the dividend to the State Government and suggested that SA Water needs to operate in a more commercial manner where it accepts it cannot just raise prices to customers in order to control costs.

6. SA Water Service Standards

SA Water is currently required to meet 66 specific service standards and is proposing to streamline this to a simplified list of 18 service standards. While Business SA acknowledges that the underlying service standards are not changing, we are concerned that a simplified reporting format may lessen the impact of SA Water not complying with any one particular service requirement if it is subsumed within a broader standard.

For example, under the existing standards for timeliness of water service restoration, there are six different standards for both metropolitan and regional areas. Under SA Water's proposal, there would only be one standard for metropolitan areas and one standard for regional areas. Therefore, even though SA Water would still be subject to the existing requirements of the current standards, a high performance for the majority of requirements may offset a low performance for the balance which would not be reflected in SA Water reporting a combined standard.

Water service standards exist for good reason and Business SA is not of the view that the average customer would even be aware, let alone be monitoring SA Water's performance against them, particularly business customers. However, the standards exist to ensure SA Water's performance can be monitored by ESCOSA and further that there is an appropriate level of transparency to the broader customer base and other stakeholders such as consumer representative organisations. SA Water should be held to account for its service standards performance and any moves to streamline service standards should be evidenced by reasons of operational efficiency, not based on SA Water's justification that a 'simplified list enables customers to understand and monitor our performance more easily, while still capturing a full picture of our service.'¹⁰

7. Northern Adelaide Irrigation Scheme (NAIS)

Business SA has been a strong proponent of the NAIS to open up an additional 3,600 hectares of irrigated agriculture on the Northern Adelaide Plains using surplus waste water from SA Water's Bolivar Plant. This NAIS will essentially double the effective capacity of the existing Virginia Pipeline Scheme which is set to transfer to SA Water's ownership in 2018.

It is worth noting that the Virginia Pipeline Scheme is already the largest recycled water scheme of its kind in Australia and the NAIS would assist South Australia to substantially build on its renewable and 'clean and green' credentials, particularly considering the reduced flows of treated waste water into Gulf St Vincent. Furthermore, the State and Federal Governments recently announced joint funding of the \$1.1 billion Northern Connector project which will significantly improve export freight links to Port Adelaide, enhancing the case to build the NAIS to leverage off this investment.

Business SA acknowledges there may be a significant investment required by SA Water, up to \$170 million, alongside investment by growers in on-farm infrastructure. However, SA Water is currently engaging the private sector, through an expressions of interest campaign, to deliver the NAIS and we would expect the final price tag to be significantly less. Moreover, the actual cost to SA Water would be substantially supported through both State and Federal Grants.

While the ultimate success or otherwise of the NAIS will hinge on its ability to deliver recycled water to growers at a cost which supports production, it is a significant economic infrastructure project for South Australia and Business SA is surprised that any potential cost implications are not flagged in SA Water's 2016-20 regulatory proposal.

We are also uncertain as to whether SA Water's proposed \$24.6 million investment in Bolivar to support growth in the metropolitan area could be avoided through an innovative design for the NAIS which may result in a new strategically located waste water treatment plant.

8. Interstate Water Price Comparisons

Business SA acknowledges there are various differences between the nature of water networks across different States and the drivers for per unit costs. We accept that for residential consumers, average bills for SA Water while on the higher side are not significantly above interstate comparisons. However, the primary analysis upon which SA Water has compared itself is compiled by the Bureau of Meteorology which does not compare the costs of water for business customers.

Each business uses water differently but where SA Water's rising costs have impacted most severely in recent years have been for high water using businesses and trade waste customers, both types of businesses which are typically large employers. Because businesses use water differently, it is more useful to look at interstate comparisons based on metrics such as per KL rates which better reflect

¹⁰ SA Water, 2016-20 Regulatory Business Proposal, p40

marginal costs. We make the following comparisons based on a sample of the major interstate water utilities using top tier rates of water consumption as a benchmark:

- SA Water > \$3.36/KL
- Sydney Water > \$2.28/KL
- Hunter Water (NSW) > range from \$1.67 to \$2.22/KL
- City West Water (Vic) > \$2.66/KL
- South East Water (Vic) > \$3.14/KL
- Yarra Valley Water (Vic) > \$2.82/KL
- Urban Utilities (Qld) > \$4.16/KL
- Water Corporation (WA) > \$2.01/KL for metro, from \$2.16 to \$7.11 for regional
- TasWater - \$0.97/KL

We acknowledge that water pricing structures vary, particularly supply charges, but South Australian businesses are still paying amongst the highest marginal prices for water in Australia and regardless of the cost drivers, this places South Australia at a disadvantage when trying to attract interstate businesses to establish here, let alone keeping existing businesses in operation.

Conclusion

Business SA is encouraged by the direction SA Water's prices are heading and we support SA Water's recent efforts to restructure operations to find efficiencies which can be passed back to consumers. However, we cannot forget that businesses, like other SA Water consumers, have faced significant price rises over the past decade and ESCOSA and SA Water must examine all possible options to realise further efficiencies to ensure that the high prices of recent years are not locked into future price periods.

SA Water's 2016-20 capital expenditure is above its level of depreciation and we have concern over the value for money received for major projects. We are also cautious about IT expenditure being entirely based on customer 'willingness to pay' research, which does have some conflicting results and does not reflect the general willingness of business to pay for improved customer interfaces.

SA Water should be able to keep its labour costs to a maximum of CPI growth in the current high unemployment environment and we question some of the evidence used to justify above CPI increases.

Business SA supports SA Water having scope to realise efficiencies through streamlined services standards but not at the expense of reduced transparency, particularly for the regions which have high economic importance for South Australia.

The Northern Adelaide Irrigation Scheme (NAIS) presents a significant opportunity for horticultural expansion on the Lower Adelaide Plains and should be a higher priority for SA Water to facilitate. Furthermore, any additional spending on the Bolivar wastewater treatment plant should dovetail with requirements for the NAIS to ensure the optimum spend to facilitate both growth in Bolivar's wastewater treatment capacity for metropolitan expansion and the NAIS.

Additional information

Please see links below to previous Business SA submissions relating to SA Water:

http://business-sa.com/assets/submissions/140909_Business%20SA_FINAL_ESCOSA%20Water%20Price%20Reform%20Options%20submission.pdf

http://business-sa.com/assets/policy%20documents/150123_Submission%20re%20SA%20Water%20Rate%20of%20Return%2016-20%20Draft%20Report.pdf