

22 November 2013

Overview of the Commission's Pricing Inquiry
Essential Services Commission of South Australia
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ADELAIDE SA 5001

Email: escosa@escosa.sa.gov.au

To Nathan Petrus

RE: Inquiry into the reform of SA Water's drinking water and sewerage prices

Thank you for providing the Property Council of Australia (SA Division) with an opportunity to submit our views on the issues papers released by the Essential Services Commission of South Australia (ESCOSA) in relation to the *Inquiry into the reform of SA Water's drinking water and sewerage prices* (the Inquiry).

Given the absence of detailed cost-benefit analysis and sensitivity analysis, our support for some of the options outlined in the papers has been somewhat constrained. We look forward to ESCOSA modeling the impact of some of the proposed changes and providing justification and evidence for any changes to water and sewerage charges ESCOSA may wish to pursue.

Furthermore, some of the options put forward are of serious concern to us, namely the mandatory rollout of smart water meters, mandating the retrospective fit of individual meters to relevant properties and requiring landlords to fit water saving devices to their properties before passing on the cost of water and sewerage services. We believe that the costs of these options is likely to outweigh the benefits and that it should be left up to building owners to manage these decisions as best as they see fit.

We look forward to seeing and providing comment on the next stage of the Inquiry.

Yours sincerely,



Richard Angove
Executive Director
Property Council of Australia (SA Division)

About the Property Council

The Property Council represents the property investment and development sector in South Australia covering all asset classes including commercial office, retail, industrial, residential and retirement.

Our members include every major property investor and developer in the state.

Members are engaged in the entire property investment universe, which includes all:

- dimensions of property activity (financing, funds management, development, ownership, asset management, transaction and leasing);
- major property types (offices, shopping centres, residential development, industrial, tourism, leisure, aged care, retirement and infrastructure);
- major regions of Australia and international markets; and
- the four quadrants of investment – public, private, equity and debt.

Some key statistics:

- the property sector represents 11.5 per cent of the state's workforce (the largest private sector employer in the state);
- the property sector contributes 10 per cent of the Gross State Product (the largest contributor in South Australia);
- the property sector pays about 40 per cent of the State's Own Tax Revenue. This equates to about \$2.4 billion in property specific taxes paid annually to State and Local Government in South Australia; this is expected to grow to more than \$3 billion by 2015/2016.
- the value of investment grade stock under management in South Australia is about \$35 billion;
- more than half a million South Australians collectively own major segments of the state's most valuable commercial property assets through their superannuation funds;
- the market value of foreign assets owned by Australians is \$50 billion;
- total construction spending across South Australia in FY13 and FY14 is forecast to be about \$20.7 billion; comprising \$7.1 billion in residential construction, \$4.2 billion in commercial construction and \$9.4 billion in infrastructure¹; and
- \$61 million flows in to the property sector from super funds in an average week.

¹ Construction Forecasting Council [<http://www.cfc.acif.com.au/>] January 2013

Property Council of Australia (SA Division)

Comments

Water pricing – Issues Paper No. 2

State wide pricing

*Should prices for drinking water services be the same across the state, irrespective of the cost of delivery?
Or should prices reflect the effects of local conditions, costs or other circumstances?*

In theory, a price based on the cost of delivering a service to a particular area is an efficient, effective and equitable mechanism for sending the appropriate price signals and for rationale consumers to adjust their consumption patterns accordingly. In principle, the Property Council of Australia (SA Division) supports a move to a statewide pricing model that better reflects actual costs.

However, the absence of detailed scenario testing and information on the real impact on consumers makes it prohibitive for the Property Council to support Option 2 in full. We believe that ESCOSA should model the different combinations of pricing options that better reflect actual costs and analyse the impact of these pricing options on consumers.

Option 1: Retain the current statewide pricing arrangements.

Option 2: Set region-based drinking water prices.

Alternative: The Property Council supports further detailed scenario analysis of different combinations of pricing options, for instance completely cost reflective without and with subsidies, including, cost-benefit analysis for each scenario and analysis of changes in consumers elasticity of demand for water in response to the options.

Fixed and variable prices

Should prices be determined on the basis of the long run marginal cost (LRMC) of supply (that is, the cost over several decades)? If so, what factors should be considered in determining the LRMC of water?

Should prices reflect any short-run effects on costs (that is, the short run marginal cost (SRMC) of water)?

In particular, should prices reflect the scarcity of water during periods of drought or other circumstances and how will this impact water restriction arrangements?

Should the current three-tier inclining block tariffs be retained? Why?

Economic theory suggests that pricing at the long run marginal cost (LRMC) results in the price of water being equal to the next lowest cost source of additional supply.

Pricing at the LRMC delivers an efficient market outcome. In principle, the Property Council supports a move towards pricing which improves alignment with the LRMC.

However, pricing at the LRMC is difficult to achieve in practice. A LRMC pricing model will only be as accurate as the parameters set and the robustness of the data used to forecast the price. Therefore, careful consideration should be given to the associated costs employed in the model and the chosen parameters.

The Property Council suggests it would be beneficial for ESCOSA to look at national and international LRMC pricing policy frameworks, and if proven feasible and practical, develop a best practice model based on the experience of other regulators.

During times of extended scarcity, LRMC pricing is unlikely to be flexible enough to ration the demand for water. The desired impact on consumer behaviour could be achieved by pricing adjustments in response to movements in the short run marginal cost (SRMC) or through other mechanisms like water restrictions.

There may also be a case for adjusting the price of water to take into account short-run impacts on costs to reflect the scarcity of water and/or the cost of externalities, for example pollution. Failure to fully take into consideration the full economic costs of the production and supply of water could lead to unnecessary subsidisation, excess consumption and under-investment in infrastructure.

However, in the absence of a defined framework and scenario testing it is unclear whether pricing in SRMC adjustments for externalities and/or as an alternative to restrictions would appropriately impact consumer behaviour.

Option 1: Retain the current inclining block tariff approach to water usage pricing.

Option 2: Move to a long-run marginal cost of supply for water consumption.

Option 3: Set prices to reflect the scarcity of water or other significant short-term influences.

Alternative: The Property Council supports detailed scenario testing of moving to a pricing policy that better reflects the LRMC, including a cost-benefit analysis and analysis of the impacts on consumers. We also support further investigation into developing a justification for adopting price changes to reflect changes in the SRMC in response to externalities.

Furthermore, we support any investigation into whether price adjustments based on movement of the SRMC or by imposing restrictions is the most effective mechanism for changing consumer behaviour during extended periods of scarcity.

Fixed charges

Should a supply charge be based on the number and size of meters?

Should commercial supply charges change from a property value basis to some other basis?

A supply charge calculated on property value may not accurately reflect the amount of water being used on a particular property. For instance, consider two identical three bedroom houses in Unley. One house could have a family of four living in it and the other an elderly couple. A family of four is likely to be placing more demand on the water and sewage services relative to an elderly couple, yet they will pay the same supply charge.

However, a supply charge based on installed meter sizes is more likely to reflect the actual demand for water and sewerage products of a property relative to a supply charge based on property value.

ESCOSA should consider investigating the feasibility of altering the supply charge to better reflect the demand for water and sewerage to a property for not only commercial customers but also for residential customers. For example, the supply charge could be based on the number of people living at a premises.

Option 1: Retain the current supply-charge pricing arrangements.

Option 2: Supply charges based on the number and size of meters.

Alternative: ESCOSA should consider investigating the feasibility of altering the supply charge to better reflect the demand for water and sewerage to a property for both commercial and residential customers.

Vacant properties (rating on abuttal)

Should customers who do not connect to the network incur a supply charge?

If a customer is not connected to the network then they should not be charged for 'future potential access'. This position is in line with the 'user pays principle'. Furthermore, there is no evidence to suggest that the benefit of the potential future connection is accurately reflected in the land price. Rating on abuttal adds to holding costs and can contribute to inefficient investment decisions. In the absence of a strong economic rationale for its retention the Property Council supports the removal of ratings on abuttal.

Option 1: Retain the current arrangements.

Option 2: Only charge customers who directly connect to the drinking network or avail themselves of SA Water's services.

Alternative: Unless there is a strong case for the economic legitimacy of retaining rating on abuttal, the Property Council supports Option 2.

Subsidised customers

Should the price of water be the same for all types of customers, or should different classes of customers pay on a different basis regardless of costs?

Option 1: Retain the current arrangements

Option 2: Move to more cost-reflective pricing by customer types, with direct subsidy payments where appropriate

Note: See alternative option under the heading *State wide pricing* at page 3.

Water product quality

Should pricing be based on the variability in product quality or reliability?

Prices should be based on not only the cost of delivering a service but also on the quality of the product. In principle, the Property Council is supportive of a move to a statewide pricing model which not only factors in the cost of delivery but also the quality of the water provided.

We support further detailed scenario testing of different combinations of pricing options to reflect the quality of the product.

Option 1: Retain the current arrangements.

Option 2: Move to pricing that differentiates service quality.

Alternative: Include scenario testing of different combinations of pricing options to reflect the quality of the product in line with the alternative option proposed at State wide pricing (page 3 refers).

Sewerage, Trade Waste and Property-Based Charging – Issues Paper No. 3

Possible approaches and opportunities for change

Residential and commercial

As discussed at *Fixed charges* (page X refers) a supply charge for sewerage services calculated on property value (known as the rates in dollar figure) may not accurately reflect the amount of water being used on a property or the ability for that consumer to pay. A charge based on a measure that better reflects the actual usage of the sewerage services of a property relative to a supply charge based on property value will help to promote economic efficiency.

However, in the absence of detailed scenario testing of the proposed pricing reform we are unable to support any of the proposed options in full.

Option 1: Retain the current property-value based arrangements (status quo).

Option 2: Change according to an estimated amount of sewerage discharged into the network (consumption-based change).

Option 3: Price according to a fixed charge (flat rate).

Option 4: A combination of consumption-based and fixed charging.

Option 5: Price according to some other method.

Alternative: ESCOSA should further investigate the feasibility of implementing pricing reform that better reflects the actual cost and use of the sewerage service, including scenario testing and analysis of the cost and benefits to consumers of Option 2, 3 and 4.

Trade waste

What are the benefits and shortcomings of the way SA Water currently charges for trade waste services? Are there better methods? If so, what are they and what is an appropriate timeframe to allow for transitioning to a new trade waste pricing arrangement?

In principle, the Property Council of Australia (SA Division) supports a move to a charging model for trade waste that better reflects actual costs and demand for the service.

However, the absence of detailed scenario testing and information on the real impact of alternative charging regimes on consumers makes it prohibitive for the Property Council to support any of the Options 1 through to 5 in full.

Option 1: Retain the current property-value based arrangements (status quo).

Option 2: Change according to an estimated amount of sewerage discharged into the network (consumption-based charge).

Option 3: Price according to a fixed charge (flat rate).

Option 4: A combination of consumption-based and fixed charging.

Option 5: Price according to some other method.

Alternative: ESCOSA should further investigate the feasibility of implementing different sewerage pricing approaches (Option 2, 3, and 4) that better reflect the demand of the service including, scenario testing and analysis of the costs and benefits to consumers.

Non-connected properties (rating on abuttal)

What are the benefits and shortcomings of the way SA Water currently charges non-connected properties for sewerage services? Are there any better methods?

For the reasons that are outlined under the heading *Vacant properties (rating on abuttal)* (page 5 refers) the Property Council supports the removal of rating on abuttal.

Option 1: Do not charge customers unless they actually connect to the sewerage network

Option 2: Decrease the proportion that rating on abuttal customers pay compared with directly connected sewerage customers (currently this is set at 100%)

Alternative: In the absence of a strong economic rationale for its retention the Property Council supports the removal of ratings on abuttal.

Water Planning and Management Costs – Issues Paper No. 4

The Property Council recommends ESCOSA considers the *National Water Planning Report Card 2011* for South Australia².

² http://www.nwc.gov.au/data/assets/pdf_file/0006/19842/11213_NWC_Planning_Report_SA_web.pdf

Metering – Issues Paper No.5

Are the current shared water metering and shared billing arrangements satisfactory? If not, why?

Should individual metering be mandatory for new build properties even if it is shown to be more expensive than the status quo?

The Property Council believes that any investigation into mandatory metering for new build properties should be considered in the context of current building costs. In the absence of a cost-benefit analysis we are unable to support Option 3.

Should individual metering be retrofitted to existing properties? If yes, should it be mandated or optional?

Would customers be willing to pay a fee for the provision of an individual meter to an existing property?

The Property Council is strongly opposed to mandating the installation of individual meters for all properties. There is no evidence to suggest that the benefits outweigh the costs. If a property owner believes there is value in retrospectively fitting an individual meter then they can currently do that.

The Property Council is strongly opposed to mandating the installation of individual meters for all properties in South Australia. There is no evidence to suggest that the cost associated with installing and purchasing a meter outweighs the potential benefit. Residential and commercial property owners should be left to weigh up the cost and benefits and make their own informed decision about whether an individual meter is or is not appropriate for their individual situation.

Option 1: Leave the current metering system in place (status quo).

The Property Council supports:

Option 4: Optional roll out of individual metering.

The Property Council does not support:

Option 2: Mandate the installation of individual meters for all properties.

Option 3: Mandate the installation of individual meters for new builds only.

Is there a case for mandating smart meters for all properties in SA? If so, what is the best option for rollout? (e.g. phased, immediate or end-of-life basis)

Are there any reasons not to install smart water meters in South Australia?

The Property Council is strongly opposed to mandating smart meters for all properties in South Australia. There is no evidence to suggest that the cost of a smart meter outweighs its potential benefit. We believe that market forces should be left to determine the demand for smart water meters.

That is, market participants, residential and commercial customers, should be left to weigh up the cost and benefits, and make their own informed decision about whether a smart meter is or is not appropriate for their individual situation.

In the absence of a strong case for market failure, which there is not, we are strongly opposed to any mandatory rollout, whether it is phased, immediate and retrospective or end-of-life.

Furthermore, smart meter for water usage technology is likely to have to come a long way before it is economically feasible for entities to pay for the installation of such meters. In addition, there is no evidence to suggest that smart meters for water are an effective tool in changing consumer usage patterns and is more effective relative to other mechanisms such as water restrictions. Water restrictions and reeducation programs were effectively implemented in previous years when water shortages were experienced.

Victorian residential customers reportedly pay around an extra \$80 annually for a smart electricity meter. Would South Australian customers be willing to pay a similar amount for a smart water meter?

As discussed above, in the absence of a market failure, which we believe there is not, if a customer is willing to pay an additional amount for a smart meter then they should be able to decide whether the benefits outweigh the costs and choose or not choose to install one. It should be left up to the market participants to decide whether a smart meter is an appropriate investment and the decisions should not be forced upon them.

What functionality should a smart water meter have, and how would customers and water suppliers make use of the functionality that a smart meter could provide?

The Property Council believes that this question is best answered by the companies developing and investing in the smart water meter technology. It is incumbent upon those companies to economically produce a product that consumers will be willing to purchase and install.

Are there other tools or management options – or any alternatives – that should be considered and implemented in lieu of smart metering, or in conjunction with smart meters?

A smart water meter may assist in providing information to a consumer about their water usage patterns however, there is no evidence to suggest that this additional information will then result in a change in their behaviour.

The Property Council **supports**

Option 1: Leave the current metering system in place (status quo) and

Option 4: Optional roll out of individual metering but only on a user pays basis, with those receiving the new meter paying for its installation

The Property Council **does not support**

Option 2: Mandate the installation of individual smart meters for all properties

Option 3: Mandate the installation of individual meters for new builds only

Options for assessment

The Property Council **supports**

Option 1: Continue to install accumulation meters (status quo)

The Property Council **strongly does not support**

Option 2: Replace all existing accumulation meters with smart water meters

Option 3: Replace all existing accumulation meters and also install smart water meters for unmetered dwellings

Option 4: Roll out smart water meters on a new and replacement basis only

Billing Consumers Rather Than Landowners – Issues Paper No. 6

Are the current arrangements where landowners, rather than tenants, are liable for water and sewerage charges satisfactory? If not, why?

Tenants paying for their water and sewerage, including fixed charges, is in line with the 'user pays principle', it would promote economic efficiency of these services and it would also increase transparency.

The Property Council supports further investigation by ESCOSA into the potential to charge consumers directly rather than landowners.

Should landlords be required to install water efficient appliances before passing on water and sewage charges?

The Property Council strongly disagrees with the proposition that landlords should be required to install water efficient appliances before passing on water and sewage charges as it would distort the rental market.

If this was required the costs would likely be passed back to the tenant through an increase in their rent, therefore artificially distorting the market by pushing up rental prices. Furthermore, if a tenant is concerned about renting a property with water saving devices they are able to factor this in to their decision making process when deciding on which property to rent.

Should tenants be responsible for water and sewerage charges? If so, should they be responsible for all charges, including supply charges, or only water consumption and sewage disposal charges?

[Rationale at question one refers.]

Option 1: Continue billing landowners (status quo).

Option 2: Directly bill tenants for all water and sewerage charges, including supply charges.

Option 3: Directly bill tenants for their water consumption and sewage disposal only.

Landowners would still be liable for supply charges.

The Property Council **strongly does not support:**

Option 4: Require landlords to install water efficient products before passing on charges.

Alternative: The Property Council supports ESCOSA further investigation the feasibility of tenants being charged for their water and sewerage use, including fixed costs.

Managing Pricing Reform Impacts on Consumers with Subsidies – Issues Paper No.7m

NOTE: Issue Paper No.7 does not directly impact our members.