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Response to the Draft Inquiry Report on Reform Options for SA Water's Drinking Water and Sewerage Prices

The Urban Development Institute of Aust. (SA Div.) Inc. is pleased to respond to the Draft Inquiry Report of the Essential Services Commission of SA into the Reform of SA Water's Drinking Water and Sewerage Prices.

Background

In September 2012, the (then) Treasurer asked the Essential Services Commission of South Australia (ESCOSA) to conduct a formal Inquiry into SA Water's water pricing structures and charging arrangements under Part 7 of the *Essential Services Commission Act 2002*.

ESCOSA subsequently released a number of Issues Papers, highlighting the broad focus of the inquiry.

The Urban Development Institute of Aust. (SA Div.) [UDIA] subsequently engaged in discussion with ESCOSA staff, seeking clarification of the issues and raising concerns about the selective use of 'User-Pays' principles with implications for the cost to developers in developing land for housing, and the economic impact on South Australia resulting from reduced affordability of new homes for people least able to afford additional costs.

On 16 July 2014 ESCOSA publically released a Draft Inquiry Report.

Introduction

Reforms to water and sewerage price structures remain a Government policy decision. ESCOSA is undertaking the review on behalf of Government.

The Draft Inquiry Report is one of a number of different inputs the Government will take into account before any price reform is implemented. That is, social, regional (development), environmental and health impacts of pricing reform will also be taken into account, as will the concern for intergenerational equality with providing for connection and product (water and sewer) to new house buyers and existing ones in established locations.

ESCOSA's Pricing Inquiry is fundamentally about ascertaining if there are more economically efficient ways of SA Water charging its customers. It is not an inquiry about the total level of revenue that can be earned by SA Water from its customers.

UDIA seeks the concept of 'fairness in prices' between existing and new locations to be also considered. UDIA is concerned that all of SA Water's pricing review activity (via this ESCOSA Draft Inquiry Report) or via the review of charges currently being undertaken separately by SA Water will inevitably lead to a greater reliance on development charges. UDIA regards any attempt by SA Water to charge consumers for augmentation and connection of new allotments/houses to the SA Water network (water and sewer) as unfair. It is especially unfair if that infrastructure is required to be paid for by someone else (the developer/new land and house buyer). This network cost is the 'cost of doing businesses' by SA Water. It is their cost of providing a service (water and sewer provision) to households for which SA Water seeks payment from the customer, just as occurs in other commercial service provisions. This cost should be a 'cost of doing business' and should be recovered from a broad base of customers as opposed to targeted customers.

Examples of "user pays" for mains infrastructure:

Example 1 – In the Mount Barker Development Area, SA Water is seeking the augmentation and connection fees as an upfront payment of $63 million ($6,300 per each estimated 10,000 new lots) to be paid for by the new land/house owners) while existing residents including new developments within the existing town boundary are not charged at all. This is not fair.

Example 2 – The infrastructure upgrade or replacement in the Adelaide CBD like the proposed mains replacement in Grenfell Street is proposed to be delivered using maintenance funds as opposed to charging the existing users or new development on Grenfell Street. This cost will be borne by all customers of SA Water.

This issue should not be confused with the theory that by some miracle, a developer will be paying for this infrastructure. All these costs have to be passed on to the end purchaser. It should also be noted that the current practice also requires the design and construction of all infrastructure inside the development to be transferred to SA Water as free asset for SA Water to then use in selling its products to customers.

This practice affects the market and reduces the affordability of all housing in South Australia. The augmentation and connection fees for SA Water's network expansion are not determined under scrutiny of market evaluation; such cost estimates should be an efficient, commercial practice.

ESCOSA supports the 'User Pays' principle for networks where capacity-base charging could be applied, not based on property values as currently applies. This could result in people in lower socio-economic areas paying more whilst those in higher socio-economic areas paying less. This principle has also been applied to infrastructure delivery to new developments. The same impact will be felt by people living in lower socio-economic areas compared to the rest of the state. Any move by Government to consider selected services at selected differential prices whilst espousing the 'user-pays' principle is flawed; "You cannot have it both ways!"

ESCOSA has assumed revenue neutrality for SA Water in its analysis.

The Draft Inquiry Report relies heavily on economic theory and technical economic modelling.

While ESCOSA has provided information on the benefits to individual users from the changes, it should be noted that there is a significant level of uncertainty around these outcomes. The pricing and economic cost benefit modelling is based on a large number of assumptions, some of which are highly variable. As such, the Draft Inquiry Report provides only a broad indication of the economic impacts arising from pricing reform.

With changes resulting from the *Water for Good* plan adopted by the South Australian Government SA Water is no longer an authority providing a service to South Australia via mandated connection to its drinking water and sewer networks, rather is a business operating commercially to seek and gain business from customers willing to pay for services, the principle being a return on investment albeit regulated investment.

As such, connection to these customers with a network that will allow SA Water to sell its product (drinking water and sewer) is a discretionary activity by the end-use customer. This ESCOSA Draft Inquiry Report raises the possibility of replacing the current system whereby landowners are SA Water's customers with one in which end users (the actual consumers of the service, eg renters of a property owned by someone else) are the customers; and the potential impacts should meters (and potentially smart meters) be provided to all water customers.

Benefits

ESCOSA argues that pricing reform could deliver long term annual economic benefits to the State. ESCOSA has estimated that implementation of the water recommendations would provide economic benefits of around $30 to $40 million per annum. This represents around 0.03% of Gross State Product ($95b per annum).

UDIA raises concern at that modelling, preferring to seek additional analysis of the impact on demand by introducing higher costs for new house buyers relating to the pass-on of augmentation cost increases to the developer of the land. With the ESCOSA emphasis of 'user-pays', any reduced demand would result in fewer customers to SA Water for the consumption of water and sewer services, that might in turn require higher costs to be passed onto fewer customers, etc. This could severely negatively impact the South Australian economy.

The role of SA Water as a commercial entity requires it to create asset expansion and thereby increasing the revenue through more consumption in order to achieve a return on investment (from selling, providing or receiving the product – water and sewer). In this instance this rate of return is regulated by ESCOSA. SA Water is no longer a 'public authority' with activity delivering a product. Its assets must be planned, managed and prudently expanded in order to serve discretionary customers (over a term, say 50 to 100 years) with sale of a product (water or sewer).

The State Government, as owner of SA Water, should simply seek a dividend from its business (rate of return). Any specific services not undertaken for commercial return by SA Water should be the subject of community-service-obligation payment to SA Water.

Summary

UDIA is pleased to provide this response to the ESCOSA Draft Inquiry Report. Our representatives are available for further discussion with ESCOSA staff to clarify or augment information provided.

Our overwhelming concern is for fairness in fees to all housing developments attributed to connection and augmentation of properties to the SA Water network for drinking water and sewer. Such costs are part of SA Water's business and should be reflected in the market price of the water and sewer (product) delivered via that infrastructure. UDIA does not want increased costs passed on to new housing that reduces housing affordability to new home owners, nor do we want excessive and unfair costs disadvantaging either new housing developments in greenfield or brownfield/infill locations.

ESCOSA Recommendations

UDIA's comments on the various recommendations in ESCOSA's Draft Inquiry Report are provided in the attached table.

Yours sincerely

T.D. Walsh

Terry Walsh
Executive Director

10 September 2014

Attachment: ESCOSA Draft Pricing Inquiry Recommendations

	Draft Recommendations	UDIA Comment
DRINKING WATER USAGE CHARGES	1. To enhance economic efficiency, a single usage charge based on the long-run marginal cost of water supply should be adopted. The Commission estimates the LRMC of supply to Greater Adelaide to be around 62c per kL.	Customers with smaller water consumption levels would be worse off under this recommendation, whereas larger water consumers would benefit considerably.
	2. There should be flexibility to allow usage prices to increase to the short-run marginal cost (SRMC) of water supply during any future periods of emerging water scarcity. If water usage charges are increased at those times, supply charges should be reduced to ensure there is no over-recovery of revenue.	
	3. Any concessions provided by Government to SA Water's customers should not be delivered as a subsidised water usage charge. To ensure that usage charges remain cost-reflective, they should be delivered through fixed payments.	Where charges are not reflective of the principles to achieve the regulated rate of return, they should be reimbursed/charged directly to the user as/for explicit payment.

DRINKING WATER SUPPLY CHARGES	4. Drinking water supply charges should be based on the size of a water meter, which is a measure of a customer's capacity requirements and is therefore cost reflective. 5. All cost inputs to supply charges should be prudent and efficient and reviewed by the relevant decision-maker (whether the Commission or Government) on a regular basis. 6. Connection charges should be set to recover efficient connection and account establishment costs, and disconnection charges should be set to recover efficient disconnection and account finalisation costs. 7. Development connection and augmentation charges should be set to recover all efficient costs driven by developer requirements.	Coupled with the recommendations above, this would significantly increase fixed charges for residential customers and non-residential customers. There would be significant benefits to a number of commercial customers who currently pay property based fixed charges. Concerns would be raised at the social inequity created by the same payments from higher and lower valued houses. Recommendations #4 and #7 are linked. If drinking water connection charges are based on size of the water meter (and not house value), recommendation #7 must be accepted. This will raise the costs for lower valued houses in metro and in regional locations (housing affordability factor for low income earners). Recommendation #6 on connection/disconnection charges is supported. Recommendation #7 should be the subject of a business case by SA Water. It must include the costs of its delivery mechanism (network asset) for its sale of services to customers (drinking water) over the term of its asset life, and charge the usage accordingly to achieve its rate of return. These fees should be part of SA Water's 'cost of doing business,' ie selling the product (water or sewer) via its infrastructure. SA Water remains an inefficient business if it is unaware of its 'financial pain' in providing its infrastructure to provide its charged-for services to customers.

REGIONAL DRINKING WATER CHARGES	8. Consideration should be given to regional usage charges based on the long-run marginal cost of each region, noting that the additional economic benefits are small. 9. Drinking water supply charges should initially be set on a state-wide basis. For all new investments in a particular region that are not reflected in the long-run marginal cost or other fixed charges, the supply charge for that region should reflect those investments. This would result in supply charges diverging across regions over time, as assets are added or removed from each region.	History indicates that over time regional prices would increase faster than metropolitan costs. It could significantly restrict the level of future investment in regional areas if customers were unwilling to fund the investment via higher prices. This will mean reduced economic development of SA regions and the state in general; our enterprises will become less competitive, resulting in fewer customers and lower revenue to SA Water and its owner. It will 'kill off' potential developing areas and regions would be depleted.

SEWERAGE CHARGES	10. Sewerage charges should be set to recover the prudent and efficient costs of maintaining and replacing all sewerage infrastructure and ongoing account management costs. 11. Sewerage charges should reflect the 'capacity requirement' a customer places on the sewerage system, not the value of the property. The most appropriate reflection of capacity is the size of the sewerage connection.	ESCOSA recommends the charge be based on capacity, but most residential customers have the same connection size, so it effectively becomes a flat fixed charge for most customers. UDIA comments on recommendations #4 - #7 for Drinking Water Supply Charges apply here to recommendations #10 - #13 for Sewer Charges also.
	12. Sewerage augmentation charges should be set to recover all efficient costs driven by developer requirements.	As for Recommendation #7. Asset augmentation should be the subject of a business case by SA Water. It must include the costs of its delivery mechanism (network asset) for its sale of services to customers (sewer) over the term of its asset life, and charge the usage accordingly to achieve its rate of return. These fees should be part of SA Water's 'cost of doing business,' ie selling the product (water or sewer) via its infrastructure. SA Water remains an inefficient business if it is unaware of its 'financial pain' in providing its infrastructure to provide its charged-for services to customers. Recent arrangements whereby SA Water seeks sewerage augmentation fees from developers/new house and land owners in new growth areas is unfair. These fees include extraneous costs associated with treatment of sewer to a standard not required by the developer.
	13. Sewerage connection charges should be set to recover efficient connection and account establishment costs, and disconnection charges should be set to recover efficient disconnection and account finalisation costs.	Recommendation #13 on connection/disconnection charges is supported (like recommendation #6 for drinking water).

REGIONAL SEWERAGE CHARGES	14. Sewerage charges should initially be set on a state-wide basis. For all new investments in a particular region that are not reflected in other fixed charges, the sewerage charge for that region should reflect those investments. This would result in sewerage charges diverging across regions over time, as assets are added or removed from each region.	UDIA comments are as for Recommendations #8 - #9, and for Recommendation #12. History indicates that over time regional prices would increase faster than metropolitan costs. It could significantly restrict the level of future investment in regional areas if customers were unwilling to fund the investment via higher prices. This will mean reduced economic development of SA regions and the state in general; our enterprises will become less competitive, resulting in fewer customers and lower revenue to SA Water and its owner. It will 'kill off' potential developing areas and regions would be depleted.

TRADE WASTE CHARGES	15. Trade waste charges should continue to be based on volume and load, set with reference to long-run marginal cost. 16. SA Water should revisit its 'flow' trade waste long-run marginal cost estimate for Bolivar, which is set too high. 17. All of SA Water's remaining trade waste long-run marginal cost estimates, for non-flow parameters, should be independently reviewed before being implemented.	No comment
REGIONAL TRADE WASTE CHARGES	18. Until long-run marginal cost estimates have been developed for individual sewerage catchments, trade waste prices should be set with regard to the long-run marginal cost at Bolivar, which accepts 97 per cent of trade waste volume.	No comment

BILLING END-USERS	19. The end-user of a retail service, rather than the owner of the premises to which that retail service is supplied, should be SA Water's customer for that retail service.	Recommendation #19 is supported. This will make investment in the state more attractive.
DEBT RISK AND DEBT SECURITY	20. The current provisions in the Water Industry Act, which confer on SA Water the right to secure debts through a statutory charge on land, and the right to sell land to satisfy a debt, should be repealed.	Recommendation #20 is supported
NON-CONNECTED PROPERTIES	21. Customers should only be charged for a water and sewerage service if they enter into an agreement with SA Water to become a customer. 22. Customers should be able to cease being a customer of SA Water subject to providing reasonable notice and paying appropriate disconnection and account finalisation fees.	Recommendations #21 - #22 are supported

INDIVIDUAL METERING	23. The installation of individual water meters to group-metered properties, both retrofit and new properties, should be optional (i.e. maintain the status quo).	Recommendation #23 is supported. UDIA supports the market deciding on choice for meters.
SMART METERING	24. Smart water-metering should be optional (i.e. maintain the status quo).	Recommendation #24 is supported. UDIA supports the market deciding on choice for meters.

WATER PLANNING AND MANAGEMENT COSTS	25. The State Government should consider commissioning an independent public review of the prudence and efficiency of all water planning and management-related costs incurred by SA Water, including the manner in which they are recovered. 26. Until such a review is conducted, SA Water should make clear on customers' bills that a water planning and management payment is being collected through them – and that it is being done for the benefit of the wider South Australian public.	A business cannot operate commercially without planning and managing its assets, along with its operations to deliver services via such assets. This cost is a general overhead cost to SA Water - a 'cost of doing business.' SA Water should not recover such costs via a direct charge to customers. That practice promotes inefficiencies; it should be included within SA Water's overall cost structure but not included as a specific charge to customers.
IMPLEMENTATION / TRANSISTION ISSUES	27. The Government should consider transitional arrangements, to smooth the bill impacts of reform. 28. The State Government should consider ongoing implementation issues, including a review of the concession/exemption scheme to ensure that subsidies are targeted and effective.	Recommendations #27 - #28 are supported.