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Dear Mr Appleyard

The Property Council of Australia (Tasmania) welcomes the opportunity to comment on the *2012 Water and Sewerage Price Determination Investigation – Draft Report*.

The Property Council has been very clear about its support of water and sewerage service reform and its objections regarding certain aspects of the implementation and governing policy framework.

Our issues should be quite clear to the Regulator by now. From this submission we wish the Regulator to take away the following messages:

- The fixed charge is far too high and the charge for volumetric measure too low;
- The 200 kilolitre (KL) allowance is far too low and will result in the water corporations' receiving a considerable windfall at the expense of consumers;
- Payment of dividends, tax equivalents and guarantee fees to councils is a flawed policy and will cause unnecessary hardship on consumers, deprive the corporations of urgently required revenue and excessively delay consumers receiving benefits from the reform. It is unfair, unjust and inequitable that these payments are already, and will continue to be, paid at the costs of consumers, particularly those in the non residential sector;
- The corporations and the Regulator must be totally open and transparent with consumers. To this end we request that in the pricing determination a table is included showing the average annual amount per consumer of dividends, tax equivalents and guarantee fees that are being paid to the owner councils;
- The proposed annual fire service charge is a new tax selectively imposed on private properties. It is an indiscriminate upon those consumers who are already paying a grossly disproportionate amount of revenue to the corporations because of poor past pricing practices by councils. We are resolute in our conviction this charge is already embedded in existing charges and this new charge is nothing less than double dipping and revenue gouging; and
- The pricing determination should prevent councils from receiving unaccountable, excessive and unjustified revenue streams from the corporations at the expense of consumers.

As the implementation of the reform rolls out it continues to highlight the fragility of the system, the complete mismanagement of the sector and the infrastructure under council auspices, the need for a significant overhaul of the policy framework governing the corporations along with the lack of responsibility taken by State and local governments to ensure that the water and sewerage infrastructure is adequately funded and Tasmanian consumers are front and centre of all decision making.

While the Property Council is pleased that common sense has prevailed and 19 councils are supporting the merger of the three corporations into one entity on the grounds of efficiency gains of some $5 – 7 million annually, there is no timeline for the proposed merger, nor is there any indication in the *Draft Report* of what this will mean for the price determination.

It should be noted that the Property Council will expect that the Economic Regulator in his final report to signal adjustments to the price determination in line with proposed merger of the corporations as required to do and as signalled in the *Draft Report*.

However, the proposed merger does not go far enough in ensuring the viability of the sector nor is there any indication from the State Government that past council behaviour which will cost $1 billion in infrastructure requirements will be addressed either through the Regulator's report or by policy reform. Instead the Tasmanian public has, and will continue to deal with:

- The continuation of cross subsidisation;
- Two part pricing which is out of step with national best practice;
- Dividends, income tax equivalents and guarantee fees worth millions of dollars being paid to 29 councils irrespective of consumers and infrastructure needs;
- A service system which is "currently not financially sustainable into the future at current revenue levels" (*Draft Report* Executive Summary page viii);
- Inadequate or unknown performance in relation to drinking water quality (*Draft Report* Executive Summary page viii);
- Widespread non compliance of sewerage treatment plants (*Draft Report* Executive Summary page viii);
- Inadequate or unknown customer service standards (*Draft Report* Executive Summary page viii); and
- Myriad of different council pricing standards across council areas with prices often applied on an unfair basis without reflecting actual costs (*Draft Report* Executive Summary page viii).

It is somewhat surprising that the *Draft Report* continues to talk about the reform implementation in terms of "transition", as well as highlighting the State Governments tardiness in finalising the Government's Pricing Regulations which has meant that has been no independent assessment of the regulated entities' asset values and costs which ultimately impact on the consumer through the pricing regimes.

What the Tasmanian community has been left with is a "transitional" arrangement which is based on price caps not asset values and costs.

Specific Comment As Requested

Chapter 3: Service standards and regulatory obligations:
The issue of service standards and regulatory obligations requires leadership from the owners, the corporations and the State Government combined with reinforcement from the Economic Regulator.

Currently, Tasmanian consumers are dealing with poor infrastructure, inefficiencies and poor environmental and health outcomes. It is vitally important that the cost and risk of improvement does not fall on the consumer and instead sits as a clear responsibility of the owners and the corporations. Not to do this will ensure that a central tenant of the reform, equity and fairness for consumers will not be achieved.

Chapter 4: Estimating Revenue Limits

- ***Regulatory treatment of revenue limit***

The Property Council supports the concept of regulatory treatment of revenue limits, along with the examination of upper, lower and statutory limits.

As the Regulator's office would be aware the property Council has been supportive for the exclusion of capital contributions from customers, state and federal government and the private sector along with unregulated assets from the Regulated Asset Base for the purpose of determining return on assets.

However the Property Council maintains that the Department of Treasury and Finance's definition of contributed assets should not start as at the 1 July 2012, as the councils' history of ensuring others pay for vital water and sewerage infrastructure can be traced back decades and should therefore be accounted for.

- ***Results of the revenue analysis for each regulated entity***

Given there is an absence of independently assessed values and costs and this will be the case until the second regulatory period, at this stage this means that the revenue analysis is purely speculative and appears at the cost of the consumer.

This perception is not assisted by industry comment that duplication of inefficient assets which have been transferred from councils to the corporations have been undervalued to artificially produce a profit which allows for dividends to be paid to owner councils.

It is vitally important that the assessment is done immediately as it is neither sufficient nor satisfactory for it to be held over until 2015 because it is directly related to correct pricing and ensuring the value and split between variable and fixed charges is correct. Currently, it appears that this is the reason for such a high fixed component of the two part pricing.

As highlighted in the *Draft Report,* this is due to the State Government's inability to complete the regulations in time and highlights how Government's lateness is directly affecting the consumer and adding to the cost of living and business expenses.

Furthermore, the Property Council continues to question the proposition that water and sewerage consumers will automatically drop from 436 KL (as estimated by Southern Water's *Annual Report 2010 – 11*) to an average household water consumption of 200 KL per annum (section 5.4.10.1 *Draft Report*). This is highly unlikely, and sets the corporations up for significant boosts to their revenue base as well as undermining the price caps and therefore creating unnecessary community hardship.

To use an example, it is worth noting that average household consumption for the southern region was derived at 378 KL per annum based on ABS data[1]. *Southern Water's Annual Report 2010-11* suggests an average water consumption of 436 KL per connection (total sourced water 41,517 ML divided by 95,304 being the number of water connected properties). The Office of the Tasmanian Economic Regulator recently reported (September 2011) in its *Water and Sewerage State of the Industry Report 2009-10* that the average consumption per connection within the southern region was 458 KL (section 5.2, page 39). It is noted that the newly released (March 2012) *State of the Industry Report 2010-11* reports:

> *Southern Water was not able to provide a breakdown of water supply into residential, commercial, municipal and industrial uses for 2010-11, although it did provide an estimate of residential consumption for the southern region based on an assumed household consumption of 250 KL per year. It should be noted that this estimate is much lower than the 350 KL per property estimated in 2009-10, and should be treated with caution.*(section 5.2, page 41).

At the very least the corporations should be told to revise the usage to at least 350 KL to ensure there are no unforeseen price hikes above the proposed \$50/10 per cent price constraint as well as reducing the likelihood of unexpected revenue gains.

However, if the corporations have underestimated the water usage patterns and the conversion is based on the actual use, there will be extra revenue via the fixed charge once all consumers are at the target tariff.

- **The appropriateness of the level of forecast dividends**

The Property Council is on public record as strongly opposing the payment of any monies to the 29 council owners.

It is expected that millions of dollars will be handed back to councils in dividends alone, culminating in 2021 with \$64 million being paid back annually. It is worth noting that this figure excludes revenue generated from income tax equivalents or guarantee fees which if added in, could be some \$100 million annually or \$400 per rate payer going back to councils.

The hand over of water and sewerage infrastructure from local government to the corporations has demonstrated the inability and the lack of corporate responsibility exercised

[1] 140KL per capita per annum with 2.7 persons per household = 378KL per annum per household
Source: ABS, 4610.0 - Water Account, Australia, 2008-09

by the 29 councils. The Tasmanian community has been left with a litany of mismanagement, duplication and run down infrastructure, and the community is now left to foot a $1 billion bill to bring this critical infrastructure up to a standard which meets Environmental Protection Authority (EPA) and Director of Public Health requirements, let alone address the future needs.

In the Office of the Economic Regulator's *2012 Tasmanian Water and Sewerage State of the Industry Report 2010 – 11* the statement is made that:

> *Tasmanian corporations are still lagging behind their mainland counterparts in relation to compliance of treated effluent against regulated discharge limits…..the level of past under investment in much of the water and sewerage network has meant it will take many years to place the industry on a sound and sustainable financial footing…… these problems have been allowed to develop over a number of years, if not decades, and will likely take a similar time period to resolve.* (Office of the Economic Regulator's Press Release 15 March 2012)

The farcical situation with the payment of dividends has seen the writing down of assets to artificially boost profitability so dividends can be paid, while technically two of the corporations are operating in a financially unsustainable position.

Ben Lomond Water, while expecting to achieve moderate increases in annual revenue from customers, is still expected to be operating unsustainably while increasing debt to fund increase operations, maintenance and fund capital expenditure (capex). This is despite the forecast of dividends remaining relatively constant.

Southern Water is expecting to see small rises in revenue, utilising debt to fund its capex program over the period. However it will still be operating in an unsustainable financial position. It is forecasting a decrease in dividends over the period.

Whereas Cradle Coast Water, are expecting significant increases in annual revenue but will be reducing its capex levels and are applying the increase in revenue growth to meet increased operational expenses and make increased dividend payments to its owners.

It has not escaped the Property Council's notice that nine councils which opposed the merger of the three corporations into a single entity were, in the main, from the North West.

Furthermore, concern has been raised by the EPA which states that:

> *That the limit of available funds for capital expenditure is an obstacle to improved compliance and this obstacle is exacerbated by dividend payments to local government owners before the regulated entities are operating on a sustainable footing (where sustainability also includes meeting regulatory obligations* (*Draft Report*, 3.4.3.2, page 47).

On investigation of the Section 5 of the *Water and Sewerage Corporations Act 2008*, it is clear that rather than a requirement for the corporations to pay dividends to their respective owners, as suggested in the *Draft Report* (page 69), there is no such obligation.

Instead the *Act* is clear that the corporations must determine an appropriate dividend policy (*Water and Sewerage Corporations Act 2008, Section 5.32)* and furthermore the payment must be "*consistent with good commercial practice and require adequate provision to be made for expected future capital requirements and operational expenditure before the payment of any dividend to members*" (*Water and Sewerage Corporations Act 2008, Section 5.32 (2.c and d).*

Therefore, the payment of dividends at this current time is not justifiable under the *Act*.

In addition to these facts, the Office of the Economic Regulator has not provided a true picture in the *Draft Report* because it is silent on the payment of income tax equivalents and guarantee fees which further drains much needed revenue away from the provision or upgrade of infrastructure, winding back of cross subsidisation and bringing down water and sewerage pricing for Tasmanian consumers.

What also must be noted is the fact that only Cradle Coast Water will be in a financially viable position. Southern Water and Ben Lomond Water are expected to remain in a financially unsustainable position over the first regulatory period (*Draft Report*, Executive Summary page xiii) and yet all three corporations are expected to pay the 29 councils dividends, income tax equivalents and guarantee fees. Again this can only be seen as gross negligence on the part of the Government to not significantly reform the *Water and Sewerage Industry Act 2008* to negate the payment of this revenue.

It is the strong opinion of the Property Council that there is an urgent need for the Economic Regulator to step into the policy void left by local and State Government and Parliament and strongly advocate for the amendment to the *Act* to negate the need for such payments.

For millions to be paid to councils at the expense of the corporations' commercial viability, the provision and upgrade of vital infrastructure and fundamentally addressing cross subsidisation along with decreasing the price of water and sewerage services to the consumer highlights the State Government's lack of political willingness to address the cost of living and doing business. It is also questionable as to whether the Office of the Economic Regulator is there to ensure fairness and equity for Tasmanian consumers.

Chapter 5: Pricing

- **Proposal to freeze prices for customer above the target tariffs for first two years and five per cent reduction in third year**
- **Proposed tariff structure**
- **Basis for setting fixed water and sewerage charges and variable water charges**
- **Level of variable charges**

Again pricing and the move towards two part pricing further demonstrates the mismanagement of councils' approach to pricing of water and sewerage, for example in the South alone there are some 2,200 different pricing regimes, it has meant that cross subsidisation is deeply entrenched.

It was one of the Property Council's key reform issues that cross subsidisation across and within property classes be wound back as quickly as possible as it distorts and undermines equality, fairness and user pays.

However, it would appear that the current unsustainable financial nature of the sector and the lack of political willingness to amend policy has increased the perception that the continuation of cross subsidisation will be a hallmark of this reform process for some time to come. This perception is certainly reinforced in the *Draft Report (page 148)* where there is only reference which addresses the issue indicating that the end of cross subsidisation could come at the end of the second regulatory period, six years away.

Instead, commercial property owners are left with a legacy which was entrenched during local government's management of water and sewerage and sees this property class paying over and above for services which are substantially cheaper in other jurisdictions. Indeed what has occurred under this reform process is the use of commercial property owners as the cash cow for the corporations to *ensure there is no significant revenue loss (through the adoption of lower uniform tariffs)* (*Draft Report, page 85*).

Therefore the freezing of prices for customers above the target tariff for two years and a five per cent reduction in year three provides cold comfort.

There is a clear and urgent need to provide clarity, dollar value and a timeline for the number of customers who are potentially facing "*decades to transition*" (Southern Water proposed price and service plan, page 127) as a lack of acknowledgement and clear KPIs for the transition will act as a barrier to further investment, particularly in this current economic environment.

In relation to the two part pricing regime, the Property Council has been publicly supportive of the user pays model however; the Division has also been on public record that it does not support high fixed and low variable components of the bill.

It is extremely disappointing to see that objections to the proposal to have high fixed and low variable components have not been accepted and that this model remains in the *Draft Report* despite clear evidence that it will not moderate water usage and behaviour and instead continue to place unsustainable pressure on already sub optimal infrastructure.

Evidence presented by Nekon Pty Ltd in its submission on the *Draft Report* demonstrates clearly that the current pricing model is out of step with comparable water and sewerage corporations such as Hunter, South East Water and Barwon Water.

By having around 80 per cent of the bill in the fixed component is just about ensuring a steady revenue stream to the corporations, it is not about encouraging behavioural change. The range of fixed charge for a 20mm pipe ranges from Southern Water's $272.32 (2012-13) through to the highest being Cradle Coast Water at $410 (2012 -13) is out of step with other states' water corporations where the average the fixed charge is around $139.

In addition, the variable component (the remaining 20 per cent of the bill) where water is priced at $0.90 KL is again out of step with national practice which sees a high variable component and water priced at around $1.20 KL.

As mentioned earlier, the Property Council seriously doubts the assessment that water consumption will fall to an estimated 200 KL (Draft *Report section 5.4.5.2, table 5.11)* as proposed by the three corporations. While there is support for the removal of removing free water allowances as it is a distortion there are however good grounds to question the 200KL consumption estimate.

Furthermore, the corporations have not presented a case to justify this assumption. Certainly, it appears that despite volumetric charging in the North and North West, Cradle Coast and Ben Lomond Water consumers' average consumption has not decreased. Evidence from other jurisdictions also highlights the false premise that consumers substantially lessen their average consumption in light of volumetric charging.

It would appear that the corporations, with the Regulator's approval, are seeking to transfer risk away from the corporations and their owners onto consumers with the inevitable likelihood windfall revenues will ensue.

The Office of the Economic Regulator has provided evidence that supports the doubt expressed by the property industry. The 2011 Economic Regulator's report into the *State of the Industry 2009 – 10* highlighted for example that the average water consumption in the South, was 458 KL (section 5.2, page 39) which was higher than the estimate provided by Southern Water of 350 KL.

The estimated consumption of 250KL was again questioned in the latest *State of the Industry Report 2010 -11* (March 2012) as Southern Water could not provide a breakdown of water supply into residential, commercial, municipal and industrial uses for 2010 -11 despite providing a estimate of residential consumption which was 100KL lower than was estimated in the previous year.

In the words of the Economic Regulator the estimate "should be treated with caution". (Section 5.2, page 41)

Assuming that water consumption will sit at around 350KL, which is in itself a conservative estimate, it demonstrates that the corporations will be in receipt of significant "unplanned" revenue which will have adverse impacts on the price caps and transitional billing arrangements. This "unplanned" revenue based on unrealistic consumption rates could be in the order of an additional $13.5 million in the first year of the regulatory period for Southern Water alone.

It is Economic Regulator's responsibility to rigorously test the water consumption estimates to ensure that this does not occur at the expense of the consumer as well as bringing the two part pricing model into line with national practice to ensure fairness and equity for consumers rather than a dedicated revenue stream for the corporations and their owners.

- **Treatment of fire service connections**

The Property Council does not support the proposal of an annual fee for fire service as it is yet another expense and impost on business as well as being a new charge which is nothing less than double dipping.

- **Adoption of an assumed 200KL allowance to remove free water allowances**

The Property Council supports the removal of free water allowances but remains concerned and sceptical about the assumed 200KL allowance.

- **Use of equivalent tenement methodology to determine fixed charges**

It is concerning that there is no clarity regarding equivalent tenement (ET) methodology and whether during this first regulatory period it will be based on estimates or determinations. To leave the decision to 30 June to provide any degree of certainty or clarity does not allow for any budgeting flexibility.

- **Proposed pricing treatment of new and altered customer connections**

The Property Council supports the move by the Economic Regulator for the corporations to have greater transparency in the provision of concessions to non government organisations.

- **Design of a mechanism to prevent revenue loss associated with changed arrangements**

The Property Council does not support any mechanism to design to recoup or prevent revenue loss due to property changes.

Furthermore, there is no reason to ensure for owners, who are receiving millions in dividends, income tax equivalents and guarantee fees, and the corporations to penalise consumers wishing to lower their water and sewerage bills.

- **Proposed pricing arrangements to apply to limited service customers**

The Property Council supports the proposed pricing arrangement for limited service customers.

- **Content of proposed policies**

There is concern that old data from the defunct Demographic Change Advisory Council is being used to forecast customer growth. More appropriate forecasting mechanisms would be ABS population figures and the soon to be released Census data.

While there is support for the standardisation of any policy or procedures across the three corporations, the Property Council does not support certain policies such as developer and head work charges or the levying of service charges on properties which have no connection to infrastructure, irrespective of whether they are within a service land area.

The Property Council has been very clear about its objection to developer and head works charges, particularly given the redirection of revenue from the corporations to the 29 councils in the form of dividends, income tax equivalents and guarantee fees.

The existence of developer charges within the *Water and Sewerage Industry Act* was a clear indication of the lack of understanding of the economic barriers to development.

Developer charges act as a clear barrier to investment across residential and commercial sectors and are detrimental to economic growth and ultimately a passed on cost to the consumer through the price of a new house for example.

Headwork charges, when levied on a property which has had a change of use but no infrastructure upgrade or extension, is just a revenue generating mechanism by stealth and directly impacts on the cost of doing business, and in some cases acts as a barrier to generating employment.

A key issue in strongly advocating for water and sewerage service reform was the inequitable arrangement that saw vacant land paying for water and sewerage services. It is disappointing to see that this policy has continued and is proposed in the *Draft Report*.

The Property Council does not support a service charge comprising of the full fixed water target tariff and 60 per cent of the fixed sewerage target tariff.

The justification of vacant land increasing in "*capital value because of the potential access to the network but is not consuming water and that the customer is not discharging any sewerage into the network so sewerage treatment costs are not incurred*" is yet again another example of ensuring a dedicated revenue stream rather than ensuring fairness and equity.

From the Property Council's perspective, this is yet another example of where corporations are ensuring a dedicated revenue stream at the expense of the consumer.

- **Arrangements with respect to sub metering**

The Property Council has not been supportive of the approach to dealing with metering or sub metering for multi and strata titled properties as it places the onus of responsibility on, and transfers the risk from the corporations, to the property owner (in the case of rental properties) and does not allow for the user pays principle to apply.

It is disappointing that it appears from the *Draft Report*, that this inequitable arrangement will continue during the regulatory period and beyond as there is no indication that there will be moves to amend or reform the policy.

This is despite the fact the *Draft Report* notes that the proposed sub metering arrangements are *"complex and that they result in the differing treatment of strata title property owners, relevant to freehold property owners"*. (Draft *Report page 127)*.

- **Proposed approach to trade waste pricing**

For those commercial customers who have had their water and sewerage bills frozen for two years, effectively on the existing AAV pricing it seems particularly inequitable to add an extra cost to their bills.

Furthermore, the inequity is further compounded by the fact that these properties are cross subsidising other property classes, namely residential from higher water and sewerage costs.

- **Proposed indexing of miscellaneous fees**

Again the Property Council questions the Economic Regulator's acceptance of the number of miscellaneous fees and charges proposed by the three corporations, particularly in light of a lack of scrutiny due to time constraints (*Draft Report* page 127*)*.

Furthermore, given the lack of scrutiny, it seems surprising that the Economic Regulator would allow the three corporations to have different miscellaneous fees and that they would be indexed annually at 2.6 per cent.

Conclusion

It is the strong view of the Property Council, that the pricing determination is flawed and is balanced in favour of the corporations and their owners rather than ensuring a fair and equitable water and sewerage service for consumers.

As mentioned at the beginning of this response the following issues should be addressed with the highest priority:

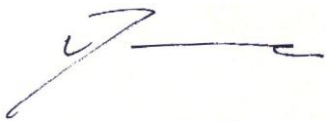
- The fixed charge is far too high and the charge for volumetric measure too low;
- The 200 kilolitre (KL) allowance is far too low and will result in the water corporations' receiving a considerable windfall at the expense of consumers;
- Payment of dividends, tax equivalents and guarantee fees to councils is a flawed policy and will cause unnecessary hardship on consumers, deprive the corporations of urgently required revenue and excessively delay consumers receiving benefits from the reform. It is unfair, unjust and inequitable these payments are already and will continue to be paid at the costs of consumers, particularly those in the non residential sector;
- The corporations and the Regulator must be totally open and transparent with consumers. To this end we request that in the pricing determination a table is included showing the average annual amount per consumer of dividends, tax equivalents and guarantee fees that are being paid to the owner councils;

- The proposed annual fire service charge is a new tax selectively imposed on private properties. It is an indiscriminate upon those consumers who are already paying a grossly disproportionate amount of revenue to the corporations because of poor past pricing practices by councils. We are resolute in our conviction this charge is already embedded in existing charges and this new charge is nothing less than double dipping and revenue gouging; and
- The pricing determination should prevent councils from receiving unaccountable, excessive and unjustified revenue streams from the corporations at the expense of consumers.

Corporations and the Regulator face enormous challenges in convincing consumers they are acting in their best interests. It is undoubtedly an unenviable and difficult task to bridge the gulf that exists but this is not a good reason for not taking the initiative and be seen to be acting in the interests of the general consumer base instead of deferring to the interests of owners.

The Property Council would like to meet with you to discuss the concerns raised in this submission as it is vital that water and sewerage services reform is implemented correctly, fairly and equitably to benefit the Tasmanian community.

Yours sincerely



Mary Massina
Executive Director (Tasmania)