

**WACOSS's submission for the ERA's
Inquiry into the Efficient Costs and Tariffs
of the Water Corporation, Aqwest and the
Busselton Water Board Draft Report**



wacoss

Western Australian
Council of Social Service Inc

*Ways to make
a difference*

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Introduction

WACOSS welcomes the opportunity to once again make a submission for the Inquiry into the Efficient Costs and Tariffs of the Water Corporation, Aqwest and the Busselton Water Board draft report.

About WACOSS

The Western Australian Council of Social Service (the Council) is the leading peak organisation for the community sector, and represents around 300 member organisations and individuals, and over 800 organisations involved in the provision of services to individuals, families and children in the community. The Council has strong relationships with the community services sector and represents the interests of the sector and the communities they serve. The Council therefore is in a unique position to comment on critical social issues that affect members of the WA community.

The Council is respected within both government and non-government arenas as an authoritative voice for consumers in regard to utility reform in Western Australia. In 2005 WACOSS commenced the Consumer Utilities Project, now the Consumer Essentials Project (CEP). CEP works with consumers and representative organisations to achieve better outcomes in the provision of essential services.

Disclaimer

Absence of comment on any portion of the draft does not imply WACOSS's consent to the matter. No part of this submission is confidential.

Contact

Please contact Chris Twomey – Director of Social Policy on (08) 9420 7222 or chris@wacoss.org.au should you have any queries regarding this submission.

Mr Lyndon Rowe
Chairperson
Economic Regulatory Authority
PO Box 8469
Perth BC WA 6849
22 October 2012

22 October 2012

Dear Mr Rowe,

RE: The Western Australian Council of Social Service Submission for the ERA's Draft Report - Inquiry into the Efficient Costs and Tariffs of the Water Corporation, Aqwest and the Busselton Water Board (25 September 2012).

The Western Australian Council of Social Service (the Council) is pleased to present this submission in response to the Economic Regulation Authority (ERA) Draft Report - Inquiry into the Efficient Costs and Tariffs of the Water Corporation, Aqwest and the Busselton Water Board (25 September 2012).

The Council is pleased with the process to date and thanks the ERA for the continued opportunity to be a voice for disadvantaged and vulnerable water customers.

If you have any queries regarding this submission please contact Chris Twomey, Director of Social Policy on (08) 9420 7222 or chris@wacoss.org.au.

Yours sincerely,

Irina Cattalini
Chief Executive Officer



wacoss

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Changing the tariff structure

The current draft report states that wastewater charges should be charged at a flat rate, rather than the existing method which uses the value of the property as a means of price determination. The reasons provided for the proposed change were as follows:

- “There is little, if any, relationship between the price charged and the cost of the service;
- The Authority is not aware of reliable evidence to support the view that there is a strong correlation between property values and income*; and
- There are administrative costs associated with property value-based pricing. The Water Corporation estimates that the annual cost of maintaining its property value database and regularly recalculating tariffs is between \$3 to \$4 million.”¹

While The Council agrees that there is little correlation between the price charged and the cost of service, we note that the pricing structure plays an important role in ensuring that low income households can afford to be supplied with water. Access to water is recognised as an essential service that contributes to multiple public good outcomes, including public health and sanitation. There is an important balance that needs to be struck between water pricing that reflects the cost of access and the desire to ensure that water charges are appropriate and affordable for those on lower incomes. The Council believes that the proposed changes to the pricing structure will have adverse consequences for low income households and particularly renters.

The Productivity Commission Australia’s Urban Water Sector report table 8.1² illustrates that households in Western Australia with the lowest disposable income quintile spend on average less on water per week than a household with higher disposable incomes. However, the percentage of their disposable income that is spent on water is 2.25 times greater than that of the middle income quintile, or more than 4 times that of the highest income quintile. Low income households are clearly more sensitive to price increases, given the disproportionate impact on their household finances.

The Council contends that many low income households move to the outer suburbs due to lower housing costs. House prices tend to be cheaper the further the property is away from the CBD.³ These households are then vulnerable to changes in interest rates and the cost of fuel.⁴ As such they are sensitive to price changes, especially that of an essential good. The Council’s own analysis (see figure 1) shows that there a strong correlation between income (and ability to pay) and property prices. With an R square value of 0.6519, this link is statistically significant. This analysis employs the

¹ Draft Report - Inquiry into the Efficient Costs and Tariffs of the Water Corporation, Aqwest and the Busselton Water Board, ERA 2012, pages 5 & 6.

² Productivity Commission, 2011, Australia’s Urban Water Sector, Productivity Commission Inquiry Report, No. 55, August. Page 209

³ See Housing in Australia in the 2000’s: On the agenda too late? The Australian Economy in the 2000s conference paper. Judith Yates, 2011 page 273 <http://www.rba.gov.au/publications/confs/2011/yates.pdf>, her graphs illustrate property decrease’s by distance to CBD.

⁴ See Unsettling Suburbia: The New Landscape of Oil and Mortgage Vulnerability in Australian Cities. Dodson and Sipe, 2008. http://www.griffith.edu.au/_data/assets/pdf_file/0003/88851/urp-rp17-dodson-sipe-2008.pdf

latest available data: the ATO's mean taxable income by postcode for the 2009/10 financial year and Perth suburbs median house price data from REIWA for the June quarter 2012.⁵

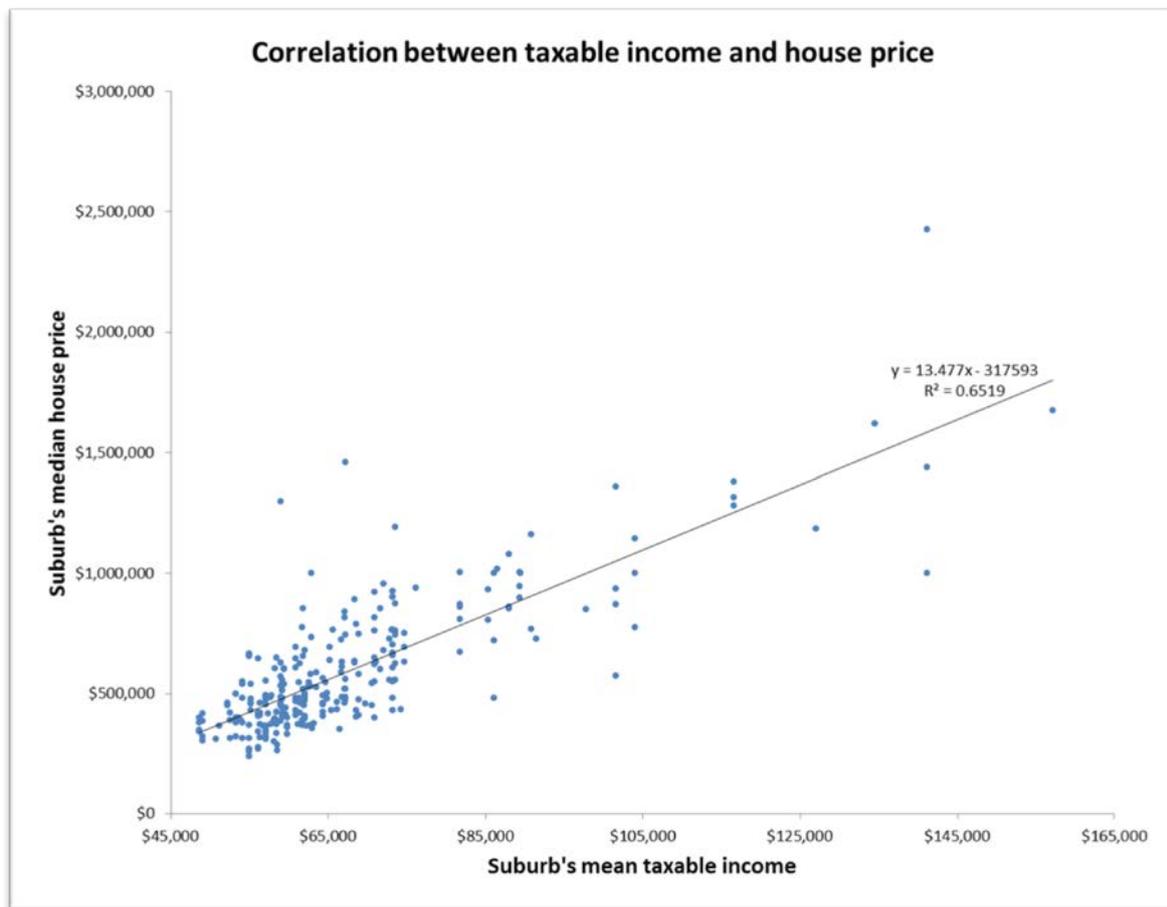


Figure 1: Correlation between a suburb's mean taxable income and median house value.

As figure 1 clearly shows a strong link between a suburb's mean taxable income and the suburbs mean house price (R square value of 0.6519). That is, contrary to the Authority's claims above, it shows evidence of a strong correlation between property values and income. The Council contends that in most circumstances people with a higher value property are likely to have a higher income.

In addition tenants will be paying more for water. The vast majority of tenants are responsible for water usage costs, while it is usually standard practice for the landlord to pay the waste water and drainage charges. On this basis, the proposed change in pricing sees usage costs increase while waste water and drainage charges decrease will ultimately mean that tenants will face higher water bills, and landlord will receive a windfall gain.

We should note that the rental market has factored in the current costs rental charges. While under normal circumstance we would expect that a sudden alteration in the cost structure will see landlords only obtain windfall profits during the time it takes for the market to readjust to the new pricing structure, we need to recognise that the current very low rental vacancy rates mean that this

⁵ Perth Suburbs Price Data, REIWA. Accessed 17/10/2012, <http://reiwa.com.au/Research/Pages/Price-growth-by-suburb.aspx> and Taxation statistics 2009-10, ATO personal tax table 3E (Column's A postcode and E Mean taxable income) Accessed 17/10/2012 www.ato.gov.au/docs/cor00305922_2010PER3E.xls. Only suburbs which had complete sets of data were used.

is not business as usual. With the current tight rental market the Council believes that rental prices are unlikely to reduce (or even increase at a slower pace) for an extended period of time, and so tenants are unlikely to see any benefits from the changing price structure in the foreseeable future. As such the proposed changes will greatly benefit landlords at the expense of tenants.

Figure 2 (below) outlines the impact that the proposed changes will have on various households based on their Gross Rental Value (GRV). It clearly demonstrates that low GRV households will be worse off, while households with a GRV of \$13,000 will be better off.

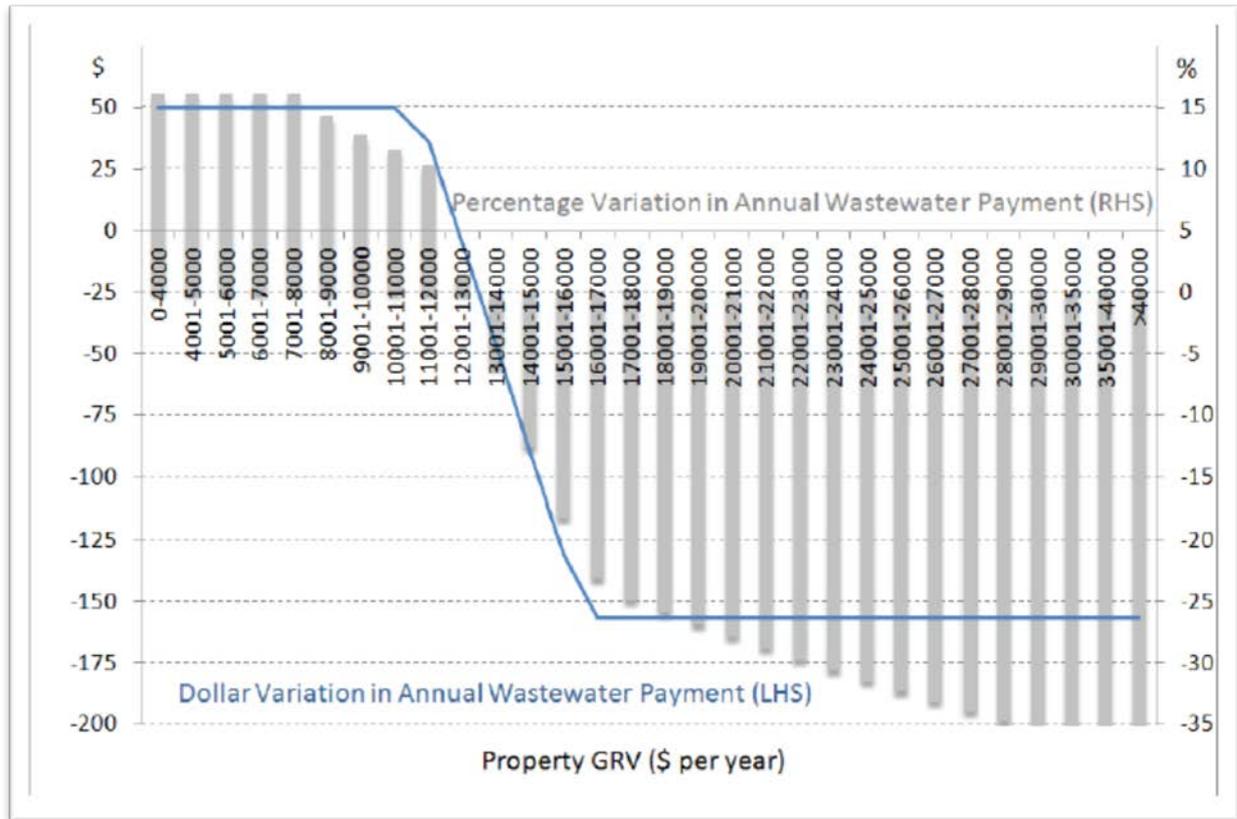


Figure 2: Impacts of Recommended Wastewater Tariffs on Residential Customers, 2013/14 Source: ERA 2012⁶

As the ERA notes

“Under the GRV method for charging there is a large cross subsidy in that customers on properties with high GRV values subsidise (through the payment of higher wastewater charges) customers on low GRV properties. For this reason, a move away from GRV pricing will inevitably involve winners and losers.”⁷

With figure 1 clearly indicating that people on low income tend to reside in lower value properties and figure 2 showing that properties with a low value property will pay more, those who will be worse off under the proposed amendments, will be low income households, in addition to tenants.

While there are administrative costs associated with maintaining property value database and the regular assessment of tariffs, the estimated cost of \$3 to \$4 million is modest when compared to the

⁶ Inquiry into the Tariffs of the Water Corporation, Aqwest and Busselton Water: Draft Report, page 79

⁷ Draft Report - Inquiry into the Efficient Costs and Tariffs of the Water Corporation, Aqwest and the Busselton Water Board, ERA 2012, page 79.

total forecast operating expenditure \$825.2 million in 2012/13. This equates to less than 0.5% of the overall operating expenditure of the Water Corporation. It would be interesting to compare this to the cost of utilities hardship and bad debts currently experienced by the Water Corporation, to consider the potential economic costs of increasing charges on low income households.

Given the modest cost of maintaining the current tariff structure and the adverse effects that such a change will have on most low income households and renters the Council recommends that the current GRV system (where waste water and drainage charges make up the bulk of the households water costs) is maintained.

Additionally, in order to ensure a transparent process, the Council recommends that the forecast of what tariffs would have been if the same GRV method of determining tariff classes remained also be included in the final report. Placing this information in the public domain will help the State Government and the broader community compare the various available pricing options.

The Council draws the attention of the Authority to its recent Cost of Living Report 2012, which indicates that for a number of low-income household types (particularly those reliant on some component of income support) their household budgets are already operating in deficit, and hence their capacity to absorb further price rises is extremely limited. Given rising rates across all indicators of utility hardship in WA, The Council thinks that it would be unwise to move to a pricing structure which is effectively reducing the pricing structure for those who can afford to pay it and increasing the cost of water for those who demonstrably are already struggling to pay it.

The Council has also advocated for the introduction of a hardship electricity tariff in its recent Pre-Budget Submission as a means of addressing increasing rates of financial stress and utility hardship, and suggests that some consideration might need to be given to similar measures for water pricing. If the Authority wishes to advocate for a simpler model of water pricing than the current GRV method, then The Council would suggest that, in principle, it should be looking to advocate a model which will not leave lower income households worse off.

Extending the review period

The Council is supportive of the ERA's views on extending the review period from 3 to 5 years. Such a change will provide customers with more certainty around future water prices. This change will enable consumers to plan ahead of time for any changes to the prices of water which will help households make informed decisions about the relative value of investing in more water efficient appliances/measures.

Moreover, while the Council is broadly in favour of increasing the timeframe for the setting of water tariffs, we note that a balance must be achieved between longer term certainty and the risk associated with unforeseen factors that may impact on costs associated with providing water. A longer timeframe has the potential to produce greater market risk for the water service providers, to the extent that market conditions are harder to predict over a longer timeframe. This has the potential to add to the market risk premiums, resulting in higher rates of return.

A higher rate of return contributes to inflated operating cost, which may ultimately be passed on to the consumer. To ensure that the water service providers are neither advantaged nor disadvantaged by changes in market conditions, and to reduce their market risk, provisions must be put in place to allow water service providers costs to be reviewed within a suitable timeframe. Such a model should reduce market risk for providers, lowering their market risk premium and ultimately the overall cost passed on to the customer. Such provisions could be included within the proposed charter.

Introducing a Charter (between the State Government, the water service provider/s and the ERA)

Introducing a charter between the State Government, the water service provider/s and the ERA will provide benefits to consumers. As such the Council is supportive of the ERA's call for the introduction of such a charter. The Council believes that all of the key elements discussed by the Productivity Commission's report should be included in the charter, these key elements include:

- "Obligation to serve (system reliability, security of supply and obligation to procure).
- Processes and procedures for choosing supply augmentation (transparent, tenders for supply, public consultation, and public reporting of the decision (including an audit of the decision by an independent body).
- Public health and environmental obligations.
- Principles for pricing and service offerings (including asset valuation and return on assets).
- Processes and procedures for setting prices that are transparent, involve public consultation, and public reporting of decisions (including a periodic review by an independent body).
- Borrowings and dividend policies.
- Customer service standards and hardship policies.
- Risk allocation (consumers, the government shareholder and private suppliers).
- Clearly specified and fully funded Community Service Obligations.
- Performance reporting against the charter.
- Performance reviews and sanctions for underperformance."⁸

The implementation of the above noted factors will help ensure static transparency. If implemented, such a charter will ensure that consumers only incur costs associated with providing water at efficient costs and that any inefficient expenditure will be dealt with by providers (or ultimately the state government with lower dividend payments). The Council also notes that the proposed charter is to a significant extent on behalf of customers as consumers, and suggests that consumer representatives might be considered as another party to the charter in addition to the providers, the regulator and the State.

⁸ Productivity Commission, 2011, Australia's Urban Water Sector, Productivity Commission Inquiry Report, No. 55, August. Page XXXVII

Support for the ERA obtaining independent advice

The Council is pleased that the ERA obtained independent advice from Cardno, which indicates that a number of improvements can be made with demand forecasting and capital expenditure planning. The Council recommends that these recommendations are included in any new charter between the state government, the water service providers and the ERA.

Expanding the customer base for drainage charges

The Council notes that a number of submissions have suggested expanding the water service charge to all customers. The Council agrees in principle with the argument in the submission from the Department of Water ^[1] that suggests drainage is a public good and therefore all customers should be charged for it. In theory, The Council welcomes a reduction in charges for customers currently subject to drainage charges, provided this outcome is achieved in an equitable fashion. However, in discussing the potential expansion of drainage charges to all customers, The Council reiterates our concerns with the impact on low-income households of a move away from GRV charging, and suggests that if the customer base is to be expanded, we would prefer it to be done on the basis of a commitment to continue the GRV method. We remain concerned that changing to a fixed levy will impact disproportionately on low income households and tenants of rental properties.

Expanding the customer base for the drainage charge will see many households being charged for drainage for the first time. While The Council accepts that such a charge should be relatively modest for low income households if the GRV method for calculating the charge is maintained (considering the \$66 p/a proposed in the draft report), we remained concerned by the potential impact of any increases in charges on low income and vulnerable households during a period in which we are seeing rising rates of utilities hardship.

The Council reiterates its concerns in relation to the results of its recent Cost of Living Report 2012, which indicates that a number of low-income household types are operating on deficit budgets and have little or no capacity to absorb further price rises. If the net impact of changes to water services charges is such that the addition of a new drainage charge for these customers is offset by cost efficiencies elsewhere and we see greater equity in the levying of water charges overall then this is likely to be a positive result. Otherwise we would recommend caution in increasing prices for households already experiencing utilities stress.

^[1] See Department of Water submission, <http://www.erawa.com.au/cproot/10303/2/20120413%20Efficient%20Costs%20and%20Tariffs%20of%20the%20WC%20Public%20Submission%20-%20Department%20of%20Water.pdf>

Recommendations:

1. Maintain the current system where waste water and drainage charges make up the bulk of the households water costs, based on the current GRV pricing structure.
 - a. To ensure that there is a transparent process, the Council would like the see tariff forecasts released in the Authorities' final report to show what the tariffs would be if the same ratios that currently exist between the tariff classes were maintained.
2. Extend the tariff review to 5 years (from the current 3 years).
3. Introduce a Charter between the State Government, the water service providers and the ERA that incorporates all of the key elements that the Productivity Commission recommends are needed in such a charter.
 - a. Include Cardno's recommendations in any new charter.
4. If the recovery of drainage charges is spread to all customers, the method to calculate the drainage charge should be based on the current Gross Rental Value pricing structure to avoid increasing prices for low income households already experiencing utility stress.