

**National Competition Council
The 2003 Policy Assessment
for Water Reform**

Submission by

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March 2003

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National Competition Council
The National Competition Policy Assessment for Water Reform
Submission from Anthony Hocking

1. Introduction

This submission has been made in response to the invitation contained in “The 2003 National Competition Policy Assessment Framework for Water Reform” (NCC February 2003).

This submission relates to the review relating to water reform in Tasmania. It notes the supplementary assessment made by the NCC in November 2002. It also refers to the Revised Urban Water and Wastewater Pricing Guidelines for Local Government in Tasmania (Tasmanian Government January 2003), the Audit that has been conducted by Tasmania’s Government Prices Oversight Commission and the water reform issues that have been identified in the Review of Tasmania’s Local Government Act that is currently taking place.

It will be argued that a significant gap remains before Tasmania can be said to have met its Council of Australian Governments (COAG) obligations with respect to Full Cost Recovery and Rate of Return Reporting and the adoption of Two Part Tariffs.

It will also be argued that there appears to be a reluctance on the part of some Local Authorities in Tasmania to addressing water reform issues. There is the question of what part of the responsibility for achieving water reform rests with the State Government, with GPOC, with the Audit process conducted by GPOC and what powers, if any, Local Government retains to circumvent such reforms.

Finally, whilst the NCC may be primarily concerned with interstate competitiveness and competitiveness between authorities within a State and either the abolition of cross subsidies between classes of consumers or the transparency of such arrangements, it will be argued that the existence of cross subsidies between consumers within a particular class is also a matter for concern and should be addressed by the NCC.

2. The National Competition Council's 2003 Assessment Framework

2.1 The 2002 Assessment

The 2002 Assessment by the Council found that Tasmania was not fully meeting its COAG obligations with respect to Full Cost Recovery and the application of appropriate asset valuation principles. Seven local authorities were found not to be complying with Full Cost recovery obligations.

In a supplementary assessment conducted in November 2002, the Council found that Tasmanian LGAs were broadly adopting acceptable methodologies for asset valuation. The NCC also noted that the 7 Local Government Authorities had made a commitment to have full cost recovery in place by 2005.

For its part the Tasmanian Government made a commitment to provide support to local governments to assist them to meet their COAG obligations.

These commitments included,

- ❑ Revision and issue of guidelines and policy statements, provision of educational material, targeted consultation and correspondence;
- ❑ Developing a water reform education support program for local governments setting out the scope, objectives, methods and timing;
- ❑ Conducting regional seminars and workshops for practitioners; and
- ❑ Establishing a Website that draws together government water-related information.

Critically, whilst the Council accepted that these commitments from Tasmania could be received as meeting Tasmania's 2002 obligations, it also noted that Tasmania now needed to implement these proposals. The 2003 Assessment therefore becomes an important test of Tasmania's commitment to full cost recovery, asset valuation and education in support of the reform process.

2.2 Issues for Assessment in 2003

Urban pricing reforms have been listed by the Council as a general issue of assessment during 2003. This is of critical interest in Tasmania and includes

- full cost recovery,
- consumption-based pricing,
- reporting of community service obligations (CSOs); and
- cross subsidies.

And in addition with respect to,

- Institutional separation

Full Cost Recovery

The expectation is that Tasmania will move to achieve its full cost recovery timetable by 2005 and is implementing its educational commitments. The NCC expects information from Tasmania on how implementation is proceeding.

Consumption-based pricing- Urban

The principle set by the NCC is that volumetric charging should be pursued as this is likely to encourage more economical water use and defer the need for costly additions to water infrastructure. The preferred NCC model is 2 part pricing that includes a fixed charge access component and a volumetric charge. It has, however, indicated that such a charging regime need only be implemented where it is cost effective to do so.

In Southern Tasmania it has been argued that 2-part pricing is not cost effective in some Council areas. It is noted that the NCC is seeking “robust evidence” from the Tasmanian Government that 2-part pricing is not cost effective for Derwent Council.

Reporting of Community Service Obligations

The NCC now expects Governments to provide information on the framework they are using to identify, cost, fund, deliver and report on CSOs.

Cross Subsidies

NCC has recognised that property-based charging schemes for water and waste water operate and affect many Tasmanian consumers. It will be argued in this submission that cross subsidies exist as a result and have not yet been identified. The NCC assessment framework requires Tasmania to advise on the existence of such subsidies, how they are being identified, whether they will be continued and those that remain will be reported in future.

Institutional Separation

Tasmania is being asked to advise on how it proposes to improve the transparency of reporting information on pricing, CSOs and cross-subsidies.

In addition, it will need to explain what progress has been made for dealing with complaints from consumers about water charging and water service standards.

Allocation of Water

The allocation of water between users has the potential to create potential conflicts of interest between allocators and users, particularly if the effective allocator is also a major user. In Tasmania the respective roles of the Rivers and Water Supply Commission as nominal allocator Hydro Tasmania (as the major user and *de facto* allocator) and rural industry (major user) has the potential to create such a conflict of interest. The NCC is seeking information to determine whether the water management plans and conditions in the Rivers and Water Supply Commission's operating licence are delivering sufficient transparency to minimise any potential conflicts of interest.

3. Tasmania's Revised Urban Water and Wastewater Pricing Guidelines

3.1 The Revised Guidelines

"Tasmania's Revised Urban Water and Wastewater Pricing Guidelines, Consistent with the CoAG Water Reforms" was released for Local Government in Tasmania in January 2003.

The guidelines address the 2 central areas of,

Full cost recovery and rate of return reporting, and
Two-part tariffs,

As such they may be considered as part of the Tasmanian government's implementation of its commitment to the NCC following the Supplementary Assessment of Tasmania made in November 2002 by the NCC,

The revised Guidelines are of relevance to the GPOC Urban Water and Wastewater Audit of local Councils with respect to full cost recovery and determination of the rate of return on their water business.

The GPOC audit request has been provided to councils in template form (Attachment 1 of the Guidelines) that requires them to,

- Establish the lower and upper limits for full cost recovery
- Disclose and include water and waste water services used by the Council itself
- Recognise and account for community service obligations.

The revised template used in the current Audit requires each Council to provide the following information for 2001-02;

- Fixed rates and charges
- Volume-based charges
- Other fees and charges
- Other revenue
- CSO payments and transfer
- Total Revenue.

Notionally at least, the guidelines and the audit process appear to provide an improved mechanism through which the Tasmanian Government will be able to satisfy the NCC that, it is meeting its commitment to issue revised guidelines and to provide assistance to local councils as they move towards compliance with respect to full cost recovery and the determination of the real rate of return on water and waste water.

The Guidelines assist local authorities in their task of identifying CSOs and report back on them to GPOC and through GPOC to the NCC.

The requirement that local councils must also report and properly value their own water and waste water usage is another important step towards full cost recovery and provides the opportunity for local authorities to treat such payments as a CSO and to transfer revenue from general rates into their water business. If full cost recovery is to be achieved by the water and wastewater business it is essential that water for Council's use is correctly valued at the rate that would have been paid by a private user.

A critical objective of the GPOC Audit must be to ensure that each authority's water and waste water business is ringfenced. In short it must be satisfied that full cost attribution is occurring and that CSOs and Councils own use are correctly identified and reported.

The GPOC Audit does not apparently directly relate to the second major plank of water reform – Two Part Pricing, though the Revised Guidelines relate to this aspect of water reform.

For many people in Tasmania failure of some Councils to either adopt 2 part pricing or to properly apply 2 part pricing is even more of a concern that their failure to ringfence their water business. These concerns relating to the failure to adopt 2 part pricing will be addressed in a later section.

The immediate concern lies firstly with the scope and boundaries of the GPOC Audit and secondly with the processes associated with it.

3.2 Scope and boundaries of the GPOC Audit

It is understood from the Revised Guidelines that the key question for the GPOC audit is,

Are councils recovering revenue (including CSOs) from their water and wastewater business that is sufficient to recover all costs, but is not so high as to provide a rate of return that indicates monopoly profits?

However, the revised template brings with it the suggestion that the audit will, or has the potential, to provide information on the extent to which Tasmanian councils are working towards the other objectives of water reform. However it is unclear where the GPOC audit stops and to what extent it may be able to provide the Tasmanian Government and the NCC with information relating the existence of cross subsidies between user classes and the transparency of such subsidies.

Letter to GPOC from Hocking January 31, 2003

A letter seeking clarification on what the audit would be able to achieve and what additional information it might gather was sent to the Chairman of GPOC on January 31. This raised a number of questions relating to,

1. The scope of the audit and the use that might be made of its results, and
2. The likelihood that the audit would provide GPOC, the Tasmanian Government, the NCC and the general public with reliable and useful information.

The letter provides a response to each of the questions posed.

By way of general comment the letter states,

In relation to your query on GPOC's responsibilities with regard to ringfencing and cross subsidies, GPOC has no responsibility to consider or report on the issue of ringfencing water and wastewater business. As to the identification of cross subsidies, GPOC is concerned with cross subsidies between water and non-water activities but not otherwise as this is outside the scope of the COAG reform requirements and thus GPOC's Terms of Reference. You may note though that GPOC has been requested to consider cross subsidies in the context of the use of property value based charges.

The questions and the replies from GPOC were as follows,

Questions to GPOC from Hocking 31/1	Response to Hocking from GPOC
<p>1. The audit involves councils providing information based on a pro forma determined by the Guidelines. How will GPOC establish that information provided by councils with respect to each of the designated revenue and cost elements is accurate?</p>	<p>1. To verify the accuracy of information provided by councils in the Reporting Template, GPOC crosschecks this information against the council's Annual Report and audited Financial Statements. Where differences in the figures are identified these issues are then raised and resolved with councils.</p>
<p>2. Which of the other aspects of COAG's water reform guidelines will come under scrutiny during the review apart from full cost recovery?</p>	<p>2. The areas of COAG's water reform guidelines covered by the audit are detailed in the Terms of Reference of the audit, a copy of which is attached for your information,</p>
<p>3. Within the subject of full cost recovery,</p> <p>3.1 Will they include the determination of CSOs and information that indicates CSO payments are met from general revenue rather than from the water and waste water business. (See Reporting Format for Full Cost Recovery Guidelines)</p> <p>3.2 Will the Audit Report provide information by Council on the breakdown of revenue from fixed charges, volume based charges and Council CSO payments?</p>	<p>3. In relation to the subject of full cost recovery:</p> <p>3.1. GPOC will assess that CSOs reported by councils are within the Community and Service Obligation Guidelines, issued by the Department of Premier and Cabinet in November 2000,</p> <p>3.2. The data requested from councils included a breakdown of revenue from fixed charges and CSO payments,</p>

Questions to GPOC from Hocking 31/1	Response to Hocking from GPOC
<p>4. 4. Will the audit probe the degree of compliance (including progress towards implementation) of 2 part pricing bearing in mind that this is the other principal element of water reform, or is it considered that this element has already been satisfactorily resolved?</p> <p>4.1 Will GPOC require justification for the prices charged to particular classes of users for water and waste water as a fixed or volumetric component or in the form of excess water charges?</p> <p>4.2 Is there to be the identification and publication of the existence and magnitude of remaining cross subsidies between classes of users?</p> <p>4.3 Will progress towards an acceptable system of volumetric charging or 2-part pricing that would further the aim of achieving water industry reform be monitored by GPOC or will this be left to the NCC?</p> <p>4.4 Is there provision for any independent assessment of conclusions reached about the cost effectiveness of 2 part pricing where Councils have found 2 part pricing to not be cost effective?</p> <p>4.5 Will there be any determination of whether the water services of each council are fully independent of other operations of local government? It is assumed that this must be an essential element of any determination of full cost recovery.</p>	<p>4. GPOC will be undertaking a high level review of the application of two-part tariffs in those councils that have implemented such a structure.....However, it should be noted that...</p> <p>4.1. the justification of prices charged to classes of water users is outside the scope of the audit;</p> <p>4.2. GPOC is not required to identify the existence and magnitude of cross subsidies between classes of water users:</p> <p>4.3. the issue of cost effectiveness of implementing two-part pricing is a matter for councils and the Government and is not within the scope of this audit;</p> <p>4.4. COAG required only that the cost-effectiveness of two-part tariffs be investigated and GPOC does not have a role in investigating the appropriateness of cost-effectiveness conclusions. However, GPOC does recognise the limitations in taking into account externalities and will be considering data provided no externalities through the audit data request: and</p> <p>4.5. the audit is essentially about determining whether the revenue from water and wastewater services is between the upper and lower bounds allowable,</p>

Questions to GPOC from Hocking 31/1	Response to Hocking from GPOC
5. Should the audit require Councils to reconcile the volume of water supplied to different classes of users (including use by the councils themselves) with the volume of bulk water taken? In such circumstances what evidence would GPOC require of system leakages and how would the existence of such leakages affect the cost effectiveness of 2-part pricing?	5. It will not always be possible for councils to reconcile the volume of water supplied to different classes of users with the volume of bulk water taken where there is no metering in place. Nevertheless councils have been asked for an estimate and costing of leakages
6. What level of scrutiny of councils operating plans is GPOC proposing to assess whether there is full compliance?	6. GPOC is satisfied that the data provided by councils will provide information to assess councils' compliance with the Guidelines. Where information is insufficient or unclear, GPOC will be seeking clarification from the relevant councils,
7. What approach does GPOC intend to take with respect to situations where water pricing is based entirely or in part on property values? Will GPOC provide information to the NCC in such circumstances that will enable it to determine whether this is "undermining the principle of consumption based pricing"?	7. As you will note from the attached Terms of Reference, the audit will include examination of the issue of water pricing based on property values for the fixed component of two-part tariffs and single-part tariffs. In particular, examination will be undertaken of whether the use of property based charges constitutes a cross-subsidy that is likely to create inefficiencies in the use and provision of water and wastewater services,
8. Where councils have been identified as not complying with full cost recovery commitments and have given an undertaking to complete reforms by the 2005 NCP assessment, what part will GPOC play in determining an acceptable timeline or in monitoring progress towards compliance over the period?	8. The monitoring of progress towards complying with the Guidelines where a council has been identified as not currently complying is the role of the Government. The audits undertaken by GPOC will provide information that the Government can use for this purpose;

Questions to GPOC from Hocking 31/1	Response to Hocking from GPOC
9. What relevance, or justification for using property values to determine water pricing, is to be found in allowing councils to “determine whether their social objectives can be met by using property values, rather than by applying a more uniform, or cost reflective pricing approach”. (UPWG 2001, p.26).	9. As noted above, the issue of using property-based charges for water pricing will be examined as part of the audit,
10. What opportunity will there be for making a submission or a comment at any stage of the Review Process either with respect to the information sought or the quality of the information provided? Or will the Review be a closed audit?	10. In relation to making submissions on water pricing, it is not appropriate in the context of the Terms of Reference for the audit that submissions be received. However, submissions can be made to the Government on issues raised in the Audit Report following its release and publication on the Department of Premier and Cabinet website,
11. Will the Audit Report that is provided to the public at the end of the process in 2003 be in the summary form adopted in 2002 or can a more comprehensive report be anticipated?	11. In relation to the form of the Audit Report, it is intended to provide a more comprehensive Report in 2003 than that released in 2002 addressing all matters are required in the Terms of Reference. In addition GPOC has undertaken to provide some high level benchmarking.

It is submitted that the GPOC audit template does provide it with the opportunity to gather much information that would enable the NCC to gain a much better appreciation of the extent to which Tasmania is making progress towards water reform.

However, it is submitted that the first task of GPOC and the NCC is to satisfy themselves that each authority has fully ringfenced its water and waste water business and that any shortfalls in full cost attribution are correctly and accurately identified as community service obligations (or their equivalent) and reported as such. It is also expected that other cross subsidies will be accurately identified and reported.

The news that GPOC's public reporting will be more comprehensive following the current Audit is to be welcomed. It is hoped that such reports will provide information in some detail with respect to each council.

It is noted that GPOC expects councils to provide information about their waste and wastewater business in their Annual Report. Our view is that the level of reporting should be such that it is possible to identify cross subsidies between classes of users, CSOs, the contribution to revenue from fixed and volumetric charges, excess water rates real rates of return and the reconciliation of water used with bulk water taken from a water authority.

4. Two-Part Pricing

The Revised Urban Water Guidelines devoted pages 14-19 and Appendix 2 to the subject of 2-part tariffs. This, in effect, provides guidance to Councils on how to develop a 2 part pricing regime. The considerations that the GPOC Audit will give to two-part pricing have been referred to in the previous Section.

However 2, seemingly contradictory, principles are being applied by the NCC.

On the one hand there is the acceptance of the principle that 2-part pricing will not be required where it can be demonstrated that 2-part pricing is not cost effective.

The second principle that has been accepted is the recognition that charges based (instead) on property values do not necessarily reflect the cost of services provided to different customer classes. The 3rd Tranche Assessment (2001) states that “where property values are used the Council will look to ensure that they do not undermine the principle of consumption based pricing”.

Charges based on property values appears to be the most frequently applied system in situations where 2-part pricing is deemed not to be cost effective. In such circumstances Tasmanian Councils that use such a charging basis will find it hard to demonstrate that the principle of consumption pricing is not being undermined.

The argument has been put forward that 2-part pricing is not cost effective for local authorities in Southern Tasmania because they do not have water meters and there is claimed to be no demand in the medium and longer term for any additional infrastructure needs.

In a paper on Hobart’s Water Reform Agenda (attached as an Appendix to this submission) we have argued that cost effectiveness assessments made for local authorities need further careful examination. It is submitted that different models involving alternative strategies for introducing water meters need to be tested with a view to determining their relative cost effectiveness both in terms of outcomes for the local authority and outcomes for the community at large.

The need to re-evaluate the cost effectiveness of 2-part pricing becomes particularly important in circumstances where,

1. Charging based on property values leads demonstrably to consumption pricing principles being seriously undermined and the emergence of significant cross subsidies, and
2. No alternative superior (non volumetric charging system) is readily available. For individuals and consumer classes there is concern if the principle of consumption based pricing is to be sacrificed in favour of cost effectiveness without the extent of cross subsidisation first being measured, For many, in such circumstances the cross subsidisation should at the very least be transparent and, at best, make a case for compensation or an adjustment to the charging regime that provides for this.

However, if water metering is denied using the cost effectiveness test, then the measuring stick that can detect and quantify cross subsidies is lost with it. Indeed it is hard to see how local government authorities in Southern Tasmania that do not have water meters will be able to complete the GPOC audit by accurately identifying existing cross subsidies.

It is apparent that there are wide disparities in Southern Tasmania between the property values of business properties and the volume of water they use. Comparisons between the ratio of water and wastewater charges to property values in Hobart and mainland metropolitan centres (shopping centres and privately operated car parks) indicate disparities that run into multiples.

Accurate information on the variance of water usage between residential properties would also indicate that there are significant variations that bear no direct relationship to property values.

Hence it is submitted that whilst water meters are currently seen principally as a cost in the cost effectiveness test they should be required by the NCC as an essential tool in assessing cross subsidies.

Given also that leakage is an unknown percentage of water use in non metered areas, environmental considerations are an additional reason why metering should be required.

In the Hobart Water Reform Submission we have submitted that water meters can be introduced in a variety of ways that greatly limit the impact on Councils or residents and businesses.

The Hobart Council's proposal to introduce 2-part volumetric pricing for businesses, but not for residential property owners appears to fail to deal with the inter class cross subsidy issue.

It has also been indicated that councils may continue to embrace property value based pricing on the basis that it enables them to achieve their social objectives. It is unclear at this stage what sorts of social objectives are considered acceptable in justifying rejection of volumetric pricing.

It is also not clear how local Councils propose to pay for water and wastewater they use themselves if their charging system for others is based primarily on property values. It would seem both logical and necessary that Councils should use the same charging formula that they apply to other classes or users.

5. The Review of the Tasmanian Local Government Act

The Tasmanian Local Government Act 1993 is currently being reviewed and submissions are currently being sought.

The Issues Paper that has been developed to aid discussion had identified National Competition Policy as one of the issues to be addressed in the review.

In the discussion it is argued that there is currently no general requirement in the Act that Local Government meet NCP obligations.

Although Local Government businesses are required to comply with competitive neutrality principles and a complaints mechanism has been established through GPOC to investigate alleged non compliance. currently there is no requirement for a council to comply with a recommendation of GPOC arising from an investigation.

It has been indicated that the following questions have been raised as part of the Review.

- Should a provision be included in the Act applying some of all NCP obligations to Local Government?
- Should provisions be included in the Act regarding the process of identifying significant businesses and the application of full cost attribution?
- How should the use of AAV to determine pricing of services such as water and wastewater be reviewed in the light of NCP requirements regarding cross subsidies?
- Should a requirement be included in the Act that councils must comply with GPOC recommendations following a competitive neutrality investigation?

The COAG agreement on water reform has occurred since the Tasmanian Local Government Act became law. Since then the National Competition Council has assumed responsibilities for National Competition Policy. A consequence is that a number of the matters relating to competition policy are not unambiguously included in legislation.

There are some in Local Government in Tasmania who, nevertheless, hold the view that the new Local Government Act should contain as few prescriptions on councils and their business operations as possible. Such a stance is natural and understandable.

Our submission is that the powers and responsibilities of local government authorities with respect to National Competition Policy should be clearly stated in the new Local Government Act in response to the questions raised in the Issues Paper. It is anticipated that the NCC would also hold this view.

6. Water Management and the Rivers and Water Supply Commission

Water resources have been and remain the basis of Tasmania's hydro electricity power generation.

Whilst the allocation of Tasmania's water resources is nominally at the disposal of the Rivers and Water Supply Commission allocation has effectively been determined by and predominantly in response to the needs of the HEC, now Hydro Tasmania. Other industrial users such as the State's rural producers have needed to gain allocations from the electricity generating authority. In the 1950s and 1960s demand from farming for irrigation waters was modest and the need for more water for additional hydro electricity was undeniable and the demand from farming for irrigation waters was modest and accommodated.

This is not the case today.

Farmers are seeking additional water allocations in the large South Esk Catchment area and have been involved in discussions with the Hydro and Rivers and Water Supply Commission about future allocations of water for farming and how much the Hydro would charge farmers for water allocations.

Given the thrust of National Competition Policy it seems curious that Hydro Tasmania should have both a dual role as both a user and an allocator of water. There remains the question of whether water is being allocated efficiently and what the respective roles of Hydro Tasmania and the Rivers and Water Supply Commission should be in the future.

If the Hydro or the Rivers and Water Supply Commission is to determine a price for water for irrigation, how is that price to be determined?

Given the added opportunities for Hydro Tasmania to sell power to mainland Australia through BassLink, how will the future needs of the Hydro and rural industry be determined and who will make that determination?

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31 March 2003

Appendix

Hobart's Water Reform Package

A Submission to the Hobart City Council

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March 2002

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Synopsis of the Submission

The Property Council of Australia has noted the environment in which the Hobart City Council has produced and endorsed its Water Reform Package and presented it for public comment.

The environment is one where all Tasmanian Councils have been required to revisit their water and waste water policies following the Council of Australian Governments' Agreements on the application of National Competition Policy.

The pressure on Councils has been to move towards a user pays policy for water, to consider the introduction of either volumetric or two-part pricing for water, to achieve full cost recovery for water services and to pursue the objectives of equity (through the elimination of cross subsidies) and transparency.

The State Government (working through GPOC and DPIWE) and the Hobart Council (through privately commissioned research) have reached certain conclusions about water reform and its application to the Hobart City Council.

These conclusions are that,

1. Full cost recovery (including a real rate of return) should be an element in the reforms,
2. Two-part pricing involving universal water metering would not be cost effective, and that
3. A public benefit test suggests that full cost attribution is to be preferred to corporatisation as the model for administering water services.

We have concerns about the soundness or relevance of the second and third of these conclusions.

Council's subsequent water reform package has 2 central features,

Full cost recovery will be based on the application of an enhanced full cost attribution model, and

2-part pricing will be introduced by 2005 but will be restricted to non-residential properties.

The Property Council of Australia welcomes the Council's decision to pursue a water reform agenda, but agrees that it has a long way to go before the reforms will achieve the COAG objectives.

Concerns about the Package include that it remains a statement of principles, with no detail and that Council appears to have no data on which to model the changes or assess the impact of such changes. In consequence, there are no indications of what

the outcomes will be for water users or ratepayers, there is no discussion of how the system will become more transparent and the timelines for implementation remain vague.

The Property Council is, nevertheless, anxious to find a way forward and believes there is a need for Council to reaffirm its commitment to completing the water reform journey.

As it stands, implementing the new package is likely to have some unfortunate, and perhaps unintended, outcomes. Full cost recovery, coupled with 2-part pricing of non residential properties only will require Council to determine the amount required to achieve full cost recovery and to break this down into a fixed component and a volumetric charge.

The volumetric component needs to be equitably spread across all classes of users. The volume used by different non-residential users will be accurately determined through water metering. Although residential users will not be metered, the volume taken by them will need to be taken as the volume of water purchased, less the water used by non-residential users. Charges to this group will then be based on AAV.

Weaknesses in this process are that the group will bear the system leakage charges and there is no provision under these arrangements for individual residents being able to reduce their water charges by changing usage patterns.

We are extremely disturbed by the fact that Council has only very poor data on water usage by property owners including little information on variance between different residential properties and poor knowledge about system leakage.

We believe that Council has been premature in dismissing the possibility of making more widespread use of water metering in both non-residential and residential sectors.

At the very least random residential water metering would provide Council with much needed information about residential consumption and allow it to test whether AAV is a good proxy for water usage.

Developing the billing system so that residential property owners could install meters at their own expense and opt to be charged on a user pays basis would lead, over time, to a fully metered system with no capital costs to Council. There would be a significant incentive to install a water meter, as the balance of full cost recovery would fall on high water users.

Finally, we have argued that the suggestion made by others that a reduction in water consumption would lead to an increase in bulk water price from Hobart Water should be ignored. Hobart Water's pricing policies are subject to scrutiny by GPOC and should be left to that authority. To advocate policies that waste resources is bizarre. We note with satisfaction that Council is committed to sustainability and is proposing other initiatives designed to educate residents and to reduce water consumption.

Summary of Recommendations

1. That Full Cost Recovery be adopted as a basic principle underpinning the water reform package.
2. That Council endorse a commitment to the principles of user pays (where appropriate), equity of treatment for all classes of users and individual users within each class, transparency of revenue and costs of supplying water and waste water.
3. That the Public Benefit Test for corporatisation be reworked with its scope enlarged to include equity, transparency and accountability.
4. It is recommended that when the Public Benefit Test is revisited, that the benefits of corporatisation and the scope and assumptions underpinning the test be re-evaluated including the nature of the Full Cost Attribution (FCA) model on which the comparison is based.
5. It is recommended that irrespective of whether a Corporatisation or Full Cost Attribution Model be adopted, that the water and waste water charging regime be transparent and subjected to scrutiny by an independent statutory body with opportunity provided for public comment.
6. It is considered that GPOC rather than a peer group body from Local Government would be an appropriate entity to conduct such reviews.
7. That Community Service Obligations (CSO) be limited to specifically identified individuals and groups within the Community and that the costs of meeting these obligations be set against the general rate rather than any user group.
8. That industrial and government water users be charged for water and waste water on a user pays principle.
9. That Council's own use of water be measured and paid for on a user pays principle.
10. It is recommended that infrastructure maintenance charges be built into a single price for water (as is the case with bulk water charges) rather than providing the justification for a 2-part pricing system.
11. That in the event of 2-part pricing being adopted, the justification for the access (fixed component) charge be scrutinised and that the use of this element to affect the equity of the charging system be resisted.
12. It is recommended that Council develop an accurate method of measuring the use of water by different classes of users.

13. All commercial, industrial, government and council properties should be metered.
14. As a very minimum Council should also install water meters in a random sample of residential properties and collect data on variations in water usage between properties and at different times of the year.
15. It is recommended that these randomly installed meters be used to test the level of inequity and cross subsidies that exist.
16. It is recommended that Council express a commitment to developing processes that deliver fair and equitable water charging for all classes of users and for individual property owners within each class.
- 17. It is recommended that the CSO argument not be used as a justification for perpetuating large scale cross subsidies between classes of users.**
18. It is recommended that Council use these water meters and their usage to test the hypothesis that AAV is a good proxy for water charges based on volumetric or 2-part pricing. If the hypothesis was found to be true this would constitute a powerful argument against universal water metering of residential properties.
19. Should this test fail, then a system must be devised that will allow individual residential properties to reduce their water and waste water charges by reducing usage, should they desire to do so.
20. It is recommended Council require metering of all new and transferred properties.
21. It is recommended Council model a voluntary metering trial that would reward low use residential and business users and would provide inducements for householders to install meters by offering them a choice between a volumetric charge or an AAV based charge.
22. It is recommended that the costs of installing water meters be borne by property owners, recognising that metering would be voluntary (except in the case of new properties and property transfers) and undertaken when property owners perceived a benefit from doing so.
23. That the cost of installing meters be borne by Council only in situations where there is a clearly identified Community Service Obligation.
24. That Council consider a number of options for reading meters and billing residential (and other) property owners with a view to reducing the administrative costs of charging and collecting revenue, and making the payment system as simple and painless for the property owner as possible.

25. Since water metering need not be compulsory, except in the case of new properties and property transfers, no timelines need be set for achieving 100 per cent metering of either residential or business properties.
26. Timelines will still need to be set to progressively reduce sectoral inequalities between the contribution to full cost recovery by business, residential, bulk commercial and public water user sectors as a whole.
27. It is recommended that such sectoral inequalities be removed within 5 years and that leakage be accurately identified within 8 years.
28. That Council endorse the recommendations of GPOC with respect to bulk water pricing by Hobart Water, particularly with respect to volumetric pricing and the application of the marginal capacity charge.
29. That Hobart City Council ignores the effects of Council's water reform package on Hobart Water, but works with GPOC to ensure that the user pays principle is applied to the supply of bulk water services.

Section One – The Issues and the Environment

1.1 Water and Waste Water

(a) Water

Hobart provides water within its council boundaries for drinking and cooking, sanitation, irrigating and fire fighting for use in domestic, commercial, industrial and public sector applications.

The water is obtained from the part Council owned Hobart Water. It is distributed through an infrastructure that includes some 450 kilometres of water mains, 6 water pump stations, 18 reservoirs, etc.

Water consumption in the financial year 1999-2000 was 11,680 megalitres equating to 696 litres per person per day.

It has been estimated by the Council that residential use makes up approximately 47% of total consumption, commercial and industrial use approximately 25% and State and Commonwealth Government a further 16%. It is difficult to verify the accuracy of each of these estimates, or the use by Council itself, or of leakages to the system in the absence of a comprehensive operational water metering system.

(b) Waste Water and Sewerage

Council has 413 kilometres of sewer reticulation mains, 21 sewage pump stations and 2 wastewater treatment plants. Over 95% of tenements are sewered. It is estimated by Council that 50% of the flow to the Council's sewer system is from domestic properties, 40% from commercial properties with domestic strength wastewater and the remaining 10% is high strength wastewater from industrial properties.

(c) Charges for Water and Sewerage

Current arrangements for water and waste water are for rates to be struck and bases on the assessed annual value of a property (AAV).

The following charges are believed to apply for Hobart.

Hobart	Component	Water Rates	Total \$Million	% of Council Income	% of Council Income
Rating basis	Water	2.4C per \$AAV	8	17	12
Rating basis	Sewerage	1.65 per \$AAV	4.5	9	6
Rating basis	Stormwater	0.47 per \$AAV			

The key feature of existing arrangements is that they are based on AAV and hence on access rather than on a payment system that takes into account the water that is used.

1.2 Current Arrangements

Whilst the need to comply with National Competition Policy has been the driver that has recently focused the attention of the Council on water and waste water charges, the Property Council of Australia and the Members it represents have been concerned about the unsatisfactory nature of existing arrangements.

Partly, and most directly, this concern has been because of a perception of unfairness in the existing arrangements. It is relatively easy to show that commercial property owners in Hobart pay a very high price for the water they use. This proposition holds both in comparison with other users of water in the Hobart Council area and when compared with similar commercial enterprises operating in similar sites in other Australian States. It must be said that this concern of the owners of commercial properties is not restricted within Tasmania solely to the Hobart Council area.

The concerns about water and waste water charges in Hobart extend beyond the immediate costs to property owners. They extend firstly, to the heavy imposts placed on their tenants from whom fully, or in part, these outgoings need to be recovered.

Looking further down the line it is apparent that such high costs place businesses wishing to establish in the Hobart CBD, or more generally in Tasmania, at a cost disadvantage. This translates directly into a loss of job opportunities.

For an investor, Hobart may be quite unattractive compared with mainland locations. This not only means lost investment opportunities, but also serves to depress all commercial property values.

1.3 COAG and the Changing Local Government Culture

National Competition Policy (NCP) is a term that usefully captures the connecting subject matter of a series of agreements made by the Council of Australian Governments (COAG) in 1995 following the recommendations of the Hilmer Committee.

The Competition Principles Agreement included Local Government services and bodies throughout Australia. In doing so it set out to reshape the environment in which Councils are required to provide services and do business. In essence the Agreement has placed pressure on Councils to develop new approaches to the delivery of services based on commercial principles and assessment methods designed to achieve improved (value for money) service delivery.

As part of the COAG “water reform agenda” Tasmania was required to review urban water pricing to ensure that its pricing systems were consistent with the effective and efficient provision of services and use of water resources. In effect this requirement is for the adoption of “consumption-based” pricing by Councils with 1,000 or more connections. This has been seen as a need to include a volumetric component in water pricing to reflect water usage **where this is cost effective.**

1.4 GPOC, Water Reform Guidelines and Two-Part Pricing

In December 1998 the Tasmania Government commissioned GPOC to develop guidelines and a model that could be used to review existing water supply schemes to determine the cost effectiveness of a move to volumetric or 2-part pricing.

Subsequently, the National Competition Council (June 1999) noted,

- ❑ Water reform in Tasmania had been delayed (largely by external factors),
- ❑ Concern that Tasmania had been unable to advise when it would meet its commitment to introduce 2-part pricing,
- ❑ Tasmania would provide an implementation program by December 1998 for each instance where 2-part pricing was shown to be cost effective, and
- ❑ Failure to do so would lead the Council to consider recommending a deduction of competition payments to Tasmania.

The Guidelines

a) Cost and pricing reform

2-part pricing to be put in place where cost effective.

Governments to remove cross subsidies wherever possible.

Where services are provided to classes of customers at less than full cost, this must be fully disclosed.

Publicly owned supply organisations should aim at a real rate of return on the written down replacement costs of assets for both urban water and waste water.

b) Local Government Water Provision Pricing Principles

Water services should be financially independent of other local government operations.

Pricing arrangements should be transparent and monitored through local government strategic planning and reporting processes.

Prices should be cost reflective including a return on investment.

Users should have an input into the process including level of services.

Cross services should be eliminated.

Water pricing arrangements should contribute to environmentally sustainable outcomes.

Consumers should have the means to influence their bills by controlling the amount of water they consume.

c) 2-part Tariffs

The fixed component should be allocated on an equitable basis.

National Competition Council does not favour the use of property values to determine users fixed charges, though Councils may determine whether their social objectives can be met by using property values.

Options for allocation of the fixed component may include,

- Equal allocation between consumers of a particular class
- Allocation in proportion to the cross sectional area of the supply pipe.

Suggested that 1 15% fall in consumption may be anticipated following the introduction of 2-part pricing.

There will be winners and losers and a transition process may be required to reduce the impact.

d) Steps in Developing a 2-part Tariff

1. Assessment of impact on demand
2. Determination of the volumetric component
3. Determination of the fixed component
4. Allocation of the fixed component
5. Incidence analysis
6. Transition arrangements

1.5 Water Metering

It is difficult to conceive of the development of 2-part pricing without the water metering of properties.

It has been argued strongly that universal metering of properties (particularly residential properties) would be uneconomic. (KPMG 1999).

The GPOC model incorporates the following assumptions,

- A 20 year time frame for the model,
- A 10 year replacement cycle for water meters, and
- Minimum reduction of 15% in water consumption as a result of 2-part pricing.

The notional primary benefits arise from cost savings associated with lower consumption and include,

- Deferment of increases in capacity for which there would not be demand at cost reflective prices,
- Smaller size of new plant
- Reductions in variable operating cost, including electricity or pumping and treatment chemicals and other materials,
- Reductions in the cost of water purchases from bulk supply authorities,
- Greater control by consumers over the level of their water charges,
- Overall lower costs, and
- More environmentally responsible water use.

Estimates of the net present value of water metering the Councils in the Greater Hobart area proved negative and led to the conclusion that water metering would not be cost effective.

Reasons for this conclusion rest on,

- The low percentage of metered connections and the high cost of installing meters,
- Minimal savings in variable costs as a result of reduced demand
- Minor savings in capital costs as a result of reduced demand
- Decreasing water use, and
- A predicted decline, or at least no growth in population and hence in water demand.

In effect the net positive and negative consequences of water metering can be resolved into 2 or 3 points.

Positive	Negative
Control of consumers over water usage	Cost of water meters including replacement costs
Environmentally responsible water use	Fall in demand for water brings minimal cost reductions

The net effect of a series of investigations by Government are that,

- Water metering may not be cost effective for the Greater Hobart area but,
- Full cost recovery will be required to be implemented by all Councils as per ARMCANZ Guidelines.

1.6 Public Benefit Test

The public benefit test (PBT) that explored the relative merits of corporatisation and full cost attribution (FCA) concluded that corporatisation was not in the public interest because the negative outcomes of corporatisation outweighed the likely positive outcomes.

Within the positive outcomes of corporatisation were,

- More transparent pricing and costing of services, and
- A marginal improvement in governance outcomes.

Amongst the limitations of the PBT analysis were,

- ❑ Determination that equity effects lay outside the scope of the study,
- ❑ Failure to consider a model where the corporate entity would have had to operate with an external regulatory framework,
- ❑ Failure of the test to conform with *Guidelines for Considering the Public Benefit under NCP* (March 1997) or *Public Benefit Test for Corporatisation of Local Government Trading Enterprises* (Nov. 1998)
- ❑ Failure to justify the subjectively applied weightings to the elements used in the Test, and
- ❑ Whilst the PBT is based on a complete FCA model no attempt has been made to assess what the differences in public benefits can be from lower level applications of FCA.

The significance of these weaknesses raises some doubt as to whether the PBT result is as robust as is claimed in subsequent discussions.

The huge advantage of corporatisation of a \$13m business is that the requirements on a body corporate acting as a legal entity are that its dealings become transparent and open to scrutiny.

It is more difficult to convince the community at large that FCA will be transparent unless its dealings are also open to the same levels of compliance and scrutiny that would be required under corporatisation arrangements.

The need for transparency and scrutiny would be satisfied if charging practices of the monopoly needed to be justified to the Government Prices Oversight Commission (GPOC).

It may be argued that requiring GPOC to scrutinise the charging regime of each Council would be onerous and a waste of resources. As we shall argue later, the

question of equity is more important than the additional costs incurred in making sure that the system is fair.

In short, the Public Benefit Test as conducted does not come to terms with the central issues that water reform needs to address.

It is recommended that the Public Benefit Test be revisited, that the benefits of corporatisation and the scope and assumptions underpinning the test be re-evaluated, including the nature of the FCA model on which the comparison is based.

It is recommended that irrespective of whether a Corporatisation or Full Cost Attribution Model be adopted, that the water and waste water charging regime be transparent and subjected to scrutiny by an independent statutory body.

1.7 Hobart Water and the Price of Water

Bulk water is provided to the Hobart City Council by Hobart Water under a Full Cost Recovery Model that is subject to approval by GPOC.

In addition to providing bulk water to Councils, Hobart Water also supplies bulk water for irrigation and undertakes commercial activities in water testing and consulting.

In its 2001 Report, GPOC noted the progress made by Hobart Water including the introduction of 2-part pricing, but held the view that there was still some way to go in developing efficient volumetric pricing.

It drew attention to the problem of determining the fixed cost components and was concerned that the approach adopted overpriced the volumetric charge.

Hobart Water adopts the methodology that equates the volumetric charge to the regional average of Long Run Marginal Cost (LRMC) equal to the sum of the Short Run Marginal Cost (SMC) and the Marginal Capacity Cost (MCC).

GPOC notes (Draft Report June 2001) that the SMRC is calculated as the average operating cost from the 3 water sources available to Hobart Water. It concludes that the base level volumetric charge of 8.5 to 10.6 c/kl is too low, based on the cost of bringing water from Ridgeway to Bryn Estyn as approximately 20 c/kl. It concludes that the calculation of SRMC is too low. It also notes that Hobart Water faces limited capacity constraints and that MCC should be close to zero.

However, it is also noted that the MCC as calculated by Hobart Water “seems to be a type of peak load pricing” which is charged when its customers exceed a threshold set by Hobart Water as the average household level of consumption within Australia. The Commission recommended that Hobart Water set the threshold level for the imposition of MCC in terms of constraints in the system.

The significance of the pricing arrangements Hobart Water makes with the Councils including the Hobart City Council is twofold,

Firstly, Hobart Water is being required to conform with National Competition Principles including Full Cost Recovery and 2-part (including volumetric pricing) under GPOC scrutiny.

Secondly, it has been argued that the impacts on Hobart Water from water metering would have a bearing on the cost effectiveness of water metering.

The extent to which these impact on Hobart Water and their implications for Hobart City Council's water reform agenda are discussed in Section 6.

Section Two - Analysis of the Hobart Council's Water Reform Package

2.1 Principal Elements of the Package

Hobart City Council is to be congratulated in taking the first steps towards urban water and waste water reform with the endorsement of its "Water Reform Package" in June 2001.

The central points of the Water Reform Package are the acceptance of full cost recovery plus a real rate of return (within the context of Full Cost Attribution) and the proposed introduction of 2-part pricing (but limiting this to non residential property owners).

This Section analyses the various elements of the package including these two central propositions.

In particular it focuses on how Council may be able to proceed down the reform path by following through along the directions it has indicated.

In doing so it is noted that,

- Hobart City Council has not kept pace with the Federal water reform initiatives and issues relating to environmental sustainability, though it may have done more than some other Councils in Tasmania on the subject, and
- Hobart City Council has a considerable journey ahead of it if it is to embrace national water reform objectives.

2.2 Physical Sustainability

It has been acknowledged by Council (p4) that it has not kept pace with the Federal water reform initiatives relating to environmental sustainability. Sustainability initiatives identified by Council include greywater reuse, the introduction of guidelines and controls on groundwater, energy minimisation in pumping and reticulation, water sewerage and stormwater, water sensitive design and harvesting, on site sewerage treatment and stormwater detention and catchment management.

It is questioned whether physical sustainability might not be enhanced by a joint approach to these matters and the development of uniform or consistent policies by the Councils in the Greater Hobart area. Alternatively, there may be merit in considering the value in charging a single authority with such responsibilities, particularly if financial benefits can be associated with the improvements in sustainability.

2.3 Financial Reform

Financial Reform is seen as the centrepiece of the Council's Water Reform Package and its attempt to comply with the COAG agreements.

Council notes the desirability of eliminating cross subsidies if possible or alternatively making them transparent.

Internal cost attribution is put forward as the means by which the system will become "far more transparent". The internal cost attribution is said to "ensure that moneys required for water come directly from those units responsible for the management of water use by Council properties".

Council currently has power under the Local Government Act to install meters on all types of non-residential properties and any property drawing water for non residential purposes must also have a meter attached.

At present it is estimated that some 46% of non residential properties are metered. Most of the remaining 54% will be metered.

Council owned grounds (not leased to others) will be required to pay for water use and technology will be used to reduce Council's demand for water on grounds without detrimentally affecting these grounds.

2.3.1 Two-part pricing

Council will retain and extend its 2 different billing systems, one for metered and the other for non metered users. The metered users will have a 2-part system with a fixed cost based on connection size and a volumetric charge.

2.3.2 Full-cost recovery and real rate of return

Council does not currently recover the full costs plus a real return on its water and waste water services. It is proposing to do this, but will need to complete a full asset inventory before this can be implemented.

2.3.4 Leakage

Council proposes further leakage studies to determine how much water is lost with the intention of saving Council considerable costs in terms of lost water.

2.4 Institutional Reform and Sustainability

Council is proposing a number of initiatives to improve the quality of the water services it provides. These initiatives include,

- Separation of general rates and water charges,
- An improved computer support system,
- Enhanced customer service with improved service delivery performance standards,
- Legislative change to facilitate water metering, and
- Education initiatives.

Taken individually and collectively these initiatives can be expected to complement sustainability objectives and also to work towards the wiser use of water with an anticipated reduction in water consumption.

2.5. Benefits of Water Reform

The Water Reform Package has identified the following benefits from water reform,

Increased financial and environmental advantages,
 Increased meter coverage to detect waste water leakage,
 Customer focused billing allowing customers greater choice in water use,
 Elimination of cross subsidies or greater transparency,
 Separate rates and water charges giving ratepayers concrete information,
 May reduce Council's legal liability,
 Better quality information to the non-residential sector,
 Demonstration of some commitment to NCP objectives,
 Council will be showing leadership within the Tasmanian context, and
 Positive changes within QA processes endorsed by Council.

2.6 Proposed Time Lines

The timeline associated with the package provides for the metering of non residential properties over the period 2001 to 2005 and the introduction of 2-part pricing for the non residential sector over the same period.

During that period it provides for an iterative process of price level adjustments with annual adjustments.

Section Three - Summary of Concerns about the Proposed Package

Notwithstanding the commitment to water reform contained in the Water Reform Package, there remain a number of concerns about the package. These are listed in this Section.

Essentially it is a combination of a statement of principle which is supported by 2 main policies and a number of supporting measures.

It fails to explain how full cost recovery will be implemented or the time line that will be pursued in the quest for full cost recovery. It does recognise that Council is not yet in a position to pursue either full cost attribution or corporatisation at this stage because of a lack of information about costs and revenue elements.

Given the preference for achieving full cost recovery through a Full Cost Attribution model, there is no indication about how Council will refine its existing Full Cost Attribution model so that it reaches the level envisaged by KPMG when conducting its Public Benefit Test.

The Package gives no indication of what the outcomes for water users of different classes will be in terms of their absolute levels of charges for water or the relative costs for people within any class of water user.

It does not address the issues relating to inequity that were raised in Section 1 of this response.

Whilst there is a commitment to the elimination of cross subsidies where possible, it does not identify which cross subsidies can be removed and which will not. Where cross subsidies remain, it promises transparency, but does not indicate how such transparency will be achieved other than by the adoption of full cost attribution.

It does not provide any indication of its modelling processes or of how such modelling can be undertaken without reliable data on water consumption.

It is apparent that Council simply does not have good quality data on water consumption in either the commercial or the residential sectors.

It does not have reliable information on water leakages and has not provided any real evidence on how good quality information may be obtained.

In the Water Reform Package it does not justify the limitation of the application of 2-part pricing to non-residential properties. It is presumed that Council's decision not to extend 2-part pricing to residential consumers is based on studies that have drawn the conclusion that 2-part pricing is not cost effective. We have significant reservations

about these studies particularly with respect to the costs of water metering and the effects on water pricing.

There is no discussion of equity issues or how Community Service Obligations might be determined and applied.

No justification has been provided for the determination of either the fixed component of 2-part pricing or the volumetric charge that might be levied.

Thus the balance between revenue raised by access charges (the fixed component) and the levels of volumetric charges have been identified.

It is apparent that in determining the relative contributions to the fixed component, Council favours the size of the connection to a property rather than assessed annual value as the determinant. However, it is still not clear what the consequences of this approach might be.

It should be apparent that the conclusion to be drawn from this list of concerns is that support for the package as it has been articulated must be qualified because of the lack of information about how the package is to be implemented.

Our comments on how to best progress the implementation of the Water Reform Package are made in the following sections.

Section Four - The Way Forward

4.1 The Need for Full Commitment to Water Reform

Whilst the apparent commitment of Council to water reform is welcomed, there is an overriding concern that the Water Reform Package does not provide an endpoint that comes close to the objectives of National Competition Policy.

Unless the way forward is spelled out in considerably greater detail, there is a grave danger that the gains from the reforms that are mooted will be quite modest. The purpose of this Section is to recommend to Council how the reforms might be advanced and many of the concerns expressed in the previous Section, overcome.

We are working from the assumption that the Council's Agenda, its processes and timelines have been developed with a genuine intention to provide Hobart residents with the benefits from water reform that it has spelled out in the Water Reform Package document.

4.2 Implications of Full Cost Recovery and Two-part Pricing

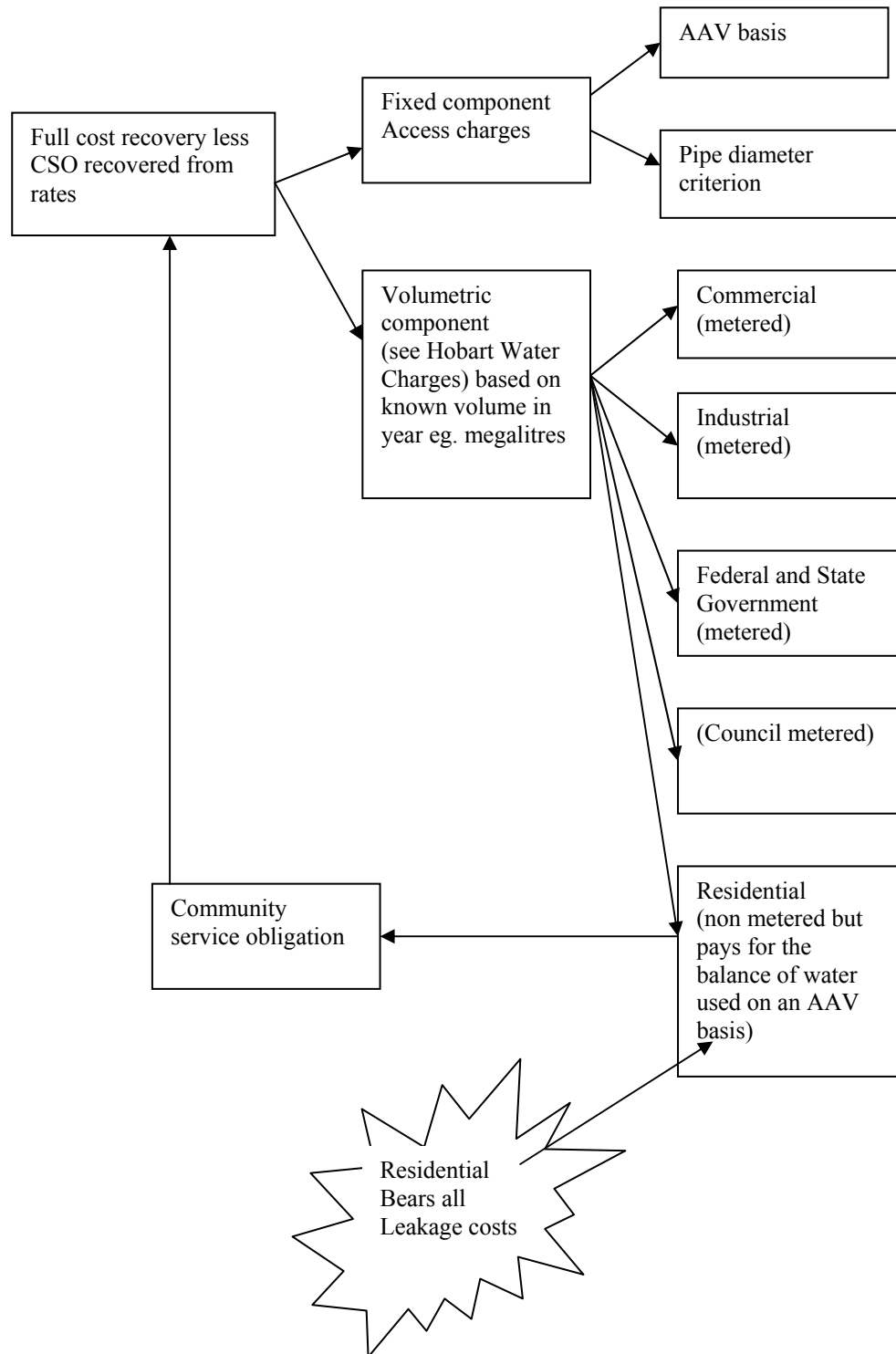
Revenue gathered from users for water and waste water apparently falls short of the amount required for full cost recovery when that recovery includes a real rate of return on Council investments according to KPMG.

It is anticipated therefore that revenue from users will need to be increased (other things being equal). Under either a Full Cost Attribution Model or a Corporatisation Model, revenue will be boosted because Council, like other non residential users, will be required to pay for the water it uses. Secondly, Community Service Obligations will be calculated and provide an additional source of revenue, without being a charge on any particular class of water users.

In a static model, once the amount of water to be consumed is estimated and the full costs of providing that water including the costs of servicing and maintaining the infrastructure have been determined under a set of realistic assumptions, then the consequences of the Council's 2-part pricing system are readily apparent.

They are identified with the aid of the following Figure.

Figure 1- Elements of a Full Cost Recovery, Two-Part Pricing Model For Urban Water and Waste Water



1. The amount required for full cost recovery will first be determined.
2. If COAG agreement principles are to be adhered to, the revenue to meet these costs will come from 2 sources,
 - 1) A fixed component or access charge, and
 - 2) A volumetric component based on the known volume of water Hobart obtains from Hobart Water in a specified period.
3. The relative size of the fixed component and the volumetric charge will first be determined, with a need to ensure that the fixed (access cost) will need to be subjected to critical scrutiny.
4. The fixed cost will be allocated between all users equitably (amongst each class) on the basis of either AAV or, in the Council's view, the diameter of the pipe, and thus in some way, reflect the infrastructure costs.
5. The volumetric charges will cover the balance of the sum required to meet full cost recovery. This will be based on the known volume of water used (Hobart Water purchases).
6. The charges will be allocated between the 5 classes of users; commercial, industrial, State and Commonwealth Governments, the Council and residential users.
7. The proportions payable by each of the first 4 classes will be accurately determined because in each case they will be fully metered.
8. The balance of the water will be paid for by the non metered residential users and determined on an AAV basis so as to meet the balance of costs less CSO obligations.

4.3 Gathering Data and Modelling the Options

A critical problem faced by Hobart City Council in the absence of a water metering system is a lack of information on which the options can be modelled. Whilst scenario modelling based on different sets of assumptions can be undertaken, charging regimes cannot be implemented with any certainty about outcomes, unless there is reliable data on which to base the simulation. And all this before we take into account the effects of changes in the regime on water consumption.

Council must develop methods that will give it reliable data that can be used to identify usage by each class of user and also the extent of system leakages.

It is also important to be able to measure the variance between users within a particular class.

At the very least some form of metering needs to be developed for all classes of users even if the principal purpose, in the case of residential users, is to provide Council with reliable information on water usage.

4.4 User Pays and Equity Issues

Our view is that scant attention has been paid in the Water Reform Package to equity issues and that this needs to be addressed.

It must be emphasised that the lack of interest in equity issues is not confined to this particular document. The Public Benefit Test study declared equity issues to be outside the scope of the study. Likewise, the assessments of the economic consequences of introducing a 2-part tariff paid no attention to equity issues.

But to ratepayers and property owner's, equity issues and the redistributive effects of a change in water pricing goes to the very heart of their concerns. It is submitted that Council must concern itself with the question of equity. This will involve consideration of both the impacts of change on any class and whether final outcomes are fair.

It is acknowledged by Government that water reform will have redistributive effects, precisely because the current system contains demonstrable inequities. A challenge to be faced is one of softening the impact of necessary change by allowing such changes to be phased in over an appropriate period. In this case, 5 years may be a useful time period.

However, the ultimate aim must be to produce a system that is fair and equitable to people of all classes and within classes.

This submission has been written from the standpoint of non residential property owners and a desire to obtain equity between this class and other classes and also between non residential users. Nevertheless, it is no less important to seek to achieve equity and fairness between users in the residential sector.

Any Hobart resident should be given the opportunity of influencing what they pay for water and waste water disposal by making rational decisions in the context of the charging system that is being applied to them.

A central part of this submission is that the studies that have dismissed 2-part pricing for residential properties have been superficial and have failed to look at 2-part pricing and water metering from the viewpoint of residential customers. These limitations are addressed in Section 5.

It is recommended that Council express a commitment to developing processes that deliver fair and equitable water charging for all classes of users and for individual property owners within each class.

4.5 Identifying and Meeting Community Service Obligations

It is recognised that Council has a duty to identify groups and individuals in special need in the community and to support them by providing services at less than the full economic cost of such services.

It follows that such individuals and groups will not be able to achieve a competitive business advantage by receiving such benefits.

Council needs to specify precisely the criteria that it will use to determine who will qualify for such benefits and the nature and extent of those benefits.

A central principle must be that the CSO cannot be applied to the community at large, nor to a broad group such as residential property owners.

Nor should the costs of CSO be placed on another class of water users.

It is recommended that the CSO argument not be used as a justification for perpetuating large scale cross subsidies between classes of users.

The CSO is a justification for not achieving full cost recovery from the water users. It allows, therefore, for these benefits to be provided from another source. It is anticipated that this other source will be the general rate.

Section Five - Water Metering

5.1 Water Metering Options

As indicated earlier, metering of non-residential properties has been rejected on economic grounds following the study of the cost-effectiveness of the implementation of 2-part pricing for urban water services in Tasmania.

Negative elements that were identified included the high cost of installing meters, the cost of reading the meters and billing and administrative charges, and the costs of education and public relations.

It was also argued that the benefits from water metering are modest given Hobart's falling water consumption and the projected population decline.

The case for water meters needs to be restated.

There are 3 strong reasons for revisiting the subject.

1. Water meters are essentially a measuring device (for water in, or water out). Without meters and the data they provided there is no evidence to determine system leakage, or to determine variation between different users. Without some form of measurement, equity issues cannot be addressed.

It is recommended that as a very minimum Council install water meters in a random sample of residential properties and collect data on variations in water usage between properties and at different times of the year and to estimate leakage.

2. Without water-metering, residential consumers who are low water users effectively subsidise high water users. Cost effectiveness tests ignore such cross subsidies within both the residential and non residential sectors.

It is recommended that randomly installed meters be used to test the level of inequity and cross subsidies that exist and also the level of system leakage.

It is recommended that Council use water meters and usage to test the hypothesis that AAV is a good proxy for water charges based on volumetric or 2-part pricing. If the hypothesis was found to be true this would constitute a powerful argument against universal water metering of residential properties.

3. If warranted, universal water metering could be introduced in a way that was costless to Council and relatively painless to the community.

All new properties would be required to have water meters fitted (as in Glenorchy and elsewhere).

New owners would be required to install water meters when properties changed hands.

All other owners would have the option of installing water meters or of paying the full cost recovery charge based on average water consumption. Under this model, it would be to the advantage of low volume users to install water meters and reap the financial savings. However, the full cost recovery of water services (including leakage) would be borne by non metered properties and would rise as the number of low volume users with water meters increased. This in turn would increase the inducement to install water meters.

With full metering, system leakages would be identified and would provide the opportunity for correcting them.

It is recommended Council require metering of new and transferred properties.

It is recommended Council model a voluntary metering trial that would reward low use residential and business users and provide inducements to install meters.

5.2 Administrative Issues

The KPMG study into 2-part pricing has been built partly on capital costs and administrative costs of introducing water meters. The capital costs have largely been dealt with in the previous section where it has been argued that installation can (in part) be made voluntary and would, in any event, be borne by property owners except where Community Service Obligations were deemed appropriate.

Administrative costs including meter reading and billing are acknowledged to be a real cost of implementing a 2-part pricing scheme.

This is a cost that Council will need to include in its full cost recovery model and which will be incurred for commercial, industrial, Government and Council properties irrespective of whether metering is extended to residential properties.

Software and billing costs are likely to be a one off cost that will not increase if residential properties are metered.

There are a number of options for reading meters and billing residential (and other) property owners that are worthy of consideration as ways of,

- Reducing the administrative costs of charging and collecting revenue, and
- Making the payment system as simple and painless for the property owner as possible.

Options might include annual or quarterly readings and the option of levelised billings.

It would be appropriate to include a charge for meter reading for those that chose the water metered option and hence, to base the charge on the number of readings taken in a particular year.

5.3 Time Lines

If the proposed voluntary water metering model was introduced together with full cost recovery then it would not be necessary to set a timeline for the completion of water metering since each business or household would make a commercial decision based on the differential between their anticipated user pays bill and the standard full cost recovery.

It is recommended that as water metering would not be compulsory except in the case of new properties and property transfers, that no timelines be set for achieving 100 per cent metering of either residential or business properties.

This does not negate the need to adhere to the timeline that will need to be set to progressively reduce sectoral inequalities between the contribution to full cost recovery by business, residential, bulk commercial and public water user sectors as a whole.

It is recommended that such sectoral inequalities be removed within 5 years.

Section Six - Hobart Water and the Price of Water

There appears to be general acceptance that the demand for urban water would fall if water metering was adopted and the user pays principle adopted. A commonly used assumption is that demand would fall by a minimum of 15% and that it could be reduced by either as little as 5% or as much as 20%.

The benefits of such a reduction in water usage have already been noted.

They include,

- Equity for different classes of users and within classes,
- Removal of pressure to undertake future capital works, or newer smaller components being built at lower cost,
- Sustainability,
- Reduction in operating costs, and
- Reduction in peak load when the system may be at, or close to, capacity.

The response to such a scenario by Hobart Water has been that a reduction in demand by Council would increase the unit cost of water per megalitre as follows,

Current situation	10% reduction	15% reduction	20% reduction
\$481	\$509	\$524	\$541

In a letter to the DPIWE Manager of Water Reform (29 October 1999) the Manager, Corporate Services of Hobart Water estimated that a 20% reduction in water demand would necessitate an increase in the bulk price of urban water by around 15% because of the high fixed component in urban water supply.

It is apparent that these conclusions relate to an “all customer” reduction in demand for water and thus therefore assume that all Councils would initiate water reform rather than just the Hobart Council. Small Councils such as Brighton and Sorell have been able to initiate user pays because their effect on overall demand is small.

The comments about bulk water do not appear to take into account the likely need for water for irrigation purposes which is likely to increase. It is understood that lack of water is seen as the principal limiting factor to a significant expansion of the Tasmanian wine industry in the Coal River Valley where investigation is being undertaken to determine the feasibility of planting 200 hectares of grapes under ideal cool climate and soil conditions.

Hence it should not be concluded that demand for water will necessarily decline to the extent postulated.

But ultimately the effect of water reform on the bulk cost of water should be separated from the questions facing Council.

The suggestion that users should be encouraged to waste water (with the implication that it has zero, or close to zero long term marginal costs) is considered bizarre. Equally paradoxical is Hobart Water's decision to place a Marginal Capacity Cost threshold at the average Australian household consumption level when it is known that Hobart consumption is well above that level and then to oppose the application of the user pays principle which would work to driving consumption down towards this threshold level.

The value of the work of GPOC cannot be underestimated with respect to the activities of Hobart Water since the reforms GPOC has advocated will, in themselves, require Hobart Water to adopt water pricing policies that more properly reflect user pays principles and the efficient use of the water resource.

It is recommended that Hobart City Council ignores the effects of Council's water reform package on Hobart Water, but works with GPOC to ensure that the user pays principle is applied to the supply of bulk water services.

It has been noted with some satisfaction that Council appears to have a strong commitment to sustainability and to conservation of resources. Within the Water Reform Package, initiatives to educate the public and to reduce water consumption on its own grounds are noted. It can be taken that these measures are an expression of a sentiment that favours a reduction in waste, even if this might have some marginal effect on bulk water charges.