ABN 13 133 655 062
Tasmanian Water and
Sewerage Corporation
(Northern Region) Pty Limited

ABN 90 133 655 008
Tasmanian Water and
Sewerage Corporation
(North-Western Region) Pty Limited

ABN 65 133 654 976
Tasmanian Water and
Sewerage Corporation
(Southern Region) Pty Limited

12 November 2010

Mr R Baker
Urban Water Inquiry
Productivity Commission
LB2 Collins Street East
Melbourne VIC 8003

Dear Mr Baker

The Tasmanian Water and Sewerage Corporations appreciate the opportunity to comment on the future of urban water reform in Australia.

Our comments focus on the recent reforms to the Tasmanian landscape, and while these reforms are still in their infancy in comparison to other jurisdictions, we provide a small number of suggested recommendations for improvement. Our comments are included as an attachment to this letter.

We look forward to receiving the Productivity Commission's findings in due course.

Yours sincerely,

Geoff L Willis
Chairman

Enc

Website www.mywatertas.com.au
Phone (03) 6236 5740

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Attachment A

Submission by the Tasmanian Water and Sewerage Corporations

1. Context

The reform of urban water in Tasmania is only just a year old. It was driven not so much by the issues of security of supply that have been so evident on mainland Australia, but more due to concern at the state of water and sewerage assets and the adverse public health and environmental outcomes that were being observed as a result of infrastructure deficiencies.

Both structurally and in a regulatory sense, Tasmania was at least a decade behind urban water in other parts of the country. As such, the initial wave of reform was both necessary and significant, and saw 31 separate providers merged into three regional corporations and a common service provider.

With reform also comes upheaval, as the new corporations have been challenged to bring many different staff cultures together, at the same time as developing a better understanding of what has been inherited, its condition and key risks. Integration of existing and new system and mapping of new processes have taken much time and resource as the foundations of the new businesses have been built.

In addition, economic regulation of the sector has yet to commence, and it is clear that the issues the sector has had in the past cannot be fixed by structural reform alone. The harder part of reform from a public view point is yet to be fully felt, with increased revenue and pricing reform a key part of reform success.

The first year of operation has therefore been characterised by a process of discovery, with all of the real benefits yet to be delivered. However, even in this brief period, significant progress has been made. The three regional water and sewerage corporations spent a combined total of $68.7 million on capital works in 2009-10 (Cradle Mountain Water - $18.6 million, Ben Lomond Water - $15.9 million and Southern Water $34.2 million), which is a 32 per cent increase on the $52 million that councils and bulk water authorities spent, on average, in the last two years in which they were still responsible for providing water and sewerage services.

The corporation's have invested in projects that will improve water quality, increase water storage capacity, improve the treatment of wastewater and remove the need for boil water notices. But there is still much to be done to realise the expected efficiencies for customers of the new structural arrangements.

With that as a back drop, the Tasmanian Water and Sewerage Corporations provide the following comments on the barriers and opportunities they see in the sector (including some obvious and immediate benefits of our reform) and put forward a small number of recommendations.

2. Barriers

A small number of key barriers need to be removed before the water and sewerage corporations can be given the chance to deliver on reform objectives in a timely manner.

Level of Government Involvement
Over the first year of operation the reforms, particularly water and sewerage price increases, became a key issue in the lead up to the 2010 State election. This resulted in commitments to cap the price increases previously agreed by the State Government, with the short fall between what prices were to be made up by a State Government grant.

The initial pricing increases were intended to progress the corporations towards full cost recovery prior to economic regulation, but the capping arrangements have effectively enshrined a price shock for customers at some point in the future when the State Government grant falls away and which will make pricing reform a more difficult task.

The corporations consider that any government intervention should be targeted to provide relief from increased prices should be targeted at the most disadvantaged customers through the use of government funded rebates, rather than blanket capping arrangements. The capping arrangements also make tariff reform extremely difficult. Rebalancing of cross subsidies inherent in pricing inherited from councils requires greater flexibility in price movement to allow reform to occur over a sensible time period.

Financial and Economic Constraints
While the balance sheets of the new corporations are larger, and while debt is generally low in the sector, in the absence of continuing price increases the corporations can only utilise their balance sheet strength for a limited time before the capital ramp up and service improvement is constrained.

The corporations see a move to economic regulation as scheduled from 1 July 2012 as a key reform requirement. However, there is a fear that political pressure may undermine the independent economic regulation of the sector in an ongoing sense and may frustrate the transition of pricing reform and delay the delivery of service improvement.

Structural Tensions
The reforms were enacted purposefully and quickly and this has created a degree of tension between the owners and businesses. The current corporatised model created an expectation amongst the corporation's council owners that returns to owners will be delivered. Managing this expectation has been operationally challenging as the corporations need to deliver on the reform objectives (including providing a return to owners), but also need to get over a significant bow wave of set up costs.

Extension of services to existing but unserviced areas
Another expectation of the reform was that existing unserviced areas of certain population sizes and density would receive reticulated services. This has led to a growing community desire for this to occur, with the corporations fielding many inquiries about the timing of such roll outs. However, introduction of services to these areas creates significant issues in capital funding.

In the case of a usual greenfield development, capital contributions are sought from the developer in the form of developer charges, contributed assets and headworks charges, which funds the extension but is then passed on to the consumer in the price of lots then on sold. However, in introducing services to existing areas there are effectively numerous individual developers, those being the households and businesses who may wish to connect to the reticulated service. Levying a capital contribution of a few thousand dollars on these blocks, even if paid over time, may simply be unaffordable for many in these areas.

While from an equity point of view, it would be preferable for the benefiting blocks to not be subsidised by other customers in a corporations' regions, the reality of service introduction means that the costs may be prohibitive if this does not occur.

For this reason, government funding to assist in these instances would help to ease the cost burden on both corporation and potential customer. Similarly, any government intervention to require a roll out where there are environmental, public health or economic externalities that customers or the corporations do not see as commercially viable, the gaps should be funded in part by the Government.

3. Opportunities

The water and sewerage corporations see the following opportunities from reform to date and for reform of the sector into the future.

Internal Planning and Prioritisation
From an operational perspective the biggest gains of institutional reform has been the ability to work across previous boundaries. Reform has provided the scope for the rationalisation of overloaded and ageing assets that were previously constrained by lines on a map. Combining existing systems and decommissioning assets which are either antiquated or surplus to requirements offers potential to make more efficient use of existing facilities and, in doing so, realise significant capital, maintenance and operational cost savings.

Given the location of the boundaries (more remote areas) of the three corporation's operations, there is probably only very limited scope to consider such rationalization across boundaries.

Integration with Land Use Planning
While the corporations can control internal optimisation, probably the biggest opportunity available to gain greater efficiencies in the sector is by reforming the way the sector interacts with the planning system in the State. Land use planning has historically been disparate as local councils have understandably focussed on maximising development within their areas, which has led to a significant footprint of ribbon development along the State's coastlines.

From the corporation's perspective greater densification of development is critical to lowering the average cost of service delivery for customers. This will allow not only productive efficiency to be delivered, but also for greater allocative efficiency in urban water delivery.

However, if the new corporations are to maximise network planning and capital spending, there needs to be a coordinated view across regions within the State as to where development nodes/areas are to be. This needs to be collectively driven by planning authorities and utilities, rather than utilities providing reactive input. Such an approach may see non-network solutions being considered for areas where future growth has not been determined, or may make a previously difficult decision about whether to service an area more certain.

Development of a forum that gives water corporations not only a seat at the table but a role in guiding the growth of particular nodes is underway through reforms being driven by the Tasmanian Planning Commission on a regional basis. The success of these regional reforms may have major benefits to the sector into the future if executed successfully.

Pricing/Water Use Efficiency
Reform success will not only be measured by customers through the level of service delivered, but also through reform of pricing which currently sees the corporations continuing with the 29 inherited council pricing approaches and a multitude of individual tariffs.

Delivering equity and consistency in pricing will be crucial to the perception of reform success and therefore engaging with customers as new pricing is developed represents a large opportunity.

The lack of consistency in pricing approach across the country suggests that, particularly for sewerage services, there is no preferred pricing approach. Therefore the corporations have a once in a generation chance to develop something that is equitable but easily understandable to the consumer and which will significantly decrease the level of frustration with current property value based pricing which is a hang-over from previous council rating approach.

Universal and consistent two part pricing in the sector also has the potential to provide significant gains in water usage efficiency as parts of Tasmania have not implemented water metering, or have variable pricing arrangement distorted by free water allowances.

Appropriate pricing should also lead to capital deferral benefits. While the rest of the country will take these benefits for granted and will have gone through such reforms many years ago when supply constraints started to bite, the infancy of the Tasmanian sector and its (largely) differing drivers of reform, will mean there are good gains to be made by these well accepted measures.

One area of potential pricing reform that has been suggested is that of nodal pricing. The corporations are strongly of the view that going to a more nodal approach for annual charging (as opposed to developer charges) will make it difficult to deliver the improvements to service that were envisaged in smaller networks in regional areas. The corporations believe that the benefits of nodal pricing (sending a better signal as to the cost of living in an area) will be outweighed, not only by the challenge it will present to delivering improved outcomes, but also the difficulty of explaining the variability in pricing when most customers between areas will
see the same services being delivered.

Asset Management
Another clear area for improvement within the Tasmanian urban water sector is the implementation of more universal asset management approaches. In this context, the current regulatory requirement to have auditable asset management plans is believed to be an important driver for efficiency gains in the sector.

Capital and Operational Delivery Efficiencies
The current institutional arrangements have provided the ability to combine like capital projects to provide a more attractive package of work to external providers (e.g. desludging programs for wastewater lagoons). However, there is opportunity for this to be done between the corporations such that larger national companies might also be attracted into the market. Similarly, there are opportunities to look outside our own sector, possibly in combination with out utilities such as electricity and gas, to leverage longer-term maintenance contracts with larger national firms.

Institutional Arrangements
There will clearly be a learning process for both corporations and regulators as each better understand the others' expectations and the new parameters governing the sector. However, as already stated, the institutional arrangements in the sector have clearly not been in place for long enough for experience to demonstrate where improvement could be made and must be given the chance to be bedded down.

However, one institutional issue the corporations consider should not be actively sought until the industry has the chance to mature is that of retail contestability. While more developed markets are moving towards the introduction of competition within aspects of the supply chain, the small customer base in the sector (approx. 200,000 customers statewide) and a significant up front sunk cost in a new billing system to service the sector, suggest that the arrangements need to be unchanged for a period.

The legislative requirement for the three regional corporations to form a shared service provider, Onstream, has received much criticism for creating a costly management hierarchy. However, clearly there are a number of services that in the absence of Onstream the corporations would still purchase from the market. Again, this structural element of the reform should be given the opportunity to streamline and deliver the efficiencies that a more mature provider would realise.

Communication of Reforms
More can be done in communicating the structural and regulatory aspects of the reform to the public. There is a lack of understanding about the corporatized model and particularly how returns make their way back to the community. Currently the community sees the corporations' profit making as gouging. Better explanation of how the regulatory environment should drive the businesses to be more efficient and the regional and state-wide benefits which will flow from this framework need to be better committed and better understood.

4. Recommendations

At the basic level, the reforms to the Tasmanian Urban Water and Sewerage Sector, both structural and regulatory, must be given the chance to deliver the benefits that were envisaged. More specifically the Tasmanian Water and Sewerage Corporations recommend:

- Government intervention to provide pricing relief should to be targeted at those most disadvantages rather than through blanket capping arrangements.

- A move to economic regulation must occur as scheduled to ensure the sustainability and viability of the newly established corporations.

- Greater integration of the water and sewerage corporations in strategic land use planning must occur so as to yield greater efficiencies for water and sewerage customers.

- Any Government intervention to require a roll out of services that is otherwise uneconomic for the corporation must be aided by gap funding by the Government.