

1 August 2005

Mr J Cox
Chief Executive Officer
Independent Pricing and Regulatory Tribunal
PO Box Q290
QVB POST OFFICE NSW 1230

Dear Jim

I refer to the Tribunal's current *Review of Metropolitan Water Agency Prices*.

Please find enclosed the submission of the Department of Energy, Utilities and Sustainability on the Tribunal's draft pricing determination for Sydney Water.

The purpose of this submission is to provide recommendations to the Tribunal from the Department on the Tribunal's draft pricing determination for Sydney Water's water prices from 1 October 2005 to 30 June 2009.

If you have any queries concerning this submission, please do not hesitate to contact me or Carolyn Davies, Director, Sustainability and Policy Coordination Unit on telephone 8281 7777.

Thank you for providing the Department with an opportunity to comment on the Tribunal's draft pricing determination for Sydney Water.

Yours sincerely

David Nemptzow
Director-General



Submission to

**IPART's draft pricing determination for Sydney
Water's water prices 1 October 2005 to 30 June 2009**

July 2005

1. EXECUTIVE SUMMARY

The purpose of this submission is to provide recommendations to the Independent Pricing and Regulatory Tribunal (IPART) from the Department of Energy, Utilities and Sustainability on IPART's draft pricing determination for Sydney Water's water prices from 1 October 2005 to 30 June 2009.

Overall, the restructure of water charges for residential customers in single dwellings provides a strong conservation signal for discretionary water use. The higher two-tiered variable usage charge and lower fixed service charge will see water usage charges representing a larger proportion of customers' water bills.

However, equity considerations suggest greater assistance should be provided to large families who may not be able to meet their necessary water needs below the level at which the higher Tier 2 water usage charge applies. In addition, to ensure all customers contribute to recovering the cost of water, increases to Tier 1 and Tier 2 prices should be accelerated. This should be offset by accelerated decreases in the fixed service charge.

Accordingly, the submission recommends:

1. Providing greater assistance to large families in Sydney than proposed by IPART by broadening the eligibility criteria to cover more families and providing a more comprehensive package of ways for large families to reduce their water use.
2. Based on equity considerations, accelerating the price path for variable usage charges and offsetting this by also accelerating decreases in the fixed service charges.
3. IPART allowing costs of household retrofits and of water savings measures for large families to be recovered from Sydney Water's revenue.

2. ASSISTANCE FOR LARGE FAMILIES

IPART's draft pricing determination clearly recognises that large families are likely to be greatly affected by the proposed new two tier water usage pricing structure, as they will have difficulty keeping their basic, non-discretionary water use below the 400 kL per year of the Tier 1 threshold. This means that they are likely to have to pay a higher, Tier 2 price for some of their basic, day to day, water needs. As a result, IPART proposed provisions to mitigate the impact of the price increases on this group of customers.

However, IPART's proposal only covers low income large families and provides limited scope to assist these families to reduce their water use. A fairer and more comprehensive alternative program is recommended.

IPART's PROPOSED ASSISTANCE

IPART's draft determination provides for an extension of the current Payment Assistance Scheme (PAS) to reduce the potential impact of the two-tiered variable water usage charge on large families (defined as household with 6 or more people) with relatively low incomes.

For households to be eligible for the extended PAS rebate, IPART proposes that they must:

- include one member who holds a Commonwealth Health Care Card; and
- contain six or more people; and
- have participated in the free water saving household retrofit program where they are able.

Under this approach, IPART will require Sydney Water to develop a rebate system so that each member of a large, low-income household will be able to use up to 80kL of water per year at the lower Tier 1 price.

In addition, IPART proposes that Sydney Water develop guidelines for welfare agencies delivering the PAS to specifically target households who are likely to be affected by the two-tiered water usage charge.

SYDNEY WATER'S PROPOSED ASSISTANCE

In its November 2004 submission to IPART, Sydney Water proposed a different set of measures to mitigate the impact of new prices on large, low-income households, including:

- extension of the free water saving household retrofit program to households experiencing financial hardship;
- no interest loans to enable households experiencing financial hardship to purchase water efficient appliances; and
- extension of the payment assistance scheme to tenants.

A RECOMMENDED FAIRER, MORE COMPREHENSIVE ALTERNATIVE APPROACH TO ASSISTANCE FOR LARGE FAMILIES

IPART's assistance proposal targets only low income families and has a reasonably complex way of determining what price is to be charged for water usage. It also relies on an interpretation of these arrangements by welfare agencies delivering the Payment Assistance Scheme. Sydney Water's assistance proposal goes further but still limits the assistance provided to large families to help them save water and reduce their water bills.

A fairer, more comprehensive alternative approach is recommended. This alternative approach provides greater assistance to more families, and delivers a better package of ways that large families can reduce their water use and save on water bills. This alternative approach provides an enhanced water saving retrofit program and rebates for water efficient appliances. The appliance rebates will be complemented by no interest loans for households experiencing financial hardship. In addition, income assistance will be provided for low income families by significantly reducing the quarterly water service charge by 50%.

This alternative approach maintains the pricing signals established under the new two-tiered variable usage charge by retaining the Tier 2 price, but assists low-income families in meeting their water bills. This assistance will be conditional on the family participating in the water saving retrofit program.

This alternative approach is fairer and more comprehensive as it combines practical assistance and information through the water saving retrofit program, incentives to allow the purchase of water efficient appliances, and income support for those on lower incomes. This alternative approach recognises the different needs of Sydney Water's customers and the proven ways of encouraging them to adopt water saving measures.

Table 1: Recommended assistance measures and eligibility criteria

Eligibility		Approx hlds	Assistance Measures
Household size	Income limit		
6 or more	Those eligible for base rate of Family Tax Benefit Part A (no more than \$86 213 per year plus \$3431 for each child after the first)	37,000	Enhanced Water Saving Retrofit Rebates for water efficient appliances (available until June 2007) No Interest Loans for water efficient appliances available to 'households in need'
6 or more	One member holds Commonwealth Health Care Card	9,000	Above measures <u>plus</u> Discount of 50% of quarterly water service charge (provided they have participated in free water saving retrofit program)

Enhanced Water Saving Retrofit

The enhanced retrofit will include:

- Priority visit by a plumber
- Replacement of up to two water efficient showerheads
- Installation of tap aerators
- Checking house for water leaks, and fixing any indoor or outdoor leaking taps and/or leaking toilets
- Installation of water saving devices in single flush toilet cisterns
- Providing customers with detailed information about rebates for dual flush toilets and water efficient washing machines
- Providing an information booklet on water efficient gardening and outdoor water use
- Providing additional water efficient gardening advice tailored to the customer's local area.

Rebates for water efficient appliances (available until June 2007)

- A \$200 rebate for a 4A or 5A rated washing machine (or equivalent star rating when the Water Efficiency Labelling Scheme is implemented after 1 July 2006)
- A \$200 rebate to replace a single flush toilet with a dual flush toilet (including installation), and an additional \$100 rebate for replacement of a second, single flush toilet with a dual flush toilet

The estimated savings in household water use and on the average bills are set out in Table 2, together with the estimated cost of each element over the four year life of the pricing determination.

Table 2: Estimated savings and costs for assistance measures

Assistance Measure	Forecasted uptake	Household water saved (kL/year)	Average bill savings (\$/year)	2005-09 cost
Enhanced Retrofit	13,875	34	49	\$305,000
Rebates for appliances	7,400	103	148	\$3,700,000 (until 30 June 2007)
No Interest Loans	3,500	37	53	\$375,000
Discount of 50% service charge	9,000	Nil	37.90 (in 2005/06)	\$1,100,000

From data supplied by Sydney Water

The cost of the discounted water service charge and no interest loans for low income families should be recouped by Sydney Water from the Government as a Community Service Obligation (estimated total of around \$1.5 million over four years). The cost of other assistance measures (enhanced retrofit and rebates for appliances) is estimated at a total of \$4 million over the proposed two year life of the program. These costs should be recovered from Sydney Water's operating revenue as outlined below.

These measures are in addition to current Sydney Water programs for pensioner rebates and payment assistance to households in need.

3. PRICE PATH

IPART's PROPOSAL

IPART's draft pricing determination sets maximum prices that Sydney Water can charge customers for the period 1 October 2005 to 30 June 2009. IPART considers that this price path is adequate to meet Sydney Water's efficient costs of providing water, wastewater and stormwater services to its customers.

The price path requires Sydney Water to adopt a two-tiered, inclining block price structure for water usage charges, with the Tier 2 price being applied to consumption over 400kL per annum (with a daily limit of approximately 1.1kL/day). The current water service charge will be reduced by 42 percent over the determination period. IPART's proposed price path is shown in Table 3 below.

Table 3: Sydney Water's current and IPART's draft determined water charges (from Table 9.5 in IPART's draft determination)

Charge	Current (1 July 2004 to 30 September 2005)	1 October 2005 to 30 June 2006	1 July 2006 to 30 June 2007	1 July 2007 to 30 June 2008	1 July 2008 to 30 June 2009
Service charge (\$ per annum) ₁	77.62 ₂	75.79 ₂	62.66 x (1+ Δ CPI ₁)	52.85 x (1+ Δ CPI ₂)	43.87 x (1+ Δ CPI ₃)
Tier 1 Usage Charge up to 1.1kL per day (\$ per kL)	1.01	1.13	1.19 x (1+ Δ CPI ₁)	1.20 x (1+ Δ CPI ₂)	1.23 x (1+ Δ CPI ₃)
Tier 2 Usage charge greater than 1.1kL per day (\$ per kL)	1.01	1.44	1.56 x (1+ Δ CPI ₁)	1.70 x (1+ Δ CPI ₂)	1.84 x (1+ Δ CPI ₃)

Where:

- (1+ Δ CPI₁) Is the movement in the CPI between the four quarters ending 31 March 2006 and the four quarters ending 31 March 2005.
- (1+ Δ CPI₂) Is the movement in the CPI between the four quarters ending 31 March 2007 and the four quarters ending 31 March 2005.
- (1+ Δ CPI₃) Is the movement in the CPI between the four quarters ending 31 March 2008 and the four quarters ending 31 March 2005.

IPART believes that an inclining block tariff with a two-tiered variable usage charge and a reduced, fixed service charge is the most appropriate price structure, as it:

- sends a strong signal to customers about the need to conserve water, particularly to high water users;
- has considerable potential to reduce customer demand for water; and
- is relatively easy to understand, implement and administer.

A RECOMMENDED FAIRER, ALTERNATIVE ACCELERATED PRICE PATH

On equity grounds, all customers should contribute to recovering the cost of water. As outlined above, the two-tier water price structure proposed by IPART for single dwellings will result in particular large families having larger water bills. There are some categories of customers which will not be as greatly affected, as they will not be impacted by tier 2 prices. These include:

1. Small households (2 people) in single dwellings, which make up 24% of households in Sydney
2. Households in multi-unit dwellings, which make up 20% of households (including townhouses and semi-detached dwellings)
3. Non-residential customers, as they are not subject to Tier 2 prices.

As a result, it is recommended that the Tier 1 price change be accelerated to ensure these categories of customers more equitably contribute to recovering the cost of water, with the price reaching IPART's levels by 2008/09.

To offset the increase in usage charges and have water usage charges making up an even larger proportion of the customer's bill, the reduction in service charges should also be accelerated at a faster rate than proposed by IPART in its draft determination. Again, the charges should reach IPART's proposed levels in 2008/09.

In addition, to provide even stronger pricing signals for high users, it is also recommended Tier 2 prices be accelerated after the first year (giving customers a year to introduce water savings measures) to end at the same level as IPART's proposal in 2008/09.

The recommended, alternative accelerated price path is set out in Table 4 below:

Table 4: Recommended fairer, alternative accelerated price path for Sydney Water's water charges

Charge	Current (1 July 2004 to 30 September 2005)	1 October 2005 to 30 June 2006	1 July 2006 to 30 June 2007	1 July 2007 to 30 June 2008	1 July 2008 to 30 June 2009
Service charge (\$ per annum) ¹	77.62 ₂	62.66 ₂	52.85 x (1+ΔCPI ₁)	43.87 x (1+ΔCPI ₂)	43.87 x (1+ΔCPI ₃)
Tier 1 Usage Charge up to 1.1kL per day (\$ per kL)	1.01	1.20	1.23 x (1+ΔCPI ₁)	1.23 x (1+ΔCPI ₂)	1.23 x (1+ΔCPI ₃)
Tier 2 Usage charge greater than 1.1kL per day (\$ per kL)	1.01	1.44	1.84 x (1+ΔCPI ₁)	1.84 x (1+ΔCPI ₂)	1.84 x (1+ΔCPI ₃)

Where:

- (1+ΔCPI₁) Is the movement in the CPI between the four quarters ending 31 March 2006 and the four quarters ending 31 March 2005.
- (1+ΔCPI₂) Is the movement in the CPI between the four quarters ending 31 March 2007 and the four quarters ending 31 March 2005.
- (1+ΔCPI₃) Is the movement in the CPI between the four quarters ending 31 March 2008 and the four quarters ending 31 March 2005.

The proposed accelerated price path is consistent with IPART's pricing decision to increase water usage charges overall, and decrease fixed water service charges so the fixed charges represent a smaller proportion of customers' water bills.

The accelerated Tier 1 price is consistent with IPART's recommendation that under a two-tier pricing structure, the Tier 1 usage charge should be set at the long run marginal cost of supply (LRMC). IPART estimated the LRMC to be between \$1.20 and \$1.50 per kL (in 2004/05 dollars) and so under the accelerated price path, this level is reached more quickly.

Impact on revenue

The overall impact of the accelerated price path is revenue neutral as any additional revenues will be used for implementing the large family assistance program and other retrofit programs.

The accelerated price path would increase overall revenue compared to IPART's draft determination by an estimated additional \$12 million for year to June 2006, \$10 million for 2007, and \$2.7 million for 2008. There is no additional revenue in 2009, as the prices are the same as IPART's in this year.

It is recommended these additional revenues be used over the next two years to fund household retrofits to assist customers reduce water bills, as well as provide for rebates for large families for water efficient appliances.

Under the Government's Metropolitan Water Plan, Sydney Water will continue its residential retrofit program to achieve a total of 500,000 retrofits (including Do-It-Yourself water savings kits) by July 2007. This commitment will be met under the funding outlined in Table 5 below.

Table 5: Programs to be funded

		Financial year	
		2005/06	2006/07
Sydney Water's proposed Demand Management Programs	Household retrofits	\$6,000,000	\$6,000,000
	DIY retrofits	\$2,200,000	\$200,000
Assistance measures under Family Savings Program	Enhanced retrofits	\$200,000	\$100,000
	Rebates for water efficient appliances	\$2,500,000	\$1,200,000
	Total	\$10,900,000	\$7,500,000

Assumes Family Savings Program operates for 2 years, with two-thirds of uptake in first year of program