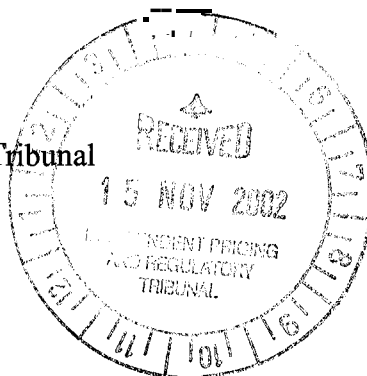


J. P. Cox
Acting Chairman
Independent Pricing and Regulatory Tribunal
P. O. Box Q290
QVB Post Office
NSW 1230



Dear Mr Cox,

Review of Prices Charged by the Metropolitan Water Agencies

I refer to your letter of 11 June, 2002 advising that the Tribunal is reviewing the charges for each of the four metropolitan water supply authorities – Sydney Water Corporation, Hunter Water Corporation, Gosford City Council and Wyong Shire Council. Forwarded with your letter was an Issues Paper outlining the review process, industry structure and performance, and proposing some options for future pricing structures.

The Department of Housing is the largest domestic client of the metropolitan water authorities with over 104,000 residential properties located in the areas served by the four water supply authorities. The Department also oversees and regulates the management by community providers of a variety of forms of social housing and develops strategies to enhance the affordability of housing in the private sector.

Through these roles the Department has always had a substantial commitment to reducing water consumption and an interest in the payment systems of water authorities.

The key to reducing water consumption lies largely in residential markets. Under current payment systems the majority of tenant households do not receive the pricing signals associated with paying for water usage. If the NSW Government seriously wishes to address increasing consumption, water authorities should move to a payment system where tenants in separately metered properties are directly billed for water usage.

A direct billing system would make a substantial impact on water usage through:

- passing on appropriate pricing signals wherever possible and encouraging landlords to install separate water meters in multi-unit properties; and
- establishing a direct relationship between water authorities and their real users thereby providing considerable opportunities for conveying promotional messages regarding water conservation.

The current billing of landlords only, not tenants, also prevents water authorities from establishing equitable and well targeted subsidy programs for pensioners. Government assistance is poorly targeted, providing subsidies to owner-occupiers, not the most economically disadvantaged in the community who are generally tenants.

In paying the costs of all water charges for its pensioner tenants, the Department of Housing is effectively meeting costs which should be subsidised by water authorities. This represents a form of cost shifting from one Government authority to another. Prior to the introduction of direct billing, the Department of Housing should be provided with discounts in water charges from all metropolitan water authorities, estimated at \$4.66m per quarter, being equivalent to the subsidy for pensioner owner-occupiers.

The Department has worked with Sydney Water to develop a \$1.5m program in 2002/03 to retro-fit over 12,500 dwellings with water saving devices. This program needs to be accelerated and completed as soon as possible. It is strongly recommended that Sydney Water provide further funds, currently estimated at \$10m, to complete the joint program over the next 3-4 years. This would assist around 85,000 households in conserving water and save an estimated 1.7 Glitres annually.

Attached is a submission which explores these issues and associated recommendations further. In addition the submission provides comments on the pricing proposals outlined in the IPART Issues Paper and supports:

- Future pricing structures and levels being reflective of the funds required for the efficient operation of water authorities and ongoing maintenance of infrastructure.
- Further consideration of “step pricing” for water authorities where they draw water in excess of demand management targets (provided increased costs are not passed on to the consumer).
- The use by Hunter Water of a “two part tariff” being reviewed to ensure that overall revenue raised is not in excess of requirements for efficient operations and ongoing maintenance.

Thank you for the opportunity to have an input into the Review of Prices Charged by the Metropolitan Water Agencies and provide comments on the associated Issues Paper. If you wish to discuss any aspect of the Department’s submission, please do not hesitate to contact me on ph. 9821 6695.

Yours sincerely,


Beryl Jamieson
Executive Director
Corporate and Support Services

14/11/02



**REVIEW OF PRICES CHARGED BY THE
METROPOLITAN WATER AGENCIES**

***SUBMISSION BY THE DEPARTMENT OF
HOUSING, NSW***

Compiled October, 2002

REVIEW OF METROPOLITAN WATER AGENCY PRICES

SUBMISSION BY THE NSW DEPARTMENT OF HOUSING

BACKGROUND:

The Independent Pricing and Regulatory Tribunal (IPART) is reviewing the maximum charges to apply from 1 July, 2003 for each of the four metropolitan water supply authorities – Sydney Water, Hunter Water, Gosford City Council and Wyong Shire Council.

An issues paper was forwarded for comment which outlines the review process, the industry structure and regulatory framework. It also puts forward several options for future pricing structures and raises some issues regarding these options for review.

ROLE OF THE DEPARTMENT:

The NSW Department of Housing is the largest domestic client of the metropolitan water agencies. It plays two major roles:

- Ownership or management of around 104,300 dwellings located in the areas served by the four metropolitan water supply authorities. Payment of all water service charges for these properties in the last financial year totalled in excess of \$58m (\$33.66m for access fees and \$24.46m for usage charges).
- Oversight and regulation of community housing providers of a variety of other forms of social housing – housing associations, crisis and supported accommodation - involving a further 9,600 residential dwellings within the areas of the four metropolitan water authorities. These providers currently have differing policies and practices regarding the charging of tenants for water consumption.

In addition, the Department develops strategies and initiatives to enhance the supply of affordable housing within private housing markets and reduce housing related poverty. In this capacity it advocates on behalf of low income earners and socially disadvantaged groups within the community.

WATER CONSUMPTION:

Sydney Water will not meet its demand management targets set by IPART for 2004/05. Per capita water consumption in 2001 was 17% higher than targets and had steadily increased over the previous five years. This is of major concern to the State Government and all associated agencies.

Similar to other tenures, consumption in Department of Housing properties in the Sydney Water Corporation's area has increased from an average of 229 kilolitres per property per annum in 1996/97 to 254 kilolitres per property in 2000/01 (see Diagram A attached).

In addition, a substantial proportion of properties have very high levels of consumption, with approximately 12% using 301 - 400 kilolitres per property per annum and a further 16% consuming more than 400 kilolitres per property (See Diagram B attached).

DOMESTIC PAYMENT SYSTEMS:

The key to reducing water consumption lies largely in residential markets. These high and increasing levels of domestic usage highlight the problem that responsibility for water consumption costs is not being passed on to tenants in rental markets.

Households living in private or public tenancies make up approximately 30% of the NSW community. The proportion of households renting homes rather than purchasing property is gradually increasing. Under current regulations, the majority of these tenant households do not receive the pricing signals associated with paying for water usage.

Landlords generally pay for water usage either because of the cost of separately metering multi-unit properties or as an incentive to attract and retain tenants. Citizens renting property need to be directly responsible for their water consumption and contribute to the management of demand, similar to home owners.

If the NSW Government seriously wishes to address increasing consumption, water supply authorities should move to a payment system where tenants in separately metered properties are directly billed for water usage. Victoria introduced the direct billing of tenants for water consumption in 1994, with the landlord continuing to be responsible for service availability charges. The latter charges remained a debt on land, whereas water consumption charges became a personal debt of the tenant.

A direct billing payment system has the advantages of:

- providing consumers in both public and private rental markets with incentives for water conservation through appropriate pricing signals wherever possible;
- encouraging landlords to install individual water meters in new properties and / or retro-fit meters in existing properties to reduce expenses on water services; and
- establishing a direct relationship between water authorities and the real users of their services with associated opportunities for conveying promotional messages regarding the need for water conservation.

This type of system would considerably assist the NSW Government in its water conservation objectives. In particular, it would assist Sydney Water and other water authorities in meeting their demand management targets set by IPART.

The introduction of a direct billing system for tenants in public and private rental markets would require amendments to the Residential Tenancies Act, 1987 under which landlords are currently responsible for paying all service charges for water and sewerage issued by a water authority.

In addition, the Water Board Act, 1987 and Water Board (Finance) Regulation, 1988 would require amendment to provide for tenants being liable for fees or charges rather than all debts being secured as a charge on land.

Recommendations: It is recommended that:

- **Water authorities move to payment systems which directly bill tenants in both the public and private rental markets for water usage where it can be accurately metered.**

and that:

- **No change occur to water availability charges, which would remain a property owner responsibility.**

PENSIONER SUBSIDIES:

Water authorities currently provide subsidies of approximately \$82.5m per household per quarter in the fixed service availability charges to pensioners who are owner occupiers. No subsidies, however, are available to pensioner tenants who rent properties where consumption charges are passed on by the landlord.

This is an inequitable and poorly targeted approach to the provision of Government assistance. It excludes those households who are the most socially and economically disadvantaged. The introduction of direct billing of tenants by water authorities would provide the Government with the opportunity to develop a far more equitable and better targeted system of providing assistance. Available Government subsidies could then be distributed equitably through discounts in water usage charges to low income earners in both private ownership and rental markets.

In paying the costs of all water service charges for its tenants, the Department is effectively meeting the costs of pensioner subsidies which should be paid by water authorities. This represents a form of cost shifting from one Government agency to another.

Prior to the introduction of direct billing, water authorities should provide the Department with a discount in the water service availability charges to compensate for the costs of providing this subsidy to its clients. With 54.3% of Departmental tenants being in receipt of the aged, disability or other types of pensions, this would represent a discount of approximately \$4.66m per quarter for clients within the areas of all four metropolitan water authorities.

Recommendation: It is recommended that:

- **The Department of Housing receive discounts in water service charges equivalent to the costs of the subsidy normally available to pensioner owner-occupiers in the greater metropolitan area, currently estimated at \$4.66m per quarter.**

ADMINISTRATIVE SAVINGS:

The Department also seeks discounts in water service charges in return for the administrative savings water authorities receive through:

- simple bulk billing arrangements developed at expense to the Department; and
- guaranteed payments and associated savings in bad debt write offs.

To simplify dealings with water agencies, bulk billing and single transaction systems have been put into place over the years at some expense to the Department. These arrangements provide the water authorities with considerable administrative savings in the billing of clients and receipt of payments. Estimated savings for metropolitan water authorities in printing, handling, postage, etc total around \$620,000 per annum (estimates based on Departmental contracts with Australia Post - \$1.45 each for printing and sending an automated letter, and \$1.30 per bill for collection of monies).

Unlike other domestic clients, the Department provides guaranteed payment of bills to water authorities. This enables considerable savings in debt collection and bad debt write-offs. Water authority recovery levels in recent years have been in the vicinity of 98%. Even with this low level of unrecovered arrears, the lack of any defaulting by the Department represents a saving of \$1.2m per annum to water authorities.

These administrative and debt collection efficiencies represent considerable cost savings to the management and operation of water authorities. These savings should be shared with the Department.

Further discounts estimated at \$1.22m per annum (\$620,000 for the costs of individual billing and 50% of \$1.2m for savings in bad debts) in the charges of water authorities are sought, to allow the Department to reap some of the cost saving benefits of the efficient administrative systems which have been put into place.

Recommendation: It is recommended that:

- **The Department of Housing be provided with a further discount in water charges, estimated at \$1.22m annually, in acknowledgment of the savings water authorities receive through bulk billing and guaranteed payments.**

WATER CONSERVATION INITIATIVES:

The Department is committed to the conservation of water and has initiated two major measures in recent years to reduce consumption in social housing dwellings.

- Installation of water saving devices in all newly constructed properties and replacement of items in existing housing.
- Working with Sydney Water to develop a \$1.5m program in 2002/03 to retro-fit over 12,500 dwellings with water saving devices.

The Department is concerned that the joint retro-fit program with Sydney Water needs to be accelerated and completed as soon as possible. This would assist around 85,000 households in conserving water and overall savings in consumption would total around 1.7 Glitres. The fast tracking of the joint retrofit program would make a substantial contribution to conserving water and assist Sydney Water in meeting its demand management targets.

The joint retro-fit program in Departmental properties could be completed within 3-4 years if funds were available. It is estimated that around \$10m will be required to complete the program.

Recommendation: It is recommended that

- **Sydney Water provide sufficient funds, currently estimated at \$10m, to complete the retro-fitting of Department of Housing dwellings with water saving devices over the next 3-4 years.**

OTHER ENVIRONMENTAL INITIATIVES:

Whilst the Department places a high priority on progressing the retro-fitting of properties with water saving devices, it would also be interested in working with water authorities to develop other environmental initiatives if appropriate incentives were supplied.

For instance, the Department could incorporate the re-use of waste water in some residential developments for social housing. These examples could be used to showcase

the methodology and promote the further use of this type of technology in private residential markets.

Similarly, social housing developments could include “dry” gardens in common areas. These examples could also be used to encourage water conservation through local promotion and entry in community garden contests or other such educational/promotional competitions.

The Department would also be interested in working with water authorities to explore the benefits of electronically read water meters provided any additional costs were met. This type of technology could be trialed in certain new developments or locations with a view to expansion to other areas, if proven to be cost efficient.

Recommendation: It is recommended that:

- **Water authorities work with the Department of Housing to explore options and associated incentives for the re-use of waste water, dry gardens and electronic meters in future social housing developments.**

PRINCIPLES OF PRICING:

The Department supports pricing structures and levels that effectively balance the need for:

- Adequate consumer protection;
- Efficiency in the supply of services; and
- Promotion of water conservation.

In the review of pricing proposals it is considered essential to ensure that the consumer, particularly social housing clients and low income earners, are protected from unnecessary increases in price levels, or inequitable pricing structures, which disadvantage certain household types or groups within the community.

The Department favours pricing levels that reflect the efficient operation of water authorities and make adequate provision for the ongoing replacement of infrastructure. In this context, it is noted that the real operating costs per property have declined between 1993 and 2001 for three of the metropolitan water agencies, whilst Gosford City Council’s costs have remained steady. Substantial price rises to the consumer could not therefore be supported.

The Department supports pricing systems that effectively pass on pricing signals to all users thereby providing an incentive for water conservation. Any pricing structures developed specifically to encourage water conservation should, however, take into account the need to ensure equity and not disadvantage certain groups within the

community. Similarly, they should not provide water authorities with revenue in excess of that required for their efficient operation.

PRICING OPTIONS:

As part of the discussion on demand management, the IPART Issues Paper canvassed a number of pricing proposals. Comments on these proposals, particularly in relation to the Department, community housing clients and other low income earners, are outlined below.

Inclining Block Tariffs – This option involves the marginal cost of water increasing with greater levels of consumption. It is a method used in many European countries and is largely based on the assumption that wealthier households are likely to consume more water.

This pricing structure has the following disadvantages and is not supported:

- It would substantially increase the cost of water consumption for the Department of Housing, particularly where clients consume over the average levels of water per annum.
- Inclining tariffs would increase the cost of water for community housing clients and low income earners where water usage charges are passed on to the tenant. This would place already disadvantaged households in a worse economic position, possibly forcing them to live below the poverty line.
- It would be an inequitable system resulting in larger households, who are often economically disadvantaged, paying more for the same level of consumption per person compared to smaller households.
- Inclining block tariffs are unlikely to be an effective demand management mechanism as clients would have little knowledge of the marginal cost of their consumption or the “block price” relating to their higher levels of consumption – they would only be aware of the overall cost.

In addition, this type of pricing system would collect revenue in excess of that required for the efficient operation of water authorities. It would not provide an incentive for water authorities to make further savings in their operating costs. In fact, this system would lead to the generation of surplus revenue for water authorities at the expense of agencies such as the Department of Housing. This would be an undesirable form of cross-subsidisation between Government agencies.

Split Between Access and Usage Prices – This model involves increases to water usage charges which are then offset by a reduction in fixed service availability charges. In this

way the proportion of total bills resulting from usage charges is increased with the intention of strengthening the consumption price signal.

Artificially increasing the price of water usage as proposed in this model is not supported because it would be socially inequitable. It would result in larger households subsidising smaller ones thereby increasing the economic disadvantage of larger households.

In addition, split access and usage prices would not be reflective of the high level of fixed costs associated with the operation of water authorities or the cost of necessary replacement of infrastructure. It would destroy the current transparency in the funding of water authorities, develop internal cross subsidies, and effectively provide commercial incentives for such authorities to increase water usage levels to raise revenue for further replacement of assets.

Step Pricing – This option involves significant increases in the average volumetric charge paid by a water authority to the catchment authority for water drawn beyond demand management targets. The model proposed entails not passing on the increased cost to consumers.

This type of inter-agency charging system is favoured by the Department for the following reasons:

- It would largely affect Sydney Water being the authority that is most unlikely to meet its demand management targets in 2004/05. It would provide a commercial incentive for Sydney Water to better manage demand.
- Step pricing would encourage Sydney Water to further invest in their demand management program, including fast tracking the joint retro-fit initiative with the Department of Housing.
- The model proposes that increased costs are not passed on to the consumer and would have little impact on the cost of water for the Department, community housing clients or low income earners in general. Nor are there any significant new social equity issues raised by this model.

Step pricing could result in catchment authorities receiving excess revenue when water supply authorities draw water levels over and above their demand targets. The Tribunal could consider using these funds for state-wide water conservation activities such as community campaigns or research into the wider re-use of waste water.

Two-part Tariff for Wastewater – This pricing model involves consumers being charged separately for general water usage and estimated wastewater discharges or sewerage by volume. The rationale behind this method of charging is that it strengthens the demand signals for water and is more reflective of the greater costs associated with volumes discharged into the sewerage system.

This pricing mechanism is not supported for the following major reasons:

- It would result in an unnecessary increase in the overall cost of water consumption for users such as the Department of Housing, community housing clients and low income earners.
- Accurate metering of domestic wastewater discharges is difficult. Estimations are not a satisfactory method of charging users.
- Consumers generally have less means of reducing their discharge of waste water into the sewerage than they have to control their use of outside water. It would not therefore be an effective demand management strategy to reduce overall water consumption.

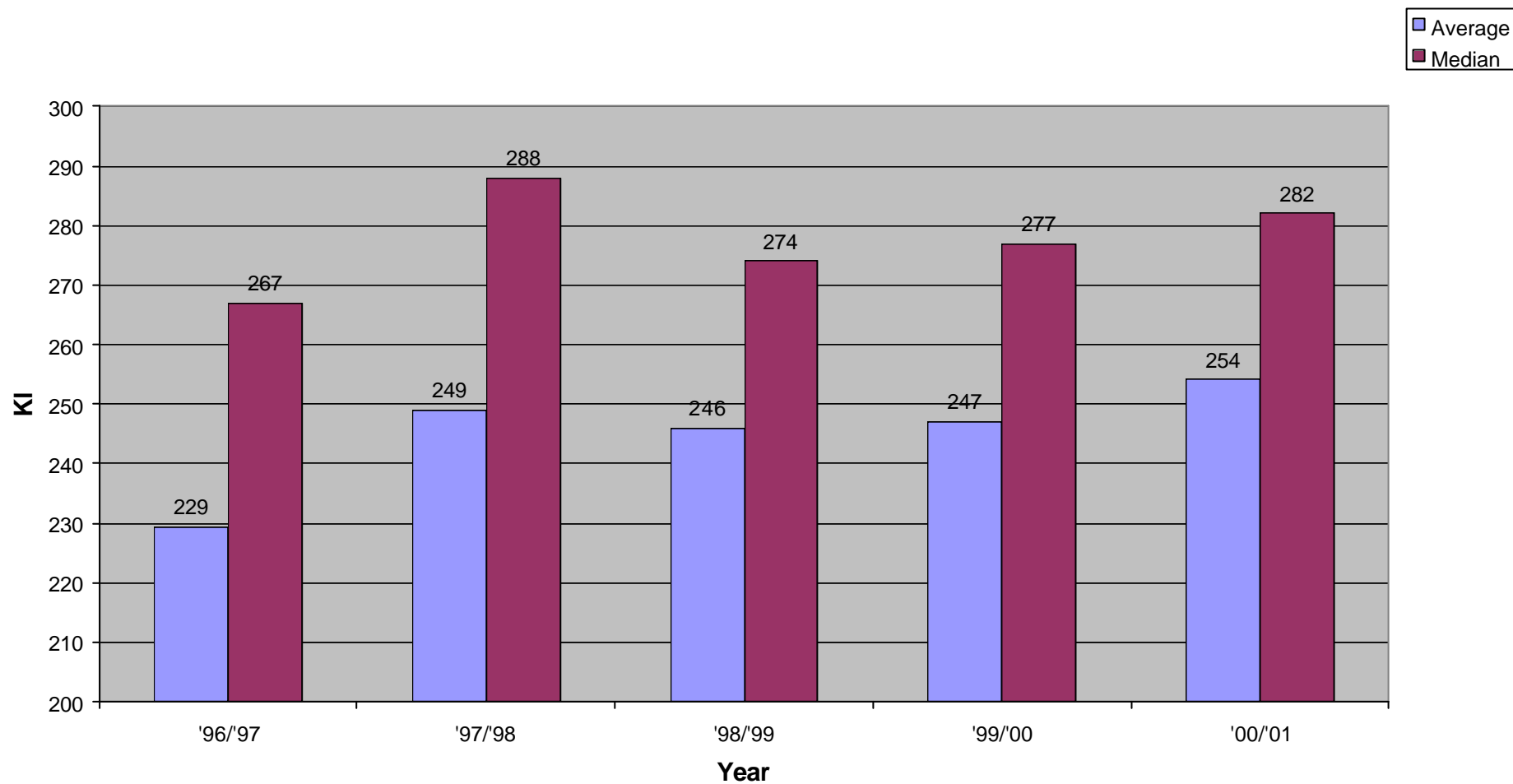
In addition, a two part tariff is not necessarily reflective of the level of fixed costs associated with the transport of waste water. It may result in excess revenue being raised from combined general water usage and waste charges that neither reflects the efficient operation of water authorities nor the funds required for ongoing maintenance.

A two-part tariff is currently sanctioned for Hunter Water which assumes that 50% of all water usage is discharged into the sewerage system and 50% is used outdoors. Water supplied through Hunter Water is currently one of the most expensive by volume of the metropolitan water supplies. The use of a two-part tariff by Hunter Water should be reviewed with a view to reducing the cost of water to the consumer and ensuring that revenue in excess of efficient operating costs and ongoing maintenance is not being raised.

Recommendations : It is recommended that:

- **Pricing structures and levels for the consumer be reflective of the funds required for the efficient operation of water authorities and associated ongoing maintenance.**
- **The Tribunal further consider the introduction of “step pricing” for water authorities where water is drawn beyond demand management targets provided these price increases are not passed on to the consumer.**
- **The use by Hunter Water of a “two part tariff” be reviewed to ensure that overall revenue raised is not in excess of requirements for efficient operations and ongoing maintenance.**

NSW Land and Housing Corporation Sydney Water consumption per dwelling



**Sydney Water average indoor usage
per DoH household
(2000/01)**

