

INFORMATION PAPER

Rural water charging system review

The NSW Government asked IPART to conduct a review into bulk water charges to be completed by **15 August 2012**. The full terms of reference is available from IPART's website (www.ipart.nsw.gov.au). The objectives of the review are to:

- ▼ identify options for bulk water price structure that can alleviate the stress on farm businesses' cash flows during times of low water availability and low revenue
- ▼ identify options for determining NSW Government cost shares for State Water (SW)'s operations that are subject to ACCC's price determinations
- ▼ recommend options for bulk water price structure and Government cost share, taking into account the potential impact on SW's and NSW Office of Water's (NOW) cash flows, NSW budget, pricing principles under ACCC and any barriers to implementation.

Background

As part of its election commitments in September 2010, the NSW Government promised a review into "the water charging system with a view to a new system that better reflects the cash flows of farmers, businesses and provides compassion for families doing it tough".

The ACCC will be responsible for making price determinations for SW's operations in the Murray-Darling Basin after June 2014. After June 2014, IPART will continue to determine prices for the NOW and most likely, SW's coastal operations.

The Department of Premier and Cabinet has written to the ACCC indicating that IPART is not seeking accreditation under the *Water Act 2007* to be a state regulator. The Government has not reached a view on the opt-in or out for the coastal region.

SW currently has a 40:60 fixed to variable pricing structure. All SW's customers are metered. NOW has a 70:30 fixed to variable pricing structure, where meters are installed. Few of NOW's customers on unregulated rivers or groundwater are metered.

The ACCC water charge rules do not prescribe a certain price structure, but ACCC will have regard to certain principles in assessing price structure proposals, such as:

- ▼ promote the efficient use of infrastructure
- ▼ provide a sufficient level of revenue for infrastructure operators to meet its obligations
- ▼ be clear and transparent.

In determining prices to meet the revenue requirement of an operator, the ACCC will assess whether an infrastructure operator's cost to deliver services are prudent and efficient. The revenue requirement will then be calculated, taking into account any contributions from other sources, for example, contributions from state governments.

As part of our previous determinations for SW and the NOW we have developed cost sharing ratios to determine how efficient costs should be shared between extractive users (eg, irrigators) and Government (ie, on behalf of the community where benefits are shared by the public and/or legacy features of these costs). This is so extractive users and the community both pay a fair share of the efficient costs of managing the bulk water system.

SW currently recovers 100% of user share of notional revenue, except in the South Coast, North Coast and Peel valleys. NOW currently recovers 100% of user share of notional revenue only in selected valleys such as the Murray. About 35% to 40% of SW's and 40% of NOW's revenue requirement is currently funded by NSW Government.

Under the new arrangements, ACCC will have annual reviews where prices will be updated for revised demand forecasts. This will most likely mean that prices will have the potential to rise and fall from year to year in line with these forecasts.

Key issues

The key issues for this review are:

- ▼ to gain an understanding of the impact of water variability and water charges on farm cash flows, given different valleys customer groups are affected differently by water variability
- ▼ in recommending options for price structure and government cost shares, taking into account policy constraints, such as ACCC's rules, National Water Initiative pricing principles, State Budget and State Water's and Office of Water's financial viability.

Questions

We would like to discuss the following questions:

1. How can we better understand the relationship between farm cash flows and the impact of water variability? We know for example, (see table below) water availability varies by location. What other variables affect the level of impact on farms (eg, years below a certain threshold or lack of trading opportunities)?

Table 1 Average allocations by valley 1989-90 to 2008/09

Valley	General security	High Security
Border	33%	100%
Gwydir	34%	100%
Hunter	97%	100%
Lachlan	64%	87%
Macquarie	60%	100%
Murray	79%	95%
Murrumbidgee	77%	98%
Namoi	58%	100%
North Coast	95%	100%
Peel	74%	100%
South Coast	81%	100%

Note: Data for the North Coast valley from 2003/04 only.

Source: IPART Analysis.

2. What are the options for price structures / hardship policy? We understand SW had preliminary discussions on the following options with some stakeholders:
 - increase the proportion of fixed charges (from the current 40%) to align better with State Water’s fixed cost base
 - revenue cap (SW would set the prices within the cap) with annual adjustment by ACCC based on updated demand forecasts
 - higher fixed charges with partial deferral of payment.Other options:
 - retain the existing 40:60 fixed to variable ratio
 - customers to choose between different fixed to variable ratios depending on their circumstances with the choice locked in for a defined period of time.
3. What are the options for cost shares?

The table below shows the current cost share ratios.

The ACCC rules do not facilitate specific cost shares or government contributions. Continuing the current cost shares is an option but requires agreement from the NSW Government, prior to ACCC’s price review process.

Table 2 IPARTs decision on percentage user cost share of operating and capital expenditure

Activity	User share
<i>Operating expenditure</i>	
Customer Support	100%
Customer Billing	100%
Metering & Compliance	100%
Water delivery & Other Operations	100%
Flood Operations	50%
Hydrometric Monitoring	90%
Water Quality Monitoring	50%
Corrective Maintenance	100%
Routine Maintenance	100%
Asset Management Planning	100%
Dam Safety Compliance Capital Projects pre-1997	0%
Dam Safety Compliance	50%
Environmental Planning & Protection	50%
Insurance	100%
<i>Capital expenditure</i>	
Asset Management Planning	100%
Routine Maintenance	100%
Dam Safety Compliance - Pre 1997 Construction	0%
Dam Safety Compliance	50%
Renewal & Replacement	90%
Structural and Other Enhancement	100%
Corporate Systems	100%
Environment Planning and Protection	50%
Environment Planning and Protection	50%
Flood operations	50%
Office Accommodation Capital Projects	100%
Information Management Projects	100%
River Channel Protection Works	50%
Water Delivery and other operations	100%
Hydrometric Monitoring	100%

Note: Some activity codes have not been used to set prices for the 2010 Determination period.

Source: IPART, *Determination Review of bulk water charges for State Water Corporation from 1 July 2010 to 30 June 2014*.

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4. How do we assess the options? Possible criteria:
- financial impact on State Water and Office of Water
 - financial impact on State Budget
 - conformity with ACCC rules and principles
 - alignment with National Water Initiative pricing principles
 - effectiveness in addressing customer impacts
 - economic efficiency
 - ease of administration.