



Hunter Water Corporation
ABN 46 228 513 446

PO Box 5171
HRMC NSW 2310
36 Honeysuckle Drive
NEWCASTLE NSW 2300
1300 657 657 (T)
(02) 4979 9625 (F)
enquiries@hunterwater.com.au
hunterwater.com.au

14 October 2016

Our Ref: HW2011-1081/3

Mr Hugo Harmstorf
Chief Executive Officer
Independent Regulatory and Pricing Tribunal
PO Box K35
Haymarket Post Shop NSW 1240

Dear Mr Harmstorf

REVIEW OF THE LOCAL GOVERNMENT RATING SYSTEM

Hunter Water welcomes the opportunity to comment on the *Independent Pricing and Regulatory Tribunal's Review of the Local Government Rating System – Draft Report* (the Draft Report), as published on 22 August 2016.

Hunter Water currently pays approximately \$1.3 million per annum in land rates to local councils in the Lower Hunter. Hunter Water owns land that is entitled to a land rate exemption in a number of areas: Tomago Sandbeds, Grahamstown Dam, Chichester Dam, Anna Bay Sandbeds and the Williams River Catchment. This land plays a role in ensuring water quality for the supply of potable water to areas served by Hunter Water. Currently, Hunter Water receives rate exemptions on land used directly for water quality purposes within the Tomago Sandbeds and Grahamstown Dam catchments, located within the Port Stephens local council area.

Hunter Water has concerns with IPART's draft recommendation to remove rate exemptions for water corporation land, including land vested in or owned by Hunter Water. There is also uncertainty and concern regarding the impact on Hunter Water and its customers of the use of Capital Improved Value (CIV) as the basis for setting rates.

Removal of exemptions for land used by a water corporation

IPART's Draft Report (page 77) puts forward the case that rate exemptions should not be based on ownership, and that land use involving commercial activities should be rateable. Hunter Water questions the basis for the three supporting policy rationales outlined by IPART:

*"First, commercial activities generate private benefits and revenue.
Therefore these ratepayers have the ability to pay, and should pay, rates."*

Hunter Water is a state-owned corporation subject to price regulation by IPART as a monopoly supplier of water utility services. Hunter Water pays dividends, tax equivalents and government guarantee fees to the NSW Government. Hunter Water does not accrue private benefits in the form described in IPART's Draft Report.

IPART conducted a 12-month review of Hunter Water's prices during 2015-16. IPART's public review process included the engagement of external cost consultants to scrutinize and recommend operating expenditure allowances over the four-year period to 30 June 2020. IPART's final determination sets prices to allow the recovery of IPART's final decisions on efficient operating expenditure, including a continuing efficiency adjustment.

Hunter Water estimates that the removal of rate exemptions could cost somewhere in the order of \$800,000 over a four-year period, assuming rates are assessed using unimproved land value.

Hunter Water does not have any ability to recover unanticipated, additional costs from customers during the current determination period. To be consistent with the principle of 'ability to pay', Hunter Water considers that IPART's Final Report should set out some form of transitional or phase-in period allowing alignment of price determination periods with the introduction of any changes to the rating system that applies to water corporations.

"Second, commercial activities impose costs on council. Therefore, it is equitable and efficient that those responsible for the costs make a contribution to them by paying rates. This would also provide them an incentive to minimise these costs."

Hunter Water's activities on currently exempt lands do not, generally, involve the provision of local government services. These lands are typically separately fenced and securely maintained. Hunter Water is responsible for all grounds maintenance such as lawns, trees, feral animal management and maintaining internal access roads. In addition, Hunter Water maintains and upkeeps land that it does not own, on which Hunter Water assets are located. The costs of garbage and waste collection services are borne by Hunter Water – local council services are not utilised. Hunter Water does use public roads to access its land.

Hunter Water has six local government areas in its area of operations. All of the currently exempt land falls within one of these council areas (Port Stephens). If existing rate exemptions are removed, these costs would eventually be passed through to the broader customer base. In effect, water customers outside a given local council area would fund a greater share of a single council's costs. IPART is recommending a transfer of revenue from Hunter Water's broader customer base to the benefit of ratepayers in a single council area, where that local government does not incur costs in servicing Hunter Water's land.

"Third, granting exemptions for land used for commercial activities gives those conducting the activities a competitive advantage, which is contrary to the principle of competitive neutrality. This may lead to less efficient suppliers entering industries based on a tax advantage, or disadvantage efficient competitors."

The *Water Industry Competition Act 2006* does allow private operators to provide water industry infrastructure and retail services in Hunter Water's area of operations. In all cases to date, private water utilities in the Lower Hunter have sourced potable water supplies from Hunter Water. IPART is in the process of determining wholesale prices for the provision of a potable supply on the basis that Hunter Water is a monopoly supplier of this service. Similarly, IPART's 2016 Determination of Hunter Water's retail prices was made under the provisions of the IPART Act relating to the monopoly supply of water services by a government agency. Hunter Water does not consider that the current land rate exemptions

have any impact on competitive outcomes or the efficient delivery of water services in the Lower Hunter.

Allowing councils to use Capital Improved Value

IPART's Draft Report includes recommendations to allow councils to use Capital Improved Value (CIV) as the basis for setting rates. The potential impact on Hunter Water's costs and the subsequent impost on customers is unknown. There is not enough detail in the Draft Report to make any informed assessment of possible costs, as much depends on the valuation methodology adopted by a council and any limits on the type of land such valuations would apply to.

Hunter Water owns assets such as treatment plants and pump stations that have a high CIV. This high capital value is not correlated with any demand for council services, and is inconsistent with IPART's 'benefits received' tax principle. As such, Hunter Water considers that IPART should make clear that the CIV proposal does not relate to the provision of essential infrastructure services.

Summary

IPART published its final determination of Hunter Water's prices for a four-year period in June 2016 – along with Sydney Water and Water NSW. Hunter Water is of the view that IPART's Final Report for the local government review should detail a possible implementation plan and timetable if it recommends the removal of existing rate exemptions for water corporations. This approach should enable the recovery of any additional land rates from the start of the next price period in 2020.

Hunter Water was unaware that this review of the local government rating system could have material cost impacts for public water utilities prior to the release of the Draft Report. Of particular concern is the proposal to allow councils to apply a CIV valuation to some land categories. The Draft Report does not provide sufficient detail or guidance on the possible financial consequences for different categories of rate payers that could result from such a recommendation. Hunter Water is of the view that councils should not be able to set rates for land used for the provision of essential water infrastructure services using the CIV method.

Yours sincerely



Fiona Cushing
Chief Financial Officer

