

24 September 2020

The Secretary  
Legislative Council Select Committee – TasWater Operations  
Legislative Council  
Parliament House  
HOBART 7000

Email: [tw@parliament.tas.gov.au](mailto:tw@parliament.tas.gov.au)

Dear Sir/Madam

**Legislative Council Select Committee - TasWater Operations**

Thank you for the opportunity to provide a submission to the Legislative Council Select Committee. This submission has been prepared by the Local Government Association of Tasmania (LGAT), with the Chief Owner Representative, on behalf of the Local Government Sector in collaboration with our Members.

LGAT is incorporated under the *Local Government Act 1993* and is the representative body and advocate for Local Government in Tasmania. Where a Council has made a direct submission to this process, any omission of specific comments made by that Council in this submission should not be viewed as lack of support by the LGAT for that specific issue.

If you have any questions or would like further information, please do not hesitate to contact me at [Katrena.Stephenson@lgat.tas.gov.au](mailto:Katrena.Stephenson@lgat.tas.gov.au) or (03) 6146 3743.

Yours sincerely



Katrena Stephenson  
**Chief Executive Officer**



Mayor Doug Chipman  
**Chief Owner Representative**

## **LGAT Submission**

### ***Legislative Council Select Committee TasWater Operations***

#### **Introduction**

To inform this submission, LGAT has discussed the Select Committee Inquiry with Members through our General Meeting process and through direct engagement with Council Owner Representatives of TasWater.

Four key themes were identified:

1. Local Government as owners of Taswater;
2. The effect of dividend policy on council revenue;
3. The need to depoliticize pricing for TasWater services; and
4. The constraints on development and infrastructure expansion.

#### **1. Local Government as Owners of TasWater**

Local Government ownership of TasWater provides a number of advantages. These include -

- A direct line of sight from TasWater to communities through councils and conversely; strong access through, and advocacy by, owners to TasWater, for communities.
- An absolute commitment to merit-based project prioritization without political interference and/or pork barrelling; and
- Equal consideration of the needs of smaller and larger communities.

TasWater was established as an independent company, incorporated under the Commonwealth Corporation Act (2001). While owned by the 29 Tasmanian councils (90%) and State Government (10%), it has a skill-based and independent Chairman and Board of Directors. The TasWater Constitution requires the Board Selection Committee, members of the Owner Representative Group, to appoint to the Board individuals who have “the experience and skills necessary to assist the Corporation to achieve its principal objectives”.

The Board and TasWater are required to deliver on the following objectives:

- The efficient provision of water and sewerage functions in Tasmania;
- Activities which encourage water conservation, demand management and re-use on an economic and commercial basis;
- A successful business operating in accordance with good commercial practice and delivering sustainable returns to its members; and
- Cost efficient service delivery.

Through the Shareholder Letter of Expectations (SLE) the Local Government owners of TasWater have clearly established a commitment to customer and community engagement. Specifically:

*The Corporation shall develop and implement open and transparent processes to engage its customers and the community in its planning processes to ensure, amongst other matters, that the standards of services it provides meet regulatory requirements and the needs and expectations of customers and the requirements of the Industry's regulators; and*

*The Corporation shall make:*

- *Information about the services it provides available to the public;*
- *Information about water conservation and the responsible use of water and waste water available to the public; and*
- *Educational material about the water industry available to schools and communities.*

Under the SLE, TasWater has significant formal accountability to its Owners including through annual planning meetings, annual reporting meetings, quarterly performance reporting meetings and general meetings. The level of scrutiny of TasWater is high, undertaken by the Owners, the independent Regulators and the Parliament.

The Local Government sector remains committed to ensuring that, as majority owners, using the powers provided within the TasWater Constitution, Shareholder Letter of Expectation and Owner Representatives Charter; we monitor performance, raise issues and concerns and influence the development of the capital plan, all with the goal of driving strong economic and service outcomes.

This commitment has recently led to the convening of owner only meetings to determine key issues and questions to be raised with TasWater, and the establishment of an expert advisory group to support the Chief Owner Representative. This group will develop and deliver on a targeted workplan commencing with a periodic review of the Shareholder Letter of Expectations. LGAT will provide secretariat support including engagement of external expertise as required.

## 2. The Effect of Dividend Policy on Council Revenue

In LGAT's first submission to the Premier's Economic and Social Recovery Advisory Council (PESRAC), we noted that in the context of COVID 19:

*It has not taken long for councils to start experiencing significant financial impacts from:*

- *Lost fees and charges revenue e.g. parking, sports centres and child care;*
- *Relief measures as outlined above, including deferral of payments, remissions, waivers and grants;*
- *Lost revenue from TasWater dividends - with no dividends to be paid for the second half of this financial year (having an immediate cash flow impact) and the likelihood of no dividends next year; and*
- *Increased cleaning costs.*

The impact of COVID-19 on TasWater's earnings, as illustrated by the immediate non-payment of dividends, has councils deeply concerned about their ability to rely upon a consistent dividend stream from TasWater into the future. This in turn makes it extremely difficult for Councils to have confidence in the accuracy and reliability of their long-term financial plans as many councils rely on the dividends for their budgets.

While acknowledging that the current legislative framework in which TasWater operates makes it very difficult for TasWater to pay dividends from a loss making position, there is a strong feeling amongst councils that they have already provided significant community relief in response to COVID 19 through a range of measures and should not have to provide further relief through dividend hits as well.

While the COVID 19 circumstances were exceptional and the response by TasWater understandable, this is the second significant change to dividends to councils. In 2016 the council owners of TasWater agreed to a significant reduction in dividends in order to provide sufficient funding for the strategic 10-year capital plan, which will deliver significant improvements to both drinking water quality and sewerage treatment.

During engagement with councils for our PESRAC submission it was clear that councils would like more certainty around dividends and at the very minimum a mechanism to smooth dividend shocks should be contemplated.

The dividends are used in meaningful ways for communities and have been increasingly important as we have seen a decline in relative funding through the Commonwealth's Financial Assistance Grants, erosion of the rates base (for example through changes to business models by the University and charities) and political and community demand for limited rate rises. Councils have a range of infrastructure which must be provided and

maintained for communities and have been trying to balance the competing needs as well as increasing demands for services for many years.

Ultimately if there are to be no TasWater dividends for councils there needs to be a broad understanding that there will need to be reconsideration of current rates policies. The TasWater dividend can represent between 3.5% and 8% of rates income, dependent on the council.

In summary:

- Most councils have not received the level of dividends agreed as part of the initial reform agenda or when they complied with National Competition Policy as asset owners.
- There is no certainty around payment of dividends which makes long-term financial planning difficult, leaving councils exposed.
- One of the significant drivers of the lack of certainty/guarantees around the dividend stream is the politicization of key matters, such as pricing and headworks (to be addressed later in this submission).
- In addition to dividend losses councils now pay significant water and sewerage charges on public assets.
- For some councils, the TasWater dividend represents a significant proportion of revenue (e.g. up to 8%).
- Solutions to dividends shortfall for councils include increased rates or borrowings or service reductions.

### **3. The Need to Depoliticize Pricing for Taswater Services**

TasWater pricing is currently set by the independent regulator to ensure the corporation operates efficiently as a water and sewerage service provider. Furthermore, TasWater is required by legislation to move towards full cost recovery. However, under the MOU with State Government related to their investment in TasWater, prices have been capped below that set by the Regulator. An event of the scale and impact of the COVID- 19 pandemic was not anticipated at the time the MOU was developed and as such the price capping agreement needs to be revisited. Further, LGAT believes that future hardship relief should be based on individual customer need rather than a broad approach which results in winners and losers.

Any move away from independent pricing regulation is at odds with the national water initiative and further escalates the risk to TasWater's viability. Compared to like utilities, TasWater charges per customer are amongst the lowest in the country, despite having the highest level of capital investment per customer.

The politicisation of pricing has meant there is enormous pressure on TasWater to hold pricing at an unsustainable level. This political cap on revenue has led to an increased debt and will negatively impact on TasWater's ability to invest in infrastructure. Hence, the artificial capping will act as a handbrake on Tasmania's growing economy. Over time such an approach can lead to poor infrastructure provision, ironically, the very justification the State Government gave for water and sewer reform in the first place.

The economic consequence of dividend reduction to councils is that they have less to spend on infrastructure themselves or are forced to adopt higher rates, which offsets the reduction in water and sewerage pricing and ultimately doesn't lead to any easing of cost of living pressures (see comments on dividend policy above).

In their submission, TasWater have suggested there be legislative allowance for a re-opening of a price determination in certain circumstances: As regulatory pricing periods increase (e.g. from 3 to 4 or more years) this will provide appropriate flexibility to respond to unforeseen circumstances. For example, where there is a material adverse impact as a result of an event outside TasWater's control and which could not have been contemplated at the time the price determination was made. This would allow for increased flexibility and responsiveness to significant changes in the broader environment. It is suggested that some of the benefits that may be derived from such a change include greater equity (e.g. reduction in cross subsidisation) for customers, or more sustainable cost recovery for TasWater, and minimization of compliance costs and delays.

Additionally, TasWater has suggested there should be a legislative obligation for the Economic Regulator to undertake a "financeability" test of its pricing determination. This would provide the ability for TasWater to recover the costs of providing services and reduce cross-subsidisation across the customer base, leading to improved consideration of TasWater's long term plans and associated outcomes.

#### **4. The Constraints on Development and Infrastructure Expansion**

There is currently a 'headworks holiday' in relation to TasWater's infrastructure contribution charges, initially imposed by the State Government in late 2014 with the intent to assist development and developers. Initially put in place for a period of two years, at the completion of this period the TasWater Board determined that it would continue the headworks holiday, and it remains today because there is no suitable headwork mechanism available. This policy position has resulted in some perverse outcomes. Councils have noted that it can stifle development in critical growth areas (including those identified as key development sites within Regional Land Use Strategies).

The current system means that there can be an untenable ‘first mover’ cost, whereby the costs of the necessary sewer and water infrastructure to develop an area are too high for the first mover where there are multiple land owners in an area, which there generally are. All subsequent developers would effectively be subsidised by the ‘first mover’.

TasWater requires that the infrastructure be suitable to service the area. An expectation that developers fully fund any water and/or sewerage infrastructure upgrades where infrastructure is at or near capacity appears to be holding development back.

Most other states have a system for infrastructure contributions or headworks, as Tasmania used to. Each system varies in its scope and characteristics, but all are intended to ensure that all development (especially urban growth) pays for its demand and impacts on public infrastructure and not just the first movers. Further, most seek to achieve, or at least improve, harmonisation in charging across infrastructure management authorities, be they councils or public utility providers. The methodology is robust and transparent and provides for equitable outcomes. Importantly, it also ensures that the cost of basic infrastructure is not a handbrake on orderly development and growth planning.

As TasWater note in their submission, where there is no available system capacity, or capacity constraints within systems, developers have the choice of paying to bring forward TasWater’s scheduled capital works (if any), waiting for TasWater to undertake the capital works or undertaking the capital works themselves. Developers are responsible for the installations and costs associated with water and sewerage assets, which are then transferred to TasWater. This includes reticulation assets within the development, external extensions to connect to TasWater’s network, and external expansions where existing capacity is insufficient to support the development.

LGAT is currently undertaking background research and engagement with councils on the issue of infrastructure contributions more broadly and will also contemplate in more detail the models proposed by TasWater in their positions paper a part of the development of their Pricing and Service Plan 4.

Reintroduction of headworks may not be the only mechanisms for encouraging first movers. Careful consideration by all parties including the State Government to ensure there is a sustainable way forward that balances growth, risk, timing, and capacity to pay for developments; along with the robustness of business cases. Revisiting headworks provides the potential catalyst for a comprehensive discussion and broader economic policy development.

## 5. Summary

- Councils are responsible owners, adding value to TasWater and are investing, with the support of LGAT, in more focused oversight by the Owners Representatives.
- However, they would like better recognition of the significant transfer of assets from their balance sheets in 2009 with the promise of equity in a new company which would as a priority ensure true service cost recovery and a fair return on their investment.
- Councils appreciate the legislation establishes TasWater as a commercial entity which requires them to operate sustainably and profitably. As a result of COVID-19 councils believe there is an urgent need to revisit the cap on prices so that the corporation can return to profitability and dividends can be paid.