

*Infrastructure Partnerships
Australia leads the national
infrastructure debate by
bringing together both the
public and private sectors
to promote partnerships in
infrastructure provision.*

Infrastructure Partnerships Australia

Submission to
Inquiry into Melbourne's Future Water Supply,
Parliament of Victoria, Environment & Natural
Resources Committee
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Contact

Joanne McCafferty
National Manager, Policy
Infrastructure Partnerships Australia

P | 02 9240 2050
E | joanne.mccafferty@infrastructure.org.au



Infrastructure Partnerships Australia

Infrastructure Partnerships Australia (IPA) is the nation's peak infrastructure body. Our mission is to advocate the best solutions to Australia's infrastructure challenges, equipping the nation with the assets and services we need to secure enduring and strong economic growth and importantly, to meet national social objectives.

Infrastructure is about more than balance sheets and building sites. Infrastructure is the key to how we do business, how we meet the needs of a prosperous economy and growing population and how we sustain a cohesive and inclusive society.

Infrastructure Partnerships Australia seeks to ensure governments have the maximum choice of options to procure key infrastructure. We believe that the use of public or private finance should be assessed on a case-by-case basis. IPA also recognises the enhanced innovation and cost discipline that private sector project management and finance can deliver, especially with large and complex projects.

Our Membership is comprised of the most senior industry leaders across the spectrum of the infrastructure sector, including financiers, constructors, operators and advisors. Importantly, a significant portion of our Membership is comprised of government agencies.

Infrastructure Partnerships Australia draws together the public and private sectors in a genuine partnership to debate the policies and priority projects that will build Australia for the challenges ahead.

1. INTRODUCTION

Infrastructure Partnerships Australia welcomes the opportunity to submit to the Inquiry into Melbourne’s Future Water Supply (Inquiry) being undertaken by the Parliament of Victoria’s Environment & Natural Resources Committee (Committee).

This submission outlines core aspects of IPA’s position on urban water management and makes specific suggestions concerning the Melbourne’s future water supply which we encourage the Committee to consider in developing its report to the Victorian Parliament.

2. BACKGROUND

With climate change predicted to add pressure to Melbourne’s water supply, and population continuing to increase, Melbourne is facing some serious water challenges, including ensuring a secure supply of water and protecting our natural assets, such as Melbourne’s creeks and rivers and Port Phillip Bay.

The current drought is in its tenth year and the last decade has been the driest on record in Victoria. Last summer Melbourne received only 40% of the average summer rainfall and stream flows into major catchments were well below average. The amount of water flowing in rivers and streams and stored in Victoria’s water supply reservoirs is at all time lows.

Melbourne’s nine major water storages to the north and east of the city are currently 32.3% full (as at 19 August 2008).

Although, Melbourne residents have reduced their consumption by 22% over average 1990s levels, Stage 3a water restrictions are in place in Melbourne in addition to the permanent water saving rules introduced across Victoria in 2005. Stage 3a is the second phase of Stage 3 water restrictions and has been introduced due to low rainfall over summer and below average stream flows. Stage 3a helps to save water while minimising the impact on businesses and community sporting facilities.

IPA supports the Victorian Governments various efforts to provide water security for Victoria’s growing population and economy by diversifying and boosting water supplies and networking the State’s water resources in a Victorian Water Grid to improve responsiveness to changing future water needs. In June 2007, the Victorian Government launched the second phase of its Our Water Our Future Plan (OWOF Plan).

The plan included the announcement of \$4.9 billion of projects to secure Melbourne and Victoria’s water supplies for the long term, including:

- A 150 billion litre desalination plant to provide water for Melbourne, Geelong, Westernport and Wonthaggi to be built in the Wonthaggi region by the end of 2011 at a cost of up to \$3.1 billion, funded through water bills;
- A major irrigation upgrade in the Food Bowl in Northern Victoria to deliver water savings to be shared equally between irrigators, the environment, and Melbourne; and

- A major expansion of the Victorian Water Grid with pipelines to connect Melbourne’s water system with the desalination plant and Northern irrigation upgrades, connect Geelong to Melbourne’s supplies, and connect Hamilton to the Grampians Wimmera Mallee System.

These projects are expected to deliver a 50 per cent boost to Melbourne’s water supply within five years and increase Victoria’s total supply by 375 billion litres each year, with Melbourne receiving 75 billion litres in 2010, and a further 150 billion by the end of 2011.

These actions are in addition to the reconnection of the Tarago Reservoir by 2009 and the upgrade of the Eastern Treatment Plant announced through the Victorian Government’s Central Region Sustainable Water Strategy, which considered issues affecting the wider region such as bulk entitlements, water allocations between water authorities, environmental health and new water allocations.

Finally, the Water Supply-Demand Strategy for Melbourne also proposes a program of actions to maintain reliable supplies and manage water demand for the next 50 years with climate change.

IPA endorses the Victorian Government’s strategic direction in the OWOFF Plan. The particular focus of the second phase of the OWOFF Plan’s on responding to the need for need for new (and renewed) water infrastructure, which IPA has long argued is one of the greatest challenges facing government in this country, is decisive and timely.

The leadership taken by the Government in Victoria in tackling the water infrastructure challenge in partnership with the private sector is most welcome.

3. IPA’S POLICY POSITIONS ON URBAN WATER MANAGEMENT

Water is a vital commodity, essential to life, agriculture and industry. It is in demand as our population and the economy grows. There are increasing concerns about the way in which this vital resource is being managed. Growing demand for water and diminishing supply from existing sources requires all of us to examine how we use this scarce resource and find ways to manage our water use in a more sustainable way.

Rapid urban development in Australia’s major cities has resulted in a corollary increase in the demand for urban water and wastewater services. This in turn has stretched public utilities.

There are two ways to deal with an expected deficiency in supply. Either reduce demand or augment existing water supplies.

Australian governments have embarked on rigorous campaigns to reduce water supply pressures, through the installation and encouragement of water saving and water efficient devices, public education campaigns, and through enforced reduction of the consumption of water.

IPA has argued for some time that there are more efficient ways of managing water than simply relying on demand management measures. It is unwise to encourage over-reliance on demand reduction as a long term solution to Australia’s urban water needs. Governments’ initiatives to reduce water demand have been widely employed across the country to effect but will eventually produce diminishing returns at the margins.

Furthermore, we believe strong legislative approaches, such as stringent water restrictions, run the risk of creating conflict and hostility between governments and their electorates, as many consumers place the blame for Australia’s failure to invest in essential water infrastructure squarely with our governments.

The need for new (and renewed) water and wastewater infrastructure in Australia is one of the greatest challenges facing government in this country. The need for this infrastructure is not contested, but the responsibility for its commission, funding, delivery, political and financial risk and ultimately the success of any given piece of water infrastructure is an issue of great currency.

In May 2007, Infrastructure Partnerships Australia undertook a major research project with The Allen Consulting Group into the need for urban water reform and the key elements to achieve sound urban water management in Australia. IPA’s research confirmed institutional factors are constraining investment in water infrastructure – not the lack of capital. Government should place greater emphasis on the supply side and on overcoming impediments to investments in capacity generation.

IPA is also of the view that systematic consideration of an increased role for the private sector in the provision of water and wastewater must form a part of any considered approach to securing and augmenting Australia’s urban water and waste water services.

FIGURE 1: THE SIX ELEMENTS OF SOUND URBAN WATER MANAGEMENT



IPA submits there are six fundamental elements of ‘best practice’ urban water management (Figure 1). Current management practices in Australia embody most of

these elements but to varying degrees. There is scope for considerable improvement, as discussed below.

3.1 Pricing urban water

A majority of Australia’s water utilities are unable to charge a price that is equivalent to or in the vicinity of their long run marginal cost of producing water. Utilities with a smaller customer base are further handicapped in recovering the full cost of service delivery rendering them dependant on state and federal grants to fill in the gaps.

In any system of competitive markets, price acts as the lever which balances supply and demand. Consumers decide how much of the commodity they will consume based on the price, and the price offered by the suppliers represents the least cost method of supplying the commodity.

IPA is of the view that prices charged by water utilities should generate sufficient revenue for the water companies to cover all commercial costs of supplying water including operating, capital and a rate of return on assets.

IPA also submits that retailers should be able to purchase supplies from a competitive wholesale market.

It is important to note that non-market based pricing regimes in the water sector ensure that PPP procurement mechanisms used to develop new water infrastructure cannot be structured as “economic PPPs”. PPPs must instead be structured as “social” PPPs, relying on State “availability” payments.

3.2 The institutional framework for urban water management

Appropriate institutions are critical for efficient management of water resources, promoting competition and investments in new infrastructure and new energy saving technologies.

Currently nearly all water utilities are government owned and there exist inherent conflicts between the multiple roles that they perform. Typically governments have:

- a shareholder role in which they have an interest in the financial performance of the water utility;
- a welfare role ensuring that benefits of essential infrastructure like water accrue to the community at large and water utilities continue to discharge their functions at minimum cost to the environment; and
- a regulatory role ensuring a level playing field to all players in the industry and protecting consumer interests.

There are obvious conflicts between discharging all these roles. Sound governance calls for separation, clarity and devolution of these to parties which are best suited to undertake them.

IPA submits there is urgent need to consolidate the jurisdictions of smaller fragmented water utilities to make them financially viable and capable of ensuring water security to their customers. At present, judgements on key water infrastructure issues, such as the use of PPPs as a procurement mechanism, are impaired by a very narrow focus and a lack of project scale.

IPA contends that the private sector should have a greater role in investing, operating and maintaining water infrastructure (excepting water storage). We believe it can do so, in the most efficient way, under an overall regulatory framework set by government.

Where feasible, public sector water utilities should be encouraged to enter into partnerships with the private sector for construction, financing, operation and maintenance of existing and new facilities. The utilities would benefit from advice from a central PPP advisory body on PPP best practices and procurement models. The consolidation of smaller utilities would be essential in order to attract greater private sector involvement.

3.3 Regulation in urban water markets

Regulation of natural monopoly service providers is an accepted practice in Australia and a variety of models exist across the country in regulating economic infrastructure. For instance, in the market for gas in Australia there is a mix of both Government and privately owned transmission and distribution activities, their activities regulated by the States and Territories.

The appropriate regulatory framework for water and sewerage utilities across the nation depends on specific needs and challenges that the utilities face in times of changing business environment. However, IPA submits that sound regulation requires the regulator to be separated from the water businesses and have the power to ensure compliance and regulatory best practice.

There is also need for regulatory oversight of water trading, infrastructure access by third parties, water and environmental quality monitoring.

3.4 Models of private partnerships for urban water

Private involvement and contribution to water supply in Australia has grown steadily and beneficially in recent decades and through a variety of forms. The private sector is a large, essential and most likely a growing contributor in expertise, service, development and innovation.

Currently the private sector has considerable expertise in Australia in the areas of maintenance of water/wastewater assets and systems. While these may be considered as effective outsourcing arrangements, it is widely believed that these may not bring the required levels of efficiencies desired, which may be available through the involvement of private debt and equity investors.

World over, there is significant demand from equity investors in water assets, yet only a small percentage of the installed base of Australia’s water infrastructure has been financed by private means. There is considerable scope for increased private investment in Australia’s water infrastructure, given the right conditions. Table 1 outlines a few models which may be suitable for use by urban water utilities to facilitate greater involvement of the private sector.

State-controlled water authorities would derive significant benefits from accessing private finance, in particular:

- Added discipline in costs of design, construction and operation;
- Appropriate risk transfer between State and the private sector;
- Innovation in delivering solutions that optimise cost and use of latest sustainable technology;
- Re-direction of cash-flow to other areas with their portfolio of projects;
- Flexibility to drive a cost/benefit outcome based on discipline and risk transfer versus marginal increases in funding cost;
- Possibilities for market based business models.

Table 1: Models for Private Sector Participation

Type of Arrangement	Responsibilities of Operator	Financial Arrangement	Risk Sharing	Ownership of Assets
Management Contract	Supplies management services to the utility in return for a fee	Fixed fee indexed to inflation	Small	Contracting Authority
Lease	Runs the business, retains revenue from customer tariffs, pays a lease fee to the contracting authority, but does not finance investment in infrastructure assets	Revenue from customers, operating and maintenance costs, lease fee	Operating and commercial risks: Significant	Contracting Authority
Concession (e.g. PPP)	Runs the business and finances investments but does not own the infrastructure assets	Revenue from customers, operating and maintenance costs, finance costs, any concession fee	Operating and commercial and investment related risks: Major	Contracting Authority
Divesture	Runs the business, finances investments and also own the infrastructure assets	Revenue from customers, operating and maintenance costs, finance costs, any license fee	Operating and commercial and investment related risks: Major	Operator

Source: A Discussion Paper on the role of the Private Sector in the Supply of Water and Wastewater Services, Department of Prime Minister and Cabinet, August 2006.

One key point in favour of public-private partnerships (PPPs) in water is the guarantee of adequate maintenance of assets. At present the existing State monopoly water authorities can be exposed to varying dividend payments from the States.

At the financial close of a transaction, the future cost of a PPP project is known; the public sector will receive known outputs for known costs. Under a PPP structure the maintenance program is secured for, say 25 to 30 years. This ensures the

taxpayer will have these assets functioning properly without risk of maintenance programs being deferred.

This is in contrast to traditional procurement where the costs of project completion and future maintenance of the assets are uncertain and remain the responsibility of the public sector and at risk to the vagaries of State budgets.

CONCLUSION

IPA recognises that issues affecting urban water utilities are varied and complex and there are no ready made solutions. Water is fundamental to life and there is nothing more important than devising suitable management strategies to efficiently allocate and manage this resource amongst its competing users.

As indicated above, IPA endorses the Victorian Government’s strategic direction in the OWOFF Plan. The particular focus of the second phase of the OWOFF Plan’s on responding to the need for need for new (and renewed) water infrastructure, which IPA has long argued is one of the greatest challenges facing government in this country, is decisive and timely.

The leadership taken by the Government in Victoria in tackling the water infrastructure challenge in partnership with the private sector is most welcome.

Victoria’s public sector has developed significant expertise in harnessing private support to build infrastructure projects and obtain the best value for money for the community. There is still further scope for more active involvement of the private sector in providing the finance, ownership and ongoing stewardship of public sector water and waste water infrastructure in Victoria. The private sector is well equipped to provide the expertise and innovation that further challenges to Victoria’s urban water and waste water services will demand.

The Victorian Government needs to continue to take long term sustainable decisions to renew investments in water infrastructure, achieve full cost recovery through pricing practices, create conditions for further private sector participation and set up an efficient institutional framework to achieve high standards of service delivery.

IPA hopes that this submission demonstrates our support of the Victorian Government’s recent efforts to secure Melbourne’s future water supply and that it is useful to the Environment & Natural Resources Committee in making its final report to the Parliament of Victoria.

Any queries regarding this submission should be addressed to Joanne McCafferty, National Manager, Policy, on (02) 9240 2053.



Infrastructure Partnerships Australia
8th Floor, 8-10 Loftus Street, Sydney NSW 2000
www.infrastructure.org.au

T 02 9240 2050
F 02 9240 2055
E contact@infrastructure.org.au