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**SUBMISSION TO THE ECONOMIC REGULATION AUTHORITY: DRAFT DECISION ON PROPOSED REVISIONS TO THE ACCESS ARRANGEMENTS FOR THE WESTERN POWER NETWORK**

The Urban Development Institute of Australia (WA) is pleased to make this submission to the Economic Regulation Authority on the Draft Decision on Proposed Revisions to the Access Arrangements for the Western Power Network (**Draft Decision**).

UDIA (WA) is the peak body representing the urban land development industry in Western Australia. UDIA is a membership organisation with members drawn from the development, planning, valuation, engineering, environmental, market research and urban design professions. Our membership also includes a number of key State Government agencies and Local Government Authorities from across the state. Nationally, UDIA represents the interests of thousands of members and includes all the major land development companies, both public and private, and specialist consultancy firms.

## OVERVIEW

UDIA would like to take the opportunity to highlight two areas of concern with the **Draft Decision** being:

- the treatment of gifted assets
- the assumptions around peak load and energy cost

### The Treatment of Gifted Assets

Required Amendment 21

*No amounts in relation to tax on capital contributions must be included in the Target Revenue*

UDIA is extremely concerned that Required Amendment 21 in the **Draft Decision** will result in a significant financial impost on the new homebuyer and calls on the ERA to further investigate the financial implications of gifting of assets by urban developers to Western Power.

Currently, developers construct assets required to extend the Western Power grid to end customers and vests these assets to Western Power. In itself that is estimated to cost new home buyers around $9,000 per lot inclusive of infrastructure and reticulation.

It has been estimated that shifting the taxation liability to developers for gifting the asset would add a further $1,500 per lot.

*Direct Benefit*

- Electricity customers benefit from the gifted asset and therefore should contribute to the taxation liability.
- Synergy, Horizon and any other wholesale purchasers of electricity from the grid for sale to domestic customers gain from the grid connections that result from the gifted asset.
- Local Governments also gain through uplift in the rates base as the value of a lot that is connected to the grid is higher than a lot that is reliant on its own power.

Developers are required to connect lots to the grid as a condition of subdivision and, whilst they gain from the sale of the lot, they do not have any long term benefit from the long term use of power in a development. All of the profits from that activity flow back through Synergy and Horizon Energy to Western Power.

*Upfront costs*

The most efficient way to pay for the taxation is by Western Power passing through the cost rather than cost shifting that liability back to new home buyers. Any costs that are placed onto the homebuyer will be subject to Goods and Services Tax (GST) and/or Stamp Duty[1], developer margin, plus the mortgage interest rate.

Where the taxation liability is passed through to the user of the energy it only attracts Western Power and retail margins.

The following example assesses the impact of the new arrangements on housing affordability for a typical new $450,000 "turn-key" house and land package. The analysis shows that the proposed system is 92% more expensive than passing the tax liability through the existing system. This is because, although there are two commercial margins for Western Power and the retailer applied, the process is not subject to GST, transfer duty or mortgage interest.

*Figure 1*

| **Proposed system** | |
|---|---|
| Taxation liability for gifted asset per lot | $ 1,500.00 |
| Commercial margin[2] | $ 270.00 |
| GST | $ 177.00 |
| Subtotal | $ 1,947.00 |
| Stamp duty[3] | $ 95.00 |
| Subtotal | $ 2,042.00 |
| Interest[4] | $ 2,683.28 |
| Total repayment | **$ 4,722.76** |

[1] GST applies to the purchase of a detached house, Stamp Duty applies to a land sale. If the transaction for the land and dwelling occurs in one transaction ie for a townhouse, apartment, unit or turnkey detached house, both taxes apply.

[2] Based on 18%

[3] Based on a purchase price of $450,000 plus tax recovery, commercial margin and GST

[4] Based on a purchase price of $450,000 plus tax recovery and costs over a 25 year period at 8%pa

**Flow through system**

| | |
|---|---|
| Taxation liability for gifted asset per lot | $ 1,500.00 |
| Commercial Margin WP | $ 270.00 |
| Subtotal | $ 1,770.00 |
| Commercial Margin Retailer | $ 318.60 |
| Total | **$ 2,088.60** |
| # of weeks of disposable household income (net impact)[5] | 2.7 |
| # of weeks of disposable household income (gross impact) | 4.9 |
| Extra mortgage payments per month | $ 15.74 |
| Uplift in cost | 96% |

*NB: The calculations above do not take into consideration asset depreciation or cost of money over time*

*Cost recovery through depreciation*

The previous section considered the direct impact of recovery of the taxation through either directly burdening the new home buyer or recovery over time through power bills. The cost to consumers is virtually doubled under the taxation recovery proposal which is persuasive in itself, but it has to be remembered that the actual cost that needs to be recovered is simply the time cost of money as the asset is depreciated over time bringing the net costs close to zero.

*Circularity arising from recovery of tax costs*

The calculation in Figure 1 does not give regard to the circularity of the cost recovery mechanism, that is, the income received to cover the taxation liability of $1500 would in itself trigger a further liability. Each round of this circularity will create an added burden on new home buyers in what effectively becomes a tax on a tax on a tax. This would clearly erode housing affordability and create an inequitable outcome for new homebuyers.

*Party has a tax benefit from gifted asset*

Whilst the developer will write off the gifted asset and receive a tax concession for this amount as a cost of business, this in no way covers the out of pocket costs involved in delivering this vital infrastructure. As a rule of thumb 70% of the cost is still included as part of the cost of development. Major developers may have up to $50 million in infrastructure liabilities at any one time and further burden my make many projects unviable, which will interrupt land supply and potentially have significant roll on impacts on the broader economy.

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[5] Based on ABS 6523.0 Household Income and Income Distribution 2009/10: Western Australia weekly household disposable income

*Administrative Burden*

The calculations included in this submission do not take into consideration the additional administration in relation to the collection of cash to meet the taxation requirements. Given that assets may be vested from hundreds of developers over the course of the year it would be expected that the cost of administering recouping the tax will be considerable and may, indeed, be equal to or greater than the amount being sought in the first place. This is an inefficient process which we caution against.

*Conflict with the role of the ERA*

*"The ERA's functions are designed to maintain a competitive, efficient and fair commercial environment, particularly where businesses operate as natural monopolies, for the benefit of the Western Australian community. In making its decisions, the ERA strives to ensure consumers receive quality services for a reasonable price."*

The required Amendment 21, which sees the cost shifting a tax liability to home buyers resulting in a higher cost than the current process, would seem to be in breach of the role of the ERA. If the ERA's role is to benefit the Western Australian community, this required Amendment 21 will contribute to the increased pressure on housing affordability and will potentially impact project viability. Given that the undersupply of housing in Perth is well documented, this required Amendment is likely to exacerbate the critical community issue of housing affordability and impose additional costs on households when they can least afford it.

*Housing affordability*

Living affordability comprises a range of items including: the cost of the accommodation (whether renting or buying); cost of transport, energy, water and food. The proposal to cost shift the tax liability on gifted assets places an additional burden of $15.74 per month on the mortgage. In comparison, the a flow through arrangement for recovering the tax liability over time from consumers works out at only $0.15 per customer.[6]

Whilst energy prices are a vital component of affordable living, it makes no sense to escalate other living costs to a greater level than the original amount in order to avoid increasing power costs.

*Disproportionate penalty to new home purchasers*

New homebuyers have been significantly disadvantaged through government policy over the last two decades which has seen the cost shift of infrastructure moving from the authority to the purchaser. This period has also seen the introduction of the GST, which for a built form outcome, unfairly penalises purchasers. Energy ratings are now mandated to Six Star which delivers new dwellings that are more energy efficient, on average, than the existing housing stock. The proposal to re-coup taxation costs from this small cohort and add a further $2,500 or more in costs above the $1,500 to be recovered is clearly inequitable and contrary to broader government policy.

[6] Based on 20,000 new dwellings per annum with a total of 900,000 dwellings attached to the grid.

**UDIA POSITION ON Required Amendment 21:**

**UDIA urges strongly that this Amendment is not to be implemented without further analysis of the roll on impact of this change on the end energy consumer as it is an inefficient method of collecting taxation.**

## Assumptions on Peak Load and Energy Costs

*Item 269: Smart Grid*

UDIA is supportive of smart grid as a strategy for spreading the peak load only where it does not generate increased power consumption.

UDIA has investigated smart metres and has found that if smart metres can be used to turn air-conditioners on and off at different times across a suburb, the overall power requirement of the suburb might be decreased, because they are not all running at the same time. This is beneficial because it reduces the peak load and therefore reduces the need for greater levels of infrastructure to manage the load.

However, we have also found that turning an airconditioner off may increase the energy requirement for that machine overall. When the airconditioner is switched back on it needs to "make up ground" to maintain the desired temperature causing it to work harder and thereby consuming more energy. In some instances it would be a more efficient use of energy to leave the air-conditioner running at a lower level, however that may not be possible for older machines and it does not address the issue of peak load.

UDIA notes that Western Power's position is benefits of smart metres will accrue through lower wholesale prices[7] however if the units of energy consumed are greater than would otherwise be consumed the benefit may be diminished for the end customer. Further investigations are clearly needed to fully understand the functioning of smart metres and the impact on total energy consumption.

UDIA remains committed to supporting outcomes that both reduce the peak load and reduce the total energy consumed and care must be taken to ensure that this is the outcome that is realised through the use of smart grid technology.

## Summary

UDIA is opposed to the adoption of Amendment 21 as it will result in a significant additional financial burden on new homebuyers and reduce housing affordability and will potentially impact on project viability and land supply. The proposal is contrary to government policy in other jurisdictions.

UDIA's analysis indicates the cost to the new home buyer under the proposed system is more than double the current system.

[7] Page 70

UDIA urges strongly that Amendment 21 is not implemented without further analysis of the roll on impact of this change on the end energy consumer as it is an inefficient method of collecting taxation.

Recent findings of the smart metre trial shows potentially differing outcomes for peak load and energy consumption. It is clear that this area needs closer investigation to determine the overall benefits of smart metering.

We thank the ERA for the opportunity to comment. UDIA would welcome the opportunity to work with the ERA further on these critical issues and I can be contacted on 9321 1101 to arrange this.

Yours sincerely

[redacted]

**Debra Goostrey**

Chief Executive Officer