ST HELENA UTILITIES REGULATORY AUTHORITY



2016/17

REPORT ON THE MAXIMUM CHARGES OR FEES TO BE LEVIED BY CONNECT SAINT HELENA LTD

PART 1 – OVERVIEW

1.1 UTILITY SERVICES ORDINANCE 2013

On 1^{st} April 2013 the Utility Services Ordinance 2013 established the Utilities Regulatory Authority. This created a legal framework to facilitate the private sector provision of licensed public utility services ("services"). These services are the; (a) generation, distribution and supply of electricity; (b) collection, storage, treatment and distribution of water; and (c) disposal of waste water.

1.2 UTILITIES REGULATORY AUTHORITY

The members of the Authority are the Chief Magistrate (as Chair), Mr Stedson Francis BEM and Mr Paul Hickling. The Judicial Services Manager is the Secretary to the Authority, to whom any communication should be made (yvonne.williams@sainthelena.gov.sh). The Authority, and any person acting under its authority, act entirely independently and are not subject to the direction or control of the Governor, the Executive Council, Legislative Council or any other person or authority.

1.3 OBJECTIVE OF AUTHORITY

The objective of the Authority is to regulate the development and provision of services in a manner which; (a) ensures that users of such services are protected from both <u>unreasonable</u> prices and <u>unreasonably</u> low levels of service; (b) ensures (so far as is consistent with (d) and (e)) that the prices charged for such services do not create <u>unreasonable</u> hardships for households or <u>unreasonable</u> hindrance to commercial and economic development in St Helena; (c) motivates Utilities Providers to improve the quality of the services they provide; (d) ensures stability and predictability in the public utilities industry in the medium and long terms; (e) supports a progressive reduction in levels of subsidy from public funds; and (f) has regard to such other regulatory objectives (if any) as may be prescribed.

1.4 DUTIES OF AUTHORITY

It is the duty of the Authority, having regard to its objectives, to ensure that Utilities Providers comply with (a) ordinances, regulations and directives issued thereunder, regulating services; and (b) the conditions of their licence.

1.5 POWERS OF THE AUTHORITY

The Authority may, for the purpose of performing its duties, issue Directives to a Utilities Provider in connection with the provision of any service; and, without prejudice to that generality, such Directives may impose requirements concerning; (a) the quality or standard of service which the Utilities Provider must deliver to its customers; (b) payments of compensation (or abatement of charges) to compensate customers when the service provided does not meet the standards so set; (c) the maximum charges or fees to be levied by a Utilities Provider for providing the service; (d) the terms and conditions on which services are to be provided; and (e) such other matters (if any) as may be prescribed.

1.6 PENALTIES BY THE AUTHORITY

If the Authority is satisfied that a Utilities Provider has failed to comply with a Directive, or with a condition of its licence, the Authority may order the Utilities Provider to pay a penalty not exceeding the sum of £100,000.

1.7 **REVOCATION OF LICENCE**

A licence may be revoked by the Governor in Council upon the recommendation of the Authority, where the Utilities Provider is in substantial and continuing breach of (a) any of the provisions of the licence; (b) any Directives issued by the Authority; or (c) any other obligations under the Ordinance.

1.8 UTILITIES PROVIDER- CONNECT SAINT HELENA LTD

With effect from 1st April 2013 Connect Saint Helena Ltd ("Connect") were licenced by the Governor in Council to provide all said services in St Helena. The Authority was instrumental in the drafting of such a licence. Connect is a private limited company which is wholly owned by the St Helena Government ("SHG"). The Board of Directors consist of a non-executive Chair, four further non-executive directors and two executive directors. The executive directors are the CEO and Operations Director of Connect.

1.9 PURPOSE OF REPORT

Connect had requested permission to adjust the charges or fees ("tariffs") for the services to be supplied by them, as from 1st April 2016. The revised tariff proposals are as outlined in the Appendix. This report sets out the Authority's considerations, in deciding whether to grant such permission.

PART 2 - MAXIMUM TARIFFS 2016/17

2.1 TARIFF PROPOSAL

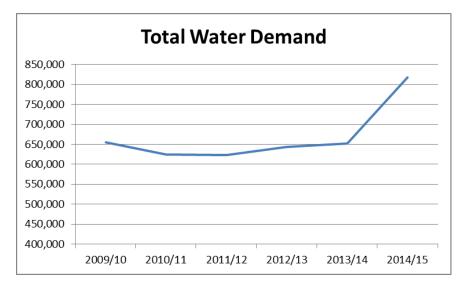
Sewerage, water and electricity revenue, from the provision of such services, amounts to 1.3%, 10% and 88.7% of the total tariff income, respectively.

2.1.1 Sewerage

The proposal was to increase charges by approximately 6%. For domestic consumers this equates to an average increase of 5.4p per week. Connect have forewarned the Authority that once planned new sewerage treatment plants are brought into service, additional operating costs will almost certainly prevail. Connect will be required by the Authority to provide detailed evidence of such costs, in support of any proposed significant increases in this tariff. This issue is however only likely to arise when the Authority is considering tariff proposals for the year from 1st April 2017 and is not a particular consideration in this report.

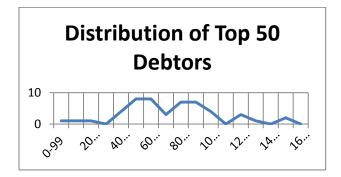
2.1.2 Water

The proposal was to increase charges by approximately 4%. The standing charges however, remain unchanged. Connect indicated that they would ideally have wanted to make more radical alterations to the tariff structure, targeting usage as a method of slowing the rate of consumption, which has increased significantly. Connect accept however, that there is at present an insufficient evidence base to support such a revised tariff structure. The following graph demonstrates the significant rate of increase in the demand for water, which if unchecked may result in water shortages. While capital investment in additional raw water resources will help in this respect, if a sufficient evidence base is identified, the said radical alteration to tariffs will be considered by Connect. This issue is however only likely to arise when the Authority is considering tariff proposals for the year from 1st April 2017 and is not a particular consideration in this report.

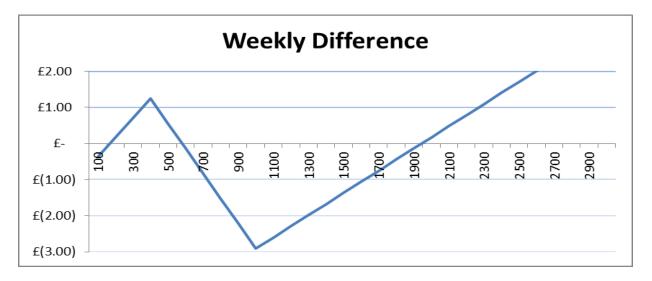


2.1.3 Electricity

The proposal was to (a) eliminate standing charges; (b) increase Band 1 from 23p to 30p for domestic consumers; (c) reduce Band 2 from 39p to 30p (effectively combining the two bands at the lower rate) for domestic consumers; (d) increase Band 3 from 43p to 46p; and (e) require government and commercial consumers to make payment at the rate of 46p per unit. With 88.7% of tariff income coming from the provision of electricity services this is where the major financial effect will be seen by some consumers of the tariff proposals. This alteration in the tariff structure inevitably creates "winners and losers". The <u>very</u> low users will be better off, because they will no longer pay standing charges. Analysis of Connect's debtors suggests that consumers, who have had difficulty paying utility bills, tend to be grouped in the current Band 2 (400 to 1000) usage range. Many of such consumers will also be better off.



The above graph shows that 82% of the top 50 Connect debtors occupy the Band 2 charge category. By comparing the distribution of debtors to the immediately following graph, (which shows the weekly financial impact of the proposed changes according to usage), the Authority is persuaded that a) generally, debtors in the 500 – 900 unit usage range will be better off, this being where current services payment problems appear to be primarily arising. To a lesser extent, payment problems are still prevalent at up to 1,700 units. This proposal also reduces the financial burden on these consumers.



The time dependant reconnection fees are to be removed for both electricity and water charges. Charges, along with other ad-hoc services, have been adjusted to reflect costs as detailed in the Appendix. These were not adjusted last year.

2.2 PUBLIC OBJECTIONS TO TARIFF INCREASES

The publication of the proposed tariffs elicited three objections. This compares with 1728 objections to the proposed tariffs for 2014/15.

2.2.1 Individual objection

One member of the public stated that "the charges have gone up for a utility of water that is still below standard". The need to improve the provision of services is well documented by the Authority, in particular in its most recent "2nd Annual Report on the Quality of Services provided by Connect Saint Helena Ltd for 2014/15". The only way in which such improvements can be achieved, is by investment in the admittedly ailing infrastructure, which Connect inherited from SHG. To remedy the under investment in such infrastructure of previous decades, requires an increase in tariffs, in the absence of any further government subsidy.

2.2.2 Making Ends Meet

The Authority carefully considered representations from the charitable company Making Ends Meet ("MEM"). This company is at the forefront of supporting people who struggle to pay utilities bills from the income they receive. MEM advised that they have experienced many cases where people are genuinely unable to afford to pay utility bills. Such cases included incurring significant costs due to an emergency repair or basically not earning enough income to cover the consumer's service usage and other living costs. By making significant efforts to conserve electricity, many consumers strive to stay within Domestic Band 1, namely up to 400 units. MEM referred to the fact that the proposed tariffs are such that the largest increase of £0.07 per unit is in this Band. MEM also referred to a social impact assessment of electricity tariffs in 2008, where it was found that single pensioner households were mainly the low users. MEM stated that there are many older persons who live alone, choose to pay their service bills

at the expense of food and other essentials. MEM expressed concern about this group, lone mothers and low earning households with children, who have no additional sources of income. Even though the standing charges have been cancelled by this proposal, MEM submits that some lower users will be worse off. MEM asserts that either tariffs are too high or incomes are too low.

MEM is correct to recognise that consumers, who will not financially benefit, are those who consume at or about 400 units of electricity. On analysis of Connect's debtors it appears that there are only three consumers in the top 50 debtors in this category. There are therefore a comparatively low number of affected consumers in this category, who "appear" to have had difficulty in making payments, in the past. It is recognised however, that this does not account for those, referred to by MEM, who prioritise utility payments above other basic needs, yet then struggle to pay for those basic needs. The electricity tariff increase, created by this proposal, should be at worst, £1.25 per week for a consumer of 400 units. Connect presently works closely with MEM and has given assurances to the Authority that it will continue to do so. Tariffs approved by the Authority will also be taken into account in defining the revised Minimum Income Standard. Connect itself also has a social fund that can be used to provide assistance for those in genuine need. This would be of particular use to those needing emergency works done, such as unblocking a sewer line or emptying a sceptic tank. These mitigating measures will reduce the burden of any increase for those less well off in society. Targeted assistance to subsidise to those in need, is considered by the Authority to be a reasonable approach, rather than through the present general tariff subsidy which benefits all, regardless of an ability to pay. The previous complicated tariff structure also presented difficulties in introducing any prepayment system The Authority is encouraging Connect to consider the introduction of such a system, as a direct alternative to disconnection. Unsurprisingly, Social Services are also said to favour a pre-payment system being brought into operation as a method of controlling debt, as opposed to disconnection.

2.2.3 Farming

The St Helena Chamber of Commerce (SHCOC) expressed concern in respect of the supply of agricultural water and electricity for commercial purposes. They stated that, as St Helena is attempting to become more self-sufficient in farm produce, many farmers have made significant investment as a result. Such farmers rely heavily upon water, both for crop production and animal rearing. SHCOC submitted that the proposed increased charges would inflate farmer's production costs substantially, at a time when they are already struggling to compete with imported produce that is being sold at relatively low prices, due to the weakness of the South African Rand. Farmers state that they cannot absorb the additional cost, as their current profit margin is minimal. Farmers are said to fear that, if they pass this to the consumer, they will lose their market to such inexpensive imported alternatives. This would result in a slump in local production, at the time when greater investment has been made. SHCOC warn of the likely failure of some fledgling businesses and a downturn in the viability of well-established enterprises. SHCOC commented that many smaller scale producers cannot obtain untreated water and so they rely on the treated supply for their farming needs. SHCOC felt strongly that the increase of over 4% from £1.23 to £1.28 should be reconsidered in the interests of sustaining, let alone encouraging, local production during the current critical period, as St

Helena prepares for increased tourism and population growth. The Authority recognises that farming is an industry currently heavily promoted by SHG. The table immediately below however shows an analysis of the estimated and relatively limited impact of increased water charges on a representative sample of farmers. As with all of the proposed tariffs there still remains a significant SHG general subsidy built into the present tariffs. It is a policy matter for SHG as to whether any further direct subsidy payments can be made to farmers to encourage local production.

Agricultural Water Weekly increases							
Large Arable	£	1.54	Grazing	£	0.02		
Large Polytunnel	£	0.77	Arable	£	0.03		
Polytunnel	£	0.08	Arable	£	0.03		
Grazing	£	0.00	Arable	£	0.11		
Grazing	£	0.04	Pigs	£	0.06		
Grazing	£	0.02	Pigs	£	0.05		

2.2.4 General Commercial Impact

SHCOC also expressed concern regarding the domestic 'knock-on' effect of the proposed increase in the unit price of electricity. They state that this is likely to impact upon the price of fish, bread and all frozen or chilled goods. Retailers had indicated that the proposed increases would have to be passed to consumers, particularly so in the case of fish, as the St Helena Fisheries Corporation is already operating at a loss. SHCOC indicated that such produce makes up a high proportion of the population's diet and that price increases could affect the ability of persons to purchase a balanced range of products. Although SHCOC acknowledge that there is a safety net to protect the most vulnerable (Minimum Income Standard), they submitted that there are households just above the threshold for such support, who are already struggling. The Authority noted that commercial customers will also benefit from the removal of the standing charges. However higher users (both domestic and commercial) will undoubtedly fund the reductions for those domestic users who will benefit from the tariff adjustments. The loss of Band 1 will cost businesses £6.15 per week; the loss of Band 2 will cost businesses £1.85 per week; but the removal of the standing charge, will set off against this loss some £2.72 per week. An analysis of the effects of the proposed tariffs on a range of sample businesses is as follows: -

Consumer	Weekly Increase	<u>Consumer</u>	Weekly Increase
Coldstore	£235	Supermarket	£19
Snack Bar	£9	Hotel	£40
Financial Institution	£35	Prison	£13
Grocery Store	£31	Hospital	£77
Pub	£10	Princess Royal Centre	£57
Crusher (small)	£9	Industrial unit	15p

So long as the provision of utility services continues to be so significantly subsidised, it is the Authority's view that, it is again a policy decision for SHG as to whether to make targeted commercial subsidy payments, rather than distorting the entire commercial utility services market by subsiding all commercial enterprises, including those who are able to operate profitably and still make payment of their utility charges.

2.3 AUDIT

An independent back to back audit of Connect, for the first two financial years has now been completed. There was but a single qualification relating to the value of assets transferred from SHG at the time of divestment. This related to their being insufficient evidence to substantiate the value of such assets in Connect's accounts. This is not a particular concern to the Authority in this exercise. Connect have also now appointed an internal auditor who is working to provide assurance to the Connect Board in a number of priority areas.

2.4 FUNDING OF ASSET REPLACEMENT

The original Connect business plan placed a reliance on SHG to fund significant asset replacement. The Authority accepts that such is contrary to the requirements of a viable commercial business. In December 2014, Connect presented a tariff / subsidy proposal to Executive Council which enabled asset replacement reserves to be built up by them. This revised strategy was approved by ExCo and subsequently by the Authority. This is intended to progressively move Connect away from an annual capital prioritisation process, as there is no guarantee of securing asset replacement funds from SHG from subsidy in any given year. The Authority notes that the now budgeted depreciation (for such asset replacement) broadly equates to the present subsidy, such that had the asset replacement funding strategy not been altered, Connect would be operating without a revenue tariff subsidy. This funding arrangement has continued and is to be reflected in the 2020 Business Plan, currently being drafted by Connect. The Authority has placed demanding service targets on Connect, requiring continued improvements in Connect's service. The Authority is persuaded that Connect is now in a far better position to provide predictability and reliability in service provision, than that which was originally envisaged in their initial business plan. The Authority noted that significant progress has been made in recovering debt transferred from SHG to Connect at the time of divestment. The current Connect debtors are at approximately 50% of the inherited £276,000. Importantly the number of people who are in debt has also decreased by about 20% to 500. This has been achieved by assistance and repayment programs being agreed, with minimal requirement for disconnection.

2.5 FUNDING OF INFRASTRUCTURE DEVELOPMENT

SHG will continue to fund infrastructure development. Further investment in capital assets will however also bring cost pressures in the form of maintenance of such new infrastructure. This, it is hoped, will reverse the said decades of under investment in such maintenance which has been referred to in this and previous reports from the Authority.

2.6 FINANCIAL JUSTIFICATION FOR TARIFFS

The key justification for tariff increases is the fact that currently the tariffs are lower than the full costs of producing sewerage, water and electricity utilities. The proposed and historic subsidies from SHG are in the next table below. This proposal reduces the subsidy to £605,000; a reduction of £172,000. The following factors will continue the exert pressure on tariffs and costs: -

2.6.1 Reduction and elimination of untargeted subsidies

Without the proposed subsidy, an 18% increase across the board would be required, for Connect to operate without making a loss. Revenue subsidies to the company have been reducing annually as shown below:

Financial Year	Total Subsidies
2013/14	£1,109,514
2014/15	£ 845,348
2015/16	£ 777,000
2016/17	£605,000

As envisaged in Connect's business plan and in line with the Airport MOU, subsidies to Connect have been and are expected to reduce annually. This will continue to impact on Connect's finances, with pressure on costs and therefore tariffs.

2.6.2 Asset Management / Replacement

After decades of inadequate replacement and maintenance, most of the water infrastructure (except the water treatment plants) is considered to be worn out, with disproportionate levels of break down and repair. This results in unnecessary water being lost through bursts and leaks. Based on the anticipated economic life and depreciation of assets, the table below summarises the amounts that would be required to replace fully, the current depreciated assets over the next five years.

Summary of replacement values at today's replacement costs						
Replacement values	Replacement values of assets fully depreciating during the years.					
Values estimated by i	nflating the origi	nal cost by the UK i	nflation indices.			
YEAR	TOTAL	FUNDED BY	(SHORTFALL)			
	ESTIMATED	DEPRECIATION	/ SURPLUS			
	CURRENT	FUND				
	COST					
	£	£	£			
2015	10,653,296	1,224,843	(9,428,453)			
2016	1,062,541	797,000	(265,541)			
2017	-	875,600	875,600			
2018	410,755	859,170	448,415			
2019	33,815	857,817	824,002			
2020	108,049	853,495	745,446			
Total	12,268,456	5,467,925	(6,800,531)			

Capital asset replacement is now funded via the revenue account, by ring-fencing the annual depreciation charges into a cumulative fund. As previously stated infrastructural developmental investment will only be affordable with external, SHG or DfID funding. The immediately previous table shows that if all fully depreciated assets were to be replaced, in the next five years, like for like without upgrades, an estimated £6.8 million would be required from external sources such as SHG and DfID. This will be in addition to the £5.47 million that the company has to generate through annual depreciation charges funded through tariffs. For the utilities infrastructure to remain effective now and in the future, replacement of worn out parts of the networks need to be guaranteed and this is only possible when the company's operating budget is balanced out to at least break even each year. As previously stated sewage, water and electricity infrastructure projects, which are currently planned to be funded through the SHG capital programme, will still require those funds. There should be no further requirement for funding from the SHG Capital Program for the purposes of asset replacement once the individual assets are life expired, as these will be replaced from the depreciation fund previously described. The immediate future appears to have 'climate change' funding available from DfID, the funding aligning with the expansion of renewable energy and water security. Connect intends to bid for this funding with initial indications being that £2M may be available for renewable energy and £1M for water security.

2.6.3 Investment in Renewable Energy

It is anticipated that significant cost efficiencies can be realised through continual investment in renewable energy. The wind turbines and the recently commissioned solar farm together contribute a budgeted 30% of the total power generated. Dependency on diesel generation and the international oil price variability, continue to weigh heavily on the cost and predictability of the cost of electricity production. To realise tangible cost reduction, further investment in renewable energy and power storage assets, continue to be needed. Climate change funding is the next identified funding source and consultancy in this respect is complete. The consultancy has provided a roadmap to high penetration renewable energy and will be the basis for any capital bids.

2.6.4 Active Sewage Treatment

The island's first sewage treatment plant in Ruperts is expected to be commissioned during the early part of the next financial year. The Jamestown and Half Tree Hallow plants are likely to be commissioned during the last quarter of the year. While the cost of the planned sewage treatment plants will be funded by SHG's developmental capital funding programme, the costs of their running and maintenance will be borne by Connect with resultant cost pressures. This has to be provided for by being gradually built into the tariffs. The full effects of the new environmental legislation has still to be assessed as there is clearly the potential for further costs, dependant on the discharge standards required of the Chief Environmental Officer.

2.7 RECURRENT EXPENDITURE BUDGET 2016-2017

Connect is required to take in sufficient funds to meet expenditure. The 2016-2017 budgets use the following assumptions: (a) 2% growth in electricity consumption; (b) 5% growth in water consumption; (c) 4% general inflation; (d) no change in the price of fuel and (e) replacement of capital assets funded from the revenue account through depreciation charges.

The draft budget shown in the immediately following tables presents a similar position to last year with said inflationary growth. To break even Connect needs income of £4,944,595. Connect's tariff income for the year under consideration, is estimated at £4,209,303, resulting in a deficit of £735,292. This will have to be partly funded by tariff increases and partly by SHG subsidy.

	2015-16	Forecast	Proposed
	Budget	FY 2016	Budget
Administration	352,504	352,504	359,009
Employees	1,104,431	1,089,776	1,233,448
Property	179,329	179,329	230,870
Fuel	1,516,258	1,200,057	1,202,151
Maintenance	798,339	1,082,768	921,476
Depreciation	767,061	830,596	861,535
Contracts	128,165	128,165	136,106
Expenditure	4,846,087	4,863,195	4,944,595

EXPENDITURE BREAKDOWN

INCOME & EXPENDITURE

	FY 2017	FY 2016	FY 2015	FY 2014
	Budget	Forecast	Actual	Actual
Subsidy	602,151	777,000	845 <i>,</i> 348	1,109,514
Tariff income	4,212,533	3,820,229	3,687,212	3,401,260
General income	23,205	14,949	16,550	14,257
Service income	106,722	153,421	158,829	190,472
Total Income	4,944,611	4,765,599	4,707,939	4,715,503
Expenditure	4,944,612	4,787,644	4,459,743	5,177,713
Profit/(loss) before				
amortizations	-	(22,045)	248,196	(462,210)

2.8 CONCLUSION

Utility tariff increases are naturally unpopular. Historically tariffs had been unaltered for many years, which has created an additional burden in filling the gap created between the costs of providing services, (including upgrading and maintaining infrastructure), and the tariff charges collected to meet such costs. The level of tariff increase is considerably lower than that which was originally envisaged in the Connect Business Plan. The Authority notes that any reduction in the proposed tariffs would result in Connect being expected to trade at a budgeted deficit. The Authority has repeatedly made clear that it cannot order Connect to trade insolvently, thereby causing instability and a lack of predictability in the public utilities industry in the medium and long term. The tariffs remain very heavily subsidised by SHG and in the foregoing circumstances (a) are "reasonable" prices and will improve levels of service; (b) ensure stability and predictability in the public utilities industry in the medium and long terms and support a progressive reduction in levels of subsidy from public funds without generally creating "unreasonable" hardship for households or "unreasonable" hindrance to commercial and economic development in St Helena; and (c) motivate Connect to improve the quality of the services they provide. It will be for SHG to determine the method and amount of any further indirect subsidy to, the less well off or to encourage particular commercial enterprise, as this is a political and budgetary decision for them and not for the Authority, in the foregoing circumstances.

2.9 DIRECTIVE

Having carefully considered the issues summarised in this report, on 18th February 2016, in terms of Section 5(1) (c) of the Utilities Services Ordinance 2013, the Authority issued a direction, permitting the proposed tariff adjustments, which supersedes the Authority's Direction for Maximum Electricity and Water Tariffs issued in Gazette Notice No. 37 of 31 March 2015.

31st March 2016

John A MacRitchie LLB DIPLP NP SSC JP ADVOCATE (STH & ABDN) Chair, Utilities Regulatory Authority The Castle, Jamestown

SCHEDULE- MAXIMUM ELECTRICITY AND WATER TARIFFS COMMENCING 1ST APRIL 2016

[TARIFF
ELECTRICITY TARIFF CHARGES	
Quarterly Standing Charges	
Single phase meter	£O
Single phase meter (unoccupied residential)	£O
Three phase meter	£O
<u>Usage Charges</u>	
Domestic Band 1 (first 400units)	£0.30
Domestic Band 2 (units 401-1000)	£0.30
Domestic Band 3 (units over 1000)	£0.46
Commercial and 3 Phase	£0.46
WATER TARIFF CHARGES	
Quarterly Standing Charges	
Domestic	£7.18
Unoccupied residential	£7.18
Commercial	£21.53
Agricultural	£7.18
Domestic Use	
Treated Water (first 15 cubic metres / 3,300 gallons) Treated Water (over 15 cubic metres / 3,300	£0.97
gallons)	£1.28
Untreated	£0.64
Other Use	
Commercial	£2.51
Agricultural treated	£1.28
Agricultural untreated	£0.64
DRAINAGE TARIFF CHARGES	
Domestic Standing	£12.50
Commercial Standing	£19.73

ELECTRICITY OTHER CHARGES

£37.50
£37.50
£37.50
£37.50
£0
£32.50
£32.50
£32.50
£32.50
£32.50
£0
£66.00
£106.00
£66.00
£106.00
£32.50
£32.50