Comments on IPART Discussion Paper DP87

Review of DEUS Developer Charges Guidelines for Water Supply, Sewerage and Drainage

Introduction

Hunter Water Australia Pty Limited undertakes consultancy and operational contracting activities throughout Australia. Most of this work is in the four eastern states. Significant experience has been gained in calculating developer charges under the IPART methodology for major metropolitan water agencies and also under the DEUS guidelines for over a dozen NSW Councils. The assignments have ranged from policy advice to technical calculation of developer charges. Consultancy assignments on developer charges have also been undertaken in Tasmania and Victoria. We therefore consider that it is important to contribute to this IPART review because of our direct and diverse range of experience.

This response is organized in two parts. First, some overall comments are provided on the developer charges. Secondly, specific comments are provided to each of the specific questions raised in the IPART Discussion Paper.

General Comments

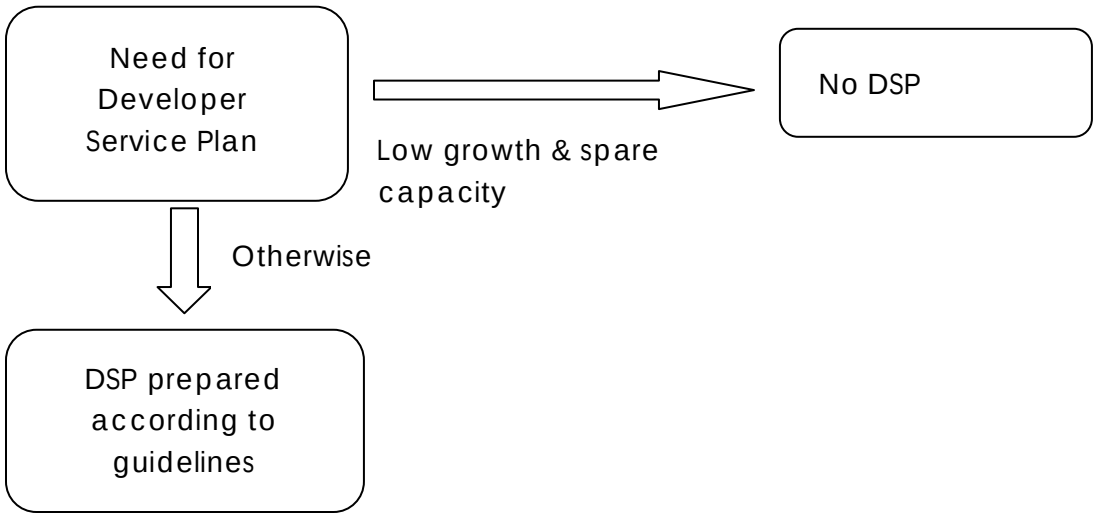
It is our opinion that the NSW Water sector is far better off than other states such as Victoria and Tasmania for having an advanced developer charges methodology. The methodology allows a "price signal" to be sent to developers about what it really costs to service their development compared to other locations. This price signal is important in a regime where "postage stamp" pricing is applied to providing water and sewerage services across a pipe network. It also achieves better inter-generational equity as existing users don't have to contribute to the extra future costs imposed by new development: pensioners are not paying extra for newcomers.

The fall back to having developer charges are higher overall charges for all users and in many cases the need for service entities to undertake various forms of "rationing" of development applications as funds become limited. These rationing mechanisms are mostly hidden, ad hoc and potentially biased. A well structured system of developer charges is superior.

The IPART developer methodology was developed for the larger regulated water entities in NSW. The regulatory regime over these entities is rigorous, data intensive and commercial in nature. Some NSW Councils would be unsuited to a regulatory regime of this type. Yet the success of implementing a regime of developer charges is dependent on a reasonable degree of rigour, data to back it up and calculations being done according to modern commercial principles. There is no perfect solution to satisfying all parties in such a situation but we wish to suggest a pathway for discussion.

First, the economics of having developer charges only makes sense when there is a significant growth rate and there is limited spare distribution and headwork's capacity. In situations where there is low growth and much spare capacity, a zero developer charge makes economic sense as every new lot reduces the unit overhead cost of managing the existing system. In effect, everyone benefits from development. The issue is how to set the rules for defining low growth and spare capacity.

Our suggestion is that if the medium growth trend in equivalent lot numbers is below 0.5% per annum, then the system is likely to be aging as water and wastewater systems have an average infrastructure age of about 50 to 60 years. Determining spare capacity is a more difficult generalisation to make. However, if a system has about 15 years of spare capacity (at a low growth rate) then there will be time to respond to growth needs if reviews are done at 5 year intervals or if a major development is on the horizon eg a new mine nearby. The decision process for such an arrangement is highlighted below.



Much costly administrative work and calculations can be avoided in developing developer service plans if the low growth, relatively large spare capacity systems are allowed to be exempt from preparing developer service plans and have zero developer charge. Such an arrangement would rule out the need to worry about small villages and towns in regional NSW which have independent water and wastewater systems.

Secondly, a more rigorous and consistent developer charging regime is needed for the remainder of water and wastewater systems if the regime is to be defensible to the development industry. IPART is the logical entity to set the rules for this regime, even if it is as a delegated function.

Specific comments are now provided to each of the questions raised in the Discussion Paper in light of the above comments.

Specific Comments

Simplicity

The Tribunal welcomes comments on whether the DEUS guidelines achieve the pricing objective of simplicity. Do the various methods allowed by the guidelines for calculating the capital charge and reduction amount add unnecessary complexity? How can the methods allowed be simplified in light of better data, more experience and a greater understanding of how developer charges are levied? Will simplification lead to a loss of flexibility?

The guidelines offer various methodologies but there is little guidance regarding under what circumstances one methodology is preferable to another leading to confusion. The need to simplify is a cover for lack of data and knowledge of the water and sewer systems. It would be better to have a single rigorous methodology for those DSP areas with sufficient growth and capital programs and an exemption policy for others.

Transparency

The Tribunal welcomes comments on whether there is a need for greater transparency in the developer charges guidelines. If so, in which areas are there a lack of transparency and how can this be improved? Are there any difficulties for LWA's in meeting transparency requirements?

Better transparency would result from more consistency. It is easier to explain and defend a single methodology. Some LWA's are reluctant to properly consult with developers/community about the process because of their own lack of understanding of the methodologies.

Consistency of charging across NSW

The Tribunal welcomes comments on the advantages and disadvantages of a common approach to the developer charge calculation across NSW. Should or could the Tribunal's methodology for metropolitan areas be adopted for use across the state? Is this a practical option? How else could consistency be improved?

The Tribunal's methodology for calculating capital charges could be applied to larger population centres with reasonable growth. It may not be so easily applied to, say, a small village of less than 500 population serviced by a sewerage system constructed in the 1960's and which has had little capital upgrading since.

The current DEUS guidelines require a DSP to be prepared for each separate water supply zone and each separate sewage treatment works catchment as well as each small town or village. An exemption is available only if the utility (not the small town or village) is experiencing growth of less than 5 lots per annum.

Better consistency would result from developing a more relevant exemption policy and applying the Tribunal's approach to the areas with growth and capital programs in place to service the growth.

Cost reflectivity

The Tribunal welcomes comments on issues associated with cost reflectivity of developer charges. Are there any significant differences between developer charges within local government areas? Should LWA have the right to balance developer and periodic charges within their areas in the way they see fit?

It is our experience that LWA's have a tendency to have a single or minimal number of developer charges

Treatment of subsidies- Treatment of cross-subsidies from existing development

The Tribunal welcomes comments on the treatment of subsidies in the calculation of developer charges. Should cross subsidies be permitted where the extent of subsidy is disclosed? Should there be limits on the amount of the cross subsidization allowed? Should any subsidies be paid out of Council's general fund rather than funded through higher water and sewerage charges on existing residents?

This is an issue where neighboring Councils are competing for the same development market. It is tempting for Councils to allow cross-subsidies from existing development in order to encourage development in their LGA. Allowing such cross-subsidies results in the investment in infrastructure by a Council to serve a development area not being fully recovered by the development and hence the Council does not adhere to one of the fundamental principles of the developer charges concept.

If cross-subsidies are allowed, the method of administering them is better dealt with by the Council.

Backlog Service Areas

The Tribunal welcomes comments on how the cost of servicing backlog areas should be treated.

Our comments focus on future development rather than past development. This is a difficult issue that requires a separate policy response.

Inclusion of subsidies in developed charge calculations

The Tribunal welcomes comments on whether subsidies given to LWA's infrastructure provision should be excluded from the calculation of developer charges.

The subsidized proportions should be excluded due to the 'double dipping'.

Regulatory oversight

The Tribunal welcomes comments on the extent to which the DEUS guidelines provide latitude with compliance and whether and how, enforcement and dispute resolution processes included in the Guidelines can be strengthened.

No comment

Developer Charges for Non-Residential Development

The Tribunal welcomes comments on how the developer charges guidelines pertaining to non-residential developments can be enhanced to better take into the account available demand and cost allocation information.

The ET allowance given to a non residential development should reflect the demand or loading the development places on a water or sewerage system. Guidelines are required to assist Councils and to ensure consistent criteria are applied throughout the State.

Technical Aspects of the DEUS Guidelines- Pre-1970 assets

The Tribunal welcomes comments on whether any pre-1970 assets should be included in the developer charges calculations. In particular, where it is suggested that's there is still capacity available in these assets to serve new developments, how should this capacity be assessed and the cost incorporated in developer charges? Is MEERA appropriate for valuating pre-1970's assets?

There is a case to include pre-1970 assets if they are still providing capacity to service growth and this is happening in a lot of small towns and villages. However their inclusion should be a function of the degree of spare capacity and the rate of growth. As previously stated, if the growth is low it is better not to include the assets or even have no charges at all in order to encourage take-up of the spare capacity.

Future Assets

The Tribunal welcomes comments on whether five years is an appropriate planning horizon for future assets. What are the issues associated with forecasting investment in assets into the future? Is it appropriate to include assets beyond five years in developer charges?

Projected works beyond five years should be included if it has been identified in an investigation and planning report that the work is needed to service projected growth and the Council has a reasonable degree of confidence that the growth will occur as planned.

Definition of system assets

The Tribunal welcomes comments on issues associated with the way the system assets are defined in DEUS guidelines. How could system assets and reticulation mains be better defined to ensure that costs are recovered appropriately?

The definition should be based primarily on how the assets have been funded, not on their category. For example reticulation assets should be included if they have been funded by Council.

Assessing the capacity of assets

The Tribunal welcomes comments on the extent to which LWA's are using different design standards for system capacity and the reasons for this. The Tribunal also seeks comments on whether it is desirable and practical to develop a consistent set of design standards.

The Tribunal welcomes comments on the way local water authorities are treating vacant lots and unoccupied dwellings in their calculation of capacity in water and sewerage systems. How can this issue be clarified in the guidelines?

The Tribunal welcomes comments on the treatment of the spare systems capacity available for development and excess unused capacity beyond the 30 year planning period.

A consistent set of design standards is preferable together with training to ensure the Councils are applying the standards correctly.

Valuation of Assets

The Tribunal welcomes comments on issues associated with the valuation of assets for inclusion in developer charges. Are local water authorities including unreasonable contingency allowances in their developer charges calculations? What, if any, is a reasonable amount or should the risk be associated with contingencies be captured in the rate of return? Are amendments to the DEUS guidelines needed to better specify the method for valuing assets?

The five year review period specified by the guidelines requires that a justifiable and higher contingency allowance be adopted. Alternatively Council's should have the discretion to review their charges in shorter time frames if unusual circumstances occur e.g. a sudden and significant increase in capital works costs.

Agglomeration of DSP's

The Tribunal is interested in the extent to which agglomeration takes place and seeks comments on whether the agglomeration rule outlined in DEUS guidelines is reasonable. Is there a better way of minimizing the number of DSP'S? The Tribunal is also interested in the issue of how much

greater the administrative burden would be on LWA's if the agglomeration rule, in particular, the 30 per cent factor, were to be altered.

The guidelines state that agglomeration of the capital charges of two or more service areas 'should' occur if they are within 30%.

Circular LWU 5 issued by DEUS in October 2004 modifies the guidelines to provide further agglomeration options and Councils can now agglomerate the developer charges of all their service areas into a single developer charge. This practice nullifies the sending of price signals but is welcomed by the Councils as they can apply a single developer charge across the entire LGA.

Calculation of the capital charge where lot take up is non uniform

The tribunal welcomes comments on whether the return on investment approach is appropriate for calculating the capital charge where lot take up is non-uniform. What are the impediments, if any to LWA's using a net present value approach in these circumstances?

Should the guidelines be modified to require use of the net present value approach where lot take up is non uniform? Alternatively, should the guidelines be modified to require use of the net present value approach in all circumstances, In line with the IPART methodology?

The net present value approach is preferable in all circumstances. The ROI formula in the guidelines gives an incorrect result if growth is not uniform. It is rare for growth to remain uniform for a projected 30 year period.

Calculation of the reduction amount

The Tribunal welcomes comments on whether the calculation of the reduction amount under the DEUS Guidelines should be more closely aligned with the Tribunal's methodology with a view to achieving greater transparency. What are the practical considerations of LWA's adopted such an approach?

No comment.

Equivalent tenements

The Tribunal welcomes comments on whether the DEUS Guidelines should be more explicit about the determination of equivalent treatments. What is the most appropriate demographic data to use for forecasting new development? How should an equivalent tenement be defined? Is it relevant to discount equivalent treatments based on monetary factors or for vacant lots?

Consistent guidelines would be preferable.

Council's report on the number of assessments (in Special Schedules) and this number needs to be adjusted to determine equivalent tenements.