



MidCoast Water's submission to:

THE IPART REVIEW OF DEUS DEVELOPER CHARGES GUIDELINES FOR WATER SUPPLY, SEWERAGE AND STORMWATER

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1. Introduction

1.1 About MidCoast Water

MidCoast Water is a local government County Council proclaimed in July 1997. We were formed at that time as an amalgamation of the NorthPower Water group, the Greater Taree City Council's Sewerage branch and Great Lakes Council's Water and Sewerage branch.

MCW is responsible for reticulated water supply and sewerage in the Greater Taree and Great Lakes council areas covering some 7000 sq km and serving about 70,000 people on the mid north coast of NSW. Greater Taree City Council and Great Lakes Council retain responsibility for stormwater management in our operational area.

Major centres served include Taree, Wingham, Forster/Tuncurry and Tea Gardens/Hawks Nest. Our role includes the operation of 4 water supply schemes and 14 sewerage treatment plants. We are also responsible for construction of new water and sewerage schemes and the control of water and sewerage infrastructure development related to population growth.

MidCoast Water's long term average capital works expenditure averages \$40 million/annum, although we will be spending \$80 million in the 2007/08 financial year due to the implementation of a number of major water and sewerage projects.

Our Mission, Vision and Values provide the foundation for our strategic direction, and can be found in Attachment A. More information about MidCoast Water and its strategy can be downloaded from:

<http://www.midcoastwater.com.au/publications/files/StrategicPlan2006-30v2.pdf>

1.2 Contrasting operating conditions – metropolitan authorities and MidCoast Water

MidCoast Water is in a relatively unique situation in NSW, whereby we were proclaimed as a County Council with responsibilities for both water supply *and* sewerage services across two local government areas. Our powers as a County Council are bestowed under the Local Government Act 1993 and as a water authority under the Water Management Act 2000 in the same way as general purpose Councils.

There is a large contrast between the operation of larger metropolitan water authorities and MidCoast Water's operating conditions that have significance when comparing capital and operating costs. These issues are summarised in Table 1 below.



Table 1 – Contrasting operating conditions – Metro authorities vs. MCW

Operating factor	Sydney Water	Hunter Water	MidCoast Water
Population served	4 million	500,000	70,000
Number of connections	1.6 million	210,000	36,000
Number of water treatment plants	9	6	4
Number of sewerage treatment plants	30	17	14
Number of water pump stations	151	84	11
Number of sewerage pump stations	659	380	229
Length of water mains	21,000km	4,500km	1,200km
Length of sewer mains	23,500km	4,500km	800km
Connections served in proportion to length of water mains	76 connections/km	47 connections/km	30 connections/km
Connections served in proportion to length of sewerage mains	68 connections/km	45 connections/km	35 connections/km

The capital and operating costs of serving our customers will always be higher due to our small and decentralised customer base and the need for many small treatment plants. In particular, we operate sewerage treatment plants in 14 separate villages, with only two plants larger than 20,000 person capacity.

Other issues particular to MidCoast Water that may vary with different authorities include:

- Our EPA licenses for several of our sewerage treatment plants are amongst the most stringent licenses in NSW
- Water supply and sewerage system demand is highly climate dependent and system yields for water supply are highly variable based on environmental conditions and types of assets (on-stream or off-stream storage, weirs, etc).
- Population peaks in our coastal centres during tourist season by 50 to 70%. This means that we must design the maximum capacity of our assets for the summer holiday period and underutilise those assets during the non-holiday period.

1.3 MidCoast Water's development charge philosophy

Our objective is to strike a balance between social and economic considerations.

In pure economic terms, MidCoast Water aims to fully recoup the proportion of the cost of assets provided in relation to development.

In social terms, MidCoast Water's 14 different villages have widely varying costs of service, and the best outcome is achieved by agglomerating developer charges across our entire operating area, in order to maintain very modest development for the smaller villages. This means that the developer charges applicable to the larger towns increases slightly to accommodate the small villages, but the potential developer charges for small villages are greatly reduced.

We only believe in attributing costs for assets that MidCoast Water is committed to in its management plan, therefore do not take the option available to include assets planned beyond 5 years from the calculation date.

2. Broad issues with the DEUS Guidelines

2.1 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 loss of flexibility?

Given the diversity in size and operating conditions of the NSW LWA's, we believe that the flexibility provided in the DEUS Guidelines is necessary. This is due to the fragmented nature of urban water management in NSW, with over 100 LWA's serving significantly different population bases, distributions, growth profiles and water and sewerage system characteristics. Smaller LWA's with little growth will clearly benefit from the simplified methods, whilst larger LWA's will likely use the more complex methods to ensure higher economic efficiency and effectiveness. There does not appear to be any benefit to LWA's in reducing the number of methods available.

2.2 Transparency

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

MidCoast Water went to great lengths to ensure transparency in our process:

- We published our DSP's and developer charge calculation report on our website.
- We advertised widely and wrote directly to the project managers for all major developers in our area, enclosing the above documentation on CD-ROM.
- When some developers appointed an advocate, we met on many occasions and made some adjustment to correct errors, perceived or otherwise.
- We supplied our calculation spreadsheets and FINMOD (financial model) results to the developer's expert consultants.
- We met with the developer's consultants on several occasions to discuss the calculations, and left the consultation period open for several months over and above the 30 day period recommended.

It is difficult to see what more can be done to improve transparency.

There are small errors made in calculation from time to time, but more frequently there are debates on matters of interpretation of the Guidelines. Our decision to finalise our latest iteration of our developer charges was made on the basis that we had made reasonably generous concessions in the calculations, such as excluding assets beyond the 5 year horizon and perceived errors of interpretation in the calculations did not change the resulting charges in a significant way.

Indeed, some of the arguments of interpretation presented would have resulted in increased developer charges rather than a reduction.

2.3 Consistency of charging across NSW

The Tribunal welcomes comments on the advantages and disadvantages of a common approach to 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?

There does not appear to be any benefit to LWA's or their ratepayers in rigidly applying a common calculation methodology.

We do not agree that IPART's methodology should be applied state-wide. Metropolitan areas have little or no small villages (less than a few hundred dwellings). These villages invariably attract high developer charges if considered in isolation. In these situations, MidCoast Water considers it imperative that social objectives must take precedence, and allow the growth in larger population centres and the general rates base to subsidise and absorb the costs of growth and operating costs in these small centres via the agglomeration of developer charges. This approach promotes affordable housing in these small centres.

2.4 Cost reflectivity

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

Each LWA has unique circumstances in their operational area that will present different concerns and therefore different pressures on the way developer charges are handled. We believe transparency and wide consultation is crucial. If the ratepaying community supports our chosen approach, and we are operating within the DEUS guidelines then why shouldn't developer charges and rates be balanced based on a Strategic Business Plan presented by the LWA?

This leads us to social objectives, which are notoriously difficult to 'price' accurately but are very important factors to a 'Triple Bottom Line' approach to managing a water utility. As an example, if the community (as represented by their elected Councillors) values the employment opportunities created by development more than a resulting water/sewerage rates increase then, the LWA must have scope to adjust developer charges and rating in accordance with those expectations.

2.5 Treatment of subsidies

2.5.1 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 the cross subsidy is disclosed? Should there be limits on the amount of cross subsidisation allowed? Should any subsidies be paid out of Council's general fund rather than funded through higher water and sewerage charges on existing residents?

As per our comments in Section 2.4, there should be scope for LWA's to make strategic plans and business decisions in relation to the mix of funding via developer charges and

rates from existing customers. These business decisions must be widely disclosed via the DSP's and Strategic Business Plans for endorsement by the community.

In relation to cross-subsidisations from general rates funds, MidCoast Water is one of a small number of County Councils in NSW and the expectation of our Councillors will be that our business will be self sustaining and would not require subsidy from the general fund of either of our constituent Councils.

2.5.2 Backlog service areas

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

IPART is probably aware that current DEUS policy for subsidising backlog areas is pegged to 1996 population levels, with an allowance of up to 20% further growth. The growth component of a backlog scheme that extends beyond this level is not subsidised. Accordingly, MidCoast Water includes the growth component in excess of 20% of future treatment plants (not reticulation) for backlog schemes within the costs calculated within our 5 year planning horizon.

Whilst subsidy has generally been less available in the past 5 years, we believe this principle would still be valid without DEUS subsidy.

2.5.3 Inclusion of subsidies in developer charge calculations

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

MidCoast Water does not support 'double dipping' whereby subsidy is received from DEUS, and then the same costs are claimed in developer charges. Our comments in Section 2.5.2 are also appropriate to this question. This is becoming less of an issue for MidCoast Water as subsidy is much less prevalent now than in years previous.

2.6 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.

We believe that MidCoast Water's primary responsibility is to its ratepayers and should generally be given latitude to make business decisions that comply as far as is practicable with their expectations, which are embodied in our Strategic Business Plan. This approach implies a degree of latitude with compliance and necessitates a degree of flexibility in the DEUS Guidelines.

We have no comment to offer on the application of enforcement processes or dispute resolution processes, except to acknowledge their necessity.

2.7 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 account available demand and cost allocation information.

It is probably worthwhile to consider applying tests of significance to non-residential development. If the non-residential component of the LWA's demand is above a certain percentage, perhaps the ET approach may need to be elevated in significance. However, LWA's with small non-residential demand should be given latitude to use simplified demand calculation methods.

As a County Council, we ensure full recovery of rates and developer charges from our constituent Councils for public use.

3. Technical aspects of the DEUS Guidelines

3.1 Which assets should be included in developer charges?

3.1.1 Pre-1970 assets

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

MidCoast Water operates in a coastal area and has experienced high growth over many years. Population in our service area has doubled every 20 to 25 years or so. Our developer charge calculations are not particularly sensitive to the inclusion of pre-1970's assets, as this capacity is largely taken up.

However, this is not necessarily the case for LWA's with low growth, and flexibility may need to be maintained.

3.1.2 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.

MidCoast Water has taken the conservative approach and only included assets within the 5 year planning horizon. We have found that predicting further than 5 years has a few issues:

- Demand patterns regularly change as initiatives such as demand management are implemented.
- Service level expectations from our customers are increasing and need to be reviewed regularly.
- We have found developer intent notoriously difficult to predict, and growth sequences difficult to control. We find this is influenced more by the real estate market than other factors.
- Regulatory issues are significant. Environmental flows in rivers, EPA licensing legislation and Department of Planning intervention into the density of development are just a few. In general, costs of compliance are incurred due to the higher levels of service expected by our regulators.
- Climate variability affects the effectiveness of our assets, and new information is becoming available.
- As we have relatively decentralised population centres, the need to build one large asset can be avoided and inherently allows us to stage infrastructure construction.

In saying all of the above, we have no objection to including assets beyond 5 years if directed to by the Guidelines.

3.1.3 Definition of system assets

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

We think that a key test for a reticulation main to become a system asset is whether that reticulation main is required to be upsized for use by another development site. The costs of upsizing should then be apportioned to developer charges, as those costs should not be apportioned to the initial developer, and should not be apportioned to the ratepayer either.

Whilst the above process introduces some additional complexity, 'double dipping' is avoided by only including the incremental costs of upsizing the main.

We don't agree that the presence of a property connection to a 'reticulation main' should exclude it from developer charges.

3.1.4 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.

LWA's have widely varying demand characteristics, which are evidenced by DEUS reporting for Local Water Utilities. It is worthwhile to mention the changes to Building Sustainability Index (BASIX) legislation by the Department of Planning to scale BASIX from a 40% water demand reduction in coastal local government areas to 10% in inland LGA's due to different climatic conditions across NSW. Clearly the Department of Planning considered that different standards were necessary due to different climatic conditions across local government areas.

However, standardisation of the methodology and terms used within system capacity calculations may be achieved by the adoption of standards such as the Water Service Association of Australia (WSAA) codes. The figures used within these calculations *must* be derived locally.

It is unrealistic to expect LWAs to adopt a uniform standard for design of system capacity. The regional variations in system demands, population fluctuations, etc, require that it is only appropriate to use local figures in the calculation of system capacity.

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?

Where developers provide a compelling case, and where it is practicable MidCoast Water often provides for deferred time based payment of development charges based on a entering into a supplementary agreement. The agreement addresses a fall-back position if payment is not received. We think that this is an issue for individual LWA's and not the DEUS Guidelines.

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

MidCoast Water provides information on asset takeup across a 30 year horizon and apportions costs to developer charges accordingly. It is preferable of course to stage infrastructure augmentations across smaller time scales, and where spare capacity is 'discovered' due to reduced demand there is invariably avoided costs in deferred later stages of infrastructure works. We think this is a fair and reasonable approach.

3.2 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 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?

MidCoast Water applies DEUS pricing schedules to value its assets. The alternative is to produce specific cost estimates for replacement assets, and applying the same contingencies embodied in the DEUS pricing methodology. We see the DEUS contingencies as being fair and reasonable and do not see the need to change this methodology.

3.3 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 the DEUS guidelines is reasonable. Is there a better way of minimising the number of DSPs? 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.

MidCoast Water is concerned about the administrative burden on managing many DSP's, but even more concerned about the impact of disproportionately high developer charges on modest development in our small villages (refer again to our comments in Sections 2.1, 2.3 and 2.4). We are a strong supporter of agglomeration and would not support a decrease in the 30% factor.

3.4 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?

MidCoast Water uses the NPV approach and we are comfortable with it. The question is whether all LWA's are in support of mandatory use.

3.5 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 adopting such an approach?

We used the NPV of annual charges approach and believe this gives us sufficient flexibility to manage our price path. MidCoast Water is concerned that fixing prices will remove this flexibility and encroach on our ability to deliver the best strategic outcomes for our customers and community.

3.6 Equivalent tenements

The Tribunal welcomes comments on whether the DEUS guidelines should be more explicit about the determination of equivalent tenements. 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 tenements based on monetary factors or for vacant lots?

Definition of an ET is clearly a complex issue, and attempting to standardise ET's is fraught with difficulty. There are many factors influencing demand of an ET, such as demographics, occupancy ratios, holiday usage, demand management initiatives (or lack thereof in some demand sectors) and even geological or hydrological differences such as the presence of domestically accessible groundwater. LWA's need to be given the necessary flexibility to adjust for their own unique demand conditions as well as for the risk appetite of the LWA and community expectations on levels of service.

4. Summary

We believe MidCoast Water has the right balance of cost recovery and agglomeration to suit our socio-economic climate. Our neighbouring local water authorities have widely varying conditions and need to retain the freedom of application that the current DEUS Guidelines provide. However MidCoast Water has no objection in principle to removing some of the 'oversimplified' portions of the calculation methodology.

There are unique conditions in relation to our small coastal villages that create wide disparity in developer charges without agglomeration which would adversely affect affordability for modest development in small villages. It is for this reason that MidCoast Water would object to the application of IPART's methodologies for metropolitan water authorities to its calculations.

We look forward to attending IPART's public workshop at Port Macquarie on 18 June 2007 to further discuss the contents of our submission, and also look forward to viewing IPART's recommendations in due course.

5. References

1. MidCoast Water (April 2006) *Future Directions in Water Management – Strategic Plan 2006 – 2030*, Accessible at:
<http://www.midcoastwater.com.au/publications/files/StrategicPlan2006-30v2.pdf>
2. MidCoast Water (February 2006), *Developer Servicing Plan for Water Supply and Sewerage*, Accessible at:
<http://www.midcoastwater.com.au/publications/files/DevServPlanW&S%20.pdf>
3. MidCoast Water (2007), Webpage: *Developer Charges and Servicing Strategies*. Accessible at: <http://www.midcoastwater.com.au/permits/DevCosts.html>
4. MidCoast Water (March 2006), *Equivalent Tenement Policy*, Accessible at:
<http://www.midcoastwater.com.au/publications/files/18832v7EquivalentTenement.pdf>
5. MidCoast Water (June 2006), *Fees and Charges for 2006/07*, Accessible at:
<http://www.midcoastwater.com.au/publications/files/FeesCharges06-07.pdf>

Attachment A MCW's Corporate Mission, Vision & Values



Our Mission

Our purpose is to manage the provision of sustainable water related services to meet our community's needs.

Our Vision

To be recognised as a leader in the water industry and community.

We Value

Our Business – Managing all aspects of our business in a transparent and sustainable manner, while providing best value for money to our community.

Community – Providing an essential service in a way that is accountable to our stakeholders and supports our regional community's development.

Customers – Meeting the needs and expectations of our customers.

Relationships – Being open, supportive and constructive in all our relationships.

Employees – Developing staff committed to quality, professional service, teamwork, safety, striving for continuous improvement and accepting personal responsibility.

Environment – Conserving resources and protecting and enhancing our natural environment, particularly the water cycle.