I feel it necessary to go back to basics.

The risk free interest rate can be seen as the rate which represents the average market opinion on the appropriate compensation for the lender, in return for delaying the eventual expenditure (of the lender after repayment) and for the fact that prices will change over that time. Various other interest rates exist in the market with each one the combination of three factors: the return for delay in obtaining benefit, the return for inflation and the return for participating in the arrangement that has some risk of failure and loss. Measures of cost of capital attempt to measure the appropriate return for funding a particular organisation by aggregating returns of the different risk profiles being used. What all these measures have in common is an attempt to determine a reasonable return for the risks being taken.

The question could then be considered to be who is taking what risk and what compensation is appropriate. In reading the IPART proposal I fear the question of "who ?" has been overlooked and the review jumped straight to trying to select which commonly used interest rate measure might be best. However a quick consideration of who, would show that the theoretical basis of the various options is based on fundamentally different assumptions to what we are looking at.

The first question that should be asked is "under s94, who is intended to bear the costs and risks?" The answer is that s94 intends that the existing residents should not bear the burden of providing the infrastructure required by new populations. The only risk to be assumed by the old population, or by the Council which is effectively their agent, is the risk associated with failing to identify the need. The law is clear in saying that the Council is not entitled to take any surplus that might accumulate in a s94 fund if estimating errors create one. Likewise there is no mechanism to compel a Council to fund a shortfall. (In reality works are generally scaled up or down to meet the available funding.) It seems somewhat bizarre to me to use any aspect of a rate of return theory in a situation where there is a statutory bar to any return occurring.

The purpose of a Net Present Value calculation in a s94 contributions plan is to equitably distribute the total costs between the various developers. In such a situation the criteria to assess what discount rate is best is surely that which has the best chance of equitably raising the right amount of revenue.

In a situation where a s94 fund constructs upfront and uses a loan, the average interest rate of the loans has the best chance of raising the correct amount and also is totally consistent with the objectives of the legislation. If that were not enough, it does not require multiple mechanisms to provide for estimating errors. Given that most s94 funds will be run by town planners with minimal financial skills, this should not be ignored.