

Review of developer charges, backlog sewerage charges and other related charges for metropolitan water agencies

6 March 2018

Our timetable

Milestone	Timeframe
Release Issues Paper	24 October 2017
Utilities' submissions due on the Issues Paper	11 December 2017
Receive public submissions on Issues Paper and utilities' submissions	22 January 2018
Public hearing	6 March 2018
Release Draft Determinations and Draft Report	June 2018
Receive submissions to Draft Determinations and Draft Report	July 2018
Release Determinations and Final Report	September 2018

What will this review include?

1. **Developer charges**

- Water, sewerage and stormwater charges for Sydney Water, Hunter Water and the Central Coast Council
- Excludes developer charges for recycled water

2. **Backlog sewerage charges**

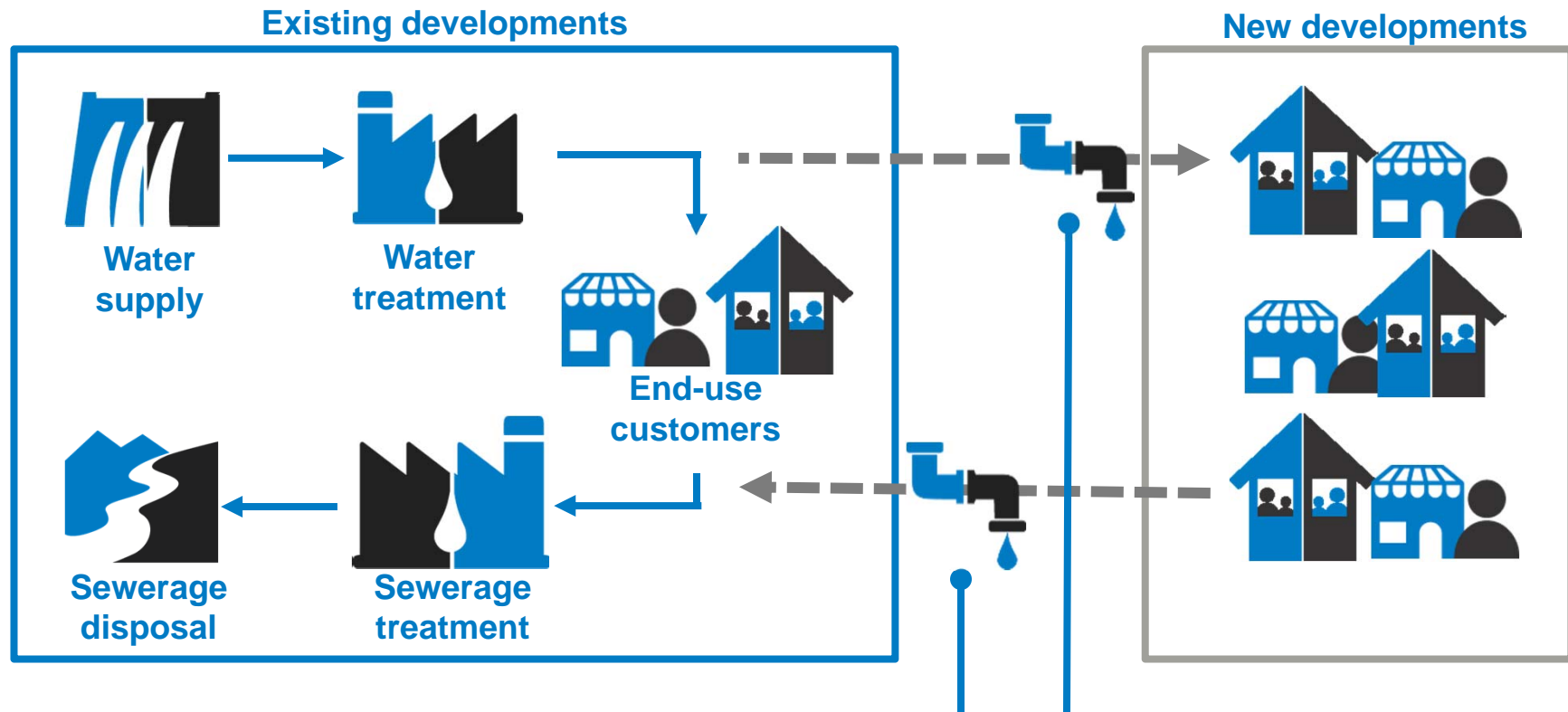
- To extend sewerage connection to existing properties

3. Other **charges** based on similar methodologies:

- SWC's **minor service extension** charge
- HWC's potential **major service connection** charge
- We will also examine Sydney Water's **Developer Direct** charge.

Session 1: Developer charges

What are developer charges?

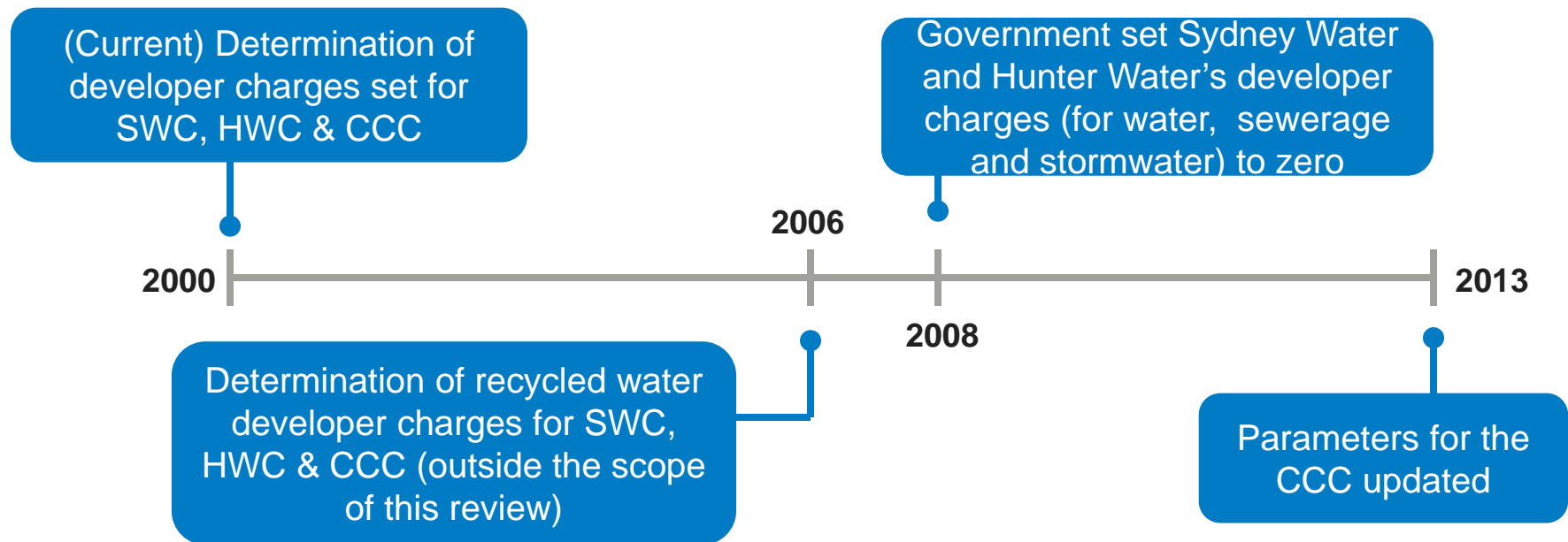


Developer charges are upfront charges water utilities levy on developers to recover the costs of providing or upgrading infrastructure for new developments

Why developer charges?

- Developer charges
 - Reflect the capital costs to service new developments plus the difference between average operating costs (reflected in the postage stamp price) and the operating costs of servicing the specific development area
- Developer charges:
 - aim to ensure there is no cross-subsidy between existing customers and new development
 - signal the costs of extending services to different locations
 - enhance the potential for competition in the supply of water and sewerage services to new developments.

The current status of developer charges



The current determinations set an **NPV methodology** & the **procedural requirements** that water agencies must use to calculate developer charges

Our current NPV methodology

$$\text{Developer charges} = \frac{K_1}{L_1} + \frac{K_2}{L_2} - \frac{NPV(R_i - C_i)}{L_3}$$

for $i = 1, \dots, 30$

The formula calculates, on an equivalent tenement (ET) basis, the costs of providing services to a new development area (defined by a Development Servicing Plan, DSP), comprised of:

- a capital charge for pre-1996 and post-1996 assets
- net of a 'reduction amount', or any operating surplus resulting from servicing customers in that DSP area at retail (postage stamp) prices
- negative 'reduction amount' (arising when operating costs in the DSP are higher than average) results in a higher developer charge

Our current procedural requirements

Under our current determinations, we require that utilities:

- Develop a **development servicing plan (DSP)** for each service area, detailing information on the capital works, standard of service and calculation of developer charges.
- Publicly **advertise** and **exhibit** a draft DSP for at least 30 days and consider stakeholder submissions.
- Forward the DSP to IPART for **registration**, informing us of any submissions. IPART then registers the DSP.
- **Review** DSPs and developer charges once every five years or as required by IPART.
- Use a calculation spreadsheet that has been **approved by IPART**.

Questions we asked in our Issues Paper

- Does the current NPV methodology remain **fit for purpose**?
- Should we **update key parameters** for SWC and HWC (as per CCC 2013 Determination)?
- Does our method to calculate the **capital cost component** remain appropriate?
- Does our '**reduction amount**' remain appropriate?
- What **discount rates** should apply?
- Is our **measure of ET** appropriate?
- Are there **other issues to consider**? (eg, implications of wholesale customers and application to stormwater)

Utilities' views

The current **methodology is sound**, subject to **updating parameters** in line with our 2013 CCC Determination, ie:

- **Discount rate** for post-1996 assets and future revenue and costs set to the pre-tax WACC in the prevailing retail price determination
- **Average customer consumption** set to the average residential consumption in the prevailing retail price determination (report)
- **Indexing factor** for DSP charges set to March-on-March CPI.

Procedural requirements continue to be adequate, but

- Waive the DSP periodic review requirement while the zero developer charges policy applies
- Allow a transition period if developer charges are 'reactivated'
- Allow more flexibility in the review period (more often than once in 5 years if required).

Utilities' views - additional issues

Sydney Water stated in its submission that:

- Refinements to the methodology might be considered to better support **liveability** and **affordable housing**
- There may be merit in considering **other methods** for developer charges (eg, a cap, a postage-stamp charge, a developer charge offset, etc)
- There may be a case for **voluntary agreements** with developers for delivery of higher levels of service
 - These agreements may better support **Integrated Water Cycle Management (IWCM)** and stormwater solutions above basic levels
 - There is growing competition to service new developments, and a lighter-handed approach to regulation is preferred.

Other stakeholders' views

The current **methodology is generally supported:**

- WaterNSW : **headwork costs** should not be included in Sydney Water's developer charges
- WSAA : the **specificity of the methodology**/higher data requirements increase the risks of the utilities being challenged by developers
- HIA: the methodology appears to be fit for purpose and generally accepted by stakeholders.

Stakeholders also commented on links between developer charges and **housing affordability**, and on **Integrated Water Cycle Management**

- Developer charges policy is a matter for the Government
- We plan a separate review of recycled water developer charges (and our approach to regulating PWU's recycled water prices) after the Government completes its review of barriers to recycled water.

Our preliminary position

Our preliminary views on developer charges are:

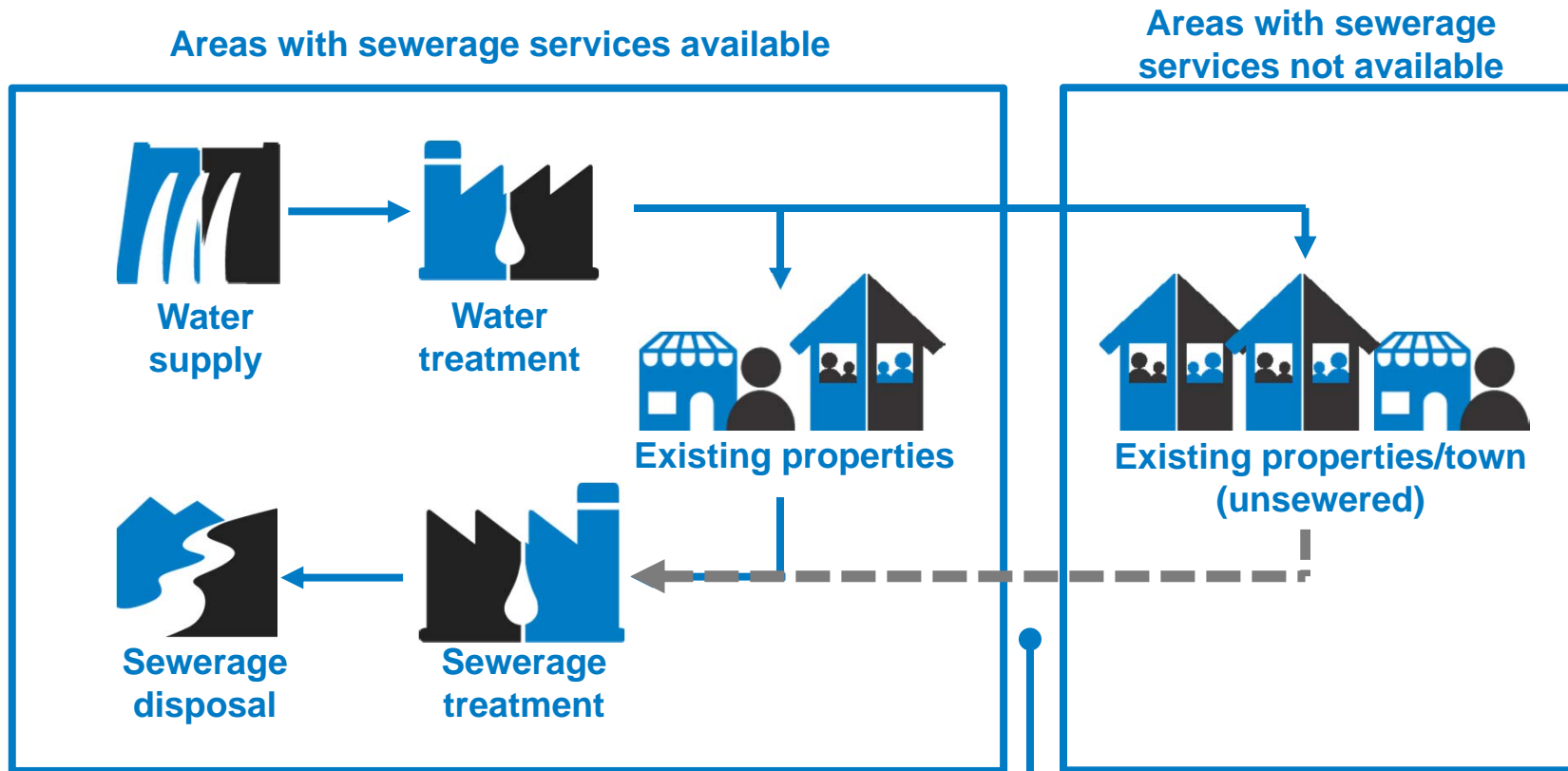
- **Maintain the 2000 Determination**
- **Update parameters** for Sydney Water and Hunter Water (as we did for the Central Coast Council)
 - discount rate, average consumption and CPI
- Amend procedural requirements to:
 - Allow more **flexibility** in the review of DSPs
 - Suspend the DSP review requirement while the zero developer charges policy applies to Sydney Water and Hunter Water
 - Allow for a **transition period** if this policy is removed.

We seek your feedback on the following:

- What are your views on our preliminary position?
- What alternatives should we consider?
- Should we allow **unregulated voluntary agreements** between a utility and developers?
 - What would such an unregulated agreement cover? How could it differ from regulated developer charges?
 - What would be the benefits of such agreements? What would be the risks? What would be their effect on competition?
 - What procedural or other requirements, if any, should relate to voluntary agreements (eg, reporting requirements?, ring-fencing?)?

Session 2: Backlog sewerage charges

What are backlog sewerage charges?



Backlog sewerage charges recover some of the capital costs associated with constructing reticulated sewerage systems in previously unsewered areas

Current backlog charge methodologies

Currently, there are **3 different methodologies**:

- For SWC, HWC and CCC
 - [Except in Hunter Sewerage Project Priority Area 1 and in Gosford where residents have not contributed to a water/sewerage funding scheme]
 - Recovers 25% of the capital charge, capped at \$3,000 nominal
- For former Gosford City Council area of the CCC
 - Applies to areas where residents have not contributed to water/sewerage funding scheme
 - Methodology depends on whether an area is a Priority Sewerage Program (PSP) area
 - PSP areas are designated by the Government.

Current backlog charge methodologies

- For the former Gosford City Council area of the CCC, backlog charges for:
 - PSP property
 - up to \$5,400 plus 67% of the residual capital charge net of subsidies
 - Non-PSP property
 - as per developer charges methodology.
- That is, in some cases a **cap** is placed on backlog charges or only a **share of costs** is passed onto backlog customers

Questions we asked in our Issues Paper

- What backlog sewerage charges are currently levied and in what areas?
- Do our current methodologies continue to be appropriate? If not, what is appropriate?
- Should backlog customers continue to have the option of an upfront payment or annual charges?

Utilities' views

- SWC supports reassessing the methodology to **recognise wider benefits** to the community when backlog properties are connected
- HWC argues for more flexibility/higher thresholds for backlog sewerage customer contributions (ie, **more cost-reflective backlog charges**)
- CCC argues for more flexibility in sharing the connection costs with the broader community and allocating a larger share of costs to the wider customer base (ie, **lower backlog sewerage customer contributions**).

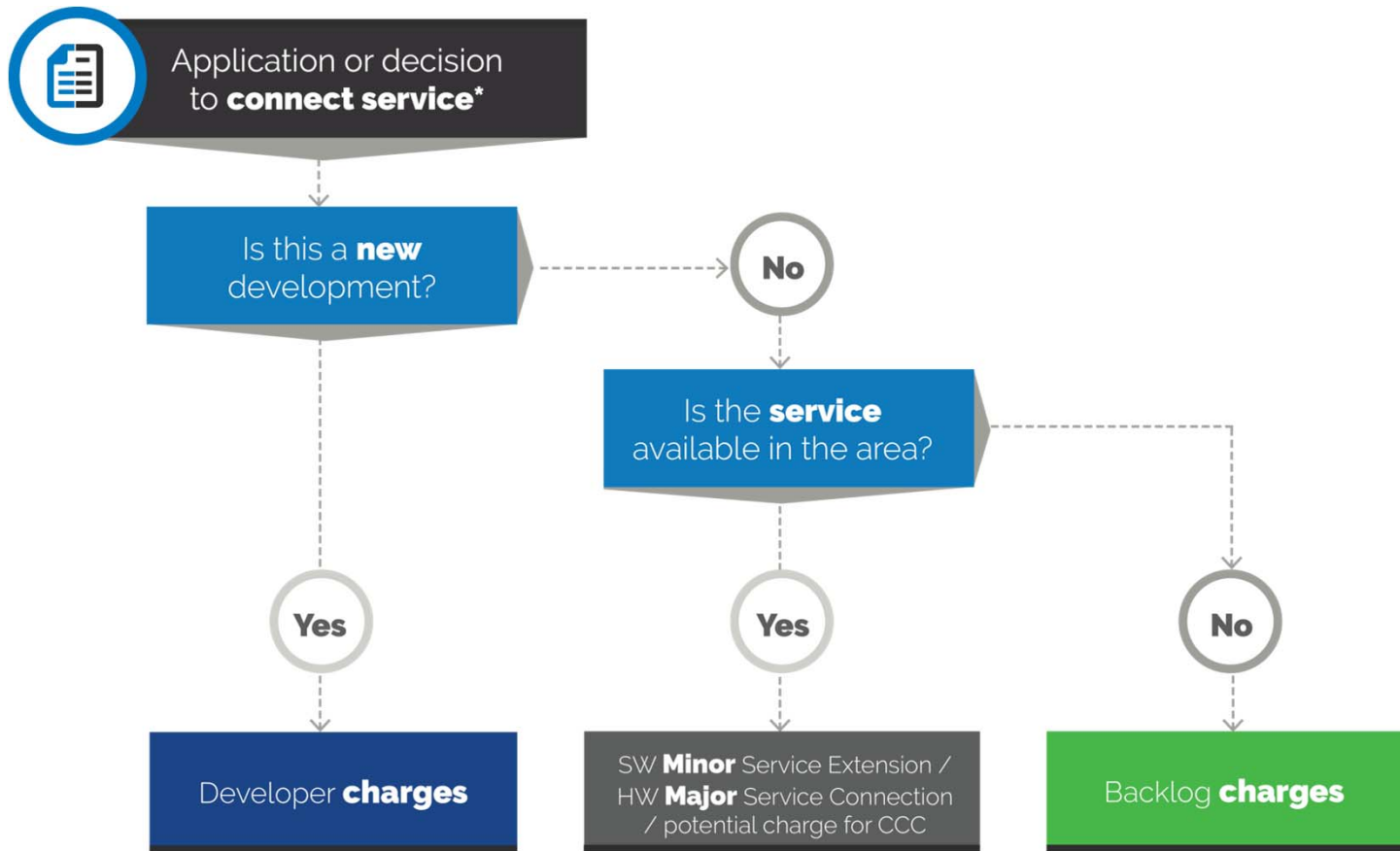
Other stakeholders' views

The City of Newcastle submitted:

- IPART should maintain avenues for the delivery of backlog sewer services
- Hexham has been nominated by the Council, and endorsed by NSW Health and NSW EPA, as an environmentally and public health **priority for connecting the sewerage system**
- For Hexham, the principal beneficiary is the environment. Consistent with Wyee, it would be **inappropriate to charge Hexham residents** a \$3,000 backlog charge.

¹ The City of Newcastle submission to IPART's Issues Paper, p 2.

Our preliminary position on how the charges apply



*Excluding standard re-connections

Our preliminary position – backlog charges

The developer charges methodology should be used to determine the **cost** of backlog sewerage services.

However, there may be cases where these costs should be shared b/w backlog customers & others (the broader community and/or customer base).

We propose to:

- apply the developer charges methodology and procedural requirements to backlog charges – as the default position
- consider any variations to this in terms of cost-sharing rules or caps on case-by-case (area-by-area) basis during a periodic retail price review
- maintain the annuity payment option, and grandfather existing charges.

We seek your feedback on the following

- How often and in what circumstances are backlog charges currently applied?
 - Can customers choose to receive a backlog service or are they compelled to at a particular point?
- What are your views on our preliminary position?
 - Should backlog charges generally be set using the developer charges methodology, and be subject to the same procedural requirements?
- Should backlog charges be subject to a cap or cost sharing arrangement? If so,
 - When and why (in what circumstances)?
 - How should/can a cap or cost share be determined?
 - Who should pay the difference between the backlog customer's share of costs and the full efficient costs?

Session 3: Other issues

We are reviewing other capital charges

Sydney Water's **minor service connection charge**

- On the **request of a property owner** to SWC to **extend the sewage system and/or water supply system** to their property
- Current methodology mirrors developer charges method and is set out in periodic SWC price determinations
 - However, the capital costs are set on a 'marginal' basis – ie, no contribution for existing assets

Hunter Water's proposed **major service connection charge**

- Would apply to **existing properties** in areas with sewerage services to **connect to HWC's sewerage network**
- Proposed methodology was based on IPART's 2000 developer charges determination.

Questions we asked in our Issues Paper

- Should the methodology for the minor service extension be set in SWC's periodic price reviews or under this review?
- Should we maintain the current methodology for determining the minor service extension charge? Should we apply this to other utilities?
- Is the potential HWC major service connection charge warranted, and if so how should this be determined?

Utilities' views

SWC minor service extension charge

- SWC submits that the methodology could be simplified
- HWC argues that it is potentially an unregulated service as it recovers the cost of providing services to existing properties

HWC major service connection charge

- HWC sees merit in applying a major service connection charge if the Government reinstates developer charges

We seek your feedback on the following

Capital charges

- Our preliminary view is to make a new determination to apply the **developer charges methodology and procedural requirements** to all capital charges under review (ie, developer charges, backlog charges and service extension charges).

We seek your comment on

- Our preliminary view.
- Should large customers be given the **option to opt-out** from the new determination, if they can reach agreement with the utility?

We are reviewing other capital charges

Sydney Water's 'Developer Direct' (SWDD) charge

- Instead of engaging a Water Service Coordinator, developers can obtain their Section 73 Compliance Certificate through SWDD
 - This service applies to complying development only
- Charge also **includes a quote for construction work** related to connecting the property to the water and sewerage network
- We are considering whether we should regulate the price of construction services provided by SWDD and, if so, how these prices should be determined.

Sydney Water Developer Direct

Questions we asked in our Issues Paper

- Should we regulate the price of construction services provided under SWDD
 - if yes, how should these prices be determined?

Utilities views

- SWC and HWC argue that this charge should be unregulated

Other stakeholder views

- WSAA supports the construction services of SWDD to be unregulated
- A Water Service Coordinator suggests that the SWDD charge for **application** services (excluding the quote for construction) is **below the competitive market level**

We seek your feedback on the following

Sydney Water Developer Direct

- Is the application fee component of SWDD cost-reflective? Is the fee set appropriately?
- Is there any effect on competition for relevant construction services from SWC quoting for these services?

Other stakeholders' views – new issues for this review

Fire and Rescue NSW on **water pressure and the capacity to fight fires:**

- Brownfill developments rely on existing water infrastructure, which often has insufficient flow and pressure to the fire hydrants on the street.
- Continuing growth in multi-unit developments has an effect on water pressure in mains, requiring apartment blocks to install onsite fire hydrants/pumps/tanks. These onsite systems can lead to delays in the time required to respond to a fire.
- These costs could be avoided if Sydney Water upgraded its mains in multi-unit development areas to increase pressure.
- The funding model for water infrastructure should be reviewed to provide for upgrade of existing water infrastructure (to facilitate firefighting).

We seek your feedback on the following

- How does SWC consider this issue in its decision-making?
- What has been the effect of the current MoU b/w SWC and FRNSW, signed in 2015 (and required by SWC's OL)?
- What can/should be done to address the firefighting/water pressure issue?
 - Is there a case to impose a standard on Sydney Water to maintain water pressure to facilitate firefighting? If so, how should the standard be set?
- Who should pay for additional measures (above what is required to provide 'standard' water services to customers) to facilitate water pressure for firefighting (and how)?
 - All SWC customers, a sub-set of these customers, or the broader community?