



Central Coast Council
Submission in response to IPART Issues Paper;
"Review of developer charges and backlog sewerage charges for
metropolitan water agencies"



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Introduction

The NSW Independent Pricing and Regulatory Tribunal (IPART) issued a paper titled “Review of developer charges and backlog sewerage charges for metropolitan water agencies” (Paper) on 24 October requesting responses on the matters raised in the paper from the metropolitan water agencies including Central Coast Council (Council). This report sets out Council’s submission of responses.

Background

Developer charges contained in Council’s Developer Servicing Plans (DSP’s) are an important component in the continued development of water and sewerage infrastructure of the Central Coast. This subsequently plays an important role in enhancing economic development of the region. It is therefore critical that the framework for setting these charges establishes an appropriate balance between the recovery of the cost of infrastructure and the encouragement of appropriate economic development. Council’s response to IPART’s Paper reflects this balance of needs.

In the case of backlog sewerage charges a similar balance is required namely that of improving the environment for the wider community and affordability for the impacted customer group. Some areas where backlog sewerage has been proposed by Council residents have rejected the proposal on affordability grounds. Consequently, the project has not proceeded and the positive environmental outcomes that benefit the community have not been forthcoming. Council’s response reflects these concerns.

In responding to IPART’s Paper, Council has given cognisance to minimising administrative costs whilst providing transparency of information to stakeholders.

Structure of the paper

Council’s response is structured to follow the sequence of issues raised by IPART in section 1.7 of the Paper.

Council has brought forward an additional matter relating to the timing which it is believed would both reduce costs and improve transparency.

Council's responses to the 28 items raised by IPART as numbered below

Current methodology and parameters

1 Does the current methodology remain fit for purpose in setting developer charges?

Council's response

Council has an emphasis on different performance drivers to both Sydney Water and Hunter Water. Council is required not only to optimise financial and operating performance of its water and sewerage infrastructure but also to use such infrastructure to enhance the economic development of the Central Coast.

Conceptually Council supports the current methodology for determining developer charges however there are some matters where Council considers that additional changes could be made to improve transparency and enhance economic development on the Central Coast.

2 Should we update the parameters for the Sydney Water and Hunter Water developer charges methodology in line with the changes made in 2013 for Gosford and Wyong Councils (now the Central Coast Council)?

Council's response

This is a matter for Sydney Water and Hunter Water to address.

Capital costs included in developer charges

3 Does inclusion of existing assets in the capital charge component of developer charges continue to be appropriate? If not, why and how should it be modified?

Council's response

A capital charge should continue to be part of developer charges. Section 2.2.1 of the Paper sets out the components of capital which should be excluded under the current methodology.

One of the exclusions is:

that part of an asset provided for a reason other than to service growth (e.g. to accommodate amendments to environmental legislation)

Council is required to construct assets that are in accordance with legislated or regulated standards applicable at the time of construction in accordance with the actions of a prudent operator. It would not be expected for developers to pay for the cost proportion of any such upgrade that is attributable to existing customers (in accordance with the apportionment framework). However the developer should pay for the developer apportionment of assets constructed, including costs related to compliance with legislated and regulated standards and practices.

It would be inappropriate to include in developer charges, the costs of assets for which Council has received grant funding from a third party e.g. Federal or State governments. The apportionment of any such grant should be in accordance with the cost apportionment framework.

A further exclusion under section 2.2.1 of the Paper is:

any asset that was unreasonably oversized relative to system and capacity requirements, based on available demographic data at the time it was commissioned

Council agrees with the exclusion however there is always uncertainty that the development does not proceed as expected; this could result in temporary or permanent excess capacity in assets. Council suggest that IPART's methodology for developer charges should allow for changes in capital costs of such assets during the periodic review process. This would be required where the development of the area does not meet expectations resulting in either temporary or permanently over-sized asset. Adopting this approach would allow Council to reduce costs where the development does not meet the forecast expectation. Conversely if development levels increase again, the capital costs can be re-introduced into the development charge.

In line with Council's desire to see continued economic growth, Council agrees with the current incremental approach to establishing the capital cost of assets in the capital component of developer charges.

- 4 Would it be appropriate to modify the period of exclusion of assets from the current 'pre- 1970 assets' to those commissioned prior to 30 years from the time of the DSP review?

Council's response:

Council does not support the exclusion of assets that are over 30 years old.

The current developer charge methodology excludes pre 1970 assets. Adopting this position at 2018 would only include in developer charges assets with a life of less than 48 years. The average life of Council's water and sewerage infrastructure assets is just less than 64 years therefore the current methodology excludes 25% of Council's infrastructure assets from the calculation of developer charges. Adopting a 30 year cut-off would increase this exclusion to 53% and as such the methodology would not appropriately reflect recovery of infrastructure assets.

- 5 Would it be appropriate to limit the period of inclusion of future assets? If so, what is the appropriate period (eg 5 or 10 years)?

Council's response:

Council proposes a rolling 10 year time period for including future capital costs into the calculation of developer charges.

Whilst capex forecast for periods beyond 10 years are helpful for strategic planning the robustness of such costs reduces as the timeframe lengthens particularly when combined with uncertainties associated with

future developments. Infrastructure for developments may have a disproportionate level of upfront costs. It is therefore important that the calculation should use a 30 year demand projection to avoid loading the initial developers with a higher developer charge, thereby reducing incentive for development.

- 6 Is it appropriate to include the capital costs of headworks infrastructure assets in the calculation of developer charges if these assets are not owned by the utility?

Councils' response

Council owns its own headworks infrastructure and does not anticipate operating with a structure utilising third party assets in the near future.

Council notes that the current methodology does not consider the implications on developer charges of "Build own operate" (BOO) or "Build own operate transfer" (BOOT) arrangements in place for provision of services from infrastructure. Whilst Council does not currently anticipate using BOO or BOOT financing of infrastructure it is appropriate that the developer charges methodology considers this and presents an appropriate framework so that the implications can be quantified in future if required.

- 7 How should the cost of assets that serve more than one DSP area be apportioned between DSP areas?

Council's response

The current methodology of using an Equivalent Tenement (ET) based methodology is considered appropriate.

However, the definition of ETs is largely left to individual businesses to establish. Council would prefer that as far as practicable a standard definition for ET be used. Currently available sources are NSW Public Works and the Department of Primary Industries' (DPI) Water Directorate but it is recognised that these documents may not provide a definition of ET for all potential developments. Where this is the case the DSP should then explain how the ETs in any DSP not in accordance with the approved standard have been established. It is recognised that having the third party keeping such definitions up to date is a challenge.

- 8 What information is considered necessary, but not currently provided by water utilities, to ensure that assets are apportioned correctly between DSP areas?

Council's response

Council considers that all required information is currently provided in DSPs. This is borne out by the fact that Council does not receive many requests from developers for additional information for its DSPs.

- 9 Does MEERA continue to be appropriate to value existing assets, for the purpose of the developer charge determination? If not, how should existing assets be valued?

Council's response

Council considers that the Modern Engineering Equivalent Replacement Asset (MEERA) principle is the appropriate basis for establishing the value of assets to be included in developer service charge calculations.

The basis of establishing MEERA is not defined, therefore leaving the basis of setting such costs up to each business. Council establishes the MEERA value of assets by aggregating construction costs sourced from the Reference Rates Manual for Valuation of Water Supply, Sewerage and Stormwater Assets (2014) published by the former NSW Office of Water plus the direct costs of Council. These costs are adjusted for timing differences as appropriate using construction cost indices as published by DPI.

The construction costs in this document are based upon

Competitive contract prices obtained by NSW Public Works for water supply and sewerage projects within NSW, supplemented by published rates for water supply, sewerage and stormwater works and also rates obtained from a number of LWUs (Local Water Utilities) and other agencies¹.

As such, this is a brownfield not a greenfield rate.

The 'reduction amount'

10 The 'reduction amount' component of the developer charge formula takes into account postage-stamp revenues and location-specific operating costs for a period of 30 years. Does this approach continue to be appropriate? If not, how should it be modified?

Council's response

In principle Council agrees with this approach however believes that the following matters should be addressed in the updated methodology:

- i. Period over which the assessment should be made

For similar reasons that Council supports a 10 year capex forecast, opex and revenue forecast should also be for a 10 year forecast period.

- ii. Establishing opex levels

Opex should include the opex costs on gifted assets, assets for which third party funding (primarily Federal and/or State government grants) is received and opex costs for assets that comply with legislated or regulated service standards. The opex cost should reflect the provision of assets to the legislated or regulated standard as of the date of commission or the date of establishing/reviewing the DSP.

¹ NSW Reference Rates Manual Valuation of water supply, sewerage and stormwater assets, June 2014, Section 1.2

Discount rates

- 11 What discount rates should apply in the developer charges methodology? Is it still appropriate to distinguish between pre and post 1996 assets?

Council's response

IPART's proposal to adopt the pre-tax Weighted Average Cost of Capital (WACC) applied in the current price determination in force at the time of the calculation is considered appropriate. This should apply only to post 1996 assets.

Including pre 1996 assets would result in a material increase in developer charges which would be likely reduce developers' incentives to develop on the Central Coast. This is contrary to achieving one of Council's drivers of encouraging economic development.

However, Council considers that more flexibility should be included if there has been a material change in the fiscal environment subsequent to the determination. IPART's draft report Review of WACC methodology Oct 2017 addresses this issue for pricing water and sewerage services as follows:

Continue to estimate the cost of debt as the midpoint between our estimates of the current and historical cost of debt when the uncertainty index is at, or within one standard deviation of, its long-term average.

Adjust our estimate of the current cost of debt to reflect the cumulative monthly change in the actual cost of debt during the regulatory period, and to make this adjustment through a regulatory true-up:

- at the beginning of the following regulatory period, and
- in the notional revenue requirement (NRR) for the next regulatory period.²

Council proposes that WACC for DSP calculation should be adjusted in the same circumstances with any such revision to WACC to be agreed with IPART.

Equivalent tenements (ETs) and consumption forecasts

- 12 Does our measure of ET continue to be appropriate for determining developer charges? If not, how could it be improved?

Council's response

Council considers that ETs are the appropriate methodology to adopt in the calculation of developer charges. However, we again propose that the source of ETs should be standardised.

In the case of sewerage services the demand needs are assessed using demand for water multiplied by an appropriate discharge factor. Again the discharge factor is left to the business to establish. Council adopts the Water Directorate's information as a basis. To provide consistency and transparency for developers it

² Review of our WACC method, July 2017, Section 4.3

would be appropriate to use a standard reference point and then detail in the DSP how these may have been adjusted to reflect local conditions. Any such changes should be substantiated within the DSP.

- 13 In line with the Central Coast Council determination, is it appropriate to update the annual consumption for an average residential customer of Sydney Water and Hunter Water, with average consumption values established in the water utility's prevailing price determinations?

Council's response

This is a matter to be addressed by Sydney Water and Hunter Water.

Implications of wholesale customers and WICA licensees

- 14 What are the implications (if any) of wholesale customers and WICA licensees for the public water utilities' developer charges methodology and determination? That is, do wholesale arrangements or the activities of WICA licensees mean the methodology and/or determination should be amended? If so, how and why?

Council's response

Council has little experience in addressing the issues surrounding WICA licences and is therefore not in a position to appropriately address this matter.

Stormwater contributions

- 15 In funding stormwater infrastructure for new development, how has each of the former Central Coast Councils (ie, Gosford and Wyong) distinguished between developer charges and development contributions under section 94 of the EP&A Act?

Council's response

Council receives all contributions for stormwater development through section 94 of the EP&A Act. Council considers that developers fully understand this approach.

- 16 Is the distinction between stormwater services that Central Coast Council funds through developer charges and those funded via contributions under section 94 of the EP&A Act clear to developers and customers? If not, what should be done to improve the transparency of charges?

Council's response

Council receives all contributions for stormwater development through section 94 of the EP&A Act.

Determining DSP areas

- 17 What principles or criteria should guide the determination of DSP areas? Are the developer charges in the consolidated DSPs for the Central Coast Councils cost-reflective?

Council's response

Council currently has three DSPs; one covering the former Wyong Council area, one for the Gosford CBD and another for the balance of the former Gosford Council area. These three DSPs have resulted from an agglomeration of a number of previous DSPs and have been established to be cost reflective.

There were a number of reasons for the agglomeration of DSP's, the primary ones being:

- Councils DSPs prior to the agglomeration contained a significant number of sub areas (in the case of Wyong there was approximately 80 sub areas). Agglomeration has provided the following advantages;
 - reduced administration challenges with associated decrease in costs
 - the larger development area allows Council the funds to provide more timely repayment of the design and construction credits owing to developers who have funded the design and construction of assets. These developers then receive a credit against their contributions payable until the DSP account contains sufficient funds. With a larger number of small development areas the developer was required to wait until the subsequent follow on development occurred in that area to generate the DSP revenue to pay-back the balance of credits owed to the developer.
- The provision of two DSPs for the former Gosford Council area allowed the substantially higher cost of development within the Gosford CBD (due to high restoration, traffic control and impacts on other services) to be reflected while the remainder of the former Gosford LGA was included within a single DSP. There is currently no region in the former Wyong Council area with all the characteristics of the Gosford CBD.
- A high percentage of future development across the Central Coast is occurring as infill or within pre-determined greenfield sites such as Warnervale. The development of these sites is being driven by the State Government North Wyong Structure Plan, and Council's Local Environmental Plans which encourage orderly development in line with the adopted land zonings. This 'guiding' of development shows there are many factors other than just Water Supply and Sewerage Infrastructure costs that influence the location of development.
- Following the construction of major capital works such as the Mardi High Lift Pump Station, the former Wyong Council water supply network now operates essentially as one large system, with multiple inter-connections for redundancy. A single charge reflects the operation of the system. The former Gosford Council water supply system also operates in a similar manner with all source water being treated at the Somersby or Mardi Water Treatment Plants and then distributed via the Kariang Reservoirs to the rest of the network, also with interconnections between reservoir zones for operational redundancy.
- Topography had previously divided the former Wyong Council area into a series of sewerage sub areas DSPs which was problematic for the reasons described above. The proposed single charge encourages the provision of infrastructure by developers which assists in 'unlocking' new development sites, encouraging economic development.
- The former Gosford Council sewerage network ultimately converges on a single ocean outfall with a series of increasingly larger major sewage pumping stations conveying flows from upstream areas to the Kincumber outfall system.

The ultimate test of acceptance of this agglomeration is that the Development community has welcomed the use of a larger DSP area as it provides them with uniform costs and a more timely refund of any credits owing from funding the design and construction of assets.

- 18 What role, if any, should IPART play in determining or reviewing DSP areas (eg, should IPART be required to approve DSP areas)?

Council's response

Developers perceived preference for the agglomeration of the previous numerous DSPs into the current three indicates that Council has undertaken the appropriate rationalisation. Council therefore recommends that there is no reason for IPART to become any more involved in the determining and reviewing of DSP areas than currently.

Price indexation factor

- 19 Should the March-on-March CPI adjustment factor, as used in our retail price determinations, be applied to index developer charges over time? Or should a different indexation factor be applied in some instances, eg for the Central Coast Council?

Council's response

This is consistent with the pricing framework and Council considers this appropriate.

Procedural requirements

- 20 Do the current procedural requirements, including DSP content requirements and IPART's role in reviewing and registering DSPs, remain appropriate?

Council's response

Council considers the current procedural requirements appropriate and would not wish to see additional administrative requirements that would result in increased costs.

The adequacy of the procedural requirements is borne out by the acceptance of developers to the current process. The majority of disputes from developers related to developer charges being around why they should pay at all and not in the calculation methodology.

Backlog sewerage charges methodology and application

- 21 What backlog sewerage charges are currently being levied by water utilities, and in what areas? Will they be required in future?

Council's response

Council currently renders backlog sewerage charge for Cockle Bay towns and Mooney Mooney Chero Point. Consideration would be given to establishing similar schemes in future under appropriate environmental and economic drivers.

22 Do our current methodologies for backlog sewerage charges continue to be appropriate? If not, what is an appropriate methodology for determining backlog sewerage charges?

Council's response

Council agrees that the current methodologies are appropriate but suggests a change to the parameters adopted for the calculation.

The Cockle Bay towns and Mooney Mooney Chero Point contribution charges are based on IPART's current framework. The approach being that the benefiting property owners pay the majority of the cost remaining after subsidies are applied and the remaining portion is spread amongst the wider customer base.

Whilst this seems fair for the reasons explained by IPART it can and has made the cost to connect unaffordable for many potential users. Three of Council's proposed schemes (Patonga Creek, Little Wobby and Bar Point) did not go ahead due to lack of customer support in these areas, meaning the benefits to the wider community from such schemes have not been realised. The outcome may have differed if the costs to customers were lower.

Council proposes an option to allow more flexibility in the level of costs that should be borne by the wider community. This could be achieved by allowing costs to be allocated to the wider customer being based up to a level whereby the price of water and sewerage services does not increase by more than a nominated percentage. Given Central Coast has a wider customer base than the two individual predecessor Councils such an approach would provide a methodology for reducing backlog sewerage charges without a material impost on other users thereby increasing the chance the wider community benefits of backlog sewerage being realised.

There are a number of aspects in IPART's current Determination that are ambiguous:

- i. Costs are described as per lot, rather than per ET. Council recommends a consistent approach of using ETs. The 2006 determination for Mooney Mooney Chero Point noted that charges were per property not per ET. Council considers that the charge should be per ET particularly as a property basis is not used for any other aspect of the charge.
- ii. ETs should be defined as including where there is a current approval as at the date of establishing the backlog area for dual occupancy.
- iii. It is unclear as to whether costs external to the project e.g. enhancement to existing assets, primarily headwork assets should be included in the calculation. For issues of affordability and introduction of complexity as some of these assets may be subject to DSPs Council considers that these costs should be excluded from the calculation of backlog sewerage charges.
- iv. Council wishes that sub divisions that occur within 2 years of the schemes commissioning should incur a backlog sewerage charge.
- v. Under the Country Town Water and Sewerage Scheme program the contribution may be expressed either as a lump sum or per ET unit. Council proposes that lump sum contributions from third parties should be converted to ETs. If (iv) above is adopted, consideration will be required as to how to address the allocation of third party contributions.

Council has not addressed the issues noted in the Paper relating to Priority Sewerage Programs (PSP) as there is no indication from government that additional PSP funding is available.

- 23 Should backlog customers continue to have the option of an upfront payment or annual charges? If so, is it appropriate to use the WACC established in the water utility's prevailing retail price review as the discount rate to calculate the annuity charges?

Council's response

Council proposes that the discount factor upon which the annuity is calculated should be the nominal debt rate adopted in the WACC of the water utility's prevailing retail price review.

In the interests of delivering community wide environmental and economic benefits the option of upfront or annual payments should be retained (80% of the Cockle Bay Towns residents request annual payments).

To further improve affordability Council proposes that the discount rate used to calculate the annuity charge should be the nominal debt rate contained in the WACC calculation. Whilst this approach may be considered as uncommercial, Council is not strictly a commercial business and its focus, unlike Sydney Water and Hunter Water, is to deliver a wide spectrum of benefits to the community as a whole. Reducing the financial impost on customers in backlog areas will result in a greater probability of the scheme being delivered and the environmental benefits for the wider community being delivered.

Other matters

Other related capital charges

- 24 Are there any other capital contribution charges that IPART should consider incorporating into this consolidated review of developer (and other capital contribution) charges

Council's response

Under section 306 of the Water Management Act 2000 Council may impose certain requirements on developers before granting a certificate of compliance; these requirements may require investment by Council. The section provides a mechanism for Council to recover any such costs.

Council uses this section as appropriate. For example, if a developer is granted approval to develop with materially more ETs than were allowed for in the DSP, thus requiring additional infrastructure, Council negotiates with the developer to recover any such costs using Section 306.

Hunter Water's Major Service Connection Charge

- 25 Is a major service connection charge warranted and, if so, how should this be determined?

Council's response

This is a matter for Hunter Water.

Sydney Water's Minor Service Extension Charge

- 26 Should the methodology for the minor service extension charge be set in Sydney Water's periodic price review or should it be set under this developer charges review?

Council's response

This is a matter for Sydney Water.

- 27 Should we maintain the current methodology for determining the minor service extension charge, or make amendments to this methodology? Should this be applied by other water utilities (Hunter Water and the Central Coast Council)?

Council's response

This is a matter for Sydney Water.

Sydney Water's Developer Direct

- 28 If we were to regulate the price of construction services provided by Sydney Water under Developer Direct, how should these prices be determined?

Council's response

This is a matter for Sydney Water.

Additional matter for consideration

To minimise administrative costs, Council proposes the coordination of the timing of setting and review of developer charges with the price submission for water and sewerage charges. This would require changes to IPART's proposed frequency from 5 years to the period of the price determination, with the setting of a maximum period. For example, if IPART provides a four year determination then developer charges should be reviewed at this time. Similarly, if IPART agrees to any deferment then the review of DSPs should be similarly deferred (with potentially a maximum period between reviews being set). There would need to be an exception to this where there are material changes to the DSP that result in a change to the DSP charge in excess of an agreed percentage within the review period. In such cases the DSP should be reviewed to address the change and then again at the time of the price determination.

Adopting such an approach would:

- Reduce the need for repeated opex and capex cost plan forecasts. A common forecast would be utilised for both developer charges and pricing determinations
- Improve transparency for customers and developers in the setting of costs at a common time.