

IPART'S REVIEW OF MAXIMUM PRICES TO CONNECT, EXTEND OR UPGRADE A SERVICE

FOR METROPOLITAN
WATER AGENCIES



SUBMISSION TO DRAFT REPORT
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EXECUTIVE SUMMARY

The Independent Pricing and Regulatory Tribunal (IPART) is reviewing its methodologies for setting developer and related charges for metropolitan public water utilities. As part of the review IPART has invited submissions on its draft decisions, as contained in a draft report ‘Maximum prices to connect, extend or upgrade a service for metropolitan water agencies’. IPART has also released an accompanying draft determination.

IPART’s draft report supports retaining the current core developer charges methodology with some updated key parameters. IPART also propose to extend the developer charges methodology to apply to connections to existing properties. IPART consider that while the Government’s zero developer charges policy remains in place that a new marginal cost based extension of service charge could apply to existing properties wishing to connect to Hunter Water’s systems. The draft report also proposes a new marginal cost based price for upgrading water services for firefighting.

Hunter Water welcomes the opportunity to further contribute to this review. Consistent with our response to the issues paper, we support the majority of IPART’s draft decisions. We particularly appreciate IPART’s resolution of issues consistent with proposed solutions we raised in our earlier response, viz:

- recognise the Government’s zero developer charges policy in the determination
- allow for a transition period of up to eighteen months to implement developer charges should the zero charges policy be revoked, and
- provide flexibility for metropolitan water utilities to review Development Servicing Plans (DSPs) more than once in five years if circumstances warrant a review.

This submission reiterates our support for the refinement of the underlying developer charges methodology and focuses on the following three issues:

1. the proposed charge for extending services to existing properties
2. potential impacts for backlog sewerage projects, and
3. the proposed charge for upgrading water services infrastructure for firefighting.

Proposed extension charge for existing properties

Hunter Water acknowledges IPART’s logic in seeking to apply a uniform methodology to the recovery of capital costs associated with new developments and the extension of services to existing properties. It make sense as a general rule, from both the perspectives of location price signalling and equity, that properties connecting to a water utilities’ systems should meet the full capital cost of doing so. This includes recovering the opportunity cost of any reduction in the capacity of existing assets associated with new connections.

However, as outlined in this response, we consider that the proposed marginal cost based extension charge should include exemption clauses so that it does not preclude continuation of current business practices that result in efficient services delivery, such as those currently applied by Hunter Water. This is because our general policy is that properties wanting to connect to our system are required to organise the design, construction and funding of any necessary works. This policy applies to both large non-residential properties and smaller residential connection proposals. Accordingly, if IPART wishes to proceed with the proposed connection charge the final report and determination should make clear that it only applies where the relevant services are provided by the utility.

If the NSW Government’s zero developer charges policy were to be revoked, Hunter Water would support the application of the developer charges methodology to large non-residential properties that would previously have been subject to our capital contributions policy¹. This is because such properties have the potential to draw on a significant share of existing asset system capacity. However, we do not consider that

¹ Hunter Water, 2017, pages 32-33.



the methodology should apply to smaller urban infill proposals² which would have a negligible impact on existing asset capacity. In Hunter Water's view, the methodology's administrative costs and the adverse consequences of discouraging such properties from connecting to our system would outweigh any benefits.

Backlog sewerage projects

IPART's proposal to apply the developer charges methodology as the default for funding backlog sewerage schemes provides a consistent and transparent framework for identifying the full costs of proposed schemes. The approach also allows for a scheme-by-scheme assessment of any external benefits that may warrant contributions from the broader customer base or NSW Government community service obligation payments.

Hunter Water notes that IPART's proposed methodology does not diminish the funding challenges associated with any proposals to provide sewerage schemes to the remaining backlog townships and villages identified in our submission to the issues paper.³ This is particularly the case in locations where it is challenging to demonstrate and quantify the extent of broader public benefits.

IPART recommends the contestable provision of backlog sewerage services. Hunter Water acknowledges that in general competition can deliver benefits such as fostering innovation and delivering dynamic efficiencies. However the contestable provision of backlog sewerage services is essentially a matter for NSW Government consideration.

If the Government were to decide on a contestable market for the provision of backlog sewerage projects, then public water utilities should be able to choose the extent of their participation in that market. The proposal to designate public water utilities as default suppliers appears to be inconsistent with 'level playing field' principles.

Upgrading water services for firefighting

IPART's draft report proposes to set a price for upgrading an existing service to existing properties, on a marginal cost basis. The proposal responds to Fire and Rescue NSW concerns in attempting to cost effectively meet firefighting requirements related to brown field developments in inner Sydney.

Hunter Water agrees that urban fire protection should be provided in the most efficient manner possible, noting that responsibilities are currently dispersed across several organisations and regulatory mechanisms (e.g. building codes, local council development approvals). We recognise IPART's endeavours to provide a funding mechanism to enable upgrade of water supply systems as one of a suite of possible solutions to mitigate the consequences of fires in urban areas.

Hunter Water has not experienced the same difficulties as reported in Sydney in relation to disputes over meeting firefighting requirements associated with existing property development proposals. However, as conveyed at IPART's public hearing and in this submission, we have identified some legacy issues in meeting self-imposed firefighting requirements as standards become more stringent over-time.

Hunter Water's preference would be to work with Fire and Rescue NSW to agree on priority areas and the most cost-effective way of meeting fire-fighting requirements in those locations. This approach has advantages over an ad hoc response that deals with issues as they arise on a property-by-property basis.

Hunter Water is concerned that IPART's proposed voluntary upgrade charge could create an additional organisational burden for public water utilities in brokering arrangements on a property-by-property basis, particularly where some beneficiaries may not have a regulatory incentive to contribute. In addition there would be ongoing administrative costs associated with recovering repayments over many years.

² Ibid, page 30

³ Hunter Water, 2017, pages 27-28.



1 INTRODUCTION

1.1 This submission

Hunter Water welcomes the opportunity to respond to the Independent Pricing and Regulatory Tribunal's (IPART's) Draft Report *Maximum prices to connect, extend or upgrade a service for metropolitan water agencies*.

The submission is structured as follows:

1. Introduction
2. New connections to new developments
Responds to IPART's proposed methodology and procedural requirements in relation to connections to new developments (formerly called developer charges).
3. New connections to existing properties
Responds to IPART's proposed approach to extending services to existing properties including backlog sewerage programs within Hunter Water's area of operations. Also responds to IPART's recommended contestable process for the provision of community service obligations.
4. Prices for upgrading existing services for firefighting
Hunter Water's position on this proposed voluntary charge.

Hunter Water's positions on each of the 37 draft decisions and 1 draft recommendation contained in IPART's draft report are listed in Appendix A.



2 NEW CONNECTIONS TO NEW DEVELOPMENTS

2.1 Methodology

Hunter Water agrees that the current developer charges methodology remains conceptually sound. IPART's draft decisions address a number of administrative and procedural issues with the 2000 determination.

We note IPART's draft decision to continue to include post-1970 assets with a nexus to development within the methodology rather than adopt a 30-year rolling window. We accept IPART's and other stakeholders' view that this approach, if implemented now, would exclude a significant share of assets still servicing developments that are not yet fully funded. However, we suggest that IPART revisit this issue in any future reviews of the methodology given the passage of time since 1970.

We accept IPART's draft decision not to place a hard-coded limit on the timeframe for including future assets. However, Hunter Water suggests that IPART provide some indication of the evidence that would be required to include capital projects beyond a ten-year planning horizon in order to limit potential future disputes.

Hunter Water agrees with IPART's reasons as to why it would not be feasible to include a WACC cost of debt adjustment mechanism within the developer charges methodology.⁴ Moreover, we note that the inclusion of such a mechanism would add to uncertainty in making development investment decisions.

Hunter Water supports IPART's draft decision, in response to concerns raised by the Water Services Association of Australia, to amend the methodology to set maximum prices at zero when the price would otherwise be negative.

The draft report notes that IPART will consider whether the new Australian Accounting Standard AASB 16 'Leases' will affect the regulatory treatment of operating leases at the next periodic pricing reviews.⁵ Hunter Water requests that IPART work with utilities ahead of forthcoming pricing reviews to resolve the treatment of operating leases.

2.2 Procedural arrangements

Hunter Water supports the retention of the current procedural requirements accompanying the developer charges methodology with the amendments proposed by IPART.

We welcome IPART's draft decisions that are consistent with proposals in Hunter Water's submission to the issues paper, including:

- Incorporating greater flexibility for potential amendments to the review frequency
- Recognising in the draft determination the Government's current zero developer charges policy in the Lower Hunter and Sydney, and
- Allowing for a transition period of up to eighteen months to implement the methodology should the Government's zero developer charges policy be revoked.

Hunter Water supports IPART's proposals to maintain a relatively light-handed approach to regulating DSPs and in particular providing utilities with the flexibility to determine appropriate DSP boundaries.

We consider that IPART's provision of a spreadsheet methodological template for use by the water utilities represents a reasonable compromise in terms of Hunter Water's concerns regarding the need to accommodate regional differences and flexibility to accommodate automatic data population.

⁴ IPART 2018, page 39

⁵ Ibid page 30



3 NEW CONNECTIONS TO EXISTING PROPERTIES

3.1 IPART's proposal

The draft report proposes that:

- *“Maximum prices for a service extension can be presented as a composite charge, or as a sum of two components:*
 - *a price to connect a new service to a new development, calculated for a Development Servicing Plan (DSP) area on an incremental cost basis, plus*
 - *a price to build an extension to the connecting (backlog) property in this DSP area, calculated on a marginal cost basis.*
- *This approach would enable utilities to charge on a marginal cost basis for extending a service while the zero developer charges policy applies.”⁶*

Hunter Water understands that IPART's proposed approach provides a charging methodology for recovering the cost of new connection assets from Hunter Water's system(s) to an existing property whilst the Government's zero developer charges policy applies. If the NSW Government were to revoke the zero developer charges policy, then IPART's proposed developer charges methodology would apply in full to new connections to existing properties.

The draft report does not elaborate on the scope of capital works that would be considered an 'extension to the connecting (backlog) property'. The term extension is broadly defined in Schedule 7 of the draft determination as meaning the construction of an additional component, or components of a system.

Hunter Water notes that the capital works involved in providing services to specific locations vary significantly. In some cases it may be more cost effective to build new localised systems rather than to connect to Hunter Water's existing system. However, the definition of extension in Schedule 7 only refers to "system additions". Accordingly, we suggest that IPART clarify the definition of infrastructure that falls within the scope of works that would be covered by the proposed marginal cost based charge.

IPART's issues paper indicates that the above approach would replace the following:

1. IPART's prior backlog sewerage charges determinations (aside from grandfathered funding arrangements)
2. Hunter Water's previously proposed major service connection charge, and
3. Sydney Water's minor service extension charge.

Hunter Water's comments on the implications of IPART's proposed approach relative to our current approach for dealing with backlog sewerage and major and minor service connections are provided below.

3.2 Backlog sewerage programs

Hunter Water's response to IPART's issues paper described the history of programs to provide backlog sewerage services in the Lower Hunter Region as well as our current policy for identifying and funding backlog sewerage schemes for townships and villages that aligns with the NSW Government's decision making framework for Priority Sewerage Projects.

Hunter Water's response noted that there are almost 2,500 existing urban residential properties in 18 townships or villages across the Lower Hunter that rely on an on-site wastewater system (e.g. septic tanks).

⁶ IPART, 2018, page 57



There is also a significant number of small acreage, rural residential properties in the Lower Hunter that rely on an on-site system.

Hunter Water estimated the capital cost of providing a wastewater service to the 18 unsewered towns and villages at more than \$130 million. The average capital cost per residential property of providing a connection to Hunter Water's wastewater system is in the order of \$55,000 per lot. This figure ranges from \$25,000 per lot up to \$85,000 per lot depending on the characteristics of each backlog sewerage area.⁷

IPART's draft report states that

"Our 1997 Determination (for Sydney Water, Hunter Water and the Central Coast Council) set the maximum backlog charge at the lesser of:

- \$3,000 per property, and
- 25% of the total net capital cost per property of the backlog works.

*This methodology means that the water utilities fund at least 75% of the net capital costs of backlog works, typically through higher bills to their broader customer base, that is, most of the capital costs of a given backlog scheme are funded by other customers."*⁸

Under IPART's proposed methodology, property owners would fund the capital costs of backlog schemes. However, IPART would consider the recovery of costs from the regulated customer base where a scheme delivers broader positive externalities in the form of environmental or public health benefits.

Hunter Water's estimates of the per property costs of remaining backlog schemes within the Lower Hunter region highlight the funding challenge of progressing such schemes in the absence of evidence of significant positive externalities. The extent of this funding challenge would be increased if the full developer charges methodology were to be applied as proposed in the draft report should the zero charges policy be revoked.

Hunter Water's response to the issues paper noted that, in some cases, the most cost effective option may be improved maintenance and operation of existing onsite schemes, with local councils playing a role in monitoring and enforcement. Alternatively, local councils could consider financial support for residents to upgrade these systems as a way of addressing minor and localised environmental and health risks.⁹

IPART note that approval for seeking reduced property owner contributions could be sought:

- from IPART at a periodic price review (eg, the scheduled 2020 Hunter Water retail price review)
- by applying to IPART for a scheme-specific review, or
- from the NSW Treasurer under section 18 (2) of the IPART Act.¹⁰

The final report could usefully clarify how IPART and public water utility would implement any scheme-specific determinations that occurs outside of periodic price review. For example, if IPART were to determine in a scheme-specific review that a contribution from the broader customer base was warranted, it is not clear whether that contribution would be automatically included in the following periodic price determination.

We consider that IPART's draft decisions as they relate to backlog sewerage areas are broadly consistent with Hunter Water's current policy as outlined in our response to IPART's issues paper.¹¹ In essence, IPART's proposed default position is that properties fund the cost of their connection to off-site sewerage services unless broader public benefits can be demonstrated that support a case for recovering costs via a government contribution and/or from the wider customer base.

⁷ Hunter Water, 2017, page 27

⁸ IPART, 2018, page 58

⁹ Hunter Water, 2017, page 31

¹⁰ IPART, 2018, page 64

¹¹ Hunter Water, 2017, page 29



3.3 Contestable process for social policy objectives

IPART is proposing to recommend that the provision of Community Service Obligations to achieve NSW Government social policy objectives (eg, relating to the provision of backlog sewerage services) should be contestable to facilitate innovation and efficient market solutions.¹²

The draft report states that:

“... when governments are procuring these services, they should call for competitive bids or expressions of interest from the market, rather than automatically requiring public water utilities to provide them (or granting them the right to do so). In such circumstances a public water utility could bid or be a public sector comparator (and default supplier).”¹³

Hunter Water acknowledges that in general competition can deliver benefits such as fostering innovation and delivering dynamic efficiencies. As stated by IPART during the national Competition Policy Review:

“Competitive markets deliver goods and services that customers want at prices that reflect efficient cost of production. Competitive markets are responsive to changes in consumer preferences and drive innovations that lead to more choice and better value for customers.

Customers have a crucial role in competitive markets. For example, they choose the products or services they want, the level of quality they expect for a given price and at what price levels they would switch to a different product. Suppliers strive to win customers by lowering costs or providing a ‘better’ product. Competitive markets also drive innovations, which are crucial to achieving dynamic efficiency.”¹⁴

Hunter Water notes that IPART’s recommendation regarding the contestable provision of backlog sewerage services is essentially a matter for NSW Government consideration.

Hunter Water in considering individual backlog schemes would take into account all available options with a view to achieving least lifecycle cost solutions consistent with IPART’s prudence and efficiency principles. Hunter Water would also contract out the design and construction of all associated capital works.

If the Government were to decide on a contestable market for the provision of backlog sewerage projects, then public water utilities should be able to choose the extent of their participation in the market. The proposal to designate public water utilities as default suppliers would be inconsistent with the principle of a level playing field for all utilities, public or private.

Hunter Water, if requested, foresees no issues in providing estimates of the cost of a centralised solution for comparative purposes if we elected not to bid to undertake a specific scheme.

Hunter Water notes that any contestable arrangements would need to accommodate both stand-alone backlog schemes and those that required connections to and/or augmentation of a public water utility’s existing systems. It would be useful if the final report were to provide some indicative guidance on the funding and integration issues if a private water utility invested in a scheme that required consequential upgrades to the public water utility’s system.

The Government would also need to consider the administrative arrangements applying to IPART’s recommended competitive bidding or expressions of interest process to avoid any potential conflicts of interest associated with water utilities’ involvement in the process. The final report could also usefully provide some guidance on this issue.

The draft report states that if the NSW Government provides subsidies or grants directly to a utility to fund the capital costs of backlog services, these grants should not be deducted from the capital costs used in the developer charges calculation formula. This would assist with calculating the appropriate total cost of an

¹² IPART, 2018, page 66

¹³ IPART, 2018, pages 66-67

¹⁴ IPART, 2014, page 1



extension and the capital connection charge per equivalent tenement (ET).¹⁵ IPART should clarify that properties receiving backlog sewerage services would be required to pay the capital connection charge per ET less any relevant government contribution.

3.4 Major Service Connections

Hunter Water's response to IPART's issues paper noted that there are a number of existing properties located in developed urban areas in the Lower Hunter that are not connected to Hunter Water's wastewater system ('infill properties'). These existing properties are typically commercial or industrial operations and have on-site wastewater treatment facilities with environment protection licences for the discharge of treated effluent.¹⁶

The EPA and local councils have actively encouraged a number of these developments (primarily caravan parks and industrial developments) to connect to the wastewater services of Hunter Water and to cease discharge to the environment.

Hunter Water previously required existing properties that wished to connect to Hunter Water's sewerage system to provide capital contributions that were calculated in accordance with IPART's 2000 developer charges methodology.

As detailed in Hunter Water's response to the issues paper, we ceased levying capital contributions after IPART's 2015-16 review of Hunter Water's prices. The decision was based on the cost of determining the contribution amounts in the absence of updated DSPs.

Hunter Water, for the reasons outlined in our earlier response, sees merit in applying a major services connection charge to existing properties if the NSW Government were to reinstate developer charges. However, we do not support IPART's current proposal that would enable Hunter Water to levy its major service extension charge on a marginal cost basis while the zero developer charges policy applies.¹⁷ We would support the proposal with modifications that allow Hunter Water to continue business practices that result in efficient service provision.

Hunter Water currently requires any existing property that wants to connect to our system to organise and fund the design and construction of the necessary work themselves. The property owner is free to choose equipment suppliers and installers.

As noted in our response to IPART's issues paper, requests from existing properties to connect to Hunter Water's wastewater services are relatively infrequent, averaging around six requests per year, but may involve relatively high sewer loads depending on the property type.¹⁸ We issued twelve Notice of Requirements letters to existing developments wanting to connect to the system during 2016-17. The complexity of the infrastructure required to service such developments varies. For instance in one case the proponent is organising the design, construction and funding of a private pump station with telemetry as well as the connection to Hunter Water's system.

Hunter Water does not offer supply or construction services for connections to existing properties apart from an optional mains drilling service. Hunter Water's website provides the relevant advice for unserved properties wishing to connect to our systems.¹⁹

Accordingly, under Hunter Water's existing policy, the marginal cost of connecting to our system is already covered by the relevant property owner who has access to a competitive market for connection services. Hunter Water considers that relying on an existing and well-functioning market for these services is a more efficient arrangement than requiring Hunter Water to apply a connection charge and organising the design and installation of associated works.

¹⁵ IPART, 2018, page 67

¹⁶ Hunter Water, 2017, page 32

¹⁷ IPART, 2018, page 61

¹⁸ Hunter Water, 2017 page, 32

¹⁹ <https://www.hunterwater.com.au/Building-and-Development/Building-and-Renovating/Unserviced-Properties.aspx>



Hunter Water considers that if IPART wishes to proceed with the proposed connection charge then both the final report and final determination should make clear that it only applies where the relevant services are provided by the utility.

3.5 Minor Service Connections

Hunter Water's submission to IPART's issues paper noted that the case for applying our proposed major service connection charge as a locational signal is stronger for existing commercial properties than existing residential properties.²⁰ This is because charging the larger commercial properties for the use of existing assets would encourage them to weigh up the costs and benefits of upgrading or replacing an existing on-site facility versus connecting to Hunter Water's system.

The case for charging individual or small groups of residential properties for existing asset capacity is less clear. These properties would not significantly draw on existing asset capacity and it may be counter-productive to discourage property owners from connecting to the system where alternative onsite options are expensive or not suitable. Hunter Water would not support applying a marginal cost extension charge to these customers for the reasons outlined in section 3.4.

²⁰ Hunter Water, 2017, page 33



4 PRICES FOR UPGRADING EXISTING SERVICES FOR FIREFIGHTING

The draft report recognises Fire and Rescue NSW's concerns regarding reductions in water flow and water pressure due to development, which is impinging upon firefighting capacity.

IPART also note that there is no provision for Sydney Water and other utilities at the moment to recover the cost of infrastructure upgrades to increase water flow and pressure from the impactors (new multi-storey developments in brownfield areas) and/or the beneficiaries (both developments and existing properties).²¹

IPART propose to set a methodology to calculate a charge for upgrading existing services to existing properties to facilitate the funding of an efficient solution to improve firefighting capacity where the relevant parties agree.²² Specifically IPART propose that:

- *Where the owners of an existing property, or a group of owners of existing properties, agree to pay a capital charge to increase firefighting capacity, the charge should be based on marginal cost.*
 - *The charge would only relate to increasing the capacity of water assets for firefighting, and not to the costs of existing assets, because the owners already pay for existing assets through their periodic prices.*
- *In contrast, new developments would pay a capital charge using the incremental cost approach.*
 - *The charge would include the costs of existing assets as well as the cost of the upgrade.*
 - *While zero developer charges apply and the DSPs have not been reviewed or updated, our draft determination would allow utilities to levy the upgrade charges to new developments on a marginal cost basis. New developments and existing properties (who agreed to fund the upgrade) would contribute equally to the costs of infrastructure upgrades for firefighting, per ET.*
 - *Should the zero developer charges policy be reversed, a DSP would be remade to calculate a new developer charge, which would include the new development's share of the costs of existing assets, the costs of new assets to service the new development, and the cost of providing water pressure and flow capacity for firefighting.²³*

Urban fire protection is provided through a range of mechanisms such as:

- Building codes and requirements for on-site systems imposed through development approvals,
- Firefighting services and capabilities of Fire and Rescue NSW and the Rural Fire Service, and
- The water supply network.

The full range of mechanisms, and the interactions between them, determine the ability to mitigate the consequences of urban fires to properties and the community.

Water availability from Hunter Water's network for fire-fighting is affected by factors such as design standards for pipe sizing and pipe arrangements, hydrant spacing and access and housing density. Hunter

²¹ IPART, 2018, page 74

²² Ibid

²³ Ibid, pages 74-75



Water does not have a performance standard requirement in its operating licence with regard to fire flow in the water network. However, we have opted to use the Australian Standard AS 2419.1 as the basis for our firefighting flow design standards for new development.

There are approximately 50,000 fire hydrants within Hunter Water's water network the majority of which meet current firefighting flow design standards. We have not had the same experience as Sydney in relation to disputes over the most cost-effective means of meeting firefighting requirements associated with existing property development proposals.

However, as we noted at IPART's public hearing²⁴, Hunter Water does have some legacy issues as fire flow and pressure standards have become increasingly stringent over time. We have done some modelling and mapping work across our area of operations to identify locations where we may not be able to achieve the relevant flow under current standards and the significance of any variations.

Hunter Water considers that a productive next step would be to work with Fire and Rescue NSW to agree on priority areas and the most cost-effective way of meeting fire-fighting requirements in those locations. This process is supported by requirements in Hunter Water's operating licence to enter into and comply with a memorandum of understanding with Fire and Rescue NSW.

Hunter Water is unclear at this stage as to whether IPART's proposed voluntary upgrade charge would facilitate a more targeted approach to cost-effectively reducing firefighting risks across our area of operations.

We note that the charge would impose administrative costs and risks as it would be incumbent on the water utility to identify current and future properties that would benefit from an upgraded service and lock in their commitment to funding contributions. In the absence of appropriate regulatory drivers, there is unlikely to be an incentive for existing properties, other than those proposing some form of development, to contribute to an upgrade.

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5 REFERENCES

Independent Pricing and Regulatory Tribunal of NSW (IPART), 2017 (d), **Review of developer charges and backlog sewerage charges for metropolitan water agencies: Sydney Water Corporation, Hunter Water Corporation, Central Coast Council**. Issues Paper – Water, Oct.

Hunter Water Corporation, 2017, **Review of Developer Charges and Backlog Sewerage Charges, Response to Issues Paper**, December.

Independent Pricing and Regulatory Tribunal of NSW (IPART), 2018, **Maximum prices to connect, extend or upgrade a service for metropolitan water agencies, Sydney Water Corporation, Hunter Water Corporation, Central Coast**. Draft Report Water, June.

Independent Pricing and Regulatory Tribunal of NSW (IPART), 2014, **Opportunities for further reform: IPART's submission to the Competition Policy Review Issues Paper**, June.



APPENDIX A: HUNTER WATER RESPONSE TO IPART'S DRAFT DECISIONS

METHODOLOGY TO SET PRICES FOR NEW CONNECTIONS TO NEW DEVELOPMENTS

- 1 Maintain the key features of the 2000 methodology, which calculates capital charges, minus the reduction amount, per equivalent tenement (ET), on a net present value (NPV) basis.**

Supported – consistent with Hunter Water's response to the issues paper.

CAPITAL CHARGES

- 2 Maintain our current approach of calculating capital charge components separately for pre-1996 and post-1996 assets.**

Supported – consistent with Hunter Water's response to the issues paper.

- 3 Maintain our current approach to:**

- **exclude pre-1970 assets from the capital charge calculation**
- **not limit the period of inclusion of assets yet to be commissioned, and**
- **the criteria for exceptions to asset inclusion.**

Hunter Water's submission to the issues paper supported modifying the period of exclusion of assets from the current pre-1970 approach to those commissioned prior to 30 years from the time of the DSP review (i.e. a rolling 30 year window approach). However we accept IPART's draft decision to maintain the approach of continuing to include all post-1970 assets in the developer charges formula.

Hunter Water also agrees with IPART's draft decision to continue to not limit the period of inclusion for assets yet to be commissioned and the proposed criteria for exceptions to asset inclusion.

- 4 Maintain our current approach to including headworks assets regardless of their ownership or funding arrangements.**

Supported – consistent with Hunter Water's response to the issues paper.

- 5 Exclude the Sydney Desalination Plant's assets from headworks assets for Sydney Water.**

Supported noting the basis that the Sydney Desalination Plant currently operates as a drought response rather than a permanent water supply source.

- 6 Maintain our current approach to apportion shared assets between DSP areas using expected utilisation based on ETs.**

Supported – consistent with Hunter Water's response to the issues paper.

- 7 Maintain our current approach to valuing assets already commissioned on a Modern Engineering Equivalent Replacement Asset (MEERA) basis, and assets yet to be commissioned on an estimated efficient costs basis.**

Supported – consistent with Hunter Water's response to the issues paper.



THE 'REDUCTION AMOUNT'

- 8 Maintain our current approach to the reduction amount component of developer charges, which relates to postage stamp revenues and location-specific operating costs, for a period of 30 years.**

Supported – consistent with Hunter Water's response to the issues paper.

DISCOUNT RATES

- 9 Maintain the current differential application of discount rates to pre-1996 and post-1996 assets.**

Supported – consistent with Hunter Water's response to the issues paper.

- 10 Maintain the discount rates for pre-1996 assets at:**

- the real pre-tax rate of 3% for Sydney Water and Hunter Water, and
- the real pre-tax rate of 0% for the Central Coast Council.

Supported – consistent with Hunter Water's response to the issues paper.

- 11 Update the discount rates for post-1996 assets and for the reduction amount to the utility's real pre-tax WACC referred to in the Final Report accompanying the prevailing periodic price determination.**

Supported – consistent with Hunter Water's response to the issues paper.

- 12 Not to apply a WACC adjustment once the developer charges are calculated.**

Hunter Water supports IPART's reasons for not proposing to include an annual WACC adjustment mechanism within its developer charges methodology.

EQUIVALENT TENEMENTS

- 13 Maintain the annual consumption of an average residential dwelling as our measure of an equivalent tenement (ET).**

Hunter Water expressed a preference in our submission to the issues paper to allow the use of peaking factors in the developer charges formula. However we accept IPART's draft decision to measure ETs on the basis of an average residential dwelling's annual consumption.

- 14 Update the ET value with the consumption for an average residential dwelling referred to in the Final Report accompanying the prevailing periodic price determination.**

Supported – consistent with Hunter Water's response to the issues paper.



Prices cannot be negative

- 15 Amend the methodology so that if the calculated price is negative, it is set to zero.**

Supported.

Voluntary opt-outs are permitted

- 16 Allow utilities and developers to opt-out of the determination through bilateral agreements, subject to ring-fencing of unregulated costs.**

Supported – Hunter Water agrees that this would provide flexibility to consider additional development requirements and innovative proposals.

PROCEDURAL REQUIREMENTS AROUND DEVELOPMENT SERVICING PLANS (DSPS)

- 17 Maintain the current DSP content requirement, with minor amendments.**

Supported.

- 18 Maintain the current requirement to exhibit, advertise and consult on DSPs, with minor amendments.**

Supported.

- 19 Require a DSP review once every five years, however, this requirement can be shortened, extended or waived, as approved or directed by IPART.**

Supported – consistent with Hunter Water's response to the issues paper.

- 20 Suspend the DSP review requirement while the NSW Treasurer's direction on zero developer charges is in place.**

Supported – consistent with Hunter Water's response to the issues paper.

- 21 Provide for a transition period of up to 18 months to apply in the event that the Government's nil developer charges policy is removed, and set maximum prices to zero until the end of that period, or until the relevant utility complies with the relevant procedural requirements set out in the determination, whichever occurs earliest.**

Supported - consistent with Hunter Water's response to the issues paper.



22 Maintain our current role in approving the calculation spreadsheet and registering the DSP.

Supported.

23 Release a template spreadsheet that utilities can use, on a voluntary basis, to calculate developer charges.

Supported on the basis that the template is for voluntary use.

24 Maintain our current approach of not prescribing how the DSP areas are set.

Supported – consistent with Hunter Water’s response to the issues paper.

PRICE INDEXATION FACTOR

25 Update the CPI indexation factor for annual adjustments to prices between DSP reviews, to March-on-March quarter CPI, ABS all groups eight capital cities. prices for new connections to existing properties

Supported – consistent with Hunter Water’s response to the issues paper.

METHODOLOGY TO SET PRICES FOR NEW CONNECTIONS TO EXISTING PROPERTIES

26 Apply a uniform methodology to set maximum prices for a new service connection to an existing property.

This response to IPART’s draft report considers the implications of the proposed application of the developer charges policy to existing properties under three scenarios:

- Backlog sewerage schemes – see section 3.2
- Major service connections – see section 3.4, and
- Minor service connections – see section 3.5

In summary, Hunter Water supports the application of the methodology to backlog schemes and major service connections noting that exceptions can be sought where broader public benefits (or externalities) can be demonstrated.

Hunter Water does not support the application of the developer charges methodology to minor service connections on the basis of administrative cost and the likely disincentive it would provide for existing properties to connect to Hunter Water’s system.

Hunter Water would support the proposed marginal cost charging methodology to apply to connections to existing properties whilst the Government’s zero developer charges policy applies subject to exemptions as outlined below. Hunter Water already requires existing properties to organise and fund their connections to our system and does not offer design and construction services. If IPART wishes to proceed with the proposed connection charge then the final report and determination should make clear that it only applies where the relevant services are provided by the utility.

27 Grandfather existing backlog sewerage and minor service extension charges calculated and applied on an annuity basis under our:

- **1997 and 2006 Determinations of backlog sewerage charges, and**
- **2016 Determination of retail prices for Sydney Water.**



Supported.

28 Maintain the annuity payment option for providing a new service to existing properties. This annuity is based on:

- the discount rate set to the utility's real pre-tax WACC referred to in the Final Report accompanying the prevailing periodic price determination, and
- the annuity period of up to 20 years.

Supported – consistent with Hunter Water's response to the issues paper.

29 Calculate prices when the service becomes available. The CPI indexation factor applies to prices for connection at a later date (March-on-March quarter CPI, ABS all groups eight capital cities).

Supported.

30 Not to apply any WACC adjustment once the charge is calculated.

Hunter Water supports IPART's reasons for not proposing to include an annual WACC adjustment mechanism once charges are calculated for new connections to existing properties.

31 Make procedural requirements proportionate to the size of the scheme:

- Large-scale (township level) service extension schemes require making or reviewing a DSP, following the standard procedural requirements.
- Small scale extension schemes do not attract any specific procedural requirements and are subject to an ex-post review.

Supported.

METHODOLOGY TO SET PRICES FOR SERVICE UPGRADE TO EXISTING PROPERTIES

32 Set the price for upgrading an existing service to existing properties, on a marginal cost basis.

Hunter Water's response to this issue is provided in section 4. In summary, we support IPART's endeavours to provide a funding mechanism for upgrades to the water supply system where it is the most efficient means of achieving urban fire protection but we are concerned that introduction of the proposed charge may detract from a more targeted approach to addressing firefighting priorities within Hunter Water's area of operations.

33 Provide the annuity payment option for a voluntary upgrade of existing services to existing properties. This annuity is based on:

- The discount rate set to the utility's real pre-tax WACC referred to in the Final Report accompanying the prevailing periodic price determination.
- The annuity period of up to 20 years.

Supported if the charge is introduced.

34 Calculate prices when the upgraded service becomes available. The CPI indexation factor applies to prices for connection at a later date (March-on-March quarter CPI, ABS all groups eight capital cities).

Supported if the charge is introduced.



35 Not to apply any WACC adjustment once the charge is calculated.

Hunter Water supports IPART's reasons for not proposing to include an annual WACC adjustment mechanism once charges are calculated for service upgrades to existing properties.

36 Not to impose any procedural requirements for upgrading services for firefighting, subject to an ex-post review.

Supported.

SYDNEY WATER'S DEVELOPER DIRECT

37 Defer regulating SWDD's construction services until the 2020 Sydney Water price review.

Supported.

DRAFT RECOMMENDATION FOR STAKEHOLDER COMMENT

38 We recommend the NSW government's social policy objectives and community service obligations be provided through a contestable process.

This is essentially a matter for NSW Government consideration. Some additional comments are provided in chapter 5 of this submission.