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Chairman

Review of DEUS Developer Charges Guidelines for Water Supply, Sewerage and Stormwater
Independent Pricing and Regulatory Tribunal

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Dear Sir

Please find enclosed Port Macquarie-Hastings Council's submission to the Review of DEUS Developer Charges Guidelines for Water Supply, Sewerage and Stormwater.

Yours faithfully

Tim Molloy

Manager, Developer Contributions

Encl.

A sustainable high quality life for all

Submission By
Port Macquarie-Hastings Council

IPART Review of
DEUS Developer Charges Guidelines for
Water Supply, Sewerage and Stormwater

May 2007

1. Introduction

The discussion paper presented by IPART suggests in several places that the process of developer charges in local water authorities be more regulated and the guidelines be more prescriptive, thus removing some of the discretion the local authorities have in setting the developer charges.

Port Macquarie Hastings Council (PMHC) is of the view that such a move would be impractical and counter productive. While IPART regulates four urban water authorities, there are 100 local water authorities that vary in size, development pressures, age of assets, local conditions, environmental constraints and social objectives. It is noted that even IPART found it impossible to apply identical rules to the four regulated authorities and had to use different discount rates for pre-1996 assets (presumably to reflect the type of differences listed above).

LWAs manage a complex set of economic, environmental and social objectives. All decisions made by these authorities, including setting charges, balance these three objectives. LWAs are governed by local councillors who are part of their communities. They understand these objectives, and are best suited to ensure that they are addressed when setting developer charges.

PMHC considers that it would be appropriate to give more freedom to LWAs in calculating and setting the developer charges applicable to their areas.

2. Simplicity

The financial resources of various LWAs vary significantly and while larger utilities like PMHC are able to undertake more complex studies to determine appropriate outcomes, the resources of smaller LWAs are likely to be compromised if burdened with the additional cost of more complex methods. It is

therefore appropriate to allow different models depending on the size of the LWA and the extent of development to be served by the DSP.

Simple models may provide approximations and/or would be based on assumptions. In most cases this would be sufficient to set appropriate levels of charges. Authorities who choose to adopt simple models should be protected from the need to account for every assumption to the development industry.

3. Transparency

The exhibition process provides ample opportunity for public input into the development of DSPs, however the complex nature of the calculations and the general public's inability to understand much of the detail will lead to a feeling of a lack of transparency.

Some concerns about the lack of transparency centre around different opinions on water demand and population growth. Because of vast differences between LWAs in terms of growth and water consumption it is not considered possible to prescribe a particular method that will suit all situations and therefore there must remain some degree of flexibility to suit local situations.

Developers often engage consultants who have a good understanding of the process, and the calculation is transparent to them. The issue of transparency is more likely to occur with the general community, who in most cases are oblivious to cross subsidy that they may be providing to development.

4. Consistency of Charging Across NSW

There is a range of reasons why there is lack of consistency in charges. Many rural LWAs do not have or are not able to afford to prepare the rigorous financial modelling required for NPV of annual charges calculations. Many LWAs are also currently in different stages of water and sewer system upgrades and may not have the current need for the development of the detailed financial modelling at this stage.

Another reason could be the artificial cut off dates in the guidelines, in particular adopting 1970 as the cut off year for assets to be included in the DSP. This leads to the anomaly whereby an authority that had major assets commissioned in 1969 would levy lower developer charges than an authority that commissioned similar assets a year later. A similar issue exists with respect of 1996 as the transition year when ROI changes from 3% to 7%.

Stormwater is a major problem across all LWAs because of the lack of funding that has been applied in this area and the limited detail for the preparation of

Stormwater DSPs in the guidelines. A particular need is for the inclusion of worked examples for different stormwater scenarios. The recent Wagga Wagga Stormwater DSP provides a good example for use in the Guidelines.

5. Cost Reflectivity

High maximum charges as calculated for areas such as for Long Flat Water and Kew Kendall Sewer have been reduced to reflect the charging level of adjacent larger urban areas. If Council were to apply the maximum charge it would restrict and possibly completely stifle new development in these areas and limit council's ability to recover any of the high cost infrastructure needed to supply small isolated areas.

It is an acceptable practice in LWAs to cross subsidise backlog service areas, as servicing them would be unaffordable if financed only by the population of the backlog community. Adopting a similar concept is appropriate for developer charges, in order to keep the cost affordable.

Council's Strategic Planning Section has prepared urban growth strategies to guide future development of the LGA. These growth strategies take into account financial, environmental and social issues. Council needs the ability to balance developer charges to suit local conditions taking into account the wide range of identified issues.

6. Treatment of Cross-subsidies from Existing Development

There are two forms of cross subsidy although only one form, the cross subsidy from ratepayers to developers, currently needs to be disclosed. The other form of cross subsidy occurs between developers in different DSP areas where agglomeration of DSPs has been undertaken.

As shown above it is necessary for some cross subsidy to occur in order to provide for growth of smaller village areas and to allow some cost recovery for infrastructure. It is considered quite inappropriate for Council's General Fund to pay any cross subsidy to other funds particularly in the light of rate pegging. The financial constraints imposed on Council through rate pegging and the need for consideration of social and environmental issues highlight the need for flexibility in setting developer charges. It is noted that in the major metropolitan areas the operation of separate water authorities does not provide any opportunity for cross subsidy from general rate revenue. It is considered that any cross subsidy should come from the particular fund where the cross subsidy is occurring.

7. Backlog Service Areas

Backlog service areas were previously subject to government subsidy. In order to provide a satisfactory standard of service to NSW residents all backlog areas should have access to significant government subsidies.

Backlog service areas are not just considered to relate to small village areas but also to upgrading requirements such as environmental works, works for secure yield, guarantee of environmental flows and sewer discharge. Residents and government authorities are increasingly demanding these higher level works.

Small village areas in the Hastings area would have extremely high contribution rates if maximum charges were implemented. This would discourage any further development in these areas and restrict Council's ability to recover any of the high cost infrastructure that has been installed in these remote villages.

Refer also to comment under the heading Cost Reflectivity.

8. Inclusion of Subsidies in Developer Charge Calculations

There is an obligation under subsidy guidelines for Council to pay back subsidies over time and accordingly developer charges need to reflect the actual cost of infrastructure.

Discounting developer charges to account for subsidies would compromise the objective of providing signals regarding the cost of urban development. Discounting for subsidies would also contribute to inconsistency of developer charges, one of the concerns of the Tribunal, as subsidies have been provided inconsistently to regional areas in NSW.

Economic reasons would suggest that development pays for the assets serving the development, regardless of the source of funding.

9. Regulatory Oversight

Based upon PMHC's past experience it is considered that the current guidelines provide adequate latitude with compliance issues, together with a suitable and practical dispute resolution process. The existing dispute resolution provisions in the guidelines aim at keeping any such disputes out of the courts.

10. Developer Charges for Non-Residential Development

The NSW Water Directorate is undertaking studies to identify methods to take better account of non-residential development. These studies require considerable work and resources because of their complex nature and the variation of requirements between LWAs. Council welcomes any assistance in preparing the appropriate models that are able to work across LWAs.

11. Pre-1970 Assets

PMHC considers that pre-1970 assets should be included in assessing the developer charges when they serve new development. Removing pre-1970 assets would skew development to older possibly less efficient systems and would not reflect the true cost of business.

Council considers that MEERA is an appropriate method for valuing existing assets.

12. Future Assets

PMHC supports the IPART approach of including all assets if a nexus to development can be established.

A major problem that Council has faced in future planning is out of sequence development. Particular locations for growth are hard to predict even 5 years out and often depend on individual developers to proceed. A larger planning horizon is needed to enable Council to adjust to changing patterns of growth by delaying works and bringing forward other works depending development pressures.

13. Definition of System Assets

For Council's water supply system all mains 150mm or less are excluded from DSP calculations. For sewer, mains 200mm and below are excluded. Council is yet to adopt a stormwater DSP and has not adopted an approach for identifying stormwater assets for inclusion.

Council supports the IPART position that all future assets that service an area should be included subject to establishment of a nexus.

14. Assessing the Capacity of Assets

Council supports the establishment of consistent methodology guidelines however it is unlikely that solutions that will suit all state wide authorities are achievable. Occupancy rates for residential development and discharge rates from non residential developments will differ significantly across LWAs.

Another factor is local conditions. For example, water demand for a residential tenement is likely to be lower in the coastal area than in the inland areas of the state, and it is appropriate that the design standards adopted in Broken Hill are different than those in Port Macquarie.

There is also a problem in that there are currently many different standards in use by different water authorities.

15. Treatment of Vacant Lots

PMHC does not discount because of vacant lots. It is impractical to attempt to reliably predict the number of vacant lots every year for the next 30 years.

16. Treatment of Spare Capacity

Spare capacity is not an issue for PMHC however this could be a problem for some LWAs where efficiency of scale, or changes in standards or land use, result in spare capacity. Not charging for this capacity is consistent with the objective of providing price signal regarding the cost of urban development. The Tribunal suggestion that in such a case the authority recovers the cost twice is incorrect. The cost recovery from development is returned to the existing customers (in the form of lower annual charges) who funded the capacity that is being used by the development.

The restriction on the 30 year planning period means that costs may not be able to be recovered in a reasonable time period.

17. Valuation of Assets

A major problem faced by PMHC and other LWAs is the need for detailed environmental studies including environmental assessments that are required before any detailed design work can be carried out. The long lead times involved in such studies mean that Council will either need to make assessments based on limited data in order to make predictions for DSP calculations. Council's experience is that estimated costs in this manner results in significant

underestimation of costs compared to final construction costs even when a contingency amount is included for major capital works. For example

Water Supply S64 DSP Comparison of Estimated & Completed Costs

Project	Estimated Cost Used in 2001 DSP [\$M]	CPI cost 2006/07 adjusted 2006/07 Costs [\$M] ¹	Final 2006/07 Construction Costs [\$M]	Cost increase (over CPI adjusted)
Rosewood Water Conditioning Plant	1.4	1.59	1.82	14%
Wauchope Water Treatment Plant	13.76	15.62	24.912	59%
Telegraph Point Water Treatment Plant	0.92	1.04	2.61	151%
Comboyne Water Treatment Plant	0.765	0.87	2.52	190%
Long Flat Water Treatment Plant	0.62	0.7	2.21	216%
Totals	\$17.47	\$19.82	\$34.07	72%

¹ 13.5% increase (CPI Sydney 2001/02 to December 2006)

PMHC has used the best available estimates to value future assets. Design reports were used where available, and NSW Reference Rates or engineers' estimates were used for other works. It is considered that these are efficient costs, and therefore no different from IPART methodology.

Design reports typically include a contingency allowance of 15-30%, depending on the stage of the project. NSW reference rates include a 10% contingency.

From the above table it appears that these contingency allowances may be insufficient.

A major problem facing PMHC and other LWAs is escalating costs. The Guidelines only allow increasing charges at CPI. PMHC considers that a more appropriate index would be the Output of General Construction Index to keep abreast of escalating costs for proposed works. It is noted that over the passed 9 years Sydney CPI has increased by 27.65% while the Producer Price Index for Output of General Construction has increased by 44.23%.

18. Agglomeration of DSPs

Pricing should not be the only factor when considering agglomeration. An important factor is environmental issues and the need to encourage development in a sustainable fashion. Council needs the ability to take economic reality into account with other issues in balancing costs and cross subsidies to achieve a fair result for the local community.

The major growth area to the west of Port Macquarie will have the latest environmental safeguards including dual reticulation. The development of this area will provide upgraded sewer treatment and ultimately better environmental outcomes for the Port Macquarie community and for the environment. Council needs to be able to set appropriate contribution levels that will encourage development of this area to enable better environmental outcomes to be achieved. If significantly higher charges were adopted for this area development may be encouraged in less environmentally sustainable areas.

It is noted that the Director General has previously issued a circular allowing optional agglomeration of all DSPs. However this provision has been omitted from the IPART discussion paper.

19. Calculation of the Capital Charge where lot take up is non-uniform

PMHC has no objection to NPV approach, however as previously noted there needs to be a range of options to account for smaller LWAs resources.

As discussed previously (under the heading Future Assets), particular locations for growth are often hard to predict. Reliable prediction of take up rate is extremely difficult.

As discussed previously (under the heading Future Assets), particular locations for growth are hard to predict. Reliable prediction of take up rate is considered impossible.

20. Calculation of the Reduction Amount

LWAs set their annual charges and their developer charges. The DEUS method recognises the interdependency of these two elements. Therefore, the DEUS method is more suitable for unregulated authorities than the IPART method.

21. Equivalent Tenements

LWAs need to be able to determine ET, because of the wide variation in water usage between non residential uses, and in particular industrial uses, in different localities. However PMHC recognises the need for more detailed guidelines being established on how LWAs should calculate ET.

PMHC agrees that the DEUS guidelines are not sufficiently explicit about the determination of ETs. The Water Directorate attempted to fill the gap with its ET guidelines (which are being updated). However, as discussed throughout this submission, flexibility should be provided to LWAs in setting the ET policy appropriate to their business.

PMHC considers that LWAs should be able to prepare their own ET policy, or use the Water Directorate's guidelines.