

15 August 2008

Review of developer charges for metropolitan water agencies
Independent Pricing and Regulatory Tribunal
PO Box Q290
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By e-mail: ipart@ipart.nsw.gov.au

Dear Sir/Madam

The Urban Taskforce represents Australia's most prominent developers and equity financiers.

We welcome parts of the NSW Independent Pricing and Regulatory Tribunal's draft determination consequent on the tribunal's review of developer charges for metropolitan water agencies.

In particular, we are pleased to see a 20 per cent cut in charges on new homes levied by Sydney Water and a 7 per cent cut in the wastewater charges imposed on new homes by Hunter Water.

We're also pleased that the Tribunal has accepted some industry criticism about the way developer charges are calculated.

The Tribunal's proposal will offer some relief for homebuyers. Excessive infrastructure charges have made it almost impossible to build homes in vast swathes of Western Sydney. High charges in the Hunter have threatened the supply of new homes in the region. Boosting the supply of new homes is crucial if we're to get relief from the current rental squeeze.

The proposed reductions are a sensible recognition that charges have been too high for some time. The Tribunal is right to accept that assets built as long ago as 1970 should not have to be funded by home buyers in 2008. We also welcome the proposal to price water assets based on their actual cost, rather than their replacement value. Sydney Water in particular has been recovering far more than it needed to from charges on new homes.

However we do have some serious concerns with some elements of the Tribunal's draft determination.

Funding of headworks

New home buyers should not be singled out to subsidise major infrastructure investments like the Sydney desalination plant and Hunter's Tillegra Dam through increased development servicing plan (DSP) charges.

Sydney Desalination Plant

We note and agree with comments made by Sydney Water on page 86 of their *Submission to the IPART Review of Prices for Sydney Water Corporation* (14 September 2007).

Sydney Water has submitted that it is not appropriate to recover the costs of the desalination project from developer charges because the plant is to secure the water supply for all customers – new and existing – during low and variable rainfall and severe and sustained droughts, possibly related to climate change. They argued (and we agree) that it is not practicable to separately identify a component related to growth from that of security.

Furthermore Sydney Water correctly argued that if desalination costs are included in developer charges, customers would be required to make an up-front contribution to the cost of the plant even if they choose an alternative supplier of bulk water in the future. The increasing supply of recycled water for uses other than drinking is also important.

Hunter's Tillegra Dam

In the NSW Government's Hunter Regional strategy (an extract of which is attached) that was released before the government announced plans for Tillegra Dam, it was claimed that there is sufficient water for the anticipated growth set out in the strategy. The need for a dam is not suggested.

Hunter Water's current water storage capacity is 287,515 megalitres contained at Chichester Dam, Grahamstown Dam and Tomago/Anna Bay Sandbeds.

During the last 10 (dry) years storage has averaged about 80 per cent. The capacity of the proposed Tillegra Dam is 450,000 megalitres which is a 157 per cent increase on the current storage capacity. Attached are a few pages from the Lower Hunter Regional Strategy which indicate that the Tillegra Dam is not required to meet the water demands of the expected development growth between now and 2031.

Like Sydney's desalination plant, the Tillegra Dam is about securing the water supply for all customers – new and existing – during low and variable rainfall and severe and sustained droughts. To the extent that the Tillegra Dam exists to deal with growth, it can only be for growth that is anticipated after 2031. Recovering for the costs of such growth from developments that occur before 2031 would be nonsensical.

Growth costs should be shared by all

In any event – even if – despite all the evidence – the IPART decided that some part of the headworks could be attributable to a 'growth component' we do not think that any of this cost should be recovered from DSP charges.

Any increased developer charge imposition will flow through to the homebuyers (or, if this is not possible, prevent land from being developed, which in turn will place upward pressure on regional property prices). Conventional economic thinking followed by IPART is that higher developer charges lead to lower prices being received by the original owners of undeveloped land, however this argument ignores the following facts:

- In locations such as the Hunter and Western Sydney many developers have already acquired the land and factored in all the charges known about at the time of purchase – in these cases it is too late to adjust the price paid to landowners, yet the development cannot proceed unless the necessary internal rate of return can be earned.
- There is a natural floor to land prices, below which the owners of undeveloped land will not accept. This floor does, in part, reflect the opportunity cost for other uses of the land – such as rural lifestyle blocks. The floor is also driven by the long-held expectations of those land holders. Even though those expectations may not be realisable in the short term,

these land holders are very patient, hold minimal debt and originally acquired the land at very low prices. They tend to have no difficulty in waiting for prices to rise to the level consistent with their expectations.

- The production of new urban land is a highly regulated activity and many of the normal market forces do not apply because of the command and control approach of planning authorities. Large areas are unable to be developed because of legal restrictions imposed by the planning system. Land tends to be drip fed by the planning system into the market. If it is not economic for the land that has been 'released' to be developed the planning system does not normally respond by releasing more land. Instead planning authorities blame 'the market' and say that we all have to wait for the next boom when they assume the 'released' land will become economic once again. This essentially means that home buyers must pay for more than they should and wait longer than they should in order to access the newly developed land.

In theory, everyone pays for their water at the same rate – in Sydney this is \$40 a month for a modest level of usage. It's called 'postage stamp' pricing. The system of 'postage stamp pricing' is an illusion because homebuyers in new housing areas have to borrow a lot more money to cover the cost of connections to the water grid (i.e. DSP charges).

A homebuyer may have to borrow an extra \$10,000 to cover the cost of Sydney Water charges that are passed onto them when they buy a new home. This could mean they have to repay an extra \$31,000 in loan repayments over the life of the loan, or an extra \$85 a month. This homebuyer will effectively be paying three times as much for their water usage, when compared to a home owner in established housing.

It means that someone who buys a federation home in North Sydney, or a 19th century Paddington Terrace, is only paying a third of the water costs faced by a new home buyer in North Richmond.

Costs associated with the growth of the State's population are a burden that is shared by everyone - not just those whose need for housing sees them buying properties built in the new suburbs of metropolitan areas.

Development (DSP) charges imposed by water utilities are often \$10,000 or more per home. But, as Sydney Water itself admits, had they not received any developer charges since 2000-01, annual prices for water and wastewater would only be around two per cent higher than presently charged.

Higher infrastructure charges also lead to a more inefficient economic outcome because land which is reasonably well located to infrastructure, ironically, is the land least able to afford to bear higher developer charges. This is because the location of this land - and its anticipated favourable treatment by the planning system - has been factored into land prices for some time.

As charges for headworks would rarely reflect the true costs of developing a given parcel of land (and are uniform across land of different value and characteristics), more expensive well located land is less likely to be developed when such a blanket infrastructure charge is introduced or increased.

On the other hand, some land that is not as well located to infrastructure, may have been acquired at lower prices and therefore may still be developable when uniform infrastructure charges are increased. Hence the imposition or increase of uniform infrastructure charges for headworks leads to an inefficient outcome: the land that should be developed is not able to be developed; but cheaper land located further away from infrastructure may still be able to be developed.

To illustrate this point in relation to Western Sydney, the Urban Taskforce prepared a schedule showing development costs and how infrastructure charges made development economically unviable in Western Sydney. This was included in our submission lodged on 31 January 2008 (page 8, Table 1) in an earlier stage of the IPART review

There is no good policy reason why the purchasers of newly-built homes should be particularly responsible for the economic costs of growth. In many cases such purchasers will be existing residents of the region who have re-located. They are no more responsible for growth than others in the community. By making them pay for the cost of growth through higher home prices, they will be bearing a disproportionate share of the burden, because they will, in effect, be paying twice. Once through DSP charges (passed onto them through higher prices) and secondly, through their water usage charges.

Land acquisition costs

We do not support the IPART's proposal to expand the scope of DSP charges to permit the recovery of land acquisition costs. The NSW Government has just completed a process where it endeavoured to narrow the range of matters which could be subject to State and local council infrastructure charges. It is contrary to the government's policy efforts to now expand DSP charges to recover the costs of something that has never before been the subject of DSP charges.

There are good reasons why the costs of land acquisition should be treated different from the costs of plant. Unlike plant, the value of land generally rises. Plant has a limited useful life, but land, once it is no longer required by a water utility may be sold at a significant profit to the utility concerned.

If a utility was able to recover the costs of land acquisition it would be able to unjustly enrich itself, by acquiring land, recovering the cost of land acquisition from developers, and later disposing of the land at a profit, pocketing the entire proceeds. **There would be a perverse incentive for utilities to acquire more land than actually needed, in order to later dispose of surplus land.**

Wyangong Council

The Tribunal's proposal to remove a cap on charges for Wyong Council will increase the cost of new homes in the area between 2009 and 2012.

IPART has not properly quantified the implications of this proposal. Indeed, as levels of underlying demand are strong and the main reason for demand not being met is because of a high cost base, a further increase in the costs of producing new housing in Wyong will aggravate the current supply shortfall in the region.

Discretion for the government to adjust DSP charges downward

With respect, it is possible for an IPART determination on DSP charges to result in perverse, distortionary and unintended outcomes. This can occur because of an unforeseen complexity or an unexpected change in market conditions.

At present, there is a capacity for the government to avoid perverse outcomes by exercising a discretion to lower DSP charges below that level set by IPART. At present shortfall in funds is recovered from water and wastewater charges generally.

IPART's proposal that, in future, lost revenue be taken from the profit paid to the government – and therefore from the State Budget – will effectively remove the ability

of the government to lower DSP charges to address unforeseen circumstances. If the government is forced into choosing to support the production of new homes, or cut health funding, it will generally favour maintaining health funding. If the IPART proceeds with this proposal it will reduce the flexibility that is necessarily part of the system.

Thank you for the opportunity to comment on your draft determination.

As always, we are available to discuss any aspect of our submission or your draft determination.

Yours sincerely,

Urban Taskforce Australia

A handwritten signature in black ink that reads "Aaron Gadiel". The signature is written in a cursive style with a long horizontal stroke at the end.

Aaron Gadiel
Chief Executive Officer