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Dr Michael Keating
Chairman
The Independent Pricing and Regulatory Tribunal of NSW
Level 8, 1 Market Street
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By e-mail: ipart@ipart.nsw.gov.au

Dear Dr Keating

Re: IPART Review of Developer Charges

I attach Alinta's submission in response to the Tribunal's Water Issues Paper entitled "Review of developer charges for metropolitan water agencies" released in November 2007.

Should you wish to discuss this submission, please contact Warwick Tudehope on (02) 9270 4551.

Yours sincerely

A handwritten signature in black ink, appearing to read "Sandra Gamble".

Sandra Gamble
Group Manager Regulatory



IPART Review of Developer Charges for Metropolitan Water Agencies

Submission

This submission by Alinta LGA Ltd (Alinta) is made in response to the Tribunal's Water Issues Paper entitled "Review of developer charges for metropolitan water agencies" released in November 2007.

Alinta LGA Ltd is owned by Singapore Power International Pte Ltd (SPI) which, together with Babcock & Brown, purchased the assets of the former Alinta Limited in 2007. Those assets include Alinta Limited's interest in the Rosehill/Camellia Recycled Water Project and other water infrastructure developments. In late 2007, a joint venture of SPI and Babcock & Brown, together with Veolia Water Australia, was selected as the preferred tenderer to build own and operate the Rosehill/Camellia Recycled Water Project.

Summary:

Alinta's primary position on developer charges is that they should be eliminated or at least calculated in such a way that they become the exception rather than the rule. Endemic developer charges subvert the Governments' policy of maintaining postage stamp pricing for essential water and wastewater services and are inconsistent with the Government's key priority of improving housing affordability. Even if developer charges were phased out completely, usage charges would have to rise by only a modest amount to compensate. Directionally, elimination of developer charges would also assist in promoting the conservation of potable water and improve the viability of substitution options such as water recycling if the consequent increase in usage charges was taken up in per kilolitre consumption charges.

Once the Water Industry Competition Act 2006 (the WICA) is proclaimed it will be possible for businesses other than the incumbent agencies to provide water and wastewater services. If developer charges are to continue then they must be available to WICA licensees as well as to incumbent agencies. That must be the case irrespective of whether the licensee is a declared monopoly service provider under the WICA.

Developer charges and Government Policy:

The Government's established policy is that postage stamp pricing should be maintained for essential water and wastewater services within the service area of each incumbent water agency.¹ That is, within a service area, the same kinds of customers are charged the same price for the same service. As the Tribunal observes, a significant shortcoming of postage stamp pricing from an economic standpoint is that it fails to signal the diversity of costs of providing water, sewerage and stormwater services in different locations.² The result is that consumers in those areas where the cost to serve is low pay more than their allocated share of costs and those where the cost to serve

¹ See, for example:

- o NSW Government, *Consultation Paper: creating a Dynamic and Competitive Metropolitan Water Industry*, May 2006, p1 and
- o Water Industry Competition Act 2006, s41(3).

² IPART, *Review of developer charges for metropolitan water agencies – Issues Paper*, November 2007, Appendix D.1.

is high pay less. Sydney Water estimates the contribution by residential properties served by the large [lowest cost] coastal sewer networks to be at least \$80 per property per year.³

It is Alinta's understanding that the transfer between consumers in low and high cost areas under postage stamp pricing is not a cross-subsidy in economic terms.⁴ Sydney Water's analysis of the composition of developer charges (Figures 3.6 and 5.1 in its submission) shows that, on average, current and projected tariffs will more than cover the capital and operating costs directly attributable to new developments. That is, there is no cross-subsidy under current postage stamp tariffs, and removal of developer charges would not result in new developments being cross-subsidised.

The Tribunal characterises its approach to developer charges as redressing some of the shortcomings of postage stamp pricing by allowing differential charging to different development areas.⁵ While that may be the case, the charges are in practice calculated to recover costs on a "user pays" or "cost reflective" basis and would therefore appear to subvert the principle of postage stamp pricing.

Along with other up-front charges levied on new developments, developer charges add to the cost of new housing thereby contributing to a more general signal not to build at all. It is also arguable that up-front charges levied on new developments act to inflate the cost of real estate generally. The effect of up-front charges on new housing affordability has been recognised by the Lemna Government which recently announced reductions in Government charges stating that "Improving housing affordability is a key priority for [the] Government".⁶

Are developer charges necessary and effective?

The Tribunal describes the functions of developer charges as:

- ? "recovering the costs of providing water-related infrastructure to new developments
- ? signalling the costs of developing in a particular area
- ? passing some of the risk associated with the cost of infrastructure provision to developers, and
- ? achieving other pricing objectives such as economic efficiency, transparency and equity."⁷

These points are addressed in turn below.

- ? The costs of providing water-related infrastructure to new developments could equally be recovered through postage stamp usage charges.
- ? It is not clear that Sydney Water's developer charges have any significant effect on development decisions. Sydney Water observes in its submission that, developer charges are among a number of factors that contribute to the cost of development and, "[when taken together with those other factors] Sydney Water's developer charges alone are not likely to

³ See Sydney Water, *Sydney Water Submission to IPART: Review of Developer Charges*, December 2007, p18.

⁴ A cross-subsidy exists where some consumers pay less than their avoidable cost of supply or more than their stand-alone cost of supply.

⁵ IPART, *op. cit.*, p37.

⁶ NSW Government, Department of Planning, *Levies on New Homes Slashed to Improve Housing Affordability*, Media Release, 12 October 2007.

⁷ IPART, *op. cit.*, Appendix D.1.

have a great influence on where development occurs.”⁸ Moreover, once paid, the charges are sunk and are lost as an indicator of locational costs.

Irrespective of whether the charges influence where development occurs, they add to the overall cost of development and in that sense contribute to a signal not to build at all. The Government has recognised this as a policy issue and responded by reducing up-front Government charges.

- ? Managing the risks of water infrastructure provision is the core business of the incumbent water agencies. It is not the business of developers.
- ? As noted previously, the Government’s established policy is that postage stamp pricing should apply to the provision of essential water and wastewater services.

The effect of developer charges is that the transfers between low cost and high cost areas are reduced and postage stamp usage charges are lower than they would have to be if developer charges were not levied. This makes some economic sense however, given Government policy, developer charges can only deal partially with the cost disparities that exist. On the other hand, if developer charges were eliminated consistent with the direction of Government policy, the cost would be modest. Sydney Water estimates that, if developer charges had been eliminated since 2000-01, usage charges would now be approximately two per cent higher than they are.⁹

An alternative view of developer charges is that they are simply a means of reducing the agency’s capital requirements thereby suppressing usage charges. Under current calculation principles, lower usage charges lead to higher developer charges that in turn result in still lower usage charges. Alinta is not equipped to analyse how this circularity will play out. The level of developer charges may converge on a stable value. Alternatively, the circularity could lead to developer charges funding an increasing proportion of the agency’s capital expenditure on growth over time.

In Alinta’s submission, a developer charge should be imposed only where necessary to avoid an economic cross-subsidy to the development i.e. only where, in the absence of a developer charge, the development would contribute less than its marginal cost of supply, where marginal cost would include direct costs as well as the present value cost of any acceleration of expenditure on future network augmentation that is necessary to service the development.

The Water Industry Competition Act:

Developer charges are presently payable to incumbent agencies i.e. Sydney Water Corporation (SWC), Hunter Water Corporation (HWC), Gosford City Council and Wyong Shire Council. Once the Water Industry Competition Act 2006 (the WICA) is proclaimed it will be possible for businesses other than the incumbent agencies to provide water and wastewater services. Alinta agrees with the Tribunal that “the developer charges methodology needs to be applied in a balanced way to both incumbent water agencies and any new monopoly suppliers [i.e. suppliers who are licensed under the WICA and declared by the Minister to be monopoly suppliers under s51 of the WICA].”¹⁰

It is important to note that not all WICA licensees will be declared monopoly suppliers. If developer charges are to continue then a mechanism must also be established to enable undeclared WICA licensees to receive that part of any developer charge collected by the incumbent that relates to

⁸ Sydney Water, op. cit., p4.

⁹ Sydney Water, op. cit., p8.

¹⁰ IPART, op. cit., p12.



services provided by the WICA licensee. As a related matter, there should also be a mechanism whereby a WICA licensee can receive the benefit of any avoided costs in the incumbent's system that are attributable to the licensee's activities, especially in circumstances where the incumbent would have been credited with those savings if it had undertaken those activities instead of the WICA licensee.

Alinta LGA Ltd, January 2008.