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30 January 2008

Independent Pricing and Regulatory Tribunal  
PO Box Q290  
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Email: [ipart@ipart.nsw.gov.au](mailto:ipart@ipart.nsw.gov.au)

Dear Sir or Madam:

## **REVIEW OF DEVELOPER CHARGES FOR METROPOLITAN WATER AGENCIES**

We refer to your invitation for submissions on developer charges for metropolitan water agencies closing on 1 February 2008. This submission comments on Sydney Water's charges only and follows from a previous submission made to Sydney Water dated 9 October 2006 (copy attached).

All of the issues raised in our 2006 submission are still current and have not yet been addressed. Following a briefing held by Sydney Water with the development industry representatives on 16 January 2008, we understand that Sydney Water would like to address some of our concerns. The key strategies of their proposed approach are to:

1. Remove the 'operating result' component from the formula for calculating developer charges
2. Change the capital charge to reduce the weight given to past investment and increase the weight given to future investment

Strategy 2 is supported by Mirvac.

Strategy 1 is not supported as it is appropriate to reduce the required developer charges to allow for the future income that will be created by the assets provided. Problems arise when the catchments are too small and due to 'postage stamp' pricing and other issues raised in our previous submission, operating deficits occur. These deficits are then factored into the developer charge.

Since the revenue (water rates) for Sydney Water is set on a system wide basis ('postage stamp pricing'), it is appropriate that the Development Servicing Plan (DSP) is also determined on a system wide basis. The operating result should also be included in the calculation of developer charges at a system wide level.

A further workshop was held with Sydney Water on 24 January 2008. At that workshop, a number of preliminary methods were trialled for calculating the developer charges. The existing charges, charges proposed by Sydney Water and the results of these trials requested are presented in Table 1.

**Table 1 Water and Waste Water Developer Charges**

Scenario	Water Developer Charge / ET	Waste Water Developer Charge / ET
<b>1 Existing</b>	\$0 - \$9800	\$0 - \$19,500
<b>2 Sydney Water Proposal</b> Remove 'operating result' and weight capital charge toward future rather than past expenditure	\$250 - \$4000	\$800 - \$12,000
<b>3 Combine DSP Into 4 Areas Using Existing Methodology</b>		
<u>Water</u>		
Macarthur	\$866	
Potts Hill	\$246	
Prospect East	\$824	
Prospect North	\$981	
<u>Sewer</u>		
Malabar		\$1500
Cronulla		\$916
Northhead		\$1450
Bondi		\$1169
<b>4 Combine DSP Into Single Area Using Existing Methodology</b>	\$632	\$1310
<b>5 Combine DSP Into Single Area Using Existing Methodology with Operating Result Excluded</b>	\$2500	\$5200
<b>6 Combine DSP Into Single Area Using Existing Methodology with Capital Charge Reallocated as per SWC proposal</b>	\$872	\$2800

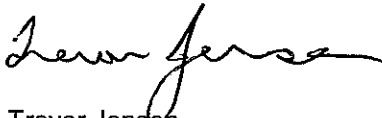
As shown in Table 1, there is a large variation between charges calculated under the existing method of calculating developer charges. The discrepancies favour the established areas which have a far lower charge than the growth areas in western Sydney. This issue is discussed further in our previous submission.

Sydney Water's proposal (Scenario 2) achieves some redistribution and levelling of the developer charges. The combination of removing the operating result and reallocating the capital charge calculation achieves this. However we consider that this method essentially 'fudges' the result and believe that it is more appropriate to combine DSP areas into 4 or preferably a single area as demonstrated by scenarios 3 & 4.

We recommend that Scenario 6 be investigated further.

To assist IPART in your review of submissions we have included a response to each of the questions posed by the invitation (see Table 2 attached). We would also like to be involved in any workshops between Sydney Water and IPART to review the charges.

Yours faithfully

A handwritten signature in black ink, appearing to read "Trevor Jensen". The signature is fluid and cursive, with a long horizontal stroke at the end.

Trevor Jensen  
Development Director  
Mirvac Homes

**Table 2 Issues for Response**

Issue	Response
1 What is the preferred date for adoption of revised DSP's and charges? Agencies should provide reasons for their choice preferred date of adoption.	No comment
2 Is there benefit in having one developer charge determination covering both recycled water services and water, sewerage and stormwater services?	Yes, providing calculations are transparent. Developer charges should be calculated for entire system as a single system as recommended in our correspondence. Also need to ensure that appropriate concessions are made when water reduction features are included in developments such as stormwater and grey water reuse systems.
3 Should the changes introduced in the recycled water developer charges determination (eg rate or return) be applied more broadly to developer charges for water, sewerage and stormwater services?	The policy of including a rate of return needs to be reviewed, particularly when it is applied retrospectively. See comments provided in our submission dated 9 October 2006.
4 Are there advantages or disadvantages if IPART was to provide additional regulatory oversight either before or after adoption of the DSP's and charges?	Additional regulatory oversight should be provided, but at a system wide level. Combining the all DSP's into 1 plan would mean that additional oversight can be provided.
5 Are there advantages or disadvantages if IPART to develop, in conjunction with the water agencies and peak development bodies, a standard calculation spreadsheet?	Yes there are advantages. See comments for Issue 4.
6 What issues may arise in the application of developer charges in light of the <i>Water Industry Competition Act 2006</i> ?	No comment.
7 Is an adjustment required to Wyong Shire Council's water and sewerage developer charges to exclude a stormwater revenue component pending Wyong Council satisfying requirements for the imposition of a separate stormwater charge?	No comment.
8 Whether particular DSP boundaries result in distortion of the associated developer charge?	As documented in this correspondence, DSP areas should be consolidated significantly, possibly to one system. If separate DSP areas are required, they should be divided into 4 areas as described by Scenario 3 as described in Table 1.
9 What principals for determining where DSP boundaries should be established?	See comment for Issue 8.

Issue	Response
10 What information do developers need on asset capacity to assess the calculation of charges?	Total transparency is required and all of the data should be made available. The data that is used to calculate developer charges should be consistent with Department of Planning population projections.
11 What information on assets values is needed by stakeholders to improve the transparency of the process?	Actual cost information.
12 What is the most appropriate method that agencies can use to supply this information?	The internet. However, documents published need to be legible. Significant parts of Sydney Water's current DSP's are not legible when downloaded. An online database should be established that allows anyone to drill down to the level of information sort. Excel spreadsheets are inefficient and prone to errors when dealing with this volume of data.
13 Whether developers and other users of asset information are satisfied with the asset information currently being provided by water agencies?	The asset information as currently provided cannot be reviewed without the cooperation of Sydney Water. The assets that are considered under a DSP should 'roll' and be considered to be paid off after a certain period of time. For example, the assets that were included as part of the DSP's in 1996 were only those from 1970 onwards. Now in 2008, assets built before 1982 should not be included as part of a DSP. Also some specification needs to be included in the DSP as sizing can change at the discretion of SWC staff. Any upsizing should be funded by SWC, not through developer charges.
14 What asset information is considered necessary but not currently provided by agencies to ensure that assets are apportioned correctly?	If it proposed to continue with the current number of DSP's with such a wide variability in charges, an online mapping tool and database should be established to allow review of DSP calculations at any level of the system and for any asset. We suggest that an alternative better approach would be to greatly reduce the number of DSP areas as discussed in Issue 2.
15 Are there arrangements in place for funding developments that fall outside IPART's current developer charge determination?	Yes. We currently have issues Hunter Water applying a capital contribution charge for recycled water in an area that they do not yet have a DSP. This issue is currently in dispute and we would be happy to discuss this further if IPART feels that it is appropriate. HWC have refused arbitration on this issue.
16 What are the advantages and disadvantages of using MEERA as the method of value assets?	Actual cost figures should be provided and used for the calculation of charges, particularly any charges applied to existing infrastructure. The MEERA values used encourage over engineering.

Issue	Response
17 What methods or guidelines should be adopted to achieve an appropriate and consistent way of determining the drivers of proposed water supply headworks expenditure?	In order to establish appropriate apportionment of a new asset to developer charges, the existing system capacity should be known and published as part of the DSP. If an asset or upgrade is required to benefit all, then the costs should be shared appropriately between development and existing Sydney Water customers. In short, developer charges should only cater for new growth, not existing system upgrades.
18 Why have operation and maintenance costs increased significantly in some DSP areas?	See recommendation in main letter
19 Are there alternative mechanisms for signalling differences between different development areas?	See recommendation in main letter
20 How and why do agencies use ET peaking factors to calculate, and ultimately to allocate, the capital charge and reduction amount?	ET's are ok to use provided they are consistent and allow for reduced demands where appropriate.
21 Is a new definition of ET's and/or re-expression of the developer charges formula required to incorporate use of peaking factors?	No, it just needs to be consistent.
22 What problems exist with the current treatment of ETs in DSP's?	No comment.
23 What improvements could be made to the methodology regarding the treatment of ETs?	No comment.
24 How should agencies determine the ET multipliers for varying development types?	ET multipliers should be consistent across agencies for various development types and they should cater for water saving measures such as Basix and grey water reuse.
25 What are appropriate discount rates for pre-1996 and post-1996 assets?	When discount rates are applied retrospectively, they add costs. Developer charges should be based on actual costs outlaid. It is not appropriate to ask home purchasers to pay for assets through developer charges and then apply a retrospective commercial return to a government agency. Once an asset is created, no discount factors should be applied to that asset.
26 Should the 1996 threshold roll forward over time?	Yes. See issue 13.

Issue	Response
27 For each agency, what is the current consumption (in kilolitres) for both pre and post BASIX average residential dwellings? In addition, on what basis should the consumption parameter be calculated when DSP's are reviewed? (For example, should the consumption parameter be set using recent data or using an average over a longer period?)	Sydney Water should be able to provide consumption figures. A reduction in usage should obviously equate to reduced charges. This did not occur in the last DSP review by Sydney Water, indicating a flaw in the methodology for calculating developer charges.
28 Should there be two consumption parameters: one for pre-BASIX ETs and one for post-BASIX ETs, or a post-BASIX only?	In general yes. There should also be a mechanism to further reduce charges if a genuine water saving can be demonstrated.
29 Has reduced consumption in post-BASIX developments been reflected in the allocation of assets in water systems and therefore reflected by reduced capital charges?	No. See issue 27.
30 Are there any additional impacts from BASIX or recycling initiatives on developer charges for water supply (including recycled water), sewerage and stormwater?	No comment.
31 What are the impacts that the 85 per cent cap on developer charges has on Wyong Council's business?	No comment.
32 What are the possible impacts of removing the 85 per cent cap on Wyong Council's charges?	No comment.
33 What methods are used by agencies to estimate existing and growth ETs from demographic data?	Department of Planning population projections should be used.
34 Is the dispute resolution process working satisfactorily, and if not, what changes are required?	No. There is a view in Sydney Water that the charges are set by IPART and unable to be changed once adopted. Section 31 needs to be better understood by Sydney Water personnel. See also comments on Issue 15.

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9 October 2006

Manager Urban Growth  
Sydney Water  
115-123 Bathurst St  
SYDNEY NSW 2000

Att: Tom Gellibrand

Dear Sir

**Re: SYDNEY WATER PROPOSED DEVELOPMENT SERVICING PLANS**

We write to comment on the draft Development Servicing Plans (DSP) recently exhibited by Sydney Water. Information contained in our submission is based on the Developer Briefing Session held with Sydney Water on 16 August, a detailed review of the Liverpool Water System DSP and a meeting with Sydney Water regarding the financial model on 21 September 2006.

We note that, due to our ongoing discussions with Andrew Jackson regarding the financial model, Sydney Water has granted an extension for Mirvac to lodge our submission until 9 October. We were hoping to further resolve some of the model issues prior to making a submission, however we are still awaiting a response from Sydney Water on questions and comments on the model provided by email on 26 September 2006. This submission reflects our current understanding of the issues.

Our comments are provided in two categories:

1. Equity Issues
2. Financial Model Issues

### **EQUITY ISSUES**

We understand that issues related to equity may be more appropriately discussed with IPART than Sydney Water. However, Sydney Water has significant input in determining the IPART ruling and therefore we believe it appropriate to provide these comments to Sydney Water.

The most important point is that Sydney Water are calculating DSP's on a catchment by catchment basis, yet rates income is fixed across the Sydney Basin. This is leading to inequities between the operating revenue and costs that are being absorbed into the DSP charges, particularly in new areas in the west of Sydney.

Thus, if there is an operating funds deficit, it needs to be questioned why Sydney Water's operating revenue and expenses are being incorporated into the calculation of DSP charges.

In the case where operating expenses exceed revenue (a deficit) it is inappropriate to collect the shortfall (for 30 years!) as a developer charge. This is particularly so for development in some of the newer greenfield areas that include homes with Basix and which have higher operating costs for treatment plants. In these cases the operating revenue needs to be reviewed, either for the particular catchment or across the entire Sydney Water Area.

In the case where revenue exceeds expenses, it is fair that the DSP charge is reduced as Sydney Water is being given assets from which they will profit.

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We also question whether the operating surpluses of established areas are fed back into reducing Developer Charges right across the Sydney basin.

Effectively, it appears that Sydney Water are using DSP's to top up those catchments where there is a shortfall, but they are not distributing the surpluses where they exist. This inequity favours established areas and penalises growth and inland areas.

## **FINANCIAL MODEL ISSUES**

A detailed review has been undertaken on the Liverpool Water System Draft DSP. A meeting Sydney Water's Andrew Jackson and Kate Powell on 21 September clarified many issues in relation to the model. The key outstanding issues are:

1. Apportionment of previous capital expenditure to future development
2. The application of discount rates to previous capital expenditure

Each of these issues is discussed below.

### **1. Apportionment**

We understand that the Liverpool Water System DSP model was first applied in 1996 and that assets were accounted for back to 1970, with population growth until 2025 used to calculate appropriate contributions. This assumption effectively states that assets required by new population are paid for over a timeframe of 55 years.

The model now takes the 2006 population and projects it to the year 2035, while the assets are still being discounted from 1970, extending the payback timeframe to 65 years. The model now calculates that the new population should pay 31% of all assets built prior to 1996 and 100% of assets post 1996. This factor is reduced in the model by the proportion of population growth from 2006 onwards (51%).

These apportionments are further complicated in the model by applying "Net Present Values" to populations. We currently believe that these formulas are applying higher than appropriate costs to the future population.

In order to assist our understanding of the appropriate DSP charges, a basic model of the Liverpool Water System DSP was prepared for the asset component of the DSP charge. The model examines all assets that are applicable only to the Liverpool System and is shown as Attachment 1.

The following criteria were used in the development of the basic model:

- Assets and Capital Expenditures were extracted from the Liverpool DSP
- It was assumed that all new population since 1970 pay for 100% of the assets in the DSP, which is valid providing all of the assets are only used within the DSP area
- All calculations were done using the "Maximum Demand ET" which is approximately correct because most of the assets in the example calculation use this demand regime.

The basic model calculates three contributions as shown in Table 1 below.

**Table 1 Basic Model Comparison with Liverpool Draft DSP**

Calculation	Charge (\$/ET)
Draft Liverpool Water System DSP Charge for "Water System Charge"	\$3,696
Scenario 1 – "Simple Calculation", no discounting of asset values or population. Total Capital Expenditure (Capex) 1970 – 2035 \$92 million, population growth 62,000.	\$1,487
Scenario 2 – "Discount Rate 3%, 30 year payback on assets". Asset values and populations discounted as per Sydney Water methodology. NPV of Capex 52.8 million, NPV of population 29,717	\$1,779
Scenario 3 – "Sydney Water Method of Discounting". Discount rates as per Sydney Water Model applied to Capex ie 3% 1970 to 1996, 7% for 1996 onwards.	\$2,855*

\* Note: this calculation is done without discounting population

As shown in Table 1, the three scenarios in the basic model calculate contributions at a much lesser charge than Sydney Water's draft DSP Water System Charge of \$3,696 / ET.

The underlying principle to DSP's is similar to S94 of the EP&A Act and is that new development should pay for new infrastructure it requires. It is difficult to comprehend that it is reasonable to charge \$3,696 per ET when there has been \$92 million spent to benefit a new population of 62,000.

If we set aside discounting (see below), this means that Sydney Water will collect over \$229 million dollars for \$92million expenditure in today's dollars for the assets created in Liverpool between 1970 and 2035.

It is also worth noting that the \$92 million spent is not the money outlaid, but is the Modern Engineering Equivalent Replacement Asset value and the amount of money expended on these assets would have been far less than \$92 million.

## 2. Application of Discount Rates

Our understanding of the use of discount rates and Net Present Value (NPV) is that the technique is appropriate for comparison of possible future expenditures at different times in the future, particularly by government agencies. The NPV factors in the "Opportunity Cost" of money spent.

Thus, if a government agency is comparing the value of spending \$1,000,000 on a new pumping station in 2006 to spending \$1,000,000 on a pipeline in 2012 benefiting the same number of people, the pipeline would be considered the preferred alternative under a NPV analysis.

The effect of the NPV analysis is to reduce the value of expenditure in the future and increase the value of expenditure in the past. In the current DSP models, most of the identified expenditure has already occurred. Thus DSP contributions are being inflated to cover theoretical past expenditure that has not occurred.

An alternative way of considering this issue is to say that Sydney Water should receive a return for capital expenditure that it has made in the past. If this philosophy is applied, then the rates collected from the new population growth between 1970 and 2006 should also be included in the model. Our understanding is that the model only allows for future rates income.

We trust that this submission will be considered in detail and would like further discussion before the DSP charges are finalised.

Yours faithfully

A handwritten signature in blue ink, appearing to read 'Trevor Jensen', with a stylized flourish at the end.

**Trevor Jensen**  
Development Manager  
Mirvac Homes (NSW)

