



IPART ISSUES PAPER
REVIEW OF DEVELOPER CHARGES
FOR METROPOLITAN WATER
AGENCIES

UDIA NSW SUBMISSION

February 2008

This report comprises the Urban Development Institute of Australia's (NSW) submission for the Independent Pricing and Regulatory Tribunal's review of its developer charges methodology for Sydney Water Corporation, Hunter Water Corporation, Gosford City Council and Wyong Shire Council.

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1. EXECUTIVE SUMMARY

UDIA NSW has reviewed the *Issues Paper* and commends IPART for undertaking a review of its developer charges methodology for the metropolitan water agencies.

The urban development industry seeks a more equitable and transparent cost allocation for the provision of water and sewer infrastructure in the metropolitan agency catchments. The current framework for calculating developer charges fails to meet these objectives and the erroneous application of the IPART Determinations is exacerbating declining affordability for new release areas in New South Wales.

UDIA NSW's fundamental position is that the current approach to development charges for water and sewer is inequitable, unsustainable and in need of comprehensive review. The application of price signals to new greenfield development on the urban fringe presents considerable intergenerational and geographical inequities and fails to recognise the need for a recurrent funding model for the ongoing provision and maintenance of infrastructure.

UDIA NSW advocates a complete change in thinking towards the application of developer charges for water and sewer in NSW. The erroneous application of successive IPART Determinations and the failure of Water Agencies to revise DSPs to account for sustainability initiatives introduced by the State Government and paid for by new homebuyers, present compelling justification for a more balanced and equitable approach to infrastructure provision.

The application of an increase in annual charges across all equivalent tenements (ETs) within a Water Agency's catchment to fund the provision and maintenance of water and sewer infrastructure is an equitable and sustainable approach that is entirely consistent with s15 of the *Independent Pricing and Regulatory Tribunal Act 1992*. UDIA NSW understands that in the Sydney Water Corporation (SWC) catchments, the cost of abandoning the plagued developer charges framework could be achieved through a net \$20 per annum increase in annual charges across all ETs. In the context of a near fifty year low in dwelling commencements in 2006/07 (29,300), and an increasingly unsympathetic regulatory and economic framework, the continued use of developer charges is questionable.

Notwithstanding advocating the above mentioned approach, UDIA NSW understands that the terms of reference within which the Tribunal must review the methodologies presents a constraint to the prompt abandonment of the developer charges concept and has therefore provided a submission that also seeks to ensure that significant and urgently needed changes to the current framework are effected.

UDIA NSW contends that the concept of price signals for water and sewer charges is a redundant concept. Development will take place when the demand and price tolerance is overcome. The urban development industry holds the logical view that there cannot be price signals after the land is rezoned. At this stage, particularly in the metropolitan areas, it is far too late. Developers will already hold the land and will proceed to meet the market demand as best it can. The housing industry is a 'cost plus industry' and therefore once committed to the development of the land the company will find economies where ever possible to manage the myriad of costs.

Since 1995 the terminology and formula used to indicate the methodology for determining development charges has been subtly changed, and the industry has not had a direct input

apart from reviewing and critiquing the interpretations. In the 1996-1999 DSPs, SWC did not add new assets beyond 5 years and the demographic demand (take-up) extended out to 30 years. That was accepted as a surrogate for providing capacity data in what is presumed to be the belief that the capacity of many assets would be exhausted.

The application of BASIX for residential development in NSW has generated a reduction in demand for water and should therefore be reflected in a reduction in the design requirements for the water and sewerage system, and DSP development take-up, or utilisation of capacity. The fundamental and overwhelming problem with the Metro Agency DSPs is that they have no solution for the determination of a charge for BASIX compliant development and the consequent reduced demand. This issue alone provides sufficient justification for the need to completely recast the DSPs.

Sydney Water Corporation has offered an alternative that cannot be supported by the development industry. It is not based upon any rational consideration of proper financial management and/or social cost/benefit. The most obvious shortcomings are that it:

- Removes a major element of the calculations for 'brownfield' areas – pre 1996 cost.
- Removes a major element of the calculations for 'greenfield' areas – net revenue.

The difficulty is that the SWC model does not use capacity in the apportionment at all. This poses the issues that the asset may not have sufficient capacity to meet the full take-up or there is surplus capacity. Both have consequences for the charge.

It must be acknowledged that the demand basis of the Determination in 2000 is out of date. In addition with the shift from fixed to usage charges, the basis of IPART's assumptions may no longer be relevant. It should be noted that BASIX does not change the rate of residential take-up.

UDIA NSW advocates an interim solution for the 2006 DSPs which did not account for BASIX. It is stressed that it must be only an interim solution. UDIA NSW recommends a 40% reduction in the adopted DSP charges for water and 20% for sewerage charges. This is as the 2006 DSPs are fatally flawed as a consequence of ignoring BASIX

UDIA NSW has responded to the matters raised in the Issues Paper and has taken the opportunity to elevate a number of particularly pertinent issues that warrant consideration from the Tribunal. UDIA NSW provides the following recommendations it believes must be adopted by the Tribunal to provide a sustainable and equitable financial framework for the provision of water and sewer infrastructure in the metropolitan agency catchments:

- 1. UDIA NSW recommends that the provision of water and sewer infrastructure be funded through increased annual charges collected across all equivalent tenements within the metropolitan water agency's catchment.**
- 2. As an interim solution UDIA NSW recommends a 40% reduction in the adopted DSP charges for water and 20% for sewerage charges to account for demand reductions generated by the application of BASIX.**

2. GENERAL ISSUES FOR CONSIDERATION

Increased Annual Charges – The Way Forward

The application of DSP charges to fund the provision of water and sewer infrastructure in new release areas is inequitable and unsustainable. The significant disparity in DSP charges across ETs in the Sydney catchment reflect the considerable intergenerational and geographical inequities that the current framework provides. The low and in many cases non-existent charges account for Sydney's eastern suburbs and reflect the presence of existing infrastructure where the capital cost for such services has been discharged.

The initial investment for those pipes and pumps was paid by the NSW Government from consolidated revenue. This in contrast to those looking to buy in Western Sydney and the Illawarra where price signals have been established to recoup the investment on such infrastructure.

Accordingly, new home buyers in the eastern suburbs of Sydney benefit from the investment and foresight of previous generations while new homebuyers in Western Sydney pay the full cost, upfront for infrastructure for themselves and successive generations. Those who have the least ability to pay, the young and geographically marginalised, pay for everything, while the comparatively wealthy of earlier generations pay for relatively nothing.

UDIA NSW contends that a alternative approach to funding infrastructure must be implemented that provides a recurrent revenue stream for the water agencies that is not dependent on the release of new land to recover investment in water and sewer. The application of an increase to the annual charges across all ETs within a catchment to fund new infrastructure provision is an equitable and sustainable financial model that will provide relief for new homebuyers. The following framework illustrates how the model will work:

1. Subsidise connection to water and sewer infrastructure as a forward investment to increase the number of ETs;
2. Increase the annual charge across all ETs – UDIA NSW understands that in the case of the SWC catchment, this would be net \$20 per annum;
3. This sends a real price signal on water usage across all ETs;
4. Allows investment in urban renewal areas;
5. Gives relief to new homebuyers in greenfield areas;
6. Produces recurrent revenue for the Water Agency beyond 25 years – as would be the case in the Sydney Growth Centres under the current charges framework; and
7. Creates an incentive for the Water Agencies to deliver infrastructure in a timely manner.

UDIA NSW understands that in the Sydney Water Corporation (SWC) catchments, the cost of abandoning the plagued developer charges framework could be achieved through a net \$20 per annum increase in annual charges across all ETs. In the context of a near fifty year low in dwelling commencements in 2006/07 (29,300), and an increasingly unsympathetic regulatory and economic framework, the continued use of developer charges is questionable

RECOMMENDATION 1

UDIA NSW recommends that the provision of water and sewer infrastructure be funded through increased annual charges collected across all equivalent tenements within the metropolitan water agency's catchment.

Price Signals

One overriding issue, not identified in the Issues Paper, is that the Tribunal have for many years expressed the view that discrete and specific charges were designed to provide price signals, and this is mentioned in the Introduction. This concept has proved erroneous and inequitable.

The industry holds the logical view that there cannot be price signals after the land is rezoned. At this stage, particularly in the metropolitan areas, it is far too late. Urban developers will already hold the land and will proceed to meet the market demand as best it can. The housing industry is a 'cost plus industry' and therefore once committed to the development of the land the company will find economies where ever possible to manage the myriad of costs.

The reduction amount however is another matter entirely, and has an even more obscure relationship to the charge. This remains the major source of concern for industry participants. The reason being that the average allowance is far below what the authorities reveal in their financial report for operational revenue and expenditure. UDIA NSW contends that the only solution to the dysfunctional methodology is to have a postage stamp reduction amount based upon the postage stamp annual revenue and expenditure. In addition the current approach is a selective process that includes only part of the income, but all of the expenditure.

BASIX

In 2004 the NSW Government introduced its key planning policy for sustainable housing, the Building Sustainability Index (BASIX). The policy requires all new dwellings to be designed to use up to 40 per cent less potable water and reduce greenhouse gas emissions by up to 40 per cent compared to benchmarked per capita averages. The implementation of BASIX in urban development has led to a reduction in potable water demand. A pre BASIX home used on average 240kL/year while a post BASIX home uses 150kL/year.

The BASIX design requirements have had financial impact upon the development industry sector and new homebuyers. Anecdotal estimates of the cost of BASIX compliance for new dwellings are around \$10-15k. The industry has however been expecting there to be savings which would potentially neutralise the cost. There may be some savings in annual charges but this is uncertain. Two external factors which logically might have brought a reduction are the design requirements for the water and sewerage system, and DSP development take-up, or utilisation of capacity.

It can be observed that for the 2006 DSP charges, the effect is the opposite and this is also the case for the design standards being contemplated for the early releases in the SW Sector. That is, the cost as a consequence of increased or no reduction in standards will add cost, and consequently development charges increase.

It is entirely disingenuous for one NSW Government Department to mandate reductions in water usage, and a resultant increase in housing construction costs, and a Government utility not recognise the reduction and mandate appropriate design standards and corresponding reductions in DSP charges.

There is a compelling need for the DSPs to be recast on account of BASIX alone. As an interim solution, UDIA NSW recommends a 40% reduction in the adopted DSP charges for water and 20% for sewerage charges to account for demand reductions generated by the application of BASIX. It is stressed that it must be only an interim solution and should be applied immediately.

RECOMMENDATION 2

As an interim solution, UDIA NSW recommends a 40% reduction in the adopted DSP charges for water and 20% for sewerage charges to account for demand reductions generated by the application of BASIX.

3. PRINCIPAL POINTS – ISSUE PAPER

DSP Boundaries

UDIA NSW supports the rationalisation of water DSP boundaries. This industry however is concerned about the loss of transparency and accountability if sewerage DSPs are amalgamated.

Net Present Value

The urban development industry understands that SWC has yet to determine how to apply a capacity analysis (for BASIX) to a Net Present Value (NPV) model. UDIA NSW contends that it requires a supplementary spreadsheet which distributes cost to an ET based upon capacity. The NPV model can then proceed by inclusion of the proportion of the asset cost relevant to the planning period.

It is a fact that the DEUS model, while it has flaws, can readily accommodate capacity. It is also a fact that the available regional DSPs apportion cost using capacity for major assets. Like the SWC model these do not account for BASIX.

Apportionment

The means to apply apportionment of the cost based upon capacity is non-existent. The failure to prepare proper take-up analysis comparing capacity with take-up over time to establish demand as well as the timing of the asset provision to meet that demand.

Valuation of Assets

The urban development industry has never accepted MEERA, which is a theoretical rate, not an average rate. The rate includes many assumed additional add-on costs. It will in many cases exaggerate the cost, which has been acknowledged recently by SWC.

MEA (Modern Equivalent Asset) was intended to be similar to the NSW Reference Rates Manual compiled by the Ministry of Energy and Utilities (June 2003). That is contract rates. The 1995 Determination considered the need to compile such a document but SWC decided to pursue MEERA which was agreed in 2000 without reference to the other stakeholders. The 2006 DSPs have adequately illustrated the consequences of the failure to adhere to the 1995 principles based upon fairness.

Net Operational Revenue

UDIA NSW supports the concept of an average net revenue amount for all water and sewerage DSPs. Calculations undertaken by EPA using SWCs financial operational statements reveal that net revenue based upon 2005 data would give an offset of \$4604.

Using a different method SWC recently estimated that the average offset could be about \$2900 for sewerage and about \$1400 for water. These are not definitive amounts but two different methods agree closely.

Peaking Factors vs Average ETs

The assumption that because peaking factors are used in various parts of the system design this should be the basis of apportionment, is flawed. It ignores any reasonable scrutiny of this assumption. There are no peak ETs. There are parts of the system which serve an average ET which are increased in capacity to meet peak demand during the day or for the highest annual daily demand etc. The SWC approach overstates the charge for an average ET.

The fact is that all designs are made to serve average ETs. The Water Directorate has prepared ET classifications to equate all user demands based upon a comparison with an average ET. It cannot be done any other way.

ETs to Include

There was no provision in the 1995 Determination (and it remains the case), to delete pre 1970 ETs from the apportionment. Further there is no provision to apportion most of the cost in the DSP to new users.

The principle adopted in 1995 is that the current value of the post 1970 assets represented the total efficient cost of the system. That was to be apportioned over all ETs in the DSP catchment to obtain an average cost of the system per ET. These principles were applied in the 1996 to 1999 DSPs.

The method currently used by SWC to exclude pre 1970 ETs is contrary to the agreed principles. It is notable that in principle the DEUS Guidelines apportion the cost over all ETs. Clearly the Department understood and agreed with the 1995 Determination principle.

ET Classifications

The ET classifications used by SWC in their DSPs for commercial and industrial are excessive by comparison with every other water authority and the Water Directorate Manual. It is also applied on a ground area basis regardless of the scale of the building. This is particularly inefficient and inequitable. UDIA NSW is aware of an example in Western Sydney where the charges for a small 2000sqm subdivision in one area were very similar to the charges for a cluster of 5-6 storey buildings in another area.

4. NEW ISSUES FOR THE DETERMINATION

4.1 Recycled Water Charges

In 2006 IPART issued two Determinations (ie # 8 and 9 of 2006).

3.1.1 *Determination No 8, 2006 - Recycled Water Development Charges*

UDIA NSW is aware of only the Rouse Hill Recycled Water development charges at 2001 as publicly listed. There are a few obvious issues to be addressed which include:

- i. The requirements to discount the charge for avoided costs, deferred costs and government directive costs. The Determination and Report of 2006 went to considerable lengths to consider all these economic factors. The fact that for Rouse Hill Recycled water charges this amounted to less than \$1 calls into question the expectations of IPART and/or the interpretation by SWC.
- ii. The approach in Schedule 1 Part 2 retains some and adds to the confusion of the provision in the 2000 Determination.

The formula makes no provision for how future DSPs might be dealt with. The 2007 date ought to be replaced with 'the DSP date'.

The definitions do not correctly describe the process. Existing assets are revalued, only future assets are discounted.

The net revenue has not, in the development industry's experience, been calculated correctly. Unlike regional DSPs, where the industry is given access to all the revenue and expenditure data, none is provided and it is open to manipulation. This is not dishonesty but results from differences in approach which remain unresolved.

In summary the methodology requires proper guidelines with worked examples which was the intention of DEUS. It would not be difficult to recast the *DEUS Guidelines* for the purpose of guiding the calculations for all DSPs in NSW.

3.1.2 *Determination No 9, 2006 - Rouse Hill Recycled Water Charges*

The industry usually has no direct interest in annual user charges. However in this instance the level of water use overall by customers in Rouse Hill is substantially more than the average for Sydney.

The apparent consequences have been:

- This valuable resource has been used wastefully to date;
- We understand that the demand has exceeded supply on occasions and the supply has been topped up with potable water however this is obviously a counter productive exercise.
- The consequent design standard for the SW Sector, based upon Rouse Hill is 270 kl/pa whereas the average demand in 2003/04 was 215 kl/pa. The 2000

IPART metro demand (set at 240 Kl/ap) is out of date and also of course a pre BASIX number.

Because of the high demand for recycled water by agriculture from West Camden STP, it is already anticipated that the recycled water system will also need to be topped up with potable water. This is surely an untenable and highlights the fundamental problem with the use and pricing of recycled water.

In summary the whole approach to the use of recycled water has been allowed to evolve in a most inefficient manner. This is fundamentally a problem of a lack of responsible decisions by state agencies which have been unprepared to objectively examine the issues. The experts and the public are calling for indirect potable to be adopted.

The current policy vacuum, out of date design standards, failure to integrate BASIX and the pricing mechanisms are all having a negative effect upon the design of future supply systems.

4.2 Transfer of Assets Provided by a Developer (not in effect free of charge)

The problem with regard to the transfer of assets provided by a developer was identified at Greystanes a number of years ago. The offset being allowed for a substantial number of DSP assets being provided by the developer did not take into account about \$3 million in interest which the DSP contained.

As a consequence for a review of the Memorandum of Understanding (MOU) with Sydney Water for Stage 1 of the SW Sector, it became obvious that there were issues with the transfer of assets from developers to SWC not only in the MOU but in the provision of the DSPs.

These include:

- SWC provide an offset against the DSP charges to be paid. It is not however based upon what has been estimated in the DSP but at the developer's contract rate, which is generally lower. This is contrary to the generally agreed principle for s94 - the value of the asset being offset is to be not less than the value attributed to it in the development charge.
- in addition no allowance/discount to the charges is made for the interest in the DSP. Clearly having provided the asset the interest should be deleted from the offset calculation.
- developer provided assets should be included in the DSP, otherwise the developer is disadvantaged by comparison with other developers in the same DSP.
- the cost for which an offset has been given, must stay in the DSP to retain the economic integrity of the DSP.

4.3 Service Quality and Design Standards

Judgements about the maintenance of standards are merely based upon assumptions that

the current levels will 'at least be maintained'. There is no judgment, and it would not be always readily apparent, where service quality is being increased.

An integral part of the service provision is the design standard which is never questioned either. A system designed to meet for example 400 kl/pa water supply would obviously meet the current service demand of 215 kl/pa and it is assumed to the quality standard required.

The IPART Determination aims at economic efficiency but there is no mechanism to test whether the service and design standards of the assets for future users is being economically and efficiently provided. There are numerous examples which illustrate this but no better than the design standards being applied to the 'greenfield' areas of the SW Sector.

The W Camden STP has been chosen as the initial location for treatment of effluent from Stage 1 of the SW Sector on the basis that it has capacity, or so it was stated. However SWC now claim it will need to be upgraded yet again. This statement could only be true if one assumes that the design standard that applied in 1972 is used.

This issue is potentially the largest one for IPART and SWC. If the effective capacity of the system is to be substantially increased because of BASIX, this also applies to the current design standards in the new systems.

The second problem for SWC is that none of the current DSPs apportion the cost on capacity as required but upon demand as calculated from a largely demographic projection of dwelling numbers.

The consequence of these two problems is that the DSPs will need to be completely recast to accommodate BASIX in particular. The capacity assessment would then allow, what is now not available, the ability to assess the system efficiency including issues such as under or over designed assets. All of these capacity assessment issues have economic consequences.

4.4 Revenue Requirements

A matter not discussed in the Issues Paper but raised in the SWC submission is the relationship of development charges and annual charges via the method used to determine the value of the Regulatory Asset Base ('RAB'). What development charges based upon appreciated value plus interest has to do with an asset value based upon historical cost less depreciation is impossible to fathom.

UDIA NSW objects to what is in effect a cost transfer, which must increase development charges (by lowering annual charges). As SWC observed it increases the disparity between new and existing users.

4.5 Determination of Recycled Water Charges – Clause 2.1

Is there benefit in having one development charge determination covering both recycled water services and water, sewerage and stormwater services?

Due to the need, as demonstrated above, for a more comprehensive review, including the expansion of the Determination to include better Guidelines, a single determination (not one

charge) would be supported by the industry in the interest of transparency and accountability.

Should the changes introduced in the recycled water development charges determination (eg rate of return) be applied more broadly to development charges for water, sewerage and stormwater services?

To maintain some order and certainty, the rates should be determined every five years. The original principles for the selection of a future rate should apply (ie ten year bond rate less CPI plus 3% for risk). 3% risk would apply to existing assets.

4.6 Regulatory Oversight - Clause 2.2

Are there advantages or disadvantages if IPART was to provide additional regulatory oversight either before or after adoption of the DSPs and charges?

As highlighted in the DEUS Guidelines Inquiry, the current metro system of minimal oversight by IPART is undesirable for all concerned. This applies to technical issues and interpretation. UDIA NSW contends that it is incongruous that IPART having gone to some considerable trouble to make the Determination provides so little support for its implementation. Certainly the industry has been able to make a case and will again that there are major issues of principle to be addressed.

Given the extent of this undertaking, it is recognised that the task may be considered too extensive to be the sole responsibility of IPART. UDIA NSW suggests that consideration be given to a formal discussion process with major industry stakeholders to achieve a resolution of technical issues.

Are there advantages or disadvantages for IPART to develop, in conjunction with the water agencies and peak development bodies, a standard calculation spreadsheet?

UDIA NSW contends that the development of a standard spreadsheet/s is only part of the solution. Adoption of a revised set of DEUS Guidelines could be a solution for the whole of NSW. That has been the industry's position for more than ten years. It has been expressed its regret that the Pricing Principles of 1996 did not achieve that.

4.7 Water Industry Competition Act 2006

What issues may arise in the application of development charges in light of the Water Industry Competition Act 2006?

The proposal is essentially a limited option to construct and transfer to the water agency. It does not diminish or replace the role of a water agency to prepare a DSP or collect charges for the most part.

The arrangements for the undertaking of the works ought to provide efficiencies which may be welcome. The evidence about efficiency of PPPs however is to the contrary for the Gerringong and Picton systems.

Control of the disputed design standards would still be with the water authority.

It is a fact that the SWC requirements for reticulation works by developers are still double the costs incurred in adjacent regional areas.

The Act is unlikely to be a panacea except that large developers may have more flexibility to provide infrastructure in a timely manner.

How the funding is managed may not be a factor in DSP charges.

4.8 Wyong Council – Clause 2.4

Is an adjustment required to Wyong Shire Council's water and sewerage development charges to exclude a stormwater revenue component pending Wyong Council satisfying requirements for the imposition of a separate stormwater charge?

Being unfamiliar with this issue it seems a matter for Wyong and IPART. It is difficult to see however how such a small charge could result in distortions of the development charges. Surely the outcome can only come from actual income and expenditure.

5. ISSUES COVERED BY THE EXISTING DETERMINATION

5.1 DSP Boundaries

Whether particular DSP boundaries result in distortion of the associated development charge?

UDIA NSW is not aware of any particular boundary related issues for sewerage DSPs. This is also given that the catchments for these are self evident, being STP based.

Water supply charges are a different matter. Why areas close to each other should either have \$0 charges or one in excess of \$2000 per ET is not readily obvious. SWC have indicated verbally a proposal to consider reducing the number of Water DSPs which is logical on initial consideration. The actual proposed boundaries and the outcomes will need to be examined in due course.

What principles for determining where DSP boundaries should be established?

UDIA NSW recommends that the DSP boundaries be:

Sewerage	Based upon a STP catchment generally. However given the 'meccano set' like systems which don't vary too much in design (in greenfield areas for example), more than 1 STP per DSP may be possible, but not favoured.
Water	Currently more than 40 DSPs seem capable of being reduced on the basis of the logical link between assets.

The secondary aim could be to rationalise the catchment to provide a more efficient charge which eliminates some of the differences between the current catchments.

5.2 Transparency of System Capacity

What information do developers need on asset capacity to assess the calculation of charges?

The Association of Consulting Surveyors 2006 submission criticised Sydney Water for not complying with the Determination and not meeting its promise to provide capacity information. The SWC have yet to provide any background data apart from MS Excel models of the calculations.

The information required is the actual capacity of each major asset in average ETs. For example the capacity of the West Camden STP in 1996 was better than 4.8 mega litres/day or 426 l/day/ET.

Reservoirs may have a peak demand of between 1500 and 2000 litres/day/ET (standard ET).

Using this data it is possible to determine when capacity will be reached or what surplus capacity may exist. Further the cost per ET is cost/capacity, not cost/take-up.

5.3 Transparency of MEERA Values 3.2.3

What information on asset values is needed by stakeholders to improve the transparency of the process?

The information required is similar, but not exclusively, to that provided by the DEUS Manual for the Valuation of Assets. SWC have offered a copy of the MEERA Manual but none has been sent since the offer made in writing to the Association of Consulting Surveyors in June 2007. UDIA NSW understands that Hunter Water also have a manual that has very restricted distribution.

What is the most appropriate method that agencies can use to supply this information?

A hard and/or PDF copy as well as supporting digital data on MS Excel spreadsheets would be the most useful information.

5.4 Calculations using NPV 3.5

The industry readily accepted using the NPV approach to calculation of the charge. This originated at Hunter Water to replicate the industry method of assessing a development project.

The problems the industry has identified include a failure to understand the principles and to apply them to the calculations. One aspect of this has been acknowledged by SWC in their 2006 DSPs which abandoned calculations using DSP date values back to 1996. Notably HWC have not amended their DSPs for this error.

The recent review of the DEUS Guidelines has further highlighted the problems with the SWC model. This is further complicated by the fact that SWC do not use capacity to apportion the cost but the DEUS Guidelines do, for major assets. In addition DEUS use a 'whole of system' approach which was abandoned by SWC.

With the advent of BASIX and the failure, indeed impossibility of incorporating BASIX into the current model, which model should be recommended is an open question. As IPART know, the DEUS Guidelines need amendment as well, including calculation from 1996 and not the DSP date.

This conundrum is more likely to be resolved if a single set of guidelines were prepared (based upon the DEUS Guidelines layout) which provided the options and explanations of the shortcomings of each, but with sufficient rigor to ensure that the answer is the same.

5.5 Asset Costs and Identification 3.5

Whether developers and other users of asset information are satisfied with the asset information currently being provided by water agencies?

UDIA NSW members are not satisfied with the information provided for the following reasons:

- The latest DSPs are illegible
- The ACS NSW has been promised a copy of the MEERA Manual but none has been provided.
- Capacity information is scant and not used to apportion costs.
- There is no link between demographic take-up and capacity to show under or over capacity. This is valuable information which would allow the industry to participate in infrastructure planning.

5.6 Apportionment of Assets 3.5.2

What asset information is considered necessary but not currently provided by agencies to ensure that assets are apportioned correctly?

The problems with the apportionment of assets include the lack of capacity information provided let alone used by the SWC and HWC DSPs. SWC merely assume that take-up equals capacity regardless of the likely under or over capacity provided by major assets. This is a flaw critical to the resolution of the BASIX effect which is a reduction in demand for capacity.

The SWC approach of applying different apportionment to existing and future ETs is contrary to proper nexus and apportionment principles adopted in 1995. SWC have made the unwarranted changes in the 2001 and 2006 DSPs.

The essential elements of a DSP include a proper ET take-up analysis and ET capacity data for all major assets. These elements used together allow assessment of cost per ET of capacity, timing of provision of assets and calculation of any under or surplus capacity.

It should be noted that BASIX does not change the rate of residential take-up. This is as the demography, as the number of new ETs per annum is not related to capacity. The population growth, occupancy rate, lot release rate and dwelling growth remain as predicted by ABS, TPDC and any supplementary demographic analysis.

5.7 Assets Transferred Free of Charge 3.5.3

Are there arrangements in place for funding developments that fall outside IPART 's current development charge determination?

The concept of exclusion of developer provided assets from the DSP is flawed. The flaws include:

- The most common scenario is that the asset being provided is already included in the DSP.
- This asset remains part of the system which will be used to determine the charge for other developments.
- For the subject development the offset is calculated as:

- The cost as included in the DSP;
- The ET offset based upon a DSP calculation that does not include interest for the relevant asset;
- The balance of the ETs are paid for at the full rate.

This provision need to be better articulated and matched in the MOU provisions for works in kind.

5.8 Valuation of Assets 3.5.4

What are the advantages and disadvantages of using MEERA as the method to value assets?

MEERA is not favoured by the industry because it is difficult to know what it is. It has too many add ons to allow for many conceivable possibilities.

Modern Efficient Asset (MEA) adopted in 1995 is preferred. Clause 6.2 of the 1995 Determination sets out the principles. This also contemplated the possibility of indexation of the historical cost which SWC is now contemplating. Provided it can be shown to be efficient, for example by way of a recent completed contract, that may be satisfactory.

UDIA NSW recommends that better ground rules need to be established. For example contingency should not be added to cost already incurred (ie existing assets).

I should be noted that the Tribunal considered the necessity of keeping unit cost rates for assets. The DWE seek comments from the private sector. Their contract rates remain higher than the private sector and their SID and contingency allowances are also higher. However these rates are generally significantly less than SWC rates.

5.9 Growth Component of Headworks

What methods or guidelines should be adopted to achieve an appropriate and consistent way of determining the drivers of proposed water supply headworks expenditure?

The original method of apportioning the cost has been based upon two factors:

1. All existing assets and future assets are valued on the same basis (MEA).
2. The cost is apportioned over all users as a surrogate to determine a new ETs share of 'capacity'. Capacity was assumed on the basis that new assets were provided not more than 5 years out. The take-up was over 30 years. Therefore on balance the capacity of the assets provided would be used up and any under or over supply at 30 years would not have a significant impact upon the charge.

Capacity compared to take-up is the only relevant driver for demand of new assets. Shoalhaven Water for example prepared a report to make this direct comparison and to assess the timing of provision. Timing is of course very relevant to the NPV model. Without capacity data however it is impossible for the industry to gauge whether the timing is correct

or indeed whether there is any under or surplus capacity in the system. It is also of course impossible to properly apportion the cost without capacity data.

5.10 Net Operation Revenue 3.6 and 3.7

The industry has been long dissatisfied with the methods used to determine this discount. In particular it appears that some of the revenue and all of the costs were being used. On average, prior to 1996, SWC financial records revealed a much higher overall net revenue. That appeared to be addressed in the 2006 DSPs as the net revenue increased overall but with a substantial tilt in outcomes. In particular the old areas benefited while the new areas were disadvantaged. It remains unclear why access to the background data has not been available.

In part the industry believes that the 2000 Determination may be partly to blame. The basis for determining the revenue is simplistic and open to interpretation. It has been expressed as the 'agency contribution' which is a misnomer.

SWC claim that new areas have more assets and are thus more expensive to maintain. Older areas have simple treatment and ocean outfalls which are also old and may not be included in the calculations.

The simplification or the assumptions made are a poor substitute for the facts which support a more uniform net revenue. As the income (not just the charge but other related income sources) and many of the costs are authority wide, a fixed single net revenue amount seems a possible way out of this problem.

It should also be noted, that 'signalling differences in costs', as indicated above, is not achieved by the current method as the industry denies that development charges are a poor basis for price signals. They do not act as price signals because land is so tightly held often before, but certainly after the lengthy rezoning processes.

Why have operation and maintenance costs increased significantly in some DSP areas?

The amounts are a result of SWC unreasonably changing their system. UDIA NSW contends that is principally because the method does not take into account the much higher efficiency of modern assets. Their unit maintenance cost rates appear to be applied to each asset regardless. As there will be more sewer assets in the West, the cost will go up. There should be less water assets also in the West but the costs don't seem to have fallen. This could be because the East has pre-1970 assets.

It also seems likely that the way SWC assess the ET Classifications could lead to understating the revenue in the East for the higher density commercial and industrial areas. Further revenue from these sources is principally from usage not annual charges.

Similarly overstating of revenue and cost because of the high classifications for the many smaller commercial and industrial developments in the West will have the reverse overall effect. Without access to the data upon which SWC rely, UDIA NSW cannot be certain but from experience and knowledge, the reasons we have been given don't adequately explain the problem.

Are there alternative mechanisms for signalling differences in capital and operating costs between different development areas?

UDIA NSW contends that the concept of price signals is redundant. There are relevant considerations as to whether the net operational allowance be determined on a postage stamp basis. The industry is very much in favour of this approach.

5.11 Peak ETs v Average ETs 3.8.1

It is a self evident fact that there can be only one definition of an ET. All other uses are rated according to their equivalence to a standard ET. Any other definition of an ET cannot be 'equivalent'.

The persistence with peaking factors as a basis for apportionment merely reveals that the authorities either do not understand the process or are using so called 'peak ETs' merely to maximise the charges. SWC have abandoned these for sewerage but persist in using it for water. UDIA NSW is concerned that the persistence is justified on the basis of a misused engineering concept, not an economic or demographic one.

The link between the development charge and the system designed using various parameters (peak day, instantaneous, average etc) is the cost. The design to serve one ET (equivalent standard dwelling of know occupancy), is created and the system constructed for a cost.

For example a reservoir must have sufficient capacity for say 1800 l/d per ET, but the dam may have sufficient capacity for 700 l/day per ET. The ET is the same for both, a demographic, and the total cost per ET, is the combined cost per ET of these. The question of a design basis does not arise once the cost is established. After all the aim of a development charge is to recover the cost for an ET, the numbers of which have been worked out as a demographic as required by the Determination.

As pointed out in the DEUS Inquiry, the Water Directorate Technical Guidelines make no reference to peak when listing conversion factors for a myriad of uses by comparison with an Average ET.

How and why do agencies use ET peaking factors to calculate, and ultimately to allocate, the capital charge and reduction amount?

The agencies use average and peak selectively all of which makes no sense as it confuses and distorts the outcome. The capital charge is maximised while the net revenue is minimised.

The example of Narellan Water illustrates the point

The average take-up for 2010 is 1194
The so called maximum take-up for 2010 is 1167

The take-up used at 2010 in the capital charge calculation is 1116.
The take-up used at 2010 for the net revenue calculation is 1194.

Why this DSP has a third basis for an ET is not explained.

There is only cost for a system for which a design peak may have been used for part of it, but which peak (day, hour or instant) is irrelevant to the DSP calculation. It doesn't matter to the Determination as only the system cost based upon those design concepts is relevant.

The cost is to be recovered on the basis of average ETs or by comparison with average ETs for all other uses. The calculation should mirror the basis of how it is actually charged.

Is a new definition of ETs and/or re-expression of the development charges formula required to incorporate use of peaking factors?

Therefore there is no question of having a new definition. It is irrelevant.

5.12 Which ETs to include 3.8.2

The fact that the Determination did not prescribe how the number of ETs should be calculated has been taken advantage of by the authorities in subsequent DSPs (post 2000).

The first DSPs in 1996 were calculated as agreed on the following basis:

- the total efficient cost divided by total number of ETs;
- the pre 1970 assets were sunk and it would be inefficient to include them;
- the total number of residential ETs equalled the projected number as advised by the Department of Planning for each year to the end of the 30 year period. To this would be added an estimate of the equivalent number of commercial and industrial ETs.

In other words the post 1970 cost at current prices (at DSP date) represented the full cost (value) of the system. That cost was apportioned over the total number of ETs to establish a reasonable charge or share. The charge is a buy-in price at current value of the whole system. This was accepted as a reasonable approach.

UDIA NSW contends that it is unreasonable for their to be four (4) different basis for apportionment (see W Camden Wastewater DSP):

- pre 1970 ETs excluded;
- 1970 to 1996 cost apportioned over all ETs - 89% to post 1996 ETs 68% to post 2006 ETs;
- 1996 to 2006 cost apportioned over ETs post 1996; and
- 2006 to 2035 cost apportioned 100% over new ETs (Post 2006).

What the above method invokes is a system that is unreasonable and has no basis in the Determination. Exclusion of the pre 1970 ETs is the most objectionable. It is based upon a number of false assumptions. Only one of these is that there are no assets provided post 1970 which serve pre 1970 ETs either as upgrades or replacements. The most important fact however is that these post 1970 assets are just part of the whole efficient system as defined by the Determination.

The conclusion is that it is necessary to return to basics and apportion the cost simply and fairly over all ETs.

What problems exist with the current treatment of ETs in DSPs?

The problem is that the principles agreed in 1995 have been abandoned in favour of an approach which has no basis in the Determination. The total efficient cost divided by all the ETs is the only acceptable method.

What improvements could be made to the methodology regarding the treatment of ETs?

It would be a vast improvement if the authorities adhered to the 1995 Determination as outlined above.

5.13 ET Multipliers (or ET Classifications) 3.8.3

All regional water authorities publish ET classifications similar to that provided by the Water Directorate. While the document has a number of shortcomings it is acceptable in principle in that it makes comparisons between other uses and a standard dwelling (1 ET) with average demand.

Its shortcomings lie in the apparent reliance on merely surveying members and averaging those as a first pass. Much further work is required to make it a viable document. There are substantial differences with those prepared by Councils which have the facility and ability to undertake flow analysis (using telemetering on assets). It is understood that two Councils, Shoalhaven and Coffs Harbour, have undertaken such work.

As previously noted the Sydney Water conversion of ET classifications are excessive and well above the provisions of the Water Directorate factors.

How should agencies determine the ET multipliers for varying development types?

It is not necessary to invent a system as water authorities have their versions of the Water Directorate system. The Water Directorate's laudable work was to provide some standardisation as not all authorities have carried out proper analysis. Indeed the basis for most are rudimentary.

5.14 Discount Rates 3.9.1

UDIA NSW disputes the basis of the discount rates. A rate of return was only appropriate to assets for which debt could be attributed. That is a real rate of 7% for post 1996 assets. The 3% was applied as a risk rate to existing assets as outlined in Eric Groom's discussion paper which was part of the Water Industry Forum papers.

What are appropriate discount rates for pre-1996 and post-1996 assets?

It is apparent that the real rate of return has dropped, but only slightly. 7% appears to remain close to the reasonable rate. 3% risk rate would not change on the basis that this is half of the full CAPM rate.

Should the 1996 threshold roll forward over time?

Agreed the thresholds have now passed their use, and should be rolled forward from 2007 by one year each. That is for both 1970 and 1996.

The reason is that the time lapses have changed the status for both sunk assets and new to existing assets. This change is on the basis of economic worth either as being so old it would be inefficient to include it or the assets has been paid for and a rate of return to meet debt is no longer justified.

It is noted that the use of the term 'sunk assets' by Sydney Water to refer to pre 1996 assets, which is confused with the proper use of the term relating to pre 1970 assets.

5.15 Consumption and BASIX 3.92

Developers are not merely concerned that '*development charges potentially could increase*', the fact is that the 2006 DSP rates did increase as a result of BASIX. The reason is that SWC used the claimed reduction in revenue to reduce the revenue offset. What they failed to address was the fact that the share of operational cost and the share of capital cost must also reduce. As previously indicated the current Determination was deemed by SWC as being unable to accommodate BASIX. The further fact is that SWC does not use system capacity as required which as the SWC model can't accommodate BASIX in the current DSPs.

The problem is how to solve this impasse in the short term to give SWC sufficient time to recast their DSPs. The simple solution would be for the DSPs to revert to a pre BASIX DSP (full operational revenue) and then the post BASIX DSP charges could be:

- Pre BASIX DSP Sewerage Charge - 20% = post BASIX DSP Sewerage Charge
- Pre BASIX DSP Water Charge - 40% = post BASIX DSP Water Charge

The following considerations must be made for each agency:

- What is the current consumption (in kilolitres) for both pre-and post BASIX average residential dwellings?
- On what basis should the consumption parameter be calculated when DSPs are reviewed? (For example, should the consumption parameter be set using recent data or using an average over a longer period?)

The data to be supplied by the agency should include:

- Current consumption data per ET (residential only)
- Projected 5 year (2011) consumption data per ET
- For sewerage this would be the average flow in l/day to the STP
- For water this would be the average consumption in l/day

Because the SWC and HWC DSPs are not capacity based the 'consumption parameter' is impossible to apply. For this reason a short and mid term solution to how the DSPs are to be amended and applied should be considered.

Should there be two consumption parameters: one for pre-BASIX ETs and one for post-BASIX ETs, or a post-BASIX only?

In any assessment of capacity there has to be two consumption parameters as while the existing housing stock will continue to use less water, it is unlikely to catch up with post BASIX housing stock. There will only be one DSP charge naturally, being for post BASIX ETs.

Has reduced consumption in post-BASIX developments been reflected in the allocation of assets in water systems and therefore reflected by reduced capital charges?

As mentioned above, the reduced consumption in post BASIX housing has not been reflected in the 2006 DSP Charges.

Are there any additional impacts from BASIX or recycling initiatives on development charges for water supply (including recycled water), sewerage and stormwater?

The BASIX Group in the Sustainability Unit of the Department of Planning have no idea of the net economic effect their initiatives. As usual they know some of the costs but little of the value (in economic terms). These people need to be engaged in useful dialog to understand where they are up to in the process and what further requirements may come in the future. For example I understand that the storage of grey water was put on hold. If that were introduced the effect on the sewerage treatment volume would change again.

It is noted that IPART went to some trouble to gauge the additional benefits of recycled water and the savings. That SWC can only see \$1 per ET benefit raises a concern about what IPART expected compared to what was not achieved.

5.16 Wyong Council's 15% Discount 3.9.3

Should Council be able to demonstrate that they have amended their demographic analysis to properly reflect the ABS statistics then consideration to abandoning the discount might be possible. UDIA NSW understands that it was not imposed because of the concern about possible impacts.

What are the impacts that the 85 per cent cap on development charges has on Wyong Council's business?

The answer for Wyong is they have 15% less income. That was not the issue. The rate was discounted on the basis of the flawed demographic assumptions that could have resulted in a 15% overcharge. UDIA NSW contends that it is the wrong question based upon a false view as to why the discount was applied in the first instance.

What are the possible impacts of removing the 85 per cent cap on Wyong Councils charges?

The only charge that can be acceptable cannot be tested by way of impacts. No such test applies to any other authorities. An acceptable charge is one which complies with the Determination. The quantum of non-compliance was 15%.

5.17 Demographic Assumptions 3.10

The demographic assumptions made by the agencies are not disclosed and there is no background data published as to how these have been made. For Sydney Water such data should be provided in tabular form to show:

- the ET assumptions for residential dwellings is based upon in part (per DSP) and in whole (the combined agency catchment - multiple LGA areas) on the Dept of Planning or ABS data.
- how the non-residential ETs are arrived at is also unknown, however the current conversion factors are excessive.

The principles of how the demographic analysis and capacity relate are not well understood as outlined in the UDIA NSW *Regional DSPs Principles Study*, already submitted to IPART for the DEUS Inquiry.

The rules are simply stated:

- ET take-up over the period of the DSP may be used as a surrogate for capacity of the smaller assets (pipelines) which have a wide range of capacities between sizes.
- The capacity of major elements, for example a group of reservoirs, have specific design capacities.
- An assessment also needs to be made for each major assets against the ET take-up whether:
 - It has sufficient capacity to supply the DSP for its full term.
 - Or whether is has insufficient or surplus capacity.

The answer to these questions will change the way the charge is calculated on a capacity basis and how much interest should accrue. Clearly an asset with insufficient capacity cannot accrue interest for the full 30 years.

What methods are used by agencies to estimate existing and growth ETs from demographic data?

The development industry looks forward to receiving detailed advice on this issue from the agencies.

5.18 Dispute Resolution 3.12

As there have been no arbitrations it might be assumed there have been no disputes. The housing industry runs like any business on a cost plus basis. Many disputes have been had with a range of outcomes and projects have been abandoned or a negotiated settlement has been achieved.

Arbitration with SWC or HWC is a daunting prospect even for major industry participants. Negotiations have therefore largely evolved as exercises in finding errors of fact or interpretation. Also the unreasonableness of some aspects of DSPs are often agreed and alternatives provided. This is acceptable to a point.

The reality is that Regional DSPs have been in a number of cases far easier to analyse because of the depth of information. The HWC and DWC DSPs are minimalist in the extreme.

Consequently before arbitration can be contemplated a developer needs to be fully informed by their consultant as to what the DSP contains. The information to answer that question just isn't available. No information = no challenge. This may be good for the authority but it is completely lacking in accountability.

Is the dispute resolution process working satisfactorily, and if not, what changes are required?

UDIA NSW contends that current the process is not working. A discussion between the stakeholders on the alternatives is required. These might include:

- mediation;
- negotiation by industry representatives as was used for the 2001 DSPs;
- a select committee to resolve technical issues.

5.19 IPART's Approach to Development Charges

Objectives D1

The question of whether development charges provide price signals is challenged. The industry view is that these cannot and do not and this concept should not colour IPART's decisions.

Whether authorities can be indifferent where revenue comes from is doubtful. Development charges are too political as politicians and authorities see these as a means of sharing in profits and easier to implement on a non-voter population.

5.20 Relationship with other Tariffs D3

The industry would be uncomfortable with the concept of development charges lowering periodic charges, a concept denied in relation to DEUS submissions in 1996. The development industry must question this view for a number of reasons which include:

- Development charges and periodic charges have very different cost structures.
- The assets upon which development charges are revalued. The assets included in any periodic are only the residual costs of these yet to be paid.

- The periodic charges include costs to meet future operational and capital expenditures, some of which will be recovered.
- Is the current approach coloured by the view that developer provided assets should be discounted from the DSP assets list? As demonstrated by this submission above the assets should not be excluded.
- The asset base therefore ought not be adjusted for development charges.
- The question of RoI is therefore in need of explanation. Is the RAB (Regulatory Asset Base) based upon historical cost, MEERA or depreciated book value?

In the current circumstance therefore, the question is whether the dividend paid to government more a turnover tax, which in effect is a reduction in the operational revenue. It has not been reported as such but obviously the industry is not as fully informed about SWCs financial arrangements as would be desirable, particularly given the state of housing affordability in NSW.

6. CONCLUSION

UDIA NSW appreciates the opportunity to comment on the IPART Water – Issues Paper and commends the NSW Government and IPART for pursuing a Review of developer charges for metropolitan water agencies. IPART is asked to give consideration to this submission.

UDIA NSW advocates a complete change in thinking towards the application of developer charges for water and sewer in NSW. An alternative approach to funding infrastructure must be implemented that provides a recurrent revenue stream for the water agencies that is not dependent on the release of new land to recover investment in water and sewer. The application of an increase to the annual charges across all ETs within a catchment to fund new infrastructure provision is an equitable and sustainable financial model that will provide relief for new homebuyers.

UDIA NSW has responded to the matters raised in the Issues Paper and has taken the opportunity to elevate a number of particularly pertinent issues that warrant consideration from the Tribunal. UDIA NSW provides the following recommendations it believes must be adopted by the Tribunal to provide a sustainable and equitable financial framework for the provision of water and sewer infrastructure in the metropolitan agency catchments:

- 1. UDIA NSW recommends that the provision of water and sewer infrastructure be funded through increased annual charges collected across all equivalent tenements within the metropolitan water agency's catchment.**
- 2. As an interim solution UDIA NSW recommends a 40% reduction in the adopted DSP charges for water and 20% for sewerage charges to account for demand reductions generated by the application of BASIX.**

7. UDIA NSW

Who We Are

UDIA is the voice of development. We represent the industry which develops new communities and proudly advocate for its interests. We pursue access to land for development, encourage the creation of a positive regulatory environment, and seek to moderate the burden of taxes and charges on our customers. We believe in affordable, sustainable, and liveable communities.

Urban development contributes \$15 billion worth of activity to the State economy each year. UDIA NSW represents the leading industry participants with over 520 corporate members.

UDIA was established in New South Wales in 1963 and operates as a non-profit institute for the benefit of its member's throughout Australia, with divisions in New South Wales, Queensland, South Australia, Victoria and Western Australia.

UDIA NSW is a progressive organisation driven by its members. Our President, Council, Chapters and Committees, Executive Director and staff ensure that we give members and sponsors maximum value for their investment.

UDIA NSW's goals are to:

- Promote high standards for the urban development industry;
- Promote respect for the inherited and natural environment while creating quality, dynamic built environments;
- Ensure the skills which make up the membership of the Institute will be applied to principles of good planning, efficient land utilisation and sustainability of resources for future generations;
- Institute a continuing education and research program to support and assist the industry and for the benefit of others associated with urban development; and
- Promote greater understanding in the community on the role and achievements of the urban development industry.

What We Do

UDIA NSW engages in a range of activities which include:

- **Advocacy** - Lobbying government so that urban development can be undertaken positively and creatively for the widest benefit;
- **Learning** - Keeping members and associates up to date on critical industry issues and best practice through seminars, conferences and communications. Our regular UDIA journal;
- **Innovation** - Encouraging innovation and excellence through the annual *UDIA NSW Awards for Excellence* and giving exposure to the best in contemporary development throughout the year; and
- **Better Business** – Providing opportunities for business networking and learning.