I P A R T
REVIEW OF DEVELOPER CHARGES FOR METROPOLITAN WATER AGENCIES

PUBLIC WORKSHOP

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THE CHAIRMAN: Ladies and gentlemen, I would like to begin by welcoming you to this public workshop being conducted by IPART and to the methodology used by the metropolitan water agencies to calculate developer charges.

I should begin of course by introducing ourselves. I am Michael Keating and I am the chairman of the tribunal. I am joined on this review by Ms Sibylle Krieger on my left, and Mr Jim Cox. Jim is the chief executive of the tribunal.

As you will appreciate, developer charges are upfront charges which are levied by the water agencies on land developers to recover some of the costs of providing water related infrastructure from new developments. In fact developer charges have a long history in the water industry going back to the early 1960s. IPART for its part made its first determination of developer charges in 1995 and the determination adopted a methodology that water agencies must use to calculate the charges rather than the perhaps more normal alternative of IPART setting the charges. That is really because there are too many different charges.

Before that determination water agencies levied charges based on their own methodologies and when IPART assumed responsibility for regulation of the manner in which developer charges were to be calculated, that was intended to improve the efficiency, transparency and consistency of the developer charges process.

As I am sure many of you aware, the tribunal reviewed that determination in 2000 and the revisions that were the outcome of that review have been in place since that time. Most recently in 2006 IPART made a determination on the methodology water agencies must use to calculate recycled water developer charges. The recycled water developer charges methodology is, in fact, similar to that used for the more traditional water and sewerage services with one exception, and that is that there is a provision for an offset when a recycled water scheme results in the deferral or avoidance of other costs.

In the eight years since the tribunal's 2000 determination there have been some significant changes in the New South Wales water industry. These changes include the introduction of building sustainability index, BASIX, and that requires reductions in the average water use in

new dwellings.

Second, there has been a commitment in the government's metropolitan water plan that new developments in Sydney's growth centres will be connected to recycled water. Third, there has been the introduction of the Water Industry Competition Act 2006 and that Act provides for greater private sector participation in the provision of water related services.

Some of the metropolitan water agencies conducted a review of the develop servicing plans and developer charges in 2006. Elements of the developer industry have raised a number of issues concerning the new charges and have questioned the implementation by the water agencies of aspects of the IPART methodology.

The primary aim of this review, then, is to assess what improvements can and should be made to the developer charges methodology to improve its application and the transparency of that application. The tribunal is committed to cost reflective charging arrangements for water and sewerage services. As you know, we have a common postage stamp water and sewerage periodic regimes across the operating area of each urban water agency.

Accordingly, in our view, developer charges have an important role to play in ensuring that development specific and regional cost differences are captured. In essence, developer charges seek to ensure that the activities that give rise to the cost bear that cost.

In conducting its review IPART will rely on its own research analysis as well as public consultation. The tribunal has previously sought submissions from interested parties, and many of you here today have taken the time to make a submission. The tribunal appreciates the efforts you have made in this regard. All of the submissions received have been placed on the IPART website and are available for viewing. All of the submissions received will be carefully considered by the tribunal in developing its recommendations.

Some of the organisations that have made submissions to the review will be participating in our workshop today, and I would like to thank those who have agreed to participate. We consider this workshop to be a very important part of our overall investigation. It is hoped also that the workshop format will not only tease out important differences between the parties, and there are important differences, but also the workshop format will allow the tribunal to explore scope for overcoming those differences and to see whether there are grounds for compromises that might be reached.

Before we commence proceedings today I would also like to say a few words about the process for this workshop. I think you have all got available to you a timetable which indicates the order in which the issues are to be considered. In the first session each participant will be given an opportunity to make some introductory comments and any changes to the methodology that they think might be necessary. This will give participants an opportunity to give an overview of their submissions, if you like. In the other sessions we will then work through the series of issues assisted by members of the tribunal secretariat. Those members of the secretariat who will be assisting us today are Richard Warner and Con Read next to him.

At the conclusion of all the schedule sessions I propose to make available a short period of time for members of the audience who are not sitting at the table, so we will give you an opportunity to express your views and opinions on what has been discussed during that session.

I would now like to ask each participant at the table to introduce themselves for the record by stating their name and the organisation they represent. I will then ask Mr Richard Warner from the secretariat to introduce the first session.

MR OWENS: Mick Owens from Landcom.

MR AMOS: Andrew Amos from Hunter Water Corporation.

MR JENSEN: Trevor Jensen from MIRVAC.

MR GRIGG: Jordan Grigg from Vaughan Constructions.

MS PRYCE: Kristen Pryce from the Property Council of Australia.

DR SCHOTT: Kerry Schott from Sydney Water.

MR RAMSAY: Alan Ramsay from Sydney Water.

MR TAYLOR: Chris Taylor from Rolyat Services.

MR BRUCE: Ralph Bruce from UDIA.

MR WILLIAMS: Rod Williams from Gosford City Council.

MR GRANTHAM: Ken Grantham from Wyong Shire Council.

MR BURKE: Martin Burke from the Association of Consulting Surveyors.

MR PRICE: Peter Price from the Economic Planning Advocacy.

MR READ: Con Read from the IPART secretariat.

MR WARNER: Richard Warner from the IPART secretariat.

As Mr Keating has pointed out in his opening remarks, developer charges have been a feature of the urban water industry in NSW for some considerable time. I seem to recall that the first legislative changes made to enable the water industry to collect these charges date back to about 1963. Developer charges provided a vehicle for the accelerated provision of water and sewerage services to new development areas at a time when there was a large backlogs in the provision of those services.

Between 1963 and 1995 the water agencies themselves were responsible for assessing and determining the developer charges payable in respect of each new development. IPART was only established in 1992. It was not until 1995 that it made its first determination in respect of developer charges.

In its deliberations on the issue of developer charges, the tribunal developed a series of principles to cover the calculation of these charges. The tribunal held that developer charges should involve full cost recovery, reflect variations in the cost of servicing different development areas, result in new developments meeting the cost but no more of the services provided through a combination of developer charges and/or annual periodic charges, cover infrastructure expenditure which can be clearly linked to the development in question and are able to be forecast reliably, be applied to existing and fringe areas alike, and be calculated transparently so that developers can understand and assess the calculated charges.

The tribunal's deliberations of 1995 and 2000 seek to give effect to these principles. The purpose of today is to update the methodology used to calculate developer charges, to reflect changes in the water industry since the 2000 determination was made, and to seek to resolve a number of definitional and operational questions that have arisen in the practical application of the methodology.

As part of this review the tribunal released an issues paper in November 2007 inviting submissions from both regulated water agencies and interested parties. Some 39 submissions were received including 21 dealing with the specific issue of developer charges being levied by Sydney Water on the Yarrunga Estate at Liverpool. As far as the four water agencies are concerned, Hunter Water and Gosford and Wyong councils have indicated that they have few concerns or issues with the existing methodology and are generally satisfied with it.

Moreover there have been few concerns raised by the development industry regarding the application of the methodology in those areas. For its part, Sydney Water has concerns about the differences in developer charges across Sydney. It considers charges are too high in the west and too low in the east. Sydney Water has proposed a range of measures to address its concerns, including a change in methodology itself along with reducing the number of development servicing plans (DSPs) it has through a process of amalgamation.

Some of the specific changes proposed by Sydney Water in its submission include the removal of pre-1996 assets from the calculation of developer charges along with the removal of the reduction amount, that is the periodic revenue minus operating cost component, and the removal of the need to revalue post 1996 assets unless there is genuine excess capacity. Sydney Water has argued that periodic revaluations result in assets being inflated above actual efficient costs; a progressive reduction in the period for the inclusion of existing assets while at the same time increasing the number of years covered for future

assets; applying a capital offset to charges in the north-west and south-west growth areas; reducing the number of DSPs through amalgamation as I have already mentioned.

There are also a number of development industry based associations who have made submissions to the tribunal's inquiry. These include the Housing Industry Association, the UDIA, the Association of Consulting Surveyors, the Urban Task Force, and the Property Council of Australia.

A number of these organisations are represented here today and we are very grateful for their participation. These bodies have advanced a range of themes in their submissions. Principally among these is a view that developer charges should be substantially reduced or dispensed with altogether.

As an alternative means of paying for infrastructure for new developments, a range of alternative propositions have been advanced. These alternatives include the proposition that what has been termed social infrastructure, such as water and sewerage services, should be paid out of general taxation; the proposition that water and sewerage infrastructure should be funded through increased annual charges levied on all properties within a water agency's operating: in short, a form of cross-subsidisation from existing customers to new entrants; the proposition that developer charges should be averaged across Sydney so that all developments pay the same, irrespective of how the cost of servicing differs between areas. This would see low-cost developments in the east subsidising high cost areas in the west.

A range of interim solutions have also been suggested. These include reductions in developer charges in recognition of reductions in service requirements due to BASIX; the introduction of incentive mechanisms where sustainability gains are achieved; a percentage reduction in existing charges for a cap on the maximum level of charges.

Submissions also discussed a range of specific issues dealing with particular aspects of the methodology and we will seek to deal with a number of these during the course of the day. A number of submissions have also been received from organisations and individuals relating to specific issues about the methodology or particular developments or locations. Key among these is the Yarrunga Estate near Liverpool where the developer charges are reported to have increased significantly as a result of Sydney Water's 2006 review. Others deal with increased charges in the Blue Mountains area.

The Tribunal is also interested in considering how developer charges might apply or might need to be modified with the introduction of the Water Industry Competition Act. That Act was introduced by the New South Wales Government in 2006 with the aim of encouraging competition in the water industry. Both Alinta and Australian Water have made submissions as new entrants into the water industry. One supports the opportunity to recover costs through the developer charges, while the other believes they should be eliminated or used sparingly.

The propositions reflect the markets in which these two firms believe they are most likely to operate. One will be competing in areas currently supplied by Sydney Water; the other envisages being the prime service provider in new release areas. Needless to say, for many of the views that have been expressed, another submission has suggested a contrary view. This should make for interesting and I hope fruitful discussion today.

As the Chairman mentioned in his opening remarks, a key element of the developer charges pricing system is to ensure that they are cost reflective and that we have a cost reflective charging regime for water and sewerage services.

Under pricing regimes where periodic water and sewerage charges are common across all agencies' operating areas, cost differences have to be recovered as part of a separate charge if the total quantum of the charges are to be cost reflective. The Tribunal has developed a charging methodology based on the present value of the cost of infrastructure required to serve a development and the present value of the cost of operations, less the revenue received from periodic water and sewerage charges reflects that objective, at least in theory.

The IPART developer charges methodology and the cost-reflective developer charges that it produces meet the important objective of ensuring that new entrants are not being made better off at the expense of making existing

customers worse off. In short, developer charges are an important component of seeking efficient, subsidy-free water and sewerage charges, an objective of the 1994 CoAG water reform framework.

In considering the issues and questions that have been put to you today, I ask you to consider them in the context of how any changes you might propose aid in arriving at a cost-reflective outcome.

THE CHAIRMAN: I will now go around the table. We might start with Hunter Water.

MR YOUNG: Thank you. Interestingly, back in the mid-80s I think Hunter Water started the developer charge regime, moving on from user pays introduction on the basis of getting rid of cross-subsidies and they started with some principles of cost signalling for resource allocation, a belief that growth should pay for growth, the minimisation of cross-subsidies across the industry and also the introduction of the operating cost offset, believing that there should not be any double-dipping and IPART picked that up, as you've said, Chairman, and it has moved forward.

I think this is a great opportunity for the industry to get together and look at continuous improvement and give these things a shake every so often. The thing that strikes me in the debate today about the different options that are available for us and the different variations, I looked at it as not whether it is a question of IPART changing its determination, but with the one determination that's out there, the amazing variations between utilities and their application.

We support IPART having a light-handed approach to regulation, I think that's an appropriate way and I'm wondering of the discussions on the different variations today, how many of these, when we talk about changes, can be made within the existing determination and how many need changes to the determination. I think that's an excellent question.

We don't get many problems from developers in terms of debate on it. The analogy I would use is I'm teaching my daughter to drive at the moment and the other day we had a talk about did she understand how a car drives us forward.

The answer was no because it's an incredibly complex arrangement. I'm not even sure I fully understand it. Over time, we've actually understood how to drive the car forward. That is like developer charges. I think it would be fair to say in discussions with developers they wouldn't understand it fully, but we do understand how to drive the model forward.

One of the things that we've put in place in the Hunter from the earlier principles is the question of limiting a bit of volatility in this area. Our approach in applying what we see as the IPART methodology has been to lengthen our window out to take a long range view and that tends to dampen the volatility because we see developers in the business of investing and they need some certainty and growth is fantastic for our area. Our application of the model through the things that we did tends to dampen the volatility, which we see as right, but there are great variations in how that's applied.

That is not to say that we don't want to make changes. I think we've got too many DSP areas. We looked at that and we're going to do it. We think we can do it within the current methodology. We would like to have a look at this question of MEERA. Interestingly, from our viewpoint, I think 10 years ago the debate in the industry was from the utility side saying that MEERA wasn't good for us, because at that time the construction industry was going down and we were seeing great technological change and because of the MEERA methodology, we were investing higher amounts than what we were getting in our MEERA valuations.

The point I would make on this is that when we talk about a methodology for the future, it needs to be based on principles for the longer term rather than just the principles that we happen to find ourselves with at the present time. It is very instructive to look back 20 years and see where there are major differences from what we find today. What we'd all want is to go for a set of principles that is going to last for the longer term, not just last for the current circumstances.

With respect to the utilities, there is always an inherent inertia to change seeing we've built it up, but I think, from our viewpoint, we would be willing to adopt any agreed changes or model that comes up. We can do it if we think that it supports the fundamental principles that

we started back in the '80s that IPART picked up. We can make changes. The only thing I would say is you're looking at a methodology that applies across a Sydney metropolitan area. You've got the smaller Gosford and Wyong, which is different, and then you've got the Hunter which is the same size as Sydney, but about a ninth of the population. We have more regional and remote considerations where things like price signals for developers are critical for us. It does make a difference.

The trick for IPART is to develop something that works across all of those areas and looks forward and what I do know is if we make changes in how we pull the levers, when we do the analysis there will be winners and losers in that, there's just no doubt. What we really need to think about is when we make major changes - some go up and some go down - how we're going to transition this forward in making those changes. Those are my key points, Mr Chairman.

THE CHAIRMAN: Thank you very much. Dr Schott.

DR SCHOTT: Thank you, Chairman. I would just like to make three points. The first is just a little bit about developer charges in the context of Sydney Water. Developer charges raise about $50m a year for Sydney Water which is less than 3 per cent of our annual revenue. Funding growth through general prices wouldn't have a large impact on customer bills because of the small amounts of developer charges we raise, so they've got nothing to do with financial viability and servicing growth and they also have significant administrative and management costs in implementing the current approach and for that reason, we would favour an approach that was simplified and therefore, much more easily transparent.

Just commenting on a point that Kevin made, there are differences between utilities and how we are applying these, but it's partly reflecting the difference in our areas and operational costs and a lot of the problems that are arising in Sydney are to do with the fact that those areas which are feeding into the three ocean outfall plants have under the current formula zero development charges because of the way the operating costs component in the formula is working.

The second thing I would like to comment on are the signals that are supposed to be being given by the developer charges and they're basically supposed to be about signalling the cost of development in different areas. I think we will need to recognise that planning decisions are far more important than developer charges in determining both the location and timing of developments. I don't doubt that if we set charges high enough we can stop development stone dead, but if you go somewhere that's less extreme than that, it seems to be the planning decisions that are driving things rather than our charges.

I have already commented on the distorted signals that we're sending at present with zero and very low charges in inner and middle Sydney, out about as far as Ryde, where most growth and significant expenditure is going to occur and it is not that Sydney Water is not spending growth expenditure there. Out to 2012, we'll spend about $300m in inner and middle Sydney for zero developer charges and by contrast, very high charges in the Illawarra, Blue Mountains and Western Sydney. As I've mentioned, the main problem with that is the operating result component.

The other signalling thing is we're supposed to be signalling the cost of future growth and to do that we're suggesting removing both pre-1996 assets and the net operating result to make sure that the charges are more incrementally based and better reflecting what the growth costs really are.

Having said that, we also recognise there are other ways to skin a cat and we're not absolutely wedded to the to the approach that we've put forward and we're very happy to go down other paths if people here think that that is a more sensible way to go.

I would just close on the way Sydney Water has been applying the formula which various submissions to the Tribunal have commented on. I have got to say, Chairman, the more I get into the detail of this the more awful the picture becomes, which is another big argument for simplification.

Going forward, there are two things that Sydney Water is intending to do. The first is to reduce the number of DSP areas. At the moment, when we combine our water and waste water areas we end up with 90 DSP areas across Sydney

and the outcome of that is large volatility and developer charges and also quite large differences between areas that can be side by side and what we're planning to do is go down to around about 20, which will reduce the volatility for developer charges going forward.

The other thing that we're planning to do is to review the assumptions that we're using mainly to assess the new way in which the water and waste water system is operating since the introduction of BASIX and more recycled water being provided. We do now reflect those changes in our planning, but that is not yet being reflected in our developer charges and it is for those reasons that Sydney Water has recently capped the increases in residential, industrial and commercial charges in a manner which we think will provide some further consistency going forward with where all of these things eventually end up.

We don't think that reviewing technical issues is going to resolve the underlying inconsistencies with the current formula. Changing the way the determinations have applied may modify charges in the west, but won't remove the large downward bias on charges in the east and inner Sydney.

Just finally, we consider it appropriate to first ensure the various elements of the formula are consistent so that we don't get this systematic bias and we don't get volatility going forward in developer charges.

THE CHAIRMAN: Thank you. I might go to Gosford and Wyong Councils.

MR KOIZUMI-SMITH: Thank you, Mr Chairman. Gosford City Council is quite different to the other agencies that are around the table. We are only a small population, with 65,000 properties. A lot of development isn't greenfields development, it's infill development and in mums and dads subdivisions in the most part.

We think at the moment developer charges work well for us as they signal costs and they allow us to capture and recover the cost of development. As I mentioned, our development really is subdivisions. There are small subdivisions from the larger lots into smaller lots and then some larger developments around redevelopment of Gosford City CBD, as well as a number of other retail areas.

As I understand it, there are two proposals on the table. One is to recover the costs to recurrent charges and the other is to average DSP charges across servicing areas. Both of those could have significant impacts on existing populations. At the moment, as a result of the drought, the Central Coast has been facing price increases as it tries to recover the costs and if we were to try and build in the cost of servicing new development, that could have an unnecessary and quite a heavy burden on the existing population.

With regard to the idea of maybe averaging developer charges across a utility servicing area, again, we have a number of smaller but large redevelopments - and they're mum and dad redevelopments - and it might be seen to be unfair for them to be picking up some of the costs of servicing newer redevelopments in the Gosford central business district. In part, whilst we've have some problem in gauging some of the technical matters of DSPs, we think in principle it is working well for us. We don't get a lot of controversy with regard to our charges, nor have we had a lot of opposition from the development industry in the Gosford area and we believe that at this time it is working well for us.

THE CHAIRMAN: Thank you.

MR GRANTHAM: Thank you, Mr Chairman. From Wyong Council's perspective, we consider that the methodology is fundamentally sound and in that context it certainly meets Wyong's needs, but that's on the condition that there are, as Kevin pointed out, different sized utilities that may have different needs. There are, though, within the determination a number of what I'll call inconsistencies. For example, the determination calls for a review every five years. Yet, at the same time, IPART has fixed some variables, for instance, water consumption, that really should be part of that five-year review and as I understand it might actually contribute to Sydney's problems in their review. Certainly, we see that those inconsistencies should be addressed.

Also within the determination there are some parameters, one directly affecting Wyong, that may not be considered as directly part of the methodology. One is

fixing the charge at 85 per cent of what could be determined under the methodology. That leads us to a point some 10 years down the track where I note in some of the submissions that we haven't been generally informed as to why that 85 per cent exists. From Wyong's perspective we've obviously said that it shouldn't exist, but to go forward, I believe if that 85 per cent is continued, it needs to be transparent and clearly enunciated within the documentation so that we don't have a situation where people are drawing assumptions as to why or why not that 85 per cent existed.

There are a couple of comments I will make in relation to some of the submissions that we've received. One issue is within the IPART methodology a number of variables, a number of assumptions have to be made going forward and these relate to things like the development rates, water usage, operating costs, the price of water, et cetera. For those reasons, the agencies recognised and fought very strongly, even though IPART wanted to fix these charges ad infinitem, for this five-year review period. That being the case, I think there is a danger if a single variable, for instance, BASIX, were reviewed in isolation.

From my perspective, the five-year review provides ample opportunity for those changes to be progressively reviewed over time, provided, of course, IPART hadn't fixed a consumption figure. I think the mechanisms that I've seen within the methodology already exist to address some of these issues.

The final point is I think there is a danger if the methodology itself is distorted to achieve other objectives. I note Sydney's problem in relation to the high cost in the west versus the lower cost in the east, but in fact that was the desired outcome and one of the desired aims of the methodology was to reflect that or to be transparent in those differences in prices of serving different areas. From my perspective, I acknowledge the difficulty that causes and I don't say it shouldn't be addressed, but should it be addressed through this methodology? I think that's another question.

THE CHAIRMAN: Thank you. We have gone through the water utilities. I would now like to call on people from the development industry.

MR JENSEN: I would also take on board Kevin's comments, that I think we have four different utilities in the room that have quite different scenarios that should be appreciated in setting the methodology. At the moment Sydney has an affordability crisis. We had the UDIA conference in Melbourne last week where Melbourne were quite happily spruiking that they've got 1,000 people a week moving into the city and most of them are coming from Sydney and within a fairly short period of time, Melbourne is predicted to overtake Sydney in size.

That affordability crisis is driven by supply and demand and I think the only way to sort out the crisis is the demand is there, but we need to sort out the supply. In essence, Sydney needs to grow. Just taking Richard's points about the pricing signals between the east and the west of Sydney - and I apologise to Gosford that I'm directing all my comments at Sydney - those pricing signals have been set and the infrastructure that's currently being provided to allow Sydney to grow is primarily in the west where technical standards are much higher.

In the east, we have the situation where Sydney Water is discharging directly into the ocean in terms of sewerage outfalls. In the west, that requires a much higher level of treatment. I think that infrastructure is a higher cost, but I don't think that higher cost should be borne only by those new residents and those new residents are the ones who can least afford to provide that infrastructure.

The other thing on pricing signals is that the revenue side of the equation is set. We have the postage-stamp pricing and then on the cost side of the equation we're trying to set these pricing signals. Particularly when you start building in the greater expected rate of return into developer charges, you're getting completely inequitable outcomes because of that situation.

My main point there is let's let the planners do the planning. I endorse Kerry's point. We shouldn't be trying to use the developer charge as a mechanism for guiding development outcomes. Sydney needs to grow, let's let that happen and my view is that the best approach to do that is by combining the DSP areas, reducing them very significantly, probably down to one I think would be the best outcome, so essentially a postage-stamp DSP as well.

Just on that issue, so that everyone has an appreciation of the sorts of dollars that we're talking about, the highest DSP charge in Sydney at the moment, if you add the water and the sewer together, is approaching $30,000, whereas if you combine that into a single area, you're down around the $2,500 mark. We have a massive disparity between the DSPs being charged.

The other key point I would like to make is that the model is too complicated. Essentially, the model should be the cost of infrastructure divided by the number of new residents: the cost of infrastructure servicing new development divided by the number of new residents. When Sydney Water revised the DSP charges a couple of years ago, I had a good look at the Liverpool water system which had a proposed DSP charge of about $3,700 per lot.

When I went back into the model and removed the discount rates and all the other complicating factors, I took the proposed cost of the new infrastructure divided by the number of new residents proposed under Sydney Water's numbers, and that cost reduced to about $1,500. I don't profess to understand the ins and outs of the model, but it suggests that there is something inherently wrong with the model if it is out by a factor or more than 100 per cent. Thank you, Mr Chairman.

MR GRIGG: Jordan Grigg from Vaughan Constructions. By way of introduction, Vaughan Constructions is an industrial developer and builder operating in Sydney and Melbourne. We build approximately $200 million worth of industrial facilities in both states each year. So it has a reasonable volume of industrial projects. I talk from an industrial perspective rather than a residential perspective. I also represent the Yarrunga land release area only, so I will talk specifically about Yarrunga as a real case in point.

Vaughan Constructions is at the coalface. I can't really contribute much to the calculating methods of how you are getting to the developer charges, but what I wanted to say today is that our land in Yarrunga, I suppose, will not be developed under the current charging systems just purely from, as Trevor mentioned, a supply and demand point of view. Industrial users have other options apart from going to a certain area. The Yarrunga release case is uneconomical in its current form, which I think is in complete conflict to the government's motivation to release new industrial areas.

To put it in perspective, we purchased a 5-hectare parcel of land near Liverpool in the Yarrunga release area. We purchased it in December 2006 with the understanding that developer charges would be in the vicinity of $500,000 for that 5-hectare parcel. Under the current calculations, which is 18 months later, that same $500,000 is now $2.3 million. The effect of that in simple terms means the land will need to be sold for plus $400 a square metre onto owner occupiers or other users.

That probably doesn't say much, but this land competes against Eastern Creek as an alternative, which is a superior location, and that land is valued at about $350 a square metre. So as a user you obviously want a superior location, and if you can get it for a cheaper rate it is a pretty simple equation for an industrial or warehouse user.

Trevor mentioned supply and demand. Industrial users have choice. He talked about Melbourne. Sydney needs to become more affordable and not more expensive for the growth to occur. We need to work out ways to do that. In effect, it is a new release area in south-western Sydney, but it just won't be developed, which is a frustration for the industry and ourselves as owners.

The Yarrunga release area is an interesting area of land in that it has a number of holders. It has small farmers, some long term land-holders who are passive investors. There are small developers who do not have the money to contribute the large proportion up front for developer charges, particularly with the current calculation. There are some larger developers like ourselves. There is also Aldi who an actual user who has recently purchased some land in the area, so there's a differing circle of people in this area who have the dilemma of how to unlock their land. I appreciate that charges need to be cost reflective, but there somehow needs to be some sort of subsidising to encourage development.

We can't question the calculation method in too much detail from our own experience, but the anticipated usage calculations we question. In addition, Aldi Supermarkets has prepared a considerable alternative calculation method for what Sydney Water anticipates to be their usage for

sewerage and water, and comparing it to an exact replica of the facility they are proposing in Liverpool. They have an exact replica in Minchinbury. It is actually using 6 per cent of Sydney Water's present calculations for usage. So there is such a big gap in between. Heavy industrial or warehouses is a way to separate those uses.

Likewise with recycled water. We appreciate that recycled water is needed in industrial facilities, but our development again is a case. It is a 50,000 square metre block of land. There will be a 30,000 square metre roof which can potentially recapture recycled water, and that can be held and it can service its own needs quite efficiently and economically.

That recycled water contribution in the $2.3 million I quoted before is $600,000 worth of about $2.3 million for recycled water contributions to the system. We would be proposing, if the development can justify its own collection methods, in some way reducing the need to tap into that system, that may be the way. That is us in summary.

MR GADIEL: Aaron Gadiel from Urban Taskforce Australia. Let me start by saying that it is government policy that sees Sydney growing. The Sydney metropolitan strategy says that Sydney needs another 1.1 million people over the coming 25 years. That means 640,000 new homes, 500,000 more jobs, 7,500 hectares of industrial land, 6.8 million squares of additional commercial floor space, and 3.7 million metres of retail floor space. Obviously that is only going to happen if it is not commercially viable for the private sector, but it is the government who has set out these growth targets for Sydney, and the private sector is trying to respond and work within that framework.

What we do have at the moment, though, is the market not functioning properly to achieve the government's objectives. The government itself has recognised this and made some policy decisions to address this late last year in terms of developer charges that might otherwise impact rates of cost on what otherwise comes from the state budget. This is another aspect of that debate.

It is well accepted within all the economic forecasts that underlying demand for housing and land in Sydney is very strong, but the supply is not matching up with the demand. If you look at lot production for new housing lots, it is half the level - and that is not taking into account population differences - of Queensland and Victoria. Apartment construction in NSW is roughly the same as in Queensland, again despite our population differences. New housing lot production in Sydney is at Adelaide levels at the moment. Last year in fact we had the lowest level of lot production in 50 years in Sydney. So there is a disconnect between what is available and what can meet consumer demand.

The main problem is that the costs for the developer are very high and the consumer is unable to afford the actual cost of the supply of the land for the new housing. If you look at north-west and south-west growth centres as a whole and average between them, the developer would make a loss on average of around $2,500 per lot if they were to try to develop that land into fully serviced residential lots. So obviously there's exceptions, it's an average, so there is ability in some areas to make modest profits, but by and large it is not a profitable proposition to develop housing lots in the growth centres at the moment.

We suggest that government and its authorities and bodies like IPART need to have regard to the need to achieve public policy objectives. IPART methodology very much sees these costs as private costs. That is reflected partly also in submissions from the utilities.

There was a reference earlier on from one of the utilities that there is an issue about the existing (inaudible) costs on existing customers as opposed to new customers, then there is an equity issue for existing customers. We reject the idea that existing customers and new customers are actually different people. They are actually the same people. Someone who is buying a housing lot built in a growth centre of Sydney was probably previously owning an apartment in Parramatta or living in rented accommodation in Liverpool. The idea that there's two distinct groups of people and asking one group to subsidise the other by having some form of uniform charge is a nonsense.

People move about. The growth is being caused by all of us as a community. We are having children. We are having, unfortunately, divorces and separations which require extra housing stock. Our children are making the

decisions to live single longer which requires extra housing stock. It is a collective problem for all of us. In fact, the people who are most likely to buy new housing stock are actually the younger lower income members of our society, or the older lower income members of our society. The apartment buyer in the inner west is generally on a lower income than a buyer of established housing in the inner west, and the same can be said for almost any part of Sydney. A purchaser of a new housing lot on the outer suburbs of Sydney is generally of lower income than a purchaser of an established house in Parramatta.

So the idea that these lower income customers are causing a problem and therefore should be charged for part of the problem more than others are is inconsistent with basic notions of equity, and is also inconsistent with achieving the government policy goals.

I certainly agree with Sydney Water that the major driver about which land is developed is not the DSP charge, and I don't think we can pretend that it is. We would love a system where the market was the driver about which land was developed. That would be a wonderful system and the charges could be structured to make sure that those decisions are made (inaudible) actual reflective costs. It would be a wonderful system, but it is beyond IPART's capacity to implement this, because you are only looking at a tiny part of the equation. The reality is we have in this state, as most of Australia, central planners deciding which land is to be developed and when, and particularly in Sydney they adopt very much a drip-feed approach which means they, without looking at market viability, make available relatively small patches of land for development. They withhold vast quantities of land that could be developed, and if that land is not developed they say, "Just sit back and wait, and eventually it will be." That is what we have in places like Edmonton Park that has been rezoned. That is very difficult to develop on a cost effective basis, and that land is sitting there. Nevertheless the Department of Planning would tell you about the vast quantities of land that have been rezoned and ready for release.

So without a holistic reform of our planning system, (inaudible) fee charges are an effective signal for which land is to be developed is, we think, a furphy. What the DSP charges can do though is delay development. Because planners are only releasing enough land in their minds to service the needs in the coming few years, if the land doesn't stack up commercially it just sits there and no development happens. DSP charges are contributing to that decision, so our submission goes to the detail of the average cost base for developing land in the outer western suburbs of Sydney, and it shows at the moment that on an average basis the loss to the developer is $2,500. A change in cost of $10,000, which is a typical DSP charge, can make a huge difference to that equation. It can actually boost the ability of the developer to develop land.

In conclusion, we would ask IPART to step back from looking at the detailed methodology. We certainly would ask IPART to resist any move to impose new charges on brownfield developments - well, effectively a new charge on brownfield developments - and we would suggest that an approach that takes into account some of the government's policy objectives is imperative in this situation. Thank you.

MR OWENS: Mick Owens from Landcom. I think the first point is about the current complexity of the system, that you only need slight variables that happen in the calculation to get completely different answers. That is reflective in some of these areas having completely different charges in the DSP areas. So there is a question of complexity.

Kerry has spoken about the administration costs associated with that, but also from the developer industry side of things, it takes us usually about six months to assess these DSPs. So it takes a while to sort that out. So you do have this problem of uneven distribution geographically which can be even quite close, so from a price signal to end consumers (inaudible) make a great deal of sense.

I think what is coming into the fray now is different standards in different areas. Now we are talking about how precious water is and new areas are saying "We need to have recycled water systems" and also water quality treatment comes into the system. You do have inequalities happening across different sections certainly in the Sydney basin.

I would like to reinforce a little from the developer

industry side of things - the impact on the viability of some of these areas, particularly in the growth sectors in the Western Sydney. I can tell you that it is quite touch and go about how viable some of these areas are, particularly in the south-west. If you look at where the government does want the area to grow, for Sydney to grow it is predominantly in the south-west where you are talking about 100,000 new home sites to add to the 600,000 that we have spoken about earlier. So there is a bit of a shift that needs to happen there.

From our point of view, we certainly support the idea of having lower DSP charges, but consistent DSP charges across the spectrum, and the ability to maybe have a slight increase to the end consumer in annual rates. From a development point of view, that is a financially more efficient way of delivering these services because you are actually charging these things much earlier in the development process at internal rates of return and investment returns of 15 per cent versus 6 or 7 per cent further down the spectrum. You start to create these inefficiencies from an overall economic point of view. So I would like to finish on that point, thank you.

MS PRYCE: Kristen Pryce from the Property Council. I would also like to start by thanking IPART for having this workshop today as outlined in the issues paper. I would also like to thank Sydney Water for being extremely transparent and open in working out their issues during the submission process.

I am unable to comment directly on the technical aspects of the methodology, but I would like to raise a few of the broader issues that our members believe should be considered when considering a methodology. I also acknowledge the issues that have been raised around the table already regarding the (inaudible) in Western Sydney, but there are concerns about issues in the infill areas and the difference between those.

At a minimum there needs to be a high level of understanding that it is very complex. As a layperson looking at this it is very difficult to get your head around it, but I think people should step back and acknowledge that there does need to be a change in the space. Of course, this will require a lot of discussion acknowledging that the high level planning agenda has been set in NSW, where it does say that 60 to 70 per cent of new dwellings will be in infill areas, and also acknowledging that there's issues in the west of Sydney where it is just becoming increasingly expensive to develop.

Three broad things that were brought out in our submission were the issue of BASIX which needs to be addressed in the methodology, and making sure that people aren't being unfairly charged for making sustainability gains. Then there's also issues where there is a desire to go above and beyond the issue of BASIX with respect to residential. Also moving into the industrial and commercial sectors where there is a desire to improve sustainability and ensuring, that this desire is supported and acknowledged in the methodology. If there is a desire to achieve this, then there is some financial incentive to do so.

Of course, there is the broader issue of the impact that developer charges are having on affordability. I think this has been widely acknowledged that it is a problem. So I definitely think that there is space there for discussion around how you can ensure that developer charges are not inhibiting development and are not making it increasingly prohibitive for people to enter the market so they are the three broad things that I would like to discuss.

MR TAYLOR: I would like to support very much what the industry members have said, particularly Mr Gadiel, that it is silly to divide people into new entrants and existing entrants. One of the things that we are doing in Sydney is we are making it incredibly difficult for young families. Apart from a bit of work I'm doing for the development industry, in the last years I have done a lot of work for the railways, looking at the south-west, north-west rail links, and development up the Central Coast. At the moment I'm working on the new Warnervale railway station. That is a two-hour train trip by a fast train to central Sydney.

Most of the people up there will have to work in the Sydney area because there are no local jobs. Some will get work in Newcastle, but most will have to commute to Sydney. Rather than take your life in your hands on the F3, I think the sensible ones will travel by train. So the commuters are looking at four hours a day minimum travelling time into the city.

I notice in today's agenda there was no mention of affordability, yet it was one of the points that was discussed in the old water industry forum 14 years ago. In recent years we have had a period of sustained low interest rates, and that is changing. We are seeing interest rates rising all around the world, and Australia seems to be leading the way. So there will be more impact on people's mortgages, young families' mortgages.

If you look at the impact that young families are being faced with, there is the increasing cost of child care. A lot of mums have to get back into the workforce and, as I say, what we are doing with working people and people who are the life blood of servicing Sydney? We are forcing them further and further out of Sydney. You will find that some of these people are commuting five and six hours a day. That will increase in the future. There will be people living up in the Hunter Valley coming to Sydney because we are squeezing them out of Sydney with the high land and house prices.

There is very high rate of marriage breakdown on the Central Coast. There's a lot of social problems. I would say there would be a great risk of people just basically being exhausted and having accidents at work, driving with that commuting load. So there are some major social impacts in the work we are doing here today.

One of the other issues I would like to raise, and it seems to me reading at agenda that we have assumed that the continuing method will be upfront charges where everything has to be paid up front. Our friends in the superannuation industry, as we know, are awash with money. Many of the industry funds particularly have spoken to the development industry and to government and said that they would very much like to invest in infrastructure. They see it as a quality investment, as a quality long term investment, and that would be a more cost effective way, certainly for the end user, of financing this development. I have never yet been convinced why these things have to be paid up front.

It seems silly to me that Australian superannuation people like Macquarie Bank are providing infrastructure for countries overseas, but paid out of Australian profits, yet we are not using the same money to provide infrastructure in Australia. I just cannot for the life of me understand the logic of that. I don't know why governments will not use that as a form of funding. There seems to be some ideological bias against it, but to me it makes perfect sense that we use Australian profits to provide better infrastructure and better lifestyle for Australians. Thank you.

MR ROBERTSON: Tim Robertson from UDIA. I would like to support Kristen it commending the tribunal for holding this review and engaging with the industry in this workshop. UDIA has reviewed the issues paper, and we think there is a compelling need to completely abandon the current methodology and charges frame work.

Just picking up on Aaron's point, there was a near 50-year low in dwelling commencements in 2006 and 2007. It is also worth recognising that in that same year nine out of every 10 dwellings in Sydney were constructed in existing urban areas within the existing urban footprint.

The cost of funding new water and sewer infrastructure is borne by those who choose to live on the fringe. This obviously presents considerable intergenerational and geographical inequities. Because those have the least ability to pay, the young and geographically marginalised have to bear all the cost while the comparatively wealthy of earlier generations have to pay effectively nothing.

UDIA has taken this opportunity to recommend a new model which does not unfairly disadvantage home buyers in new release areas. We think the current framework is flawed because it creates an unnecessary complexity which impedes transparency. It is an inefficient tax. It requires vulnerable new home buyers on the fringes to subsidise existing suburbs. The major point is that it doesn't account for system capacity and therefore penalises BASIX compliant residences.

The sunset clauses of 25 years, greenfield land supply in Sydney, will significantly increase up to 2031. Really declining affordability in NSW demands a different approach. Average connection costs in Western Sydney of $20,000 exceed the market's ability to pay when combined with other local states and Commonwealth charges.

I might defer to Peter Price who has also assisted in our submission, and he can make further comments on the

more technical issues here.

MR PRICE: When I thought about this process today and where we have been, the thing that came out of submissions as I read through them was that nobody supports the concept of price signals. It has been a cornerstone of the whole developer charge process. They don't exist for a whole lot of logical reasons. Now whether a price signal equals cost reflectivity is another question that we need to address, but the whole idea that somehow or other decisions have been made based on price signals coming from developer charges is a nonsense as has been identified by other people. It can't be better demonstrated than in the western areas of the south-west sector where decisions have been made where the acquisition of land is made long before development charges are even set.

There is a huge time gap between when land is acquired and rezoned and when developer charges are provided. As far as what has been raised as to the type of people who are moving here, there is an interesting statistic that was brought forward in 2001 by a director of the Department of Planning and that was that there is a phenomena which is the shift of people as demonstrated by the consequence of occupancy rates changing and going from, say, three down to 2.7. What that means is that there are people moving out of effectively a whole raft of houses. The department came to the view over the 20 years from 1980 to 2000 they needed 110,000 houses just to accommodate the shift in occupancy.

That obviously isn't going to be all in the south-west sector, but that's a measure of the effect of the shift in occupancy. That is besides the people who are selling a large house and moving into a smaller house, et cetera. The price signals are an important principle, it would seem to us, and if you abandon price signals as a principle, the whole process then becomes more open and logical for change.

The UDIA's view is that if the effect of abandoning developer charges is between $20 and $40 on the annual charge, why in the hell is everybody expending all this effort and bashing their heads up against each other about the development charges? Maybe that is not going to be a solution, but I think there are other aspects of the whole developer charge process that need to be considered. One was raised by somebody else here that we've got huge variations in standards, but I think what you need to understand is that we need to extend that concept a little bit further.

What we've got at the moment is these people who are paying no developer charges are living with substandard systems and somewhere down the line they're going to have to be upgraded and eventually somebody is going to say, "Why is it that the major regional councils are able to virtually, in some cases, eliminate discharges to streams and oceans and Sydney is sitting here with huge discharges to the ocean?" and whether or not that's going to be acceptable in the future and what is the cost of that and who is going to pay for that.

What the developers fear, of course, is that if it is a renewal of the existing system, the cost goes on to the annual charges which everybody pay and then in the end the people in the west aren't paying their share yet again.

BASIX is a major issue that we wish to raise and it's a capacity concept and the difficulty is that the current models that are being used by the authorities generally don't take into account capacity. It might seem a bit strange that I would say this, that the net present value model can be changed to accommodate it, but it is interesting to note that the ROI method used by the Department of Water and Energy in fact consistently uses capacity in the calculation of the cost per ET for major assets and all the regional councils are using capacity based charges for their major assets. This can't be done under the current methodology adopted by the various authorities.

We are getting confusing messages about the transfer of cost between annual charges and developer charges and this was raised in the discussion by Sydney Water and within IPART's other documents, particularly the previous review of recycled water charges, about the RAB or the regulatory asset base and the return on assets. It hasn't been resolved. I haven't been able to sit down with Sydney Water and go through their concept of this, but there are clear statements in their submission and in other locations that the current methodology potentially has the effect of using developer charges to reduce annual charges and if that's the case, obviously, you would understand that the industry would have a substantial objection. It

is just another complication in the process.

Recycled water charges are an issue and they more than any other raise the point that here are new developments meeting all sorts of new standards for all the best environmental reasons and recycled water charges clearly have a major environmental element, but the people who are bearing all of the cost are people in new developments. There is very little hope of the existing users being required to meet the demands that have been placed on new areas for recycled water.

Another fascinating aspect of the whole recycled water thing is that the impact is not so significant from the point of view that we're looking at about 5 per cent of the water being recycled now and it might grow to about 10 per cent in 2015, on Sydney Water's figures. It is a lot of cost being shifted on to new development at not a significant effect. Of course, I've always wondered why in Sydney - which has been through a fairly long period of short water supply - that water that has been treated to a high standard isn't being used, like in many other countries, for indirect potable. I just can't understand why we're not seriously considering that. The effect would be dramatic upon our water supply. The problem with recycled water is that I gather that even in the Rouse Hill area, which initially had a fairly good take-up, people are becoming less enamoured with recycled water for all sorts of possibly irrational fears about the nature of the product.

One aspect of the recycled water charges I would like to raise also is that there seemed to be an expectation by IPART that there would be some cost offsets in the process of determining the charge, because clearly there may be overlaps with the provision of other services. I don't know what IPART expected, apart from what's in your own paper, but the outcome has been for Sydney Water $1 and for Hunter Water zero dollars. If we are to have recycled water charges on new developments, we do need to look seriously at what was the expectation and how IPART expected that to be applied.

There are some variations in the models between the various authorities. Sydney Water has recently changed theirs in one aspect that we have been agitating made little sense. It doesn't make a lot of dollars, but it's just one step towards making the process more rational. I know we talk about the old times were good times, but quite frankly, the point we were in 1995 was a point that the industry could live with. We can't live with the changes that have been made since then and the complaints that we've been making are basically about the changes in interpretation and approach that have been made since that time. That goes for Sydney Water and Hunter Water in particular.

What we are concerned about are the principles. It is one of the reasons why when we prepared the New South Wales regional DSP report, we concentrated on principles that would apply broadly and it has been suggested here already that the guidance that we receive from the current determination is so minimal that it has allowed these variations to occur and what the DEUS guidelines at least had was some guidance. In fact, while it doesn't recommend it and almost nobody uses net present value in the regional areas, they use the ROI method, their description of the way that you can apply net present value to the calculation of the charge is in fact more correct than what has been used widely within water authorities.

Going back to the starting point, if we agree that price signals at best are negligible, I think we create an opportunity to widen our thinking about how we might resolve the many concerns that have been expressed around this table.

THE CHAIRMAN: Could we hear from the Association of Consulting Surveyors.

MR BURKE: My name is Martin Burke. I have been asked by the Association of Consulting Surveyors to come along and observe proceedings today. We represent the private industry in New South Wales and we're very closely related to the development industry, as you can imagine. While appreciating the importance of the methodology and formulae used in DSP development, we are equally concerned about the ability of the authorities to apply the methodology correctly in assessing DSPs for individual developments.

From a personal perspective, I have been involved in negotiations over the last five years where in the area of $10m to $20m has been incorrectly calculated. You can see there is a big issue as to the ability of the officers

within the authorities to do the calculations correctly.

We are also concerned about design allowances and ET multipliers in relation to the authorities overestimating demand and therefore over-recovering through the charges, particularly in relation to area based charges for industrial and commercial properties. As the Yarrunga Estate person said earlier, industrial land is using up to say 10 kilolitres per hectare per day on average in Sydney, higher in some areas, but our studies in Western Sydney indicate 10 kilolitres per hectare per day for water usage, while Sydney Water is charging at a rate of 35 kilolitres per day for sewer discharge for the same site which is why the ET multipliers are so high for industrial land and in the sewer area, which is the big issue. I look forward to the rest of the day. Thank you.

THE CHAIRMAN: Thank you. Are there people in the audience who want to make a general comment at this stage?

SPEAKER: Will we have an opportunity to do it later?

THE CHAIRMAN: You can do it at the end of another session.

SPEAKER: We'll learn more as we go and then we will ask a question.

THE CHAIRMAN: We will certainly give you a chance before the end of the day. Thank you. I think we're slightly late in our schedule, so we'll have a cup of tea and resume again. Can I say that I appreciate that some people disagree about whether we should have developer charges at all. That has often been linked to the view that we've got a housing affordability crisis. With $50m in total revenue for Sydney it's hard to say that that's a major element in the housing affordability crisis. A quarter of a per cent on the interest rate would add far more to the cost than $50m. You can see that every month in the paper when they report the latest interest rate increase. I think while the housing affordability crisis is obviously a critical issue, it won't be solved by developer charges.

I also appreciate the view that maybe governments should be financing infrastructure from superannuation money and so on, but that's not on the agenda today. Whether it should be, that should be taken up in a different forum. We really do need to focus on what was the purpose of the developer charges. Peter Price, for example, says that they're not very effective price signals. I suppose I would respond that while I'm sure there are a whole host of things that affect the take-up of land and where it's zoned and so on, I don't think you should necessarily then say, "Oh, we shouldn't set price signalling at all."

For example, the reason why some people buy different types of cars has to do with a whole host of factors other than the price of the car, otherwise they'd never sell a big car. Nevertheless, it is important that you also have the price signal and that should be a cost-reflective signal. Having said that, I think there are important issues as to how well we're setting the price signal at the moment and that's what I would like to think we would focus on in the sessions to come. Thank you very much. We will resume in about 15 minutes.

SHORT ADJOURNMENT

MR WARNER: This is our second session for today. This is a long session, so it will take us a bit of time to get through. I apologise for that. A lot of these things are interconnected. The things we'd like to look at during this session include cost recovery, cost reflectively and the nexus. Included for consideration under this item are going to be assets included in developer charges and asset valuation methods, period of analysis, reduction amount, and DSP areas and WICA, some of which have already come up in comments today.

The Tribunal's developer charges methodology is made up of three key elements. These relate to the value of the assets installed or to be installed to service a development, the cost of operating and maintaining the services used by the development and the periodic revenue that the water agency expects to collect in periodic charges from people who will reside in the development. These last two elements make up what is known as the reduction amount.

As has been said earlier, IPART supports cost reflective developer charges to complement its periodic charges. For assets to be included in a developer charge there should be a nexus between the asset and development: in other words, the development should derive service from the asset. The only other real restriction on the inclusion of assets is that they must be built after 1 January 1970.

While the Tribunal seeks cost reflective developer charges, it appreciates that there is the practical need to limit the number of charges and development servicing plans for reasons of administrative simplicity and manageability. Because of concerns about the level of charges in different DSP areas, Sydney Water has proposed a number of changes to the methodology and these changes encompass the removal of pre-1996 assets; the removal of the reduction amount; the removal of the need to revalue post-1996 assets; the progressive removal of the number of years of existing assets included post-1996 an increase the number of growth by years of growth assets; the application of a capital offset to changes in the north-west and south-west growth centres; a reduction in the number of DSPs and setting developer charges in priority sewerage program areas no greater than the highest non-priority sewerage program area charge.

Some of the key questions we would like you to consider under this heading are, how should the trade off between cost reflectively and the ease of administration be managed? Does Sydney Water's proposal achieve cost reflectively? Does it ensure a nexus between a development and the infrastructure that it serves?

To serve developments, the infrastructure required generally has to be in the ground before the first residents arrive. In addition, water and sewerage infrastructure is built with capacity in excess of immediate needs, with capacity taken up over the development train. This naturally means that most infrastructure is in the ground before or concurrent with development taking place.

Some have suggested that the dominance of existing assets is somehow inappropriate and that more weight should be given to assets yet to be built. There are also assets that will serve existing customers as well as including provision for allowing for growth. Tillegra Dam and Sydney Water's desalination plant provide supply security to existing users while also potentially supplying a water supply to new entrants. The question that needs to be considered is how these costs might be apportioned.

The current methodology requires that water agencies use modern engineering equivalent asset values for determining charges. Asset revaluations can mean that developer charges increase for no other reason than the value of the underlying assets has increased.

It has been suggested that a different approach be adopted, such as CPI indexed actual cost. It seems to be inappropriate to adopt a MEERA value for existing assets on the one hand, while on the other agencies may defer new expenditure in the face of those same rising costs, for example. For periodic pricing IPART adopts CPI indexation of its regulatory asset base. The use of CPI indexation is one part of the developer charges equation and can result in a divergence if a different index is used to calculate another component.

Some of the views of stakeholders on these issues include Sydney Water is of the view that future cost of development is not signalled correctly because of the emphasis on existing assets. Hunter Water proposes that growth and drought security costs for the Tillegra Dam be apportioned on the opportunity cost of not building the dam for drought security purposes and I look forward to hearing a bit more about that approach.

MR YOUNG: Stay tuned.

MR WARNER: Sydney Water comments that MEERA valuations exceed efficient costs. Mirvac comments that it encourages over-engineering. Some other stakeholders support actual cost or market cost. The questions we would like you to turn your attention to on this issue are on what basis should assets be apportioned between growth and other cost drivers? What are the advantages and disadvantages of using MEERA as a valuation method? What valuation alternatives are there - e.g CPI indexed actual cost - and what are the advantages and disadvantages?

In relation to the period of the analysis, there are issues about how far into the past and into the future to include assets. The determination currently mandates the exclusion of pre-1970 assets, rules for post-1970, post-1996 and yet to be commissioned assets and a 30-year forecast for reduction amount calculations.

There are a range of reasons for the exclusion of pre-1970 assets. Principal among these was the view that it was unlikely that new entrants would benefit from assets built more than 30 years previously and that these new entrants were unlikely to have influenced the decision to build the asset. In short, nexus was tenuous. Post-1970 and pre-1996 assets were deemed to have been built for a range of reasons, not all of which might have been on a sound economic basis.

The Tribunal also considered issues of affordability and the transition to the new charging arrangements. For these reasons, the Tribunal decided on a 3 per cent discount rate for Sydney Water and Hunter Water and a zero discount rate for Gosford and Wyong Councils on these assets.

For post-1996 assets, the position was somewhat different. It was considered that the water utilities are entitled to earn the opportunity cost of funds they invest in their infrastructure in the same way that any other business seeks to earn their opportunity cost of capital.

Indeed, if water agencies are unable to earn returns commensurate with their opportunity costs, society as a whole would be better off if the money was put to more productive ends. Post-1996 assets are therefore expected to earn 7 per cent real pre-tax. This is the discount rate used by all water agencies at present. The real issue is whether this rate should change in line with changes to the weighted average cost of capital of each agency determined from time to time by the Tribunal.

The determination also provides that 30 years worth of offset amount - that's that periodic revenue less operating costs - should be offset against the capital charge. This recognises that a component of periodic revenue also pays for assets provided by water agencies.

Stakeholders in their consideration of these matters have proposed rolling forward the 1970 deadline to maintain a 30-year nexus window, as well as using a 30-year rolling period for the inclusion of past assets and use a 10-year rolling period for the inclusion of future assets. Sydney Water proposes changes to exclude pre-1996 assets, roll forward post-1996 assets within a moving time frame and lengthen the period for inclusion of assets yet to be commissioned to 10 years. Hunter Water Corporation proposes a 30-year rolling time frame for the inclusion of assets.

Questions the tribunal would like you to consider on this issue are on what basis should the determination treat assets. Should it be nexus alone, and more particularly how should it treat post 1970 assets, post 1996 assets, and assets yet to be commissioned? Are the distinctions made still relevant?

As mentioned, the operating cost forms part of the reduction amount. The reduction amount should reduce the capital charge by the amount water and sewerage bills contribute to capital costs. This ensures that there is no double-dipping, or calling on new entrants to pay up front in time for the same assets. The reduction amount is calculated as the net present value of revenue minus operating costs per ET. The determination requires DSP specific operating costs to be used where available.

Because data became available, Sydney Water changed to DSP specific operating costs at its last review in 2006. Sydney Water reports that some of the changes in its developer charges are a result of this action. Sydney Water proposes that the reduction amount be removed from calculations. Agencies report increases in operating costs due to increased input costs, such as energy, and more stringent standards.

Some of the questions we would like you to consider are is there a mismatch between using average periodic revenues with DSP specific operating costs? How can the determination be improved as it relates to operating costs while remaining cost reflective?

DSP and WICA - there are issues about the requirement for there to be a nexus between assets charged for in the development when determining DSP boundaries. Currently agencies can choose the boundaries for their DSP areas themselves. The WICA creates questions regarding private entities and how they charge their future customers.

Sydney Water has proposed amalgamating its DSP areas, as you have heard. Stakeholders in the Sydney western growth areas support changes that would lessen cost

reflectivity (eg DSP amalgamations), those in the east do not.

Hunter Water is concerned about the requirement for nexus when amalgamating DSP areas and some potential competitors in the urban water market believe that upfront charges are necessary for them to compete with government utilities. Others have argued that they should be dispensed with.

Some of the questions we would like you to consider are what principles are important for establishing DSP boundaries or, to put that another way, if amalgamations are allowed what should guide the decision-making? Clearly with the issue of the size of DSP areas, there is a trade off between administrative simplicity and cost reflectivity - the questions about striking the right balance between the two. In considering the issues of boundaries, the tribunal will want to be careful to ensure that it does not disadvantage potential new entrants who cannot amalgamate areas and charges. What issues might arise under WICA?

The questions span two pages. I understand people have got copies of those in front of them. We are clearly not going to be able to get through all of those with comments from all speakers, so I would ask you just to touch on those things that are of interest to you.

THE CHAIRMAN: We will start with Hunter first.

MR YOUNG: I will start off with a couple of comments just following up from the last session on this question of price signal. We still see developer charges sending a price signal. I got reinforcement from that around the table from a number of developers who said they are listening to the price signal, which means they are holding off or they are not developing at the moment. Certainly in the Hunter, in some of our more regional areas, it is sending a price signal. We see that as important. Some of these areas are incredibly expensive to develop.

Looking forward on the question of cost reflectivity and administration, we would love a system that had both cost reflectivity, sending the price signal, and was really simple to administer, so if IPART could serve that up to us we would think that would be fantastic. That is a difficult thing to do, and no model is perfect, so there's some trade-offs here in the complexity, the administration and sending the price signal, but we do think that, as Richard said earlier, we would like to balance out with some lesser number of DSP areas which we think we can do at the present time.

Our difficulty is that the IPART determination talks about a nexus between assets and the developer charge area. We are probably zealots in this area and it has meant that we have taken that to the extreme where we have got a large number of DSP areas, so very cost reflective and then high administration costs. We believe that IPART should look at this to be a bit more flexible looking at geographic areas and we would like to gain benefits from grouping areas together.

On the Sydney Water question of looking at can we drop out all assets before 1996, the answer of course is yes, and we can pull those levers and go for a shorter window and get rid of the operating offset. Hunter Water has had a view that we have gone for a longer window because we believe that is beneficial to the developer community in that it gives sort of an averaged approach over time. So we went for a longer window so that we weren't picking a shorter window which we saw as more volatile. The best way I can describe that would be to look at the average results of the share market over a longer period versus saying we are going to go for a shorter window of the share market. If you look at that you can get great volatility of increases and decreases.

We have had a look at this question of dropping out pre-1996. The top one is waste water developer charges. If we just went to an average system cost, system wide operating costs, you will notice in the Hunter, right-hand side, we have a number of areas on the extreme, that there is a high price signal in that area. In fact, I think that is Paxton and Karuah, and for those the cost that we get from our postage stamp revenue would barely pay for the cost of laboratory testing for our waste water treatment plant, let alone any costs of operation, maintenance, labour, capital, return. It is an area with oysters in the local environment. It's the most expensive plant by far that we have ever considered building, and there is a huge pressure to develop this land further.

At the moment we are saying yes we can do this, but we are sending you a price signal that it is incredibly expensive for us to put water and waste water in this area, and incredibly expensive to operate and maintain. If we went to system wide averages it would significantly drop the signal in those areas. It would make virtually no difference on our weighted cost, which is the blue line and the red line you can see there.

The next one, chart 2, is the effect of removing pre-1996 assets and the net operating results for the Hunter area on water development charges. You can see that the red would be the impact of the new approach and the existing approach is the blue lines. The blue lines - in some of our inner city areas we are virtually charging nothing. In our remote areas we are sending a price signal. If we went to this approach, it would smooth them all out. We would still have some price signal, but it would be significantly reduced. Interestingly, we'd make more money on this approach than we currently do on the weighted basis. So we'd get more money from developers on a weighted basis and we would lose the price signal. This is just the results in the Hunter.

On the waste water, that is a really interesting one. It virtually makes no difference in the weighted amount of money that we make on developer charges. We lose some of the price signal - on the right-hand side of the chart - for some of these remote areas, and the major thing looking through that is that there is just a mix of winners and losers in pulling these new levers, so our approach would be in talking to the community about who is now a winner and who is now a loser with the new approach and the new levers we are pulling and how we would transition that to the future.

In summary, any model will work. Our fundamental approach is that we are still believers in price signals. We think it does work. We would be happy to move towards a system, a new approach by IPART, in different weighted applications if that could give us simplicity, but we would not like to lose the price signals and we believe that any changes have to have some consideration of a transition for people that move from winners to losers and losers to winners.

MR PRICE: On the question of price signalling, the problem there is that it seems there is a price signal here for the sake of it. What we have got here is a direct conflict between the planners and the water authority. The planners are saying, "Yes, go ahead with the development", and the water authorities are saying, "No, we are going to charge." The third element that you pointed out specifically was the location of the sewerage treatment plant that has been built to a very high standard to meet environmental issues that are issues for the broader community. So really the whole question of price signalling is not a reason for doing it in itself. There has to be an outcome. The outcome in this case is you have a direct conflict with the planning that is going on to release these areas to provide what the community wants, and that is housing. So there is a real problem right there in the attitude of price signals.

SPEAKER: It is a really interesting point. The difference there I find is that there is no environmental problem unless we get more growth. If we get more growth because of the nature of the area, that will drive an environmental problem and that means we have to respond to that with a higher level, so there is an nexus there between growth equals environmental problem. We need to spend money in that area.

The other issue is we often find in different areas that council themselves are interested in land development. From a planning viewpoint they may be keen for areas to go ahead. I look at a future - if there is no developer charge we are back into the world previously - what is the framework for us to make decisions in this area from developers coming in and saying, "I have bought this land. I am very keen to move ahead on it." I appreciate in a perfect world we say from a planning viewpoint that we are only developing in these areas, but it didn't work well in the past when we didn't have the developer charges.

THE CHAIRMAN: Time will be too constrained to allow long debate on these points. I will make one observation. The fact that a planner allows a development does not mean that it would necessarily go ahead at the same cost. If you take the builder, it may be that the cost of putting the basic footings, and so on, is higher on one lot than on another, and it may be prohibitively high in some areas so very few people want to buy in that area even though the planner says you can do it. I don't see water charges

being any different to that. Dr Schott, you have put the most radical specific proposal on the table. Perhaps you would like to talk to it.

DR SCHOTT: I might defer to Stuart Wilson. The two main things that we wanted to do was to remove the operating costs from the formula. What has happened with Sydney's use of the operating cost is that revenue, being postage stamp revenue, is spread evenly across everybody, so we have a postage stamp revenue as part of the equation, and then operating costs have been calculated on specific area costs, which we can now do.

The impact of using an evened out revenue equation and a very area specific operating cost is what is causing the very low charges in what has been roughly referred to as the east, but which, let me assure you, is not just the east. It is everything that is on our ocean outfloor systems which does go back as far as Ryde, and indeed further on some of them. So that is one of the things that is causing us a distortion. If we were just to use a standard operating cost, as we do with revenue, it would ease a lot of the bias that we are concerned about.

The other major change that we are concerned about is the assets that are pre-1996 being included in the formula. The main reason that we want to ditch the pre-1996 assets is to put a focus on incremental assets. We don't think we are sending a signal to developers if we don't do that. If you think about a pipe in the ground, for example, that was built in 1974 and it's got lots of capacity left in it, then it has low incremental cost, and that is where we would like the development to occur. So changing because of something we did 30 or 40 years ago we think is not right. It is a question of balance. We thought if we started around about 1996 and then increased the forward years, which I think certainly us and Hunter would be more capable of stretching out our forward asset plans now than we were some years past, we really don't think that average cost is sending the appropriate signal with the way that the assets are currently in there.

THE CHAIRMAN: The essential proposition is that we are trying to establish a nexus between assets and new developments. So the logic is, as I understand it, you want to shift the emphasis away from past investment and get a focus on new investment. I suppose the question in my mind is why did you stop at 1996. Why include any past assets? That is the first question. Because if you are just interested in the impact of new development, why include any past assets? Secondly, if there are new assets that were system wide, and which were being paid for by consumers generally, the desalt plant is the most obvious example, why would you include that in the assets? Thirdly, if you don't include existing assets, then, as I recollect - I might be wrong in this - your submission you propose to actually phase out the reduction amount. Is that correct?

MR WILSON: In some instances.

THE CHAIRMAN: I mean, if we didn't include past assets, then you wouldn't need to have a reduction amount, I suspect. The reduction amount is basically there to ensure you don't double-dip in effect, get people to pay for the same thing twice. So by not including past assets there seems to me less need for a reduction amount. Given the logic of what I think is your position, why did you stop where you stopped?

MR WILSON: You are correct to characterise our position as we favour incremental costs, but in doing so we all recognise we are not in a perfect world. Like in general economics, short run marginal cost is an optimal pricing rule, but we rarely get there. If we had only future assets, every year you would be dropping out some assets and putting more assets in, and we think that would create incentive problems. If a treatment plant was built one year and a developer looks and says, "If I delay development until the next year I will not have to pay for any component of that treatment plant once it's done." So whilst we think it improves signalling to move to an incremental cost basis, we realise there are trade-offs. We recognise that you need some past assets in there or you will just create incentive problems for development.

One of the second issues was the capital offset. As you said, there is less need for capital offset if you remove most past assets. That is, in effect, what is already happening, or it is the inclusion of a capital offset in the ocean outfall systems that is creating very large reduction amounts at the moment, that we think results in zero charges or even negative calculations. We don't think there should be the capital offset to the same

degree on those systems because the prices in the revenue are paying for all the past assets, not the assets that are being included on the capital side of the equation.

We have said, however, that in a new growth area where most of the assets are incremental, it is like you do need a capital reduction because the prices in a new growth area are partly paying for the capital in that area and we don't want to double-dip. We have done a bit more thinking since we put in the submission, and we've got various options for generalising the capital offset approach across all systems so that the amount of the capital reduction, or the reduction would be dependent on the amount of existing assets. I am not sure this is the forum to set out our thinking, but we would be happy to do it at another time.

We argued in our pricing submission that the system wide asset should be excluded from the developer charges calculation entirely. At the moment, if any part of it was included it would mean it was being paid for by people in a certain part of Sydney and not in another part of Sydney. More generally, we think things like desalt adds complexity to the developer charges formula because while we can exclude them from the capital component of the equation, they will be funded in prices and therefore funded through the revenue side of the net operating result. So unless IPART considers how the net operating result and the capital will interact in a new world, the net operating result will (inaudible). That may suit some objectives, but it is not suiting cost reflectivity.

MR COX: I do want to ask one question which I think is relevant to the conversation we have just had, and that is the issue of the low developer charges in eastern Sydney which you referred to as a problem a couple of times this morning already. I could see an argument that would say that that shows that the developer charges are working as they are intended to. There is capacity in the system in eastern Sydney and that is being made available at low cost. Why is that a difficulty?

DR SCHOTT: It is actually not true that where there are zero charges there are low costs of development. That is the problem with the formula. The reason why the charges are zero is because of the interplay between the uniform revenue component of the net operating costs and then the area costs that are subtracted from it.

The area costs for operations only - not for new development - are so low in the ocean outfall systems that we get very large reductions, so you get zero developer charges across large areas of Sydney. If the operating cost component of the net operating cost was a system wide cost as the revenue charge is, because of postage stamp pricing, then we would just have a sort of fixed component and we wouldn't be getting the zero bias occurring. It is the interplay between postage stamp pricing and specific area costs. Does that make sense?

MR COX: So the problem is that revenue is averaged across the system, but costs are not?

DR SCHOTT: That is correct. In fact, I mentioned earlier that we are spending $300 million over the next period on growth in those zero charging areas, which we will see no developer charges paid for.

THE CHAIRMAN: The reality is that revenue is much the same wherever you live in Sydney, but in fact it is much cheaper to actually get servicing at Bondi. The operating cost is genuinely cheaper at Bondi. Wouldn't you want to encourage people to build in Bondi?

MR WILSON: Revenue is equal across Sydney because of postage stamp pricing, where it is recognised that high cost areas receive contribution from low cost areas. So what that means when it is applied to developer charges is you are basically unwinding that system for developments on the east. The revenue is what it is in Bondi because they may want to make a positive contribution somewhere else. By getting a net operating result saying postage stamp pricing doesn't need to apply to that development in Bondi, it is a tension between the postage stamp pricing objective and the developer charges signalling objective. By going to average operating costs across the system, you would overcome most of that problem.

THE CHAIRMAN: So you are basically saying that if the revenue was cost reflective then it would be lower in Bondi to match the lower operating cost.

DR SCHOTT: Yes, and the developer charges in Bondi would still be very low compared to the developer charges in the tertiary treated systems of the west.

MR WILSON: A final comment, the IPART determination requires us to use area specific operating costs if they are available. System wide averages must not be used if the costs of providing services to the DSP area vary significantly - maintenance, administration costs, et cetera. We have those costs so we were required to use them.

MR COX: Am I right in thinking that what you would like to do is average the costs in the same way that revenue is?

DR SCHOTT: We would like to have the net operating cost removed completely because there is one more thing to drop off. If that wasn't to occur, then if the cost formula was averaged in the same way as revenue was, it would remove the distortion, and it would still mean that charges in the inner city and the east would be considerably lower than in other parts of Sydney, but at least there would be some developer charges.

MR PRICE: A flattening effect.

MR GRANTHAM: Having previously stated that I believe the current methodology to be sound, I suppose I am looking at areas where changing something could make an existing system that is working quite well more difficult. Wyong is a high growth area, so we are dealing on a regular basis with developers. First of all on nexus, I think it would be quite illogical for Sydney to reduce charges in the western area to have a single DSP across the whole Sydney area. While the methodology contains its current dispute resolution process, all that will result in is the west will get a reduction, and in the east every development will go to dispute resolution and we will get a much lower charge because again we will be introducing an inconsistency there. So this issue of nexus is critical in how it is defined, or else other parts of the determination will come into play.

In terms of asset valuation, if the valuation of assets as they stand within the DSPs after their review does not reasonably reflect reality, we will run into problems between who is going to construct that asset. Currently, if a developer has a development that's not a reasonably orderly development, in other words, just a logical extension of the existing services, but wants to develop, for instance, a little bit further out, Wyong offers them the opportunity of constructing the intervening infrastructure at the value of the DSP and getting a credit for it. If that value is now significantly less than the real cost, the developer is not interested in that option.

Therefore, in fact, you can get to the situation where what method are you going to have for providing infrastructure? Is it who is going to scream the loudest or who has the more clout, because if it's not an orderly development, the price mechanism that currently exists is going to disappear.

In terms of pre-1996 assets, yes, you could ditch them. I agree with Kevin Young's statement that any methodology can work. I think it's an issue of what signals will that send. If you ditch pre-1996 assets, that means you're saying that we're sitting on assets with about a 10-year life. One of the objectives of this determination was to encourage the efficient development of water infrastructure assets. Often times those assets have a useful life of well beyond 10 years. To exclude pre-1996, fine, as an authority constructing assets I will only provide assets that meet the next 10 years. Would that be efficient?

You might find yourself every 10 years then having to come in and augment an existing asset and it might be argued that that is quite inefficient. All I'm saying is that's an angle that needs to be looked at because this determination has a lot of interdependencies. One issue has been worked through and its effect on the other ones has been considered within the existing methodology. To change one can have effects across the methodology and that's why I just urge caution when changing one without having its impact across the whole methodology considered.

MR KOIZUMI-SMITH: Thank you. I will just make two brief points, one with regard to the inclusion of assets and whilst we have no particular point in time, the suggestion that some assets will fall out could be detrimental to the community. Development is influenced by a number of factors which are outside the control of an agency or a water utility. The suggestion that you would drop some assets out I think effectively means that the community is accepting the risk for development rates which is possibly unreasonable.

The second point goes to an earlier comment regarding price signals and government policy. I think the suggestion was made that the current formula doesn't support the government's policy or the government's commitment to new development. At the same time, the government is also committed to urban consolidation and I think in some cases the price signals that this is sending is encouraging further consolidation. With some of the proposals of averaging, you start to get development in very marginal lands which is not necessarily good from an economic perspective, nor is it with regard to some of the environment impacts. At this time, we still believe that pricing is an important issue.

THE CHAIRMAN: Before I open it up to the development industry, I am missing one line of questioning regarding Sydney Water and that's the proposal to reduce the number of DSPs. I think, Kerry, earlier in the day you talked about 90 DSPs coming down to something of the order of 20. The thing we would like to get some more information on is will that maintain cost reflectivity?

DR SCHOTT: We think it does. The big contribution in getting down to 20 is to have three DSPs for sewerage, so that we would classify sewerage by treatment, whether it was primary plus secondary or tertiary, which does reflect the cost of the charges, and the other step is to amalgamate some of the water DSP areas together, but the principal charges that would change would just go to the three sewerage areas defined by treatment which reflects both the cost of putting it in and the cost of running it, actually.

THE CHAIRMAN: We might go around the table.

MR JENSEN: I will put my views forward on a number of issues. I have already stated my view on the DSP issue. That should substantially be consolidated and I agree with what Kerry is saying. In terms of the rolling assets, I think that the point on the life of the asset is right. Essentially, the design life is approximately 25 years and I can only assume that when the first DSP was adopted, from 1996 back to 1970 reflected the 25-year design life of the assets and I think now we've moved forward to 2008, it makes perfect sense that that date rides forward as well.

In terms of the operating costs, my view is that that differs to Sydney Water in that I believe the operating revenue should be included into the model. This infrastructure is essentially being funded by developers and our customers and it has been given to Sydney Water from which they then make a return out of those assets. In my mind, it makes perfect sense that that operating result is brought into the DSP calculation.

The issue arises in the outer-lying suburbs where when that operating result is brought in, they actually make a loss, so that the losses are being compounded on to the DSP issue. That is the issue that needs to be sorted out. Really, in principle, it should be in there. I believe that can be sorted out by consolidating the DSP areas.

I would like to touch on the opportunity cost of the money and again, I make the point that the money that's being put forward is by the developers and our customers. It is not money that has been put forward by government utilities. In my mind, I don't know why it's considered necessary to make a return on that money when essentially it is money being provided by somebody else. Essentially, I believe that we shouldn't be trying to incorporate that return into the model.

The other point I would like to make is on the MEERA values. In relation to other contributions that the developers make, i.e section 94, it comes back to the cost of the asset divided by the number of residents. To then go and factor up previous expenditures to current day equivalents to my mind doesn't make sense. You should be collecting the money that is required to provide those assets. I will complete on that. Thank you.

THE CHAIRMAN: LandCom.

MR OWENS: If you don't mind, I would like to listen for the time being, thanks, Michael.

MR GADIEL: Thank you. I won't speak too long. To respond on the issue of price signalling - and we'll come to the water rates issue and a couple of others commented on it - I don't think there is any doubt that the price signal is taken into account by developers when deciding not to develop land that has been rezoned, in the sense particularly that delays can apply indefinitely in some

cases to development process and development decision. The analogy was made before with a new car purchase and it was suggested that there's a whole range of things you might take into account - the colour, the design, the model and the price - and that doesn't mean the price signal is ineffective for a new car.

I think the analogy is not a sound one because there isn't a law preventing you as a buyer of a new car from going and finding a cheaper car and buying that one. In the case of of land supply, there is a law that prevents you from accessing the vast bulk of land that might otherwise naturally be available to use for a particular development, whether you're talking about brownfield development where supply is artificially heavily constrained by planning laws preventing medium or high density development, or we're talking about greenfield development where the great bulk, for instance, Sydney's growth centres, still have not been released for residential development seven years after it was announced by the government that it would be happening.

The areas that have been released are tiny in proportion to the overall plan for the next 25 years. Developers lack the ability, by reason of regulatory constraints, to go and find the cheapest. They're very much funnelled into the particular lands by the planners and then the only decision they can make is, "Do I develop it or do I defer the development decision for the time being?" That's all the DSP charges can effectively do. They can defer development if they're too high.

The other issue I wanted to touch base on - again, Dr Keating you raised it - is the indication that Sydney Water is collecting, you're right, $50m a year from these DSP charges and the standard thing that could be argued is that's not a huge amount of money, but we should bear in mind that that's not an indication of the amount of development that is not happening. That is an indication of the amount of development that is happening and all the statistics wherever you go, the ABS, anywhere else, show that the New South Wales development industry is in deep trouble, particularly in greenfield. It is the worst in the country. We have lot production at Adelaide levels. The $50m can be used to advance an argument that the development industry is dead in New South Wales at the moment. It couldn't be used as an argument to say that DSP charges are not reducing the supply of land for development. It is quite the reverse.

Another comment was made on urban consolidation and that the current charges favour urban consolidation. That may well be an argument. The only thing I would point out is that the government's policy is that 60 to 70 percent come from brownfield development and that 30 to 40 per cent come from greenfields. If you actually look at the figures - and the government hasn't released them for a while - I think you'll find that more than 90 per cent is currently being met by brownfield, so it's way out of whack. There is the social cost for that. A pure economist might say, "That's fine, if that's the most cost-effective way of doing it."

The reason it has happened like that is because of regulatory constraints and concerns and it is imposing quite a significant social cost because it's limiting the available choice of housing for young families and other people who might otherwise want a choice.

MR TACCONE: I will have to read a bit of this because I'm not very good at speeches or whatever. First of all, I'm from the Yarrunga Landowners group. We represent some of the landowners and developers there. First of all, we would like to commend Sydney Water and IPART for its consideration in the community review of the developer charges. The current reduction in developer charges may encourage some developments to progress with the view of possibly having the charges further reduced.

Just quickly, I don't know where the figure of $50m comes from. The Yarrunga area was subject to paying roughly about $70m on developer charges for 129 hectares, so I don't understand where the $50m comes from from developer charges. Does anybody have an answer?

THE CHAIRMAN: I am sure it will be put on the table.

DR SCHOTT: It is the money that has been collected by Sydney Water.

MR TACCONE: We are only a small group.

DR SCHOTT: Can I just say that that $70m has been revised.

MR TACCONE: We understand that and I've mentioned that. In the Yarrunga submission to IPART made in February 2008, we detailed serious concerns with the formula and methods used by Sydney Water as to the unfair effects it has on, one, the inconsistent equivalent tenements designated to the different DSP areas across the metropolitan area which Brett spoke about and everybody seems to have the opinion of equalising it. The second one is the inability to assess localities within a DSP area. Yarrunga is an area which is serviced. It is on the fringe of services. People have paid costs for infrastructure, previous developers, yet, we're subject to paying the same rates as any other area that needs completely new infrastructure. I think that should be addressed.

Thirdly, there are the high conversion factors applied to industrial developments as compared to residential developments. I did a calculation previously. One hectare of industrial land was going to be the equivalent of 110 dwellings. How can that be justified? For the same cost for one hectare, you would pay the same on 110 dwellings or 60 single dwellings on three hectares of land. I think there's an out of balance there that needs to be addressed.

Government infrastructure costs have made it impossible for a developer-builder to purchase a serviced parcel of land for development with an acceptable rate of return. In most cases, a developer will not even attempt to do so as the risk of losing money is too high. I think we all need development to progress. Sydney Water has created an open playing field for various DSP areas within the Sydney region. Some are still subject to high developer charges, whilst their neighbours are completely exempt from paying developer charges. We are in Prestons. Our neighbour is Wetherill Park. We were subject to paying $486,000 per hectare which has been reduced, as Dr Kerry Schott has just mentioned, but Wetherill Park pays zero. How can we compete? Why should we build in Prestons and not in Wetherill Park? There is an imbalance somewhere along the line.

We asked IPART and Sydney Water to consider the following two options in the proposed mid-August review. Sydney Water place the developer charges and levy a small charge over all end users by the way of water rates. The abolishment of the developer charge in a competitive market will result in lower sales prices, which should in turn benefit the end user, the ratepayers. This method will also provide a fair and equivalent contribution by all users and beneficiaries. After all, the developers progressively build the assets at their expense and dedicate them to Sydney Water to generate revenue through water rates for the life those assets.

A second option that I think should be looked at is if Sydney Water were to continue with developer charges, we would submit that a fair and equal developer charge be dispersed throughout the whole of the Sydney metropolitan region, a fair and justified conversion rate with consideration to comparisons of various classes of development: for example, industrial and commercial developments as opposed to residential. A fair and justified differentiation of industrial usage. Bulk warehousing and light industrial developments have a very low usage rate, as can be demonstrated through the water bills. There is proof. They should not assessed as equal to a paper mill or other heavy water users, which at present they are. There is a set rate which is just applied to industrial and it's unaffordable. It can't happen. It won't work.

We urge Sydney Water to consider our suggestions with a view to stimulating the land development and construction sector, to provide progress for the much needed creation of employment opportunities and show fairness to developers progressing with developments. Finally, we wish to object to the proposed Hoxton Park recycled water contribution that Sydney Water is attempting to implement on developers within the Yarrunga release area. New industrial developments are easily capable of providing their own on-site water recycling system which local councils could condition as a part of development consent.

If these fees were not to be removed completely, there should be concessions for those who can provide their own on-site water and recycling. They should be encouraged. That is what I believe.

There are just a few questions that I'd like to ask in relation to the reduction. Maybe I can address them to Dr Kerry Schott, if you can answer these. How long will the new cap charges be applicable for?

DR SCHOTT: The new charges will be applicable until IPART has finished its deliberations and at that time and when the new charges come into place, we will make internally whatever charges we wish to make and IPART will make their charges: so towards the end of the year.

MR TACCONE: If the developer charges, pending the review, are reduced, will the developers who paid the charges prior to the review be reimbursed?

DR SCHOTT: That's typically not the way things are handled, no.

MR TACCONE: Okay.

DR SCHOTT: But I should say that the reason why the charges have been revised to where they are is that I'm not anticipating any major changes from those charges.

MR TACCONE: Okay.

DR SCHOTT: But don't take that as a promise.

MR TACCONE: No, that's fine. Should it be determined that the charges will be reduced, but the refunds are limited - you've answered that. That's fine. Thank you.

THE CHAIRMAN: Thank you for that information. Could I just make a couple of points. I wouldn't encourage you to anticipate that we're going to move to one flat developer charge across Sydney. I think that would be pitching your hopes in the wrong direction.

MR TACCONE: I think something has to be done. As an example, Yarrunga, on 30 June 2007 the fees, water and sewerage, were $120,000. With the formula the way it was until Sydney Water revised it, from $120,000 it jumped up to $486,000, plus a recycled water charge of $114,000 per hectare, brought it from $120,000 over the year to $600,000 per hectare. It just won't work.

THE CHAIRMAN: As I said, I wouldn't want to encourage you to think that you're going to get a flat charge across Sydney. That said, I do think it is important that we understand where there may be some unintended consequences of how the system is presently working. While we are fundamentally trying to achieve a system which gets the appropriate balance between simplicity - and that means some averaging - on the one hand and cost reflectively on the other hand, that's what we're trying to get, to get that sort of balance, if in fact we've got the balance wrong at the moment or in fact we're creating neither simplicity nor cost reflectively and we're getting too much volatility, for example, those will be the sorts of things we will try to correct. If you can give us examples of how that's affecting you, that will help us. Thank you.

DR SCHOTT: Mr Chairman, can I just say something about the particular case at Yarrunga? It is actually quite a good example of the way that the net operating cost has distorted the formula, because their net operating cost turns out to be such that it increases their developer charge and Wetherill Park, which as we've just heard is zero, happens to be in an area where the net operating cost is negative. You just get side by side very strange distortions under the current formula.

The other problem that has been highlighted here is the discharge factor. With the new way that the system is working, people using less water and more recycled water, we do have lower discharge factors and it is incumbent on Sydney Water to review the assumptions that we've been using, which we are currently doing.

THE CHAIRMAN: Thank you.

MR GRANTHAM: Could I make a comment in relation to industrial development? In Wyong this issue involved a lot of industrial land. Obviously, servicing industrial land is dependent upon assumed ET or rate per hectare or whatever and the infrastructure service ends up being based on that assumed rate. We had a situation where we were charging based on whatever that assumed take-up was and therefore, if they were in a dry industry they were paying very little, but if it was in a wet industry they were paying a lot and there was a significant cross subsidy. We've overcome that problem by charging a one ET charge upfront per subdivision lot regardless of size. If that was obviously re-subdivided, there was one ET, but then if a wet industry developed on that lot, in its development application it would pay for whatever the load on the system was, less one ET. All I'm putting on the table, Mr Chairman, is that it may not be the methodology itself, but just how it has been applied could address some of

these issues that we've raised.

THE CHAIRMAN: It does go to the important point of the transparency of the methodology and the ability of the development industry to see how the calculation was made and I suppose disputed.

MR BRUCE: Thank you, Mr Chairman. I agree with a number of the points put forward by Aaron Gadiel and also a number of the points by Kerry Schott, but I think one of the things we've missed out in the debate so far is the expression of capacity to pay. We're talking a lot about price signals but not about capacity to pay. Eastern Sydney, which has a price signal saying, "Develop here because the charges are zero", the majority of Sydneysiders haven't got the capacity to buy there. I think this is what is most unfair about the current system.

It could, in fact, be exacerbated by things like the 3DSP system that has been suggested because that will result again in the east ocean outfalls paying a lesser charge than the inland plans which are being built to a very high environmental standard. I dare say if Eastern Sydney were to start development now, we would not have ocean outfalls. We would have a much higher standard of effluent treatment. I know the word "cross-subsidy" is not to be mentioned here, but I think it has to be because we're talking about the entity of Sydney as a whole.

A number of us were down in the UDIA's Congress in Melbourne last week. Melbourne is just walking away from Sydney at the moment. It is creating jobs at three or four times the rate of Sydney. It is creating population growth at the rate of three or four times of Sydney and it is creating affordable housing. You can buy a very nice house and land package on the fringe of Melbourne - and the fringe in only 25 kilometres out, not 50 as it is in Sydney - for $350,000. Affordable housing has been promoted in the Werribee corridor at $230,000. We're flat out producing a block of land for $230,000.

LandCom's equivalent down there - VicUrban - made the comment that Melbourne's population is growing at 1,200 a week and that 1,000 of them are Sydneysiders getting out. 1,000 is probably an exaggeration, but I would argue that a lot of our key workers can no longer afford to live in

Sydney and they're voting with their feet and getting out. The result is that things like employment and land are just not being brought on and jobs are not being created and the economy of New South Wales and Sydney in particular is really starting to suffer.

DSPs are a small part of that. There are a whole heap of other issues as well that are really affecting the affordability issue in New South Wales. To equalise some charges, reduce them in the west where affordable housing needs to be created for the workers and the key industries, the working families in this state need to be able to get into affordable accommodation or they'll vote with their feet and leave.

MR PRICE: Just going through the issues quickly, one of the problems right at the outset is that cost recovery is not necessarily identified by the opportunity cost. Cost recovery and opportunity costs aren't necessarily the same things. I think that's one of the key elements. My response to most of this relates to where we started in 1995 with the agreement between all stakeholders sitting around a table like this over a period of time and coming up with a set of rules that we all agreed with and were applied in the 1996 to 1999 DSPs. They contained essential elements of the agreement.

One of the current problems is that capacity isn't considered and it wasn't considered in 1995 either. One of the problems with the idea now is that you'd somehow want to increase the new assets out 10 years instead of five. Because no capacity information was provided, the assumption was that the existing assets in many areas contained capacity for new development, particularly in brownfield areas and new assets were generally related to new areas. They all were packaged up together on the same principle and the idea was that five years was the limit because that then meant that there was sufficient time for the capacity to be taken up over the life of the DSP and so therefore, we were able to accept that five years capacity over the life was a reasonable assumption. You double that to 10 years, which Hunter Water has done, and what you have got is, of course, the projection of the take-up over that period is exactly the same. So if you double the future assets you have basically doubled the cost. That has been a serious problem with some of the changes in the DSP. Sydney Water's changes over the period have been even more

complex because they apportion the cost of various elements from 1970s through 1996 to post DSP by different numbers of ETs. There's a different apportionment for past assets to future assets. The whole thing has become a shambles from our point of view compared to where we started in 1995 where we had a bunch of assets that represented the efficient cost of all the available assets post 1996 which was apportioned over the total catchment. That has been changed dramatically.

As far as some of the future proposals go with DSP boundaries, again the industry supports a reduction in the number. I am not too sure whether two or three is the answer, because we thought to get your cost reflectivity you needed maybe a few more sewerage DSP, but it doesn't make much difference in the water because the water is a much more logical utility to reduce the number of DSPs. Sewerage maybe has some difficulty. So the larger window is a problem.

The net revenue argument - we are supportive of the idea of having a city wide net revenue amount. There is a whole bunch of reasons for this. It is not just the fact that it is reflective of how the money is collected in the first place. It is also reflective of the fact that the way it has been applied has caused a lot of problems, particularly in those areas where there is substantial high costs being attributed to the maintenance. What in effect happens is we end up with a negative net revenue, which is in fact added to the developer charge, so it is compounding the problem and developers are paying for the shortcomings in maintenance.

One of the problems with Sydney Water's approach seems to be that it is getting away from the idea of where we started, because by looking just at future assets and no net revenue, which is the way the south-west sector will work, you have got a problem because there's obviously a double-dip right there. So they have already identified that you need some sort of balance, because you have just got new assets and they are paying the same as everybody else so there ought to be an offset.

With the brownfield areas, if you take away the existing, there are a significant number of DSPs in brownfield areas that only have existing assets. So you take that away and what are you left with? So it needs to be looked at carefully. It seems unless we carefully consider the principles we started with, which worked well to start with, and work out what we are going to keep and what we are going to drop, we could find ourselves back where we started.

With the industrial process, what Ken mentioned is something that I have been putting to Sydney Water for years, and why is it that the regional water authorities can come up not only with costs that are substantially less than Sydney Water but also can come up with methods like Ken mentioned when they can phase in the charge effectively by taking the opportunity you have at the subdivision certificate stage for the land subdivision and charging something, and then you have another bite at the cherry when they lodge a DA for the actual development, and then you can adjust your charge accordingly depending upon the demands made.

I know there has been negotiation between a number of major developers about this, and some of them have managed to achieve some accommodation, but that is not a very fair system for the little guys. Not only that, the whole methodology for industrial commercial is crazy. It has been in the past charged on a land area basis. I have had a case that I can talk about now because the developer has moved on. Fourteen 2,000 square metre lots for light industrial, one charge; five, 5-storey buildings on a Norwest estate, same charge. I tell these guys, "You've got no hope because we can't afford to go to arbitration", so it is a pretty silly situation that we have got. I don't know how Sydney Water is coping with applying their charges in the inner city, but that is what has happened in the land subdivision at Penrith and a multistorey building development on the same land area at Norwest and they received the same charge. That is obviously crazy.

What the 55 ET per net hectare means is that it is almost the worst case scenario. It is cruel. At Gerringong on the South Coast we have $900,000 per net hectare. That is incredible, isn't it? There is a whole lot of reasons for it.

With regard to some of the other issues, what assets do we include, you can come up with all sorts of reasons why you should leave things in or drop them off. I think that the original 1995 determination had clear objectives

and clear reasoning. That has been lost. We need to revisit and precisely understand what we had and what we should have in the future.

With regard to valuation methods, MEERA has always been something we objected to. We weren't involved in any consultation about its implementation. The only thing we have ever had, despite requesting on numerous occasions for manuals or cost schedules or whatever, was in 2000 we got a discussion paper on MEERA which clearly outlined the things we were objecting to. There is no doubt that Hunter Water found some costs would be higher and some would be lower, but in our experience mostly it is high. Again in Gerringong and those new areas like Picton, the price has gone up dramatically from what it was - a fixed private public partnership arrangement. We knew exactly what the costs were. Clearly there was some problem with trying to apply MEERA to that because it has gone ballistic. Whereas the average price of piped water is about $150 a metre, the last time I had a job there they were charging for us to connect to the main system $300 a metre. So there is a real silly anomaly in the whole process with industrial and commercial development. The guys that get most affected are the little guys who have not got a hope in hell of going to arbitration or something similar, and it needs to be fixed.

The period of analysis - certainly there is no problem with the forward period, but it is a question of how far you go back and how you do that. We have put it in our submission, and we have been putting it for some time, that we would like to see the thing roll forward - certainly what you do and what you don't include is going to come down to a matter of analysis. We have covered the operating costs. There is a question of BASIX. I have got a running discussion going with Sydney Water about the application of BASIX --

THE CHAIRMAN: We will get on to that in the next session.

MR PRICE: There has been an interesting case that has been arbitrated on. That wasn't under the WIKA Act, was it? The ACCC - is that the sort of arbitration process you envisage would take place for a approaches under WICA?

DR SCHOTT: I hope it would be less costly and more in the dispute resolution mode than trotting off to court.

MR PRICE: The whole WICA approach is fairly difficult, and is something that has been looked at for the south-west sector. The outcome of that arbitration would tend to make it difficult for the industry to accept. So that needs to be looked at very closely in terms of what the ACCC thought.

The overall, I think there's lots of things on the table here. I have to keep looking at 1995 as the benchmark because it is the system we understood and applied. It doesn't seem to be well understood that the idea was that we had a raft of assets that served a catchment, and the idea was to absorb all those assets on an averaging basis, but at the current replacement cost. That seemed fair. The five years of new assets out seemed fair. All those things were accepted by the industry. There has been substantial reinterpretation since and there are new proposals now. We have to look at these as matters of principle. Certainly in the few sums I've done, it is quite difficult to accurately predict what the outcome of the changes might be.

THE CHAIRMAN: On a point of clarification, you are happy that the existing assets be revalued to reflect current replacement cost, you just object to the use of MEERA for that purpose; is that correct?

MR PRICE: That's correct.

THE CHAIRMAN: Someone else queried that they should be valued at all.

MR PRICE: The concept was that existing assets had capacity. Certainly for brownfield areas they have capacity. The alternative approach is if you include the historical costs, then you have to include the renewal costs, and that avoided that, so it is simplified.

MR TAYLOR: Chris Taylor. I wanted to reinforce what Peter said, that there was an emphasis on efficient costs back in the early 1990s which seems to have gone out the window. I have always had a bit of a problem with MEERA because of it is impacting on new entrants. It is an unfair system. If you are revaluing assets, existing people gain the use, or having the use of a more valuable system, so there should really be some adjustment in annual

rates as well as the prices for new development.

On a five-year price path, I think it could be easily done that rates could be adjusted which would reflect the increasing value and the MEERA value of the entire Sydney water system or the Hunter water system or the Wyong system. That would make it a fairer allocation of the costs across the whole community, because it was pointed out earlier they are only users, not necessarily new users or existing users, or whatever.

There was a big concern back in the water industry forum days that as prices went up areas would be sterilised and quarantined. We are seeing this happen. We talk about this Yarrunga estate, as prices keep going up and up, there will just be parts of the development that just won't happen, which is not really efficient development.

THE CHAIRMAN: I may have misunderstood you, but the periodic charges do reflect the revaluation of existing assets.

MR TAYLOR: If that is the case, that is fair.

MR OWENS: Just a point about one of the questions you have there is about the question of nexus. I think there should be some relaxation of nexus directed to the geographic area. When you look at some of these things that have been done now, it is hard to identify some of that work directly to a specific area. Also you have got timing differences and intergenerational differences across areas. So in the western areas now you are talking about having high quality treatment plants being required in the new areas versus middle rings and inner rings that don't have the same standards. So there has been a 20-year difference in standards between when areas are coming on and not.

You have other complications coming in with Sydney Water - how to you fund desalination plants. They have become quite complex things to do. Maybe the thing to do is have some common standard that you need to apply to an area and use that for a DSP charge, and therefore you are taking out some of the anomalies. That may be complicating it a bit more, what what it comes back to is you can't have an absolute area and have an absolute nexus. When you are looking at some of this broad based infrastructure you have to relax some of those rules a bit.

MR BURKE: The term nexus concerns me in that it is always related to an asset, where an asset is with respect to a system. I suggest that the common good, environmental protection and public health, are necessarily important to your nexus equation because everyone benefits from the higher treatment levels, so up in the Hunter everyone benefits from having Blue Mountain streams in pristine condition. That is just a social equity comment.

Secondly, I would like to ask about the Yarrunga area. You combine water and sewer DSP charges for the Liverpool water and waste water systems, and I understand that the Hoxton Park recycled water scheme does not supply all that area, is that right? It only supplies part of the area. Therefore development outside the recycled water area is paying X amount, and development within the recycled area is paying X plus $114,000 per hectare.

DR SCHOTT: On the recycled water charges, we are in the process of having a look at those. Having had a look at the water and waste water, not just for Yarrunga but for all industrial and commercial developments in Sydney, we will now turn our mind to the recycled water charges which, on the face of them, look as if they deserve being looked at.

THE CHAIRMAN: Is there anyone from the audience who would like to speak at this stage?

ANDREW: I represent Aldi with respect to the new development of a distribution centre of the Yarrunga area. Several points have been made relevant to our facility. The development of the Aldi facility would have been delayed in the event that a concession wasn't made recently by Sydney Water. Without the concession, it would have seen a liability for DSP charges of $6.4 million which would have been our single largest one-off cost. Now that that has been reduced it is in the order of less than $1.5 million. That is a good example of the point that Aaron made, that the development would be delayed by a result of the DSP charges.

Some of the other things that are relevant are the usage and the multiplying factors. If you look at light industrial there is currently a multiplying factor of 27

from an ET. We went back and compared it. I think Con made the point before about the impact of that with respect to residential development. It is 55, but it was 27 before. If we go back and have a look at the example that was part of the Aldi submission to Sydney Water and to IPART, the water usage relevant to our existing facility was seven years of history, 6 per cent compared to that of Sydney Water's calculation with respect to water, and 10 per cent with respect to sewer. I think that makes a point that someone else made in the panel that the industrial charges are not really relevant to light industrial users of today's definition. Perhaps they had some bearing and relevance to earlier heavier water users, but given many industrial uses are of a nature similar to ours with respect to distribution, they bear little relationship to the charges. We are obviously very glad that Sydney Water has reviewed the charges and we thank them for that. We look forward to further discussion with respect to the multiplying factors.

MR GRANTHAM: On this nexus issue, the nexus was associated with cost reflectivity; in other words, a nexus between the assets and the development to reflect costs. Obviously, the further you get away from the nexus and you start to combine DSPs for the purpose of averaging, you get the cross-subsidy across that reflectivity.

Obviously, the one who gets the benefit is not going to object. The one who gets the higher charge has got the capacity to object and go through the dispute resolution procedure and therefore get a verdict in their favour. All I'm putting on the table as a way forward is that for administrative simplicity it makes sense to combine DSPs in Sydney's area, but combined with that I think the determination would need to state a percentage by which the charge may vary compared to what, if it was a totally separate DSP, you could achieve, and if it stayed within that percentage it wouldn't be challengeable under the dispute resolution procedure. What I am saying is that if it said that the charge can vary by 10 per cent - in other words, you can come up with a separate DSP - provided it is not more than 10 per cent less, you can't challenge it through the dispute procedure, and you then have a mechanism for achieving the nexus with some guidance within the industry. Thank you.

MR YOUNG: You touched on the valuation of the assets.

That is a really interesting one. Our stance is that the MEERA value was to reflect current costs. We have gone through periods in the past where the valuation of the asset has dropped compared to what was historically paid with an advantage going to developers, and that reflected that over time productivity came in, new products - what is a good example? We were putting in copper lines (inaudible). We re-rated them to be 10 per cent of the historic costs because that was the efficient way of doing things.

We seem to be in a period at the moment where we have a skills shortage and construction costs are going up. Unfortunately, for a range of reasons I think construction costs are going up. I am happy to - and I am sure the industry is too - to move to a new model, but not a model that is changed depending on a window of time on specific circumstances. What I don't want to do is shift to historic costs. Then if you find this current construction market change, and we have got a downturn, and there is a lot of cost competitiveness in putting pipes in the street, and those costs drop dramatically, I would not like to be here in five years time in a discussion about moving back to MEERA because Hunter Water should not be getting the historic costs because it's now a lot more cost effective to do it than what they paid originally. I think we are happy with any system that comes out as long as it hangs in for the longer term and we cover the swings and the roundabouts.

MR GADIEL: Some of my industry colleagues have supported the position which would see some kind of fees being imposed on the eastern areas, which is really the bulk of ground for development in Sydney. The only point I make about that is that really can't be justified on equity grounds. What we are really talking about by and large there is apartment development in terms of residential. That is the low to middle socio-economic bracket in our society, and they are the same sorts of people who are looking to buy greenfield homes.

In an environment where the underlying demand is strong, supply is constrained by cost impositions, the effect of putting another charge on brownfield development in Sydney would be to further constrain the supply of apartments and again put us in an even more difficult position than the rest of the country.

MR TACCONE: Hoxton Park has a recycled water system. As far as I know it hasn't been exhibited as yet. It won't be made available until 2010, yet with the section 73 contributions, they are asking to pay the contribution at this stage. Could anybody answer how that is actually going to work? Will we need to pay once it is operational? Do we need to pay in advance?

MR WILSON: If you pay the capital contribution you would not be required to pay a developer charge once it is put in place.

MR TACCONE: It won't be ready until 2010 when we apply for a section 73 certificate. Are we required to make that contribution at that stage or do we wait until it is operational?

MR WILSON: I can't answer that. I know that there are houses at Hoxton Park with purple pipes. I am not sure of the timing of the scheme completion, but the scheme is progressing.

THE CHAIRMAN: Why don't you take this up bilaterally and we will call this section to a halt and we will start again at 1.30.

LUNCHEON ADJOURNMENT

UPON RESUMPTION

THE CHAIRMAN: Thank you everybody. We will resume. again If others join us, so be it.

MR READ: Good afternoon. This is the first of three technical sessions this afternoon. They are fairly short, they're only 45 minutes, we've got some slides for each of them, but we'll go through those quickly which will give you plenty of time for discussion.

The sessions seek to address some technical issues regarding the methodology for calculating charges that have come to the Tribunal's attention and from submissions in response to the Tribunal's issues paper. The first three topics for this session are water consumption and BASIX, transparency and system capacity and equivalent tenements.

Speaking about water consumption and BASIX, I think the first three points are fairly self-explanatory, but the final point there is one of the major topics that have come up in submissions. The first three are water consumption figures used to calculate developer charges are hard coded in the 2000 determination. Residential water consumption averages were set in the 2000 determination, but there have been changes since that time because of drought, water restrictions, BASIX. Obviously, post-BASIX developments will have a reduced consumption compared to pre-BASIX. The final point is that reduced consumption implies reduced costs and therefore reduced charges.

As you know, BASIX aims to reduce water use by 40 per cent for every house and intuitively you would think that would lead to lower costs and therefore lower charges. This has not always been the case unfortunately.

These are some of the stakeholders' views on these issues. Most agencies favour a long-term average for consumption calculations. From a pricing perspective, one of the main arguments for a long-term average for consumption is that pricing regulators seek to avoid volatility in price changes. However, this of course can lead to short-term gains and losses. The second point is that there are mixed opinions on the use of a pre or post-BASIX parameter. For example, Sydney Water argues for

adopting both a pre and post-parameter. They argue that only using a post-BASIX consumption value will lead to higher costs and therefore higher charges for future development.

The final point is there are significant concerns that water charges have risen in some areas where BASIX has been introduced. The UDIA commented on this when Sydney Water did its recent review of charges in 2006. This led to a lower revenue amount in the reduction calculation and hence, higher charges. However, the UDIA believes that Sydney Water does not take into account the impact of the reduced consumption on the operational costs and capital costs portions of the methodology.

These are the key questions to consider over these topics. How should consumption settings be set? By the determination which would be hard coded and last for a number of years, or flexibly? As an example, perhaps the agencies could do a calculation every five years when they review their charges and use that as the consumption parameter. Why have charges increased in BASIX areas? Finally, should and if so how should the methodology be changed to reflect the introduction of BASIX?

These are the four issues to be discussed in the second topic in this session: that's transparency and system capacity. The four points are transparency is important because most analysis of DSPs is performed by developers. Therefore, developers need easy access to relevant information. Under the determination, agencies are required to provide asset information in DSPs, but developers complain that more information is needed. It was particularly brought up in submissions on asset capacity and on MEERA values.

Capacity data is important so that apportionment of assets and remaining capacity can be calculated. There are some financial implications to those points, but there are also some practical ones. For example, developers only have 30 days to analyse DSPs during the public exhibition period and obviously they need that appropriate information up front in DSPs in that time. They don't have time to go backwards and forwards to agencies trying to elicit more information out of them.

These are some stakeholders' views on transparency and system capacity. Stakeholders asked for transparency, consistency and simplicity, with all information available. Some stakeholders believe that there is merit in a common calculation spreadsheet if it is transparent. At the moment there is some flexibility allowed in the format of spreadsheets used by agencies. The Tribunal checks the calculation of spreadsheets at the time of review to ensure that they comply with the determination, but this doesn't require that all spreadsheets be exactly the same.

In regard to capacity, the last two points, the agencies report that in practice they generally provide capacity information on a network basis rather than on an individual asset basis, but developers report that they need data particularly on major assets, the capacity of the major asset, so that they can determine when capacity will be reached and what surplus capacity exists.

These are the key questions to ponder. The first one is addressed to everybody. What can be done to improve transparency, consistency and simplicity? The second one is more to developers. What information on asset capacity do developers need? The final one is I suppose mostly towards water agencies. Are there any constraints that prevent water agencies providing the capacity of individual assets or systems?

The third topic, which is equivalent tenements, the main issues are: an ET is defined in the determination as the demand on systems for the water consumption and discharge of a single house. However, agencies apply average and peak factors to the capital charge and reduction amount calculations. One of the problems is that these factors vary from agency to agency. Agencies also apply ET multipliers to allocate costs to various development types, but these also vary from agency to agency. An ET multiplier basically reveals how many residential ETs it takes to satisfy the demand of a non-residential type development.

The final point that was put up by Hunter Water was that the determination does not mandate the time frame for the inclusion of ETs as it does, for example, for the inclusion of assets. In the case of assets, the time frame is 1970 to 1996, 1996 onwards and then future assets. There are no such guidelines in the determination at present.

These are some of the stakeholders' views on this issue. Sydney Water, for example, uses peak ETs for the capital charge and average ETs for the reduction amount. However, the UDIA has the view that there are no peak ETs because designs are made to serve average ETs. When speaking about ET multipliers, some stakeholders are concerned that ET multipliers vary among agencies for the same class of development and as I said before, Hunter Water has brought up this issue of whether ETs should have same inclusion time frames as do assets and they suggest that ET inclusion time frames should match those of their associated assets.

The key questions for equivalent tenements are should the determination mandate peaking factors? Should the determination mandate ET multipliers for different property types? Should the determination mandate time frames for the inclusion of ETs and if so, on what basis? They are the questions for this session. I will hand back to the Chairman.

THE CHAIRMAN: Thank you very much. I might start with Sydney Water.

MR WILSON: Taking BASIX first, I think BASIX has proved difficult for everybody. When implementing BASIX, Sydney Water did undertake an extensive process to incorporate it in developer charges. In the case of waste water, waste water charges were reduced and because the formula mandated a fixed kilolitre level of discharge for consumption, we wrote to Treasury to reduce those charges. It is on the water side that I think people have problems.

In applying BASIX to water charges the problem that arises is that with the net operating result component of the formula, we know that water consumption will go down 40 per cent under BASIX, so that will reduce usage charges in those areas by 40 per cent and that's a large component of revenue.

What we're calling the reduction or the capital reduction is much smaller than it otherwise would have been. It is also true that we took BASIX into account on the capital side of the equation, but we didn't get the same reduction in capital because the water industry is a fixed cost asset intensive industry, so you can reduce throughput, but that doesn't necessarily reduce by a proportionate amount the requirement for capital.

We actually also applied, as noted in questions, post-BASIX and pre-BASIX ETs. The effect of that was to allocate more of the capacity to pre-BASIX ETs and less to post-BASIX because they have a lower demand on the system. However, even doing all of that, we've got water charges increasing. There was an attempt to include BASIX. We're open to the discussion of how it should be done, but that's the basic outline of why charges in water went up. Maybe if we cover BASIX and then go on to some of the other issues or --

THE CHAIRMAN: I think you'd better keep going because we've only got half an hour or so.

MR WILSON: Okay. In the case of system capacity, I will just check back on the questions which are fairly technical. Transparency and system capacity - yes, we think it does have to be more transparent so that people can understand it. We have been working on that in reviewing charges and capping charges to date. As a result, when our submission to IPART was lodged, Kerry committed to reviewing our own assumptions and being transparent about getting the data out there in a readily understood form. We held a technical workshop with developers just to run through the basis of our submission. We intend to carry that through to the implementation of any future determination.

MR READ: Are there any constraints that prevent the water agencies providing BASIX individual assets?

MR WILSON: On that one, I think it would be difficult for us. Already there are some fairly arbitrary decisions made about which assets are in and which assets are out. When we make a decision that pre-70 assets are out or post-70 assets are in or pre-96 are in or out, that to a very large extent will determine your capital amounts. Going through every asset in every system and working out what proportion is a growth asset and what proportion is for other business drivers would be an extraordinary exercise for Sydney as a whole and one that would have a very high administrative cost. That is not to say that we don't have rules about how we do allocate common assets between growth and other.

MR READ: You're talking about major assets, not all assets. Is it difficult for major assets as such? One of the submissions from the developers was asking about information so that it makes it more transparent overall.

MR WILSON: I think we are happy to put out our guidelines on how we've allocated between growth and other drivers and if there is a major asset, like the Blue Mountains tunnel, then we can provide that information, but how you draw a line, is it by value or by class? I would be happy to see what Hunter thinks and what the other utilities think about allocating capacity in different assets. I think broadly the decision you make about what's in and what's out is going to be far more important than how you allocate future assets.

THE CHAIRMAN: There is another group of questions on equivalent tenements which is not up there which in the light of this morning's discussions about multipliers, I would be particularly interested in your comments on the multipliers for different property types and peaking factors and so on.

MR WILSON: We are reviewing all of those multipliers. I am not sure, to the extent that there's a consistent situation across each water utility, that you would come up with that a light industrial tenement is the same in the Hunter, in Gosford or in Wyong or whether you would have that degree of commonality so that you could set design effective charging parameters for each type. As is obvious from this morning's discussion, it is an area that we know we need to look at and to update what are actually the requirements of those sorts of developments compared to how they're traditionally being designed and charged for.

THE CHAIRMAN: The question in my mind is given the evidence put before us this morning, whether at the very least there should be more transparency in how you determine the multipliers and secondly, whether you should be getting more guidance from IPART in terms of how you do this.

DR SCHOTT: Chairman, can I just interrupt on that one? I can't help myself. The problem we've got that's different from the discussion that Wyong Council mentioned this morning is that we're actually not the zoning authority as well as the asset provider, so we've actually got a design system for whatever we're zoned for and the fact that at the moment a lot of logistics warehouses are going in that use one toilet and a hose out the back doesn't mean that somebody can't come along and put in a food processing plant. It is easier, frankly, if you're also the zoner. That is not to say that we can't be more --

THE CHAIRMAN: But again, in the unlikely event that that's going to happen in the foreseeable future --

DR SCHOTT: Yes, but there's a degree of discretion in there, I think.

MR WILSON: I think if we were transparent about what we're using and the development industry could comment on that - and Hunter may have a different set if they were transparent and Gosford was also transparent - then that might be a better approach than trying to mandate a single figure across all areas, but we take the point that transparency is a very useful device here in making sure that we have sustainable approaches.

MR KOIZUMI-SMITH: I would also make the point that when we are designing our systems, we're not always aware of the nature of the activity that will occur.

MR WILSON: That is the zoning point that Kerry is making.

MR TAYLOR: Mr Chairman, Mr Wilson makes the point that BASIX affected revenues and capital costs. I think we concede that if you've got capital investment you've made it already for existing assets, so when BASIX comes in that's not going to be affected, but one would think it would tend to defer future assets. If you've got reduced usage, obviously you can squeeze the existing assets a bit longer before you have to amplify your system.

There was no mention, though, of operating costs because if you are supplying less water and treating less waste water then one would think that the agencies would have a saving in operating costs and that wasn't mentioned in that point.

MR WILSON: There are marginal operating cost savings but again, they're not proportional to the reduction in revenue. We agreed with the point with just the numbers

when you punch them through and for BASIX we said that pre-BASIX ETs have a higher weighting if we use more of the capital than post-BASIX ETs. We're not sure that that was the right thing to do because we think we've already built lower capital costs into future assets, so we're not sure whether that was a necessary step, but it was an attempt to recognise that when system capacity is increased effectively, you can fit more ETs on the one system when they're using less water.

THE CHAIRMAN: I think the comment was made early today that it was almost counter intuitive that the introduction of BASIX when worked through had led to an increase in developer charges and the comment was made that that's counter intuitive: you would expect it to lead to a reduction. Do you agree with it?

MR WILSON: I agree that it is counter intuitive, but still given the formula that we've got in the net operating result it's still --

THE CHAIRMAN: Yes, I can see why the formula produced the answer, but if the formula produced an answer that's counter intuitive, then you might ask yourself about the formula.

MR TAYLOR: Exactly.

MR WILSON: We have made suggestions to the formula which would coincidentally overcome that reduction.

THE CHAIRMAN: Do you think it will overcome it?

MR WILSON: If there was no operating result in the formula then lower capital costs because of BASIX would result in lower capital costs per ET for new assets.

THE CHAIRMAN: Yes.

MR WILSON: It is just another complexity in the net operating result. Another factor, though, is that BASIX households, new households, tend to actually use a similar or a greater volume of water than older households. They're in newer areas, they're establishing gardens and even though their consumption is reduced from what it otherwise would be, their consumption can still be higher than older dwellings and therefore, the demands you have to supply through the system and the capacity you have to provide isn't necessarily reduced.

MR ABRAMS: Could I just add to that? In terms of costs, in terms of reductions you could get in operating costs, on the water side a lot of the cost is about fixed costs of maintaining pipes and addressing leaks and obviously they're not being reduced through BASIX. You get some reduction in say less water purchases from the SCA. In terms of waste water, it is also not as clear because the reductions in the average amount of water can also lead to increases in the concentration of the substances in the water that have to be treated when they hit the treatment plants, especially when it is secondary and tertiary.

Therefore, there's not a one-to-one link between a reduction in the volume of discharge and the actual change in operating costs on the treatment plants that ultimately are there to deal with what's in the sewerage and in the water. As a result, the reduction in the level of water just doesn't have a proportional reduction on our costs.

THE CHAIRMAN: I appreciate that it doesn't have a proportional reduction, but I don't suppose you're arguing that we should get rid of BASIX.

MR ABRAMS: No. We're just explaining why they're there. The reduction in the revenues is swamping or exceeding the reduction in costs.

MR PRICE: Mr Chairman, do you mind if I just challenge that? The fact is that I had a submission in on the West Camden treatment plant. The bottom line is that it was designed in 1972. It was demonstrated in the DSP that the demand had reduced by about 30 per cent by 1996. Then we looked at how you might apply BASIX post-2004. The bottom line is that yes, we will have the same amount of biosolids, but they represent 0.1 per cent of the total volume of effluent to be treated, 0.1 per cent, so any argument about the fact that we've got the same number of solids is hardly relevant to the substantial reduction overall of the volume of water.

The problem is in dealing with Sydney Water. I have just sat here and listened to a whole lot of reasons why they can't do something. Dr Schott said this morning that they applied BASIX to the planning but they didn't apply it

to the charge and I take that to be the case, even though I just heard that maybe that isn't the case. This is the problem. We're dealing with a number of different attitudes here.

Effectively, BASIX is a mandated requirement of the State Government and there's considerable costing in meeting it and it is all very well for Sydney Water to say in their submission, "We don't know what the outcome is going to be." Sorry, that's not good enough. The government has said, "You will not get your development consent for your house until you prove that you can reduce the demand by 40 per cent." It ought to be good enough for everybody, including Sydney Water, to take into account that fact and the fact is that if there's a 40 per cent reduction in demand, the number of ETs that any given asset has, if you do it by capacity, it must be cheaper. It must be cheaper because you're dividing the cost. That's not going to apply to things like pipes, but it certainly will be important for things like reservoirs and treatment plants and all that sort of stuff.

The problem with the ET classification then is why is Sydney Water 10 times more than anybody else? That's the basic question. Their costs are substantially more. They're substantially more in all areas. They weren't listening to Mr Grantham this morning. He said the simple system that his council and other councils in regional areas have worked out is that they charge one ET at the subdivisional stage and they get a second bite of the cherry because they have to issue a compliance certificate at the building stage and at that stage they can then look to the demands that are likely to be placed by that particular development. If that's knocked over and a new development is added to it or it's changed in some substantial way, they get another chance to review that.

It seems to me that the current rate they're using, 55, has got to be the maximum they might expect and that's pretty unreasonable. Regional councils manage this problem without a great deal of difficulty. They don't go around complaining that they might get a massive water user on one of their industrial estates and that might be a problem. They deal with the problems as they arise and they make reasonable assessments on average demand and they expect to get an average outcome. Why can these much smaller councils deal with these issues and Sydney Water can't? It is just unfathomable.

As to the question of rezoning causing a problem, it's the same for the councils. They're not the authority for rezoning. They might ask for a rezoning, but the rezoning is provided by the Department of Planning. It is really irrelevant. The bottom line is that we're always dealing with land that's rezoned. It has nothing to do with the ability or otherwise of agencies to deal with the question of demand and capacity. It is just an irrelevance. It is about time we came to grips with it.

The real problem for the current spate of DSPs is they take no notice of capacity. Everything is worked on take-up. My understanding from a previous employee is that there were two reasons why it went up. They only applied BASIX to the revenue, which never went down, they didn't look at capital costs and they didn't look at maintenance costs; and secondly, because they applied a reduction to the take-up. That is a nonsense because the take-up shouldn't change. The number of houses we're going to get over a period of time is going to be the same.

One of the problems in dealing with Sydney Water's new proposals is that we know roughly what they've done to complicate the processes in the past and that's all to do with apportionment. Even though it started in 2004, any subdivision that comes on stream for which they are going to pay a fee will have to have houses that are BASIX compliant. So virtually from now, 2006, 2004, whatever, they are only going to get new developments that are BASIX compliant. There is no point Sydney Water saying we are going to sit around and wait until they see what happens. That is not good enough from our point of view. We are paying the cost of meeting a mandated requirement which says we have to have a 40 per cent reduction, so we have to get serious about dealing with it. One of the things you are going to have to do is do what every other regional council in NSW does - assess major assets on a capacity basis. Some of those are not very substantial organisations, and they can do it. The idea that it is too hard is not acceptable. It has been demonstrated widely that it is possible and it ain't that hard, and in fact what the heck have they got in their assets register, and they don't have the capacity that every other council has. They must have an assets register. They must know whether it was designed to meet a particular capacity. If they haven't got that

information in their assets register they should have. Therefore, dealing with capacity ought not be an issue.

MR WILSON: From here could I make three points to correct the record. Sydney Water did take account of the reductions in capital costs in BASIX. I opened by saying on the waste water side the formula gave us a certain answer, but we weren't happy with that because the charges were too high and we actually wrote to the treasurer to reduce the charges below what the formula allowed, and that was a 28 per cent reduction and $8 million. So there are issues with BASIX because it is a difficult issue, but Sydney Water has taken a genuine attempt to incorporate it and nothing I think Peter says has addressed the point that revenue goes down axiomatically but the capital costs don't necessarily go down.

With respect to the industrial multipliers for conversion to ET, as Kerry said this morning 55 ETs per hectare is not necessarily the right number. It may be high, and the capacity increased from BASIX may take time to come through. We are happy to review the 55 and happy to discuss this with industry. In fact, we are committed to do that as of several months ago, as we set out to the industry then.

THE CHAIRMAN: I think Peter put forward a specific suggestion on the multiplier, reporting what happens with other councils. It was a two-stage process, as I understand it, where there was an initial view and then you vary it as things unfold. Do you have a reaction to that proposal?

MR WILSON: Other than we are happy to look at it. I don't have an answer. We can't give a commitment, but we are happy to review the 55. We are not just reviewing the number. We are happy to review the approach. This is getting into the very technical aspects, but just on capacity, we project ETs out to 2038, whereas the capital is not projected that far. So you are projecting ETs far beyond the level which is being taken up at any one time. So that is an assumption which reduces the amount of capacity per ET, because we are including over the horizon, yet we don't include the capital to that level. So that again may not be transparent, but that is an assumption which serves to reduce the allocation to each ET.

MR RAMSAY: This is a two stage recovery through a change of zoning or higher use in a common zoning. Presumably Sydney Water is required to put the capital in. It has assessed demand for that area that development area. If we recovered one ET, it leaves the balance of that commitment for capital expenditure unrecovered. I would be interested to know how that works in a system where you provide water infrastructure for the development at an assessed capacity available. You then recover one ET because you have a low usage resident on that hectare. If a higher usage resident never comes along, how do you recover the rest of the capital?

MR GRANTHAM: If I could address two points. When agencies put names or infrastructure in the ground, it does it on the basis of reasonable assumption, be it 55 ET per hectare or some other figure. That is one of the reasons for the 7 per cent return. I heard mentioned around the table here "Why should there be any return on that infrastructure?" Well, again, having sat through the initial discussions coming up with this methodology, the agency takes a risk. In other words, if it designs for 55 and only gets 40, it underrecovers. If it designs for 55 and gets 60 it might overrecover. So the answer to your question is it was always recognised that the agency up front bore a risk. Wyong's way of addressing this has been to say, "We will charge one ET upfront, and if our design criteria is reasonable then we will recover about, if it was 55, about 55." So that return on asset can be recovered.

Could I make one other comment on BASIX. BASIX is just one element which is affecting water consumption over a number of years. The drought, changes in attitude on existing properties, tanks going in, water efficient devices going in, if you want to run the argument that because BASIX has got a 40 per cent reduction on new developments, don't forget that is 40 per cent reduction on water sales, so therefore some reduction on the operating surplus also associated with those properties.

As you go back through the system, when you assess the capacity of the existing or the new infrastructure to go in, it will have a 40 per cent extra capacity. In other words, you could put 40 per cent greater number of users on that system, so that will drive down the capacity of that component. However, as you go back through existing

assets, which have been used by both the new development coming on and the existing development that is already on it, you now have got two separate lots of calculations. All I'm putting on the table is that we have heard around the table this morning that this methodology is reasonably complex. I agree. Let's not make it any more complex by having two sets of calculations preimposed, because it will become a nightmare in terms of working that out, and that's why I'm putting on the table that I believe the five-year reviews which take into account changes in consumption, and in fact IPART at their annual reviews for pricing set not just their future price path, but based on future consumption forecasts, which are in fact independently audited by IPART's auditors, so you have a very firm basis forgoing forward on which to base future consumption which again will by review over time pick up these various changes including BASIX.

THE CHAIRMAN: Thank you for that. I'm not sure we will be doing five-year price paths. It might be four.

MR YOUNG: Luckily BASIX was rolled out in Sydney earlier than it was in the rest of the state, so we were able to learn from Sydney's experience. Our position is that the developer charges should be cost reflective and evidentiary based, so that's our approach. Just to set the scene for the distribution - and Peter has talked about this - our distribution of water assets, we designed for that 40-degree day where bushfire season, people are out there using water and it is a high peak. That is what our system is designed for. The assumption that we are making internally is that the rain water tank after a long dry period is going to be empty, and so the people who own those houses are going to be looking to our water to supply the peaks. So we are not reducing our design standards or our capital for rain water tanks for our distribution system, so there is no change in our cost forecasts. There is no reflection in the change of the charge.

Because it is so new, we have not gone down the path of reducing our revenue. There is no difference from the BASIX customer. We didn't decide to jump in and reduce the revenue down. What we decided to do was to look at what were the demands for new developments and to start splitting it out for the first time because IPART sets an average of about 200 kilolitres a year for houses and what we found was all new developments are using about 260, or

265. When we put rain water tanks in with the reduction coming in they will come back more to the average of the other customers. So that has been our new evidentiary base. We are continuing to collect data in that area, but BASIX customers do not pay more in the Hunter than they do for others.

BASIX is also a third pipe solutions. What we have found from those is there is no excuse that we will get lower peak demands in the summer from third pipe because they will be using the recycled water for irrigation and toilet flushing, and that is controllable. So in some of our developments that that is in, our peak water charges dropped from 900 a house back to 200 a house because we were able to make significant deferrals on our peak capacity with those schemes. So where it is evidentiary based and we can see it, we are locked in. It will require more agencies understanding the facts in these cases.

THE CHAIRMAN: While you are on the floor, would you like to comment on the previous comment about consumption and tie it to the IPART price reviews and, secondly, the discussion we have been having about ETs and multipliers, and so on.

MR YOUNG: That is a good point. We would like more flexibility in consumption. We are locked into that. How we best do that on BASIX versus non-BASIX maybe we need flexibility from IPART as long as it is evidentiary based and it is audited.

On the multipliers, we love multipliers. When we collect all our data on commercial and industrial, we find that with commercial customers their peaks are not much more than the averages. They use water fairly consistently. We have a different factor for commercial and industrial recognising that they are efficient users of capital. So they get a discount compared to a residential house. There is no doubt that when you design for that 40-degree day, that day after day of 40 degrees, when we are designing for that peak, most of the year the assets are only running at about 50 per cent of their capacity.

Residential customers force us to invest for that short number of peak days. Commercial industrial zones are very efficient users of the capital. I think they should be rewarded for that. Hunter's approach to industrial is

more like the Wyong and Gosford approach. We do have a second bite at the cherry when people come in. For example, if you are a brewery coming in and there is a DA we will assess that individually and we will say, "Look, your land is based on this value and you need to pay more." Even later on, if that happened to be a light industrial but later on it was sold to a wet industry, generally they would do a DA to council for that swapover and we would pick that up and we reassess it at that time and ask them for more money. On occasions it means if we get a lot of wet industry in an area it will chew up our capacity a lot quicker, and that means we have to invest in more capacity which means that we roll our charges to reflect that. But if it turns out to be just light industrial, they get a lower charge. A two-bite approach is quite sound.

SPEAKER: 60 to 80 per cent of the what the state government has got for Sydney is redevelopment, and that is where a lot of us in property council work.

A couple of things have come from what has been said. If you have got capacity constraints, one of the things is to provide an incentive system which enables the developer to stick the system on site. There is no real availability of that at the moment. We are dealing with that issue at the moment in trying to disconnect residential development, redevelopment from Sydney Water system. Complete black water recycling, cutting water usage down by about 80 per cent. Those things are not really addressed and we are trying to address those at the moment. I don't have a method of doing that at the moment, but there is no incentive for us to do it.

At a commercial strata level it is a much easier way to go because Sydney Water charges you for a sewer connection fee for every property, so if you have got lots of strata properties, then you can just about pay the thing off in terms of blackwater recycling, which reduces your water usage enormously and effectively increases capacity.

If you have got a single commercial building, that is one connection fee. It doesn't really work. Strata units, similar sort of thing. You do get some payback, but that owner's corporation if it runs a blackwater or grey recycling system, it reduces the amount of usage enormously but they still have to operate their own system on site.

Now, the guys in Sydney Water also understand an issue which has not been talked about here today, and that is the price of carbon. It will come up in the next cycle. They and you guys are the big emitters of carbon. It will cost something. If we are not exporting sewer and importing water to individual properties, then the reduction in carbon can be measured, and we are about to make a submission on a smaller site to Sydney Water and get some information around that. I don't think that has been accounted for, but that is one of the other things when they start getting belted for the price of carbon, one of the ways of reducing that carbon is providing us with incentive to reduce the import and export of water. That has been raised in council submissions earlier.

One of the things that in terms of transparency from our point of view is if you are talking about having two bites of the cherry, one of the difficulties in assessing your feasibilities on these things is making sure that the information is available for us up front so we can get easily. At the moment, notwithstanding attempts by Sydney Water - and it is getting better - it is still difficult to get accurate section 73 proposals, and going from what we said earlier it is also difficult to say, "That section 73 does not make sense to me. I want to trade it off against some issues on site to take care of our own water so we don't need section 73." That is where we are at on a couple of specific cases at the moment.

MR YOUNG: With BASIX, it is a bit like the desalt plant - it is providing a benefit to everybody, and the reduction in revenues is only being applied to those new growth areas. Again, in my mind, it is an argument for consolidation of the number of DSPs.

On the transparency side of things, we have got four agencies here today. They are all running numerous spreadsheets each with their own nuances in each model. It has grown beyond that and there should be a consistent database developed available on the web for develops or any members of the public as to what those inputs and outputs are. I don't see that as a difficult IT solution to implement.

MR TAYLOR: On transparency, it was mentioned before that Sydney Water did put them some analysis out for view, which was very good, but in the industrial commercial, in some

areas some DSP charges went up by a factor of 20 times with no explanation. That is an incredible leak and charges come out in the DSP.

Another point I would raise is down in the Illawarra where waste water is being diverted from ocean outfall to go to the BlueScope Steel, which is a great scheme and everybody fully applauds it. There is a charge in the Wollongong sewerage DSP for that. Ultimately that will take about 40 megalitres a day which is about 40 per cent of the water usage in the Illawarra which will be recycled, grey and black water in the steelworks. Fantastic.

Yet when you look at the Avon water charge, the water charge went up over 100 per cent - about 150 per cent. So you think, "Hang on, if they are going to save 40 per cent of the water and use it in the steelworks, why the hell is the potable raw water cost going up by well over 100 per cent?" There seems to be no connect between the water DSP and the sewerage DSP. Again, no explanation of why there would be such a big increase in the water supply if you are managing to recycle 40 per cent.

MR BRUCE: In the south-west sector we are about to kick off with two major precinct releases based on 12,000 lots or thereabouts. 12 months ago the servicing strategy was to look at servicing basically 12,000 lots . The cost was out of sight. So we have had to interrogate the system to come right back to what is the capacity for relatively minor bits of the existing infrastructure to see if there is existing capacity and that has proven to be the case. So we have a situation where we have been able to come up with a scheme where we can start the works, the first few hundred blocks out, for relatively acceptable capital expenditure, but it meant having to drill right down to see the capacity to suit smaller bits of the infrastructure and that took considerable time, albeit with full corporation from Sydney Water.

MR PRICE: I would like to show you a diagram. The argument has been that we have one ET as a standard dwelling. The system is designed on various types of peak demand. What Sydney Water does is in fact apportion the cost for sewerage on average demand, but for some elements of capital for water they use peak demand. This is double counting in fact, if you look at this diagram. Effectively what happens is you have got an ET and the next thing that connects to that is a pipe. That pipe is designed on the peak hour demands. Therefore the size of the pipe goes up. If it was average demand it would only be one size. (Inaudible) consequently the cost goes up.

The same thing goes for a reservoir. It is designed on a peak day demand plus fire fighting allowance. Still all these systems are being increased in size to serve one ET. What Sydney Water is suggesting is you take that cost but because in any given system, if you divide the peak demand into it it will give us less ETs, we therefore should divide by a lesser number, is distorting the basic argument which starts with one ET. The system is sized for that ET, and logically the cost should be apportioned over that ET. If you said then we have got a pipe here costing X and the PDT would be 0.8 instead of 1, you divide the cost of the pipe by 0.8 and you get a higher figure than you would have got if you had divided by 1, because what they are doing is they are starting in reverse with a false assumption. The pipe has already being increased in size and its cost increase to serve one ET. Therefore that ought to be the only basis for apportionment. Peak has always been a misnomer. It is a design parameter and it has got nothing to do with apportionment, that is the BASIX logic.

MR YOUNG: On a 40 degree day the capacity of a dwelling users has to be provided for. A waste water system is designed to handle wet weather flows and if you have got four times capacity so we don't need to do it.

MR PRICE: You are missing the point. The pipe has increased to meet the peak demand. That is the peak hour and the worst day in the year and the worst hour in the day, et cetera. It is built into the cost already, right?

MR YOUNG: No.

MR PRICE: Why? If you put a pipe in the ground --

MR YOUNG: You are designing it for that peak summer condition for a new residential area, and the truth is whatever the costs are to meet that peak day is divided by the number of new growth lots and that equals the charge. If we didn't have residential there and we had commercial or industrial, then they have less peak, and we fit more of them into the area and it would be cheaper.

MR PRICE: All I am saying is that the cost is divided by one ET. What these guys are doing is discounting the number of ETs.

MR YOUNG: Maybe it is a technical issue that I am not understanding.

THE CHAIRMAN: You are happy with the way Hunter is doing it?

MR PRICE: What Sydney Water did with BASIX was - their assumption was that because BASIX reduced the demand, therefore the ETs ought to be spread out over a longer period, right? Is that what you did?

MR WILSON: I can't see your diagram Peter.

MR PRICE: You extended the take up of the ETs over a longer period?

MR WILSON: Without looking at the diagram I think we had more available capacity with BASIX so it would accommodate more ETs.

MR PRICE: I thought you said you took it out over 38 years.

THE CHAIRMAN: We might call this session to a halt.

TONY: My question comes from something I stumbled across on IPART's website. It refers to a Sydney Water submission to IPART. The submission itself was dated 14 September with a media release date of 17 September where Sydney Water was seeking a 33 per cent increase over a four-year period which would up the average water bill over that period by $275. My question is was that dealt with by IPART and, if so, what was the outcome?

THE CHAIRMAN: It has been dealt with by IPART. There has been a public hearing on that. It is not today's business.

MR BURKE: I would like to talk about ETs and demand. Sydney Water's water conservation and recycling implementation reports up to 2005 showed that water consumption per industrial property fell by 60 per cent over the previous 20 years. I don't think the issue of not knowing what is going to happen is entirely true with industrial development. Secondly, pre BASIX the average waste water per ET discharge was (inaudible) Up to 2001 DSPs it was 24 kilolitres per day per hectare. In 2006 DSP it is now 35.7 kilolitres per day per hectare. If you divide 0.645 into 35.7, you get 55.3 ET. That is where it came from.

MR YOUNG: Looking forward, I think there is a case for IPART to look at whether they want to be more prescriptive. And having listened to the discussion over the first three sessions I think there is a clear case that the utilities can do more getting together and I think UDIA and the Property Council would welcome that, to try to understand the differences in approach with the different utilities and if we could learn with each other. Is there a possible outcome from this? It is true that if you look at our website for the multipliers for different developments, looking at the other web sites - Sydney, Gosford and Wyong - we use different factors. Why is that so? There is some learning there that we could gain from looking at what other evidence people have. Maybe from an industry base and looking to more consistency you can stop some of these difficulties coming in. That would be worth a go before IPART gets involved, to get a more prescriptive definition of these areas.

THE CHAIRMAN: I think the question for us might be how far we take it on trust that you will get the right answer as distinct from you proposing your agreed position on some of these issues before we finalise this.

MR YOUNG: I think that is true. There may be good reasons why there are differences. IPART, even if you don't take it on trust, coming in is certainly looking for the best outcome for the community, and that would be based on some evidence from agencies on why we differ.

THE CHAIRMAN: We have never tried to set final answers in this area. That is why we set a methodology.

MR YOUNG: Yes.

THE CHAIRMAN: What I think we're finding is that at the moment the methodology allows considerable latitude in its interpretation.

MR YOUNG: Agreed.

THE CHAIRMAN: If your proposal was that you might have a discussion amongst yourselves about the interpretation methodology - and personally I think that could be a good idea - the critical issue for us is whether we can be informed of where you're heading on that before we finalise our determination.

MR YOUNG: Agreed. I think it would be a useful step even before you finalise your determination.

THE CHAIRMAN: That is what I've got in mind because if it hasn't gone anywhere before we finalise our determination, then we're in the position of trusting that you will get greater consistency of interpretation or us providing more guidance on that.

MR YOUNG: Yes.

MR WILSON: I would make the point that all of this discussion has taken place against the background of trying to implement the determination and there's phenomenal complexity in any moves towards simplification, so that if we don't have to go down all these paths, that would help a lot.

THE CHAIRMAN: I very much endorse that. That is clearly a key issue that emerged out of this morning; that is, the balance between, if you like, cost reflectivity and getting somewhat more simplification.

MR WILSON: A point we made on page 1 of our submission is that DSP charges are not a cost recovery mechanism for Sydney Water. They're not essential for that. We have no incentive to increase charges beyond the point at which they're appropriate. In that sense, all the discussion about differences of methods is a difference of misunderstanding rather than any sense that there is an intention to elevate charges beyond a certain point.

THE CHAIRMAN: We are not suggesting that cost reflectivity is the same as cost recovery. We are suggesting that we want to give some price signals about what's most expensive to develop. We might move to the next section because we're well behind schedule.

MR WARNER: Session 4 is going to continue with some technical aspects. What we hope to look at this time is rate of return, regulatory oversight, dispute resolution and the period between reviews.

The current determination provides for a 3 per cent rate of return for Sydney Water's and Hunter Water's pre-1996 assets, the zero per cent rate of return for Gosford and Wyong for pre-1996 assets and that was essentially brought in to minimise pricing impacts and a 7 per cent rate for all agencies for post-1996 assets to reflect the opportunity costs of money and to match the real pre-tax benchmark for rate of return IPART used for other determinations at that time.

Many stakeholders support the use of an agency's WACC as determined from time to time by IPART when setting periodic charges for post-1996 assets. For pre-1996 assets a 3 per cent rate of return is favoured by most stakeholders and Mirvac believes that a discount rate should not be applied retrospectively.

The question we would like you to consider in relation to rate of return is should the determination adopt rates of return for pre-1996 assets, post-1996 assets and assets yet to be commissioned or merely adopt the WACC determined by IPART for all assets.

In relation to regulatory oversight and dispute resolution, some of the issues or the arguments are that the regulation of developer charges is relatively light-handed by IPART. In this regard, the Tribunal does not approve charges and does not check DSPs, but merely approves the calculation worksheet or the manner in which calculations are to be made.

Where disputes occur, the current determination provides for a review by the chief executive of the water agency concerned in the first instance. Where this does not resolve a dispute, the final avenue to resolve disputes is via arbitration by an independent arbiter.

When considering this matter from a stakeholder perspective, most stakeholders believe that the current review of oversight is appropriate. Most stakeholders support the current dispute resolution process, but some have experienced difficulty in getting water agencies to

undertake arbitration. Some stakeholders have suggested that they would like to see IPART have a role in arbitrations. The questions we would like you to consider are should IPART be more involved in regulating DSPs and should IPART provide an arbitration service?

The determination mandates that water agencies must review their developer charges once every five-year period from 1 July 2001. Hunter and Australian Water propose that the more frequent reviews of developer charges be allowed if necessary and from what Wyong said this morning, I also believe they think that's the case also. Instances have arisen where circumstances have changed markedly due, for instance, to an LEP changing shortly after a review of developer charges and agencies can find themselves frustrated in their ability to actually reflect those later changes. The question we would like you to consider is should water agencies be able to review their developer charges at any time or should limits be imposed? They are the questions. We will just leave those up there. Thank you, Mr Chairman.

THE CHAIRMAN: Thank you, Richard. I might let the water authorities go first. Do you want to go first, Kerry?

DR SCHOTT: On the rate of return on assets, because we are suggesting that pre-1996 assets be knocked out of the formula, we just simply note in passing that they're at 3 per cent at the moment in the formula and we basically agree with setting a real pre-tax rate of return of at least 7 per cent.

In terms of additional regulatory oversight before adopting developer charges and IPART's involvement in dispute resolution, the current resolution process relates to IPART getting involved in methodology and I think that is completely appropriate. I would note that the majority of the issues raised since 1995 are about the application of developer charges to individual sites and to the extent that that isn't linked to methodology, it might be better to just let the developer and the agencies sort that out, possibly through an independent dispute resolution.

There are costs and benefits, of course, with additional regulatory oversight and IPART could make a determination on key issues that are currently open for interpretation and generally promote consistency across the agencies which we've all just been talking about.

In terms of the period between reviews - and I know this is going to impose more work on IPART all at the same time - we're rather disposed to having the review of future postage stamp prices that as we know occur every four years, having developer charge reviews at roughly the same time to ensure that we get some consistency between the reviews. We do think there should be some flexibility to review charges in a DSP within a review period, but really only in very limited and unusual circumstances.

MR YOUNG: I think this all depends on what model we go for and if we get rid of pre-1996 assets, it doesn't matter, but if we were to keep them, we support the 3 per cent because we believe that, as IPART have said, we made decisions back then that weren't fully commercially based, so it's fair that we don't make a full return on that. I support Kerry's comments that the assets are '96.

Should IPART be more involved in regulation? IPART has a light-handed approach, as we were saying and I generally think that works well. From the Hunter viewpoint, it has been very rare for us to have any issues on the developer charge methodology. We meet quite regularly with the UDIA and others on any issues that come up.

On arbitration, we had an issue recently with Mirvac on recycled water, but the truth of that was resolved last week. When we sat down we hadn't said that Hunter refused arbitration. We had then got to the stage of getting the CEOs involved. When we had a look at what IPART had written it said, "Before you go to arbitration, get the CEOs involved." The two CEOs sat down last week and we realised there was a way forward that didn't involve arbitration and we could meet the intent of the model. Again, it is quite rare.

Interestingly, having had some experience in the industry now, I think of the times when the industry is booming and the developers around the table are finding that land is selling incredibly quickly and that those times it is so fast-paced and I think at those times they're keen to get a quick response. We need to think too if IPART gets involved in an increased regulation oversight view what that's going to do to response times and how

developers will view it at those times. It is a bit different now and we need a system that works well for the future.

The period between reviews? I think four or five years. I hear what Kerry is saying about locking in the price path period. My only issue is significant changes can occur and for example, in our operating licence, IPART says that every four years we have to do an integrated water resource plan, but they specify that if major significant changes occur in that period then we should modify our plan and a similar clause could work in developer charges, maybe subject to IPART's approval.

I do have some sympathy with the developers that they don't want to see volatility in the charges occurring so much with revisions. I think that needs to be taken into account as well because they're making investments for the longer term and they don't want to see the charges significantly increase and then decrease.

THE CHAIRMAN: Wyong and Gosford?

MR GRANTHAM: Just on that issue I raised earlier in relation to the rate of return, that rate of return was also there to identify the risk that the agencies face in putting in infrastructure on the basis of a range of assumptions that may or may not eventuate. Certainly, I have been in the position of dealing with developers who have forecasted it and loads on the system and it wasn't until they realised that they'd be paying the costs that suddenly they sharpened their pencils in relation to exactly what those loads would be.

I think there need to be checks and balances that not only ensure the agencies are putting in infrastructure that's efficient, but also that developers are encouraged to ensure that only infrastructure that's efficient goes in and that won't be the case if they're not paying anything for it.

In terms of reviews, we've had no problems with the current process, but there's a set period for review and the mechanism provides for other reviews with IPART approval and we have no problem with that.

THE CHAIRMAN: Before I throw it open to the developers, I might just say a couple of things about my own view of IPART in relation to this. I can't imagine that we could do determinations for developer charges where we actually set them. I think we're bound to operate with a methodology because there's just too much variety in the circumstances for us to say, "The developer charge for every allotment is so much", in the way we do for the price of water, for example.

The only issue then in terms of IPART's regulatory function as to the interpretation of the guidelines is that they're presently cast in a way that can lead to, for want of a better phrase, misinterpretation or inconsistency of interpretation or whatever. That is the only issue, it seems to me.

Clearly, any suggestion of arbitration could only ever be very much the exception, not the rule. It would need to be a fairly significant test case, I would have thought, where CEOs or other people couldn't sort it out. I suppose that if it were of that nature, that there was a legitimate difficulty, I can see that IPART could possibly assist, but also possibly learn in those circumstances where it was a test case, but it would need to be a significant one in that case.

Could I just say on the period, it would be very nice to do everything at the same time, but that does pose a peaking problem for IPART and it is a strain on our water team if we are doing everything at the same time. Over a five-year period there are pressures to sequence things rather than do them all at the same time.

MR WILSON: Just on that, we fully accept that. The reason we put it forward is that the periodic price of water is an input into the net operating result which then affects the developer charges, so that they're in some senses out of date every time a new determination is --

THE CHAIRMAN: We will try to do the developer charges after the price review rather than before it. Right now we're doing both at the same time: in your case, Sydney Water, but not the other utilities.

THE CHAIRMAN: Could we have comments from the developers now?

MR PRICE: Thank you. The only question about the rate of return is it is not so much the amount. By the way, Ken is right. The 7 per cent is actually 4 per cent return at 3 per cent risk. There's a risk on the existing assets. There is one slight anomaly and it's really an anomaly that affects the principles in the determination and that is the use of a 1 January date, a calendar year date, when everybody is working on a financial year date.

The other thing of course is that we'd argue that Sydney Water have a model that now starts at the DSP date, which we have long submitted is the only correct way. Hunter Water still has a model that starts in 1996 and we don't know when that's going to change.

Regulatory oversight. I think there has to be a mixed approach. It's not as if there haven't been disputes. We've been making enough submissions to let everybody know that we're not happy about a number of aspects. Some of these issue are major, so there needs to be a sliding scale of solutions. I was happy to hear Dr Schott talk about mediation as a possibility, but there are also technical issues and I don't think that issues of implementation generally have a direct relationship to what the determination says. It is not just a matter of how it is calculated, it is understanding how it is calculated and therefore, how it will apply. I don't think application issues will necessarily be divorced from the methodology that easily.

That has certainly been my experience. It is a matter of having a good understanding of the determination and trying to work through how it might apply. There are a myriad of problems with determination, as Martin who works pretty exclusively in that area has found out.

If you go to periodic use, I don't think it is a big issue, I think you've covered that ground, but I certainly think that there needs to be some loosening up of determinations for a number of aspects. Actual water demand is an example where we've been locked into a rate that's fast declining and the agencies are asking that their charges ought be geared to the latest demand data.

THE CHAIRMAN: Could I just tease you out on that. Kevin said that developers want a degree certainty and don't want changes varying too much over time. You left me with the impression - and I perhaps incorrectly formed this impression - that you wanted the charges to vary as conditions vary.

MR PRICE: The thing is that here we are at 2008 trying to resolve what we thought was a satisfactory outcome of the determination in 2000, but we got a set of DSPs which wildly reduced the charges and introduced a whole lot of new aspects and here we are having the first opportunity to try and sort that out. The trouble is that all sorts of new systems are being proposed and it sounds around the table that we will all walk away happy and when we get the DSPs we'll find that, "No, we decided that wasn't a good idea, so we didn't do that," sort of problem. And that has been a consistent complaint with the DSPs since their inception. The reason for the 2000 determination was because the interpretation was entirely different to what we thought we'd agreed to in 1995.

THE CHAIRMAN: As I understand the proposition, Peter, the utilities are looking for a review in this area about the same frequency as the price determination.

MR PRICE: Yes.

THE CHAIRMAN: It wouldn't go from 2000 to 2008. It would go for four or five years. That would be the frequency.

MR PRICE: It would be great if we didn't have any complaints.

MR YOUNG: We all agree with that.

THE CHAIRMAN: Yes.

MR JENSEN: Mirvac has had a couple of mentions, so I'd like to respond. The first thing is in relation to the discount rate that is applied to assets that are already built. I take the point that there is a risk involved in whether there'll be take-up of assets. I think by the time you've already spent that money on the infrastructure, that risk is substantially reduced in comparison to future assets.

When the original IPART determination of the formulas to calculate the charges was made in '96, I wasn't involved in that process, but I can only assume that the 3 per cent

rate that was applied then to previous assets was an acknowledgment of what the risk had produced as opposed to those going forward and what I'm suggesting is that - and we're now at 2008 - the application of that rate backwards should be at a reduced rate.

THE CHAIRMAN: I wasn't involved either, but my colleague suggested in his presentation earlier that the choice of the 3 per cent had nothing to do with that sort of logic you've just proposed. It was purely in terms of what was deemed to be a fair thing for the market to bear. That is what Con said.

MR GRANTHAM: Having been there, I would agree with that comment. There were a lot of issues associated with the original determination and one significant issue was affordability. When the commercial basis for going forward methodology was applied in its pure form, charges went up significantly across all agencies compared to what they were. A lot of decisions were therefore made on the basis of affordability at the time.

MR JENSEN: I would contend that that position hasn't really changed. The other point is in relation to arbitration. Kevin mentioned a dispute between Mirvac and Hunter Water. I agree that it has now been resolved. The issue was that there was a reluctance at officer level to elevate it to the CEOs. As a developer, we felt there was no real avenue, but that has been resolved now. It may be that if there needs to be an appeal, that there's a third-party person you can go to to say, "These guys won't follow the process." Having said that, the process has actually worked very well.

MR YOUNG: My only comment on that is that I think lessons were learnt on both sides there. Officer level didn't elevate it, but also Mirvac didn't elevate it direct to the CEO by saying, "I'm not happy with the officer level response. I can make application direct to the CEO." That didn't happen. The CEOs got involved. They had to find out themselves what was happening and personally get involved. Yes, we both probably didn't follow the process well.

THE CHAIRMAN: I want to make it clear that if it's too easy to elevate it to arbitration, it will get elevated too often.

MR YOUNG: Yes, that's exactly right. I agree.

MR JENSEN: Thank you.

MR COOK: My name is Jim Cook from Solution 73. I am just changing the basis of the discussion here somewhat from the macro level that we've been talking about back to the micro level of Sydney Water's interpretations of how they actually develop these charges. In the submission that I made I discussed section 2 of the determination and how Sydney Water has misinterpreted that interpretation for their own benefit.

You have to remember that the discussions here all relate to the determination in the end. The determination goes out into the outside world and all the developers have are the determination and Sydney Water's published written policies. What is happening is that Sydney Water are simply not following their written policies. They have undocumented policies that they use and it is distorting the whole process of the determination. I will give you you a couple of examples which will show you what I mean.

I had one case of commercial land with an existing building. Sydney Water issued a notice of requirements and on the notice of requirements - it was subdivision of the land - it stated, "No payment required at this stage." I don't now have to do that. They then issued a section 73 certificate which showed that all charges were paid. The land was then sold for $20m. The developer came along to redevelop part of the land and Sydney Water asked for $250,000 for developer charges.

The question was raised with Sydney Water, how can you do this? These are up-front charges. At subdivision stage those charges should have been paid. The answer is in my minute, that Sydney Water will determine how these charges are applied and I said, "They do not agree with the determination." As far as they're concerned, they do.

I have another problem where we had land that was zoned commercial in 1995. It was re-subdivided in 2006. Council issued a DA for that subdivision and the developer paid section 94 contributions on all those things. Sydney Water issued a section 73 certificate for residue lots. They're not residue lots. The developer who

constructs on the commercial site makes application to Sydney Water and Sydney Water say, "We want $300,000 in developer charges."

As I see it, the problem relates again to Sydney Water's interpretation of section 31 of the IPART Act. You say that it should be difficult to go to arbitration: you should be able to sort it out. The first one that I've spoken to you about went to the CEO of Sydney Water. We had a reply which said, "We are not prepared to arbitrate on this matter." As simple as that, because Sydney Water's interpretation of section 31 is that it only applies in the area between the calculation of the methodology and the calculation of the developer charges. English is a great language. You have people talking about methodologies and developer charges. (Inaudible) Sydney Water says you can complain about the charges in the 30 days. After that time there is no complaint. You can't go anywhere.

So as far as section 31 is applied - I mean, the determination in 2000 made it fairly clear that the actual section 31 applied after the charges had been levied. They make it very clear. In Sydney Water's submission to IPART, and your response, it specifically says that the majority of issues raised with Sydney Water related to the application of developer charges to individual sites. This is distinct from the way Sydney Water has adopted the methodology to calculate developer charges. IPART's dispute resolution process relates to the latter rather than the former. Now, that is wrong. If you refer to the determination, the determination states about a dispute resolution that the developer who is dissatisfied with how an agency has calculated its developer charges may have the dispute arbitrated under section 31.

So what is the definition of "developer charges"? Developer charges means the charges paid by developers to agencies for services supplied. In other words, the dispute resolution section 31 applies to developers who have complaints about individual sites. It does not apply to that very limited area that Sydney Water has slotted it into.

THE CHAIRMAN: Are there more comments on this section?

MR COOK: When you go to Sydney Water to try to get something resolved, because they know that there is no arbitration at the end of the day, they are making decisions that are not based on fact, they are not based objectively, they are based on the assumption that everything you say is wrong and we want the charge. We need the money. So because you have nowhere to go to, you are stuck in a loop. I don't know how Sydney Water resolves that themselves in as much as they assume that everyone in Sydney Water is honest, aboveboard and whatever. I don't know what is happening in that, to be honest.

DR SCHOTT: I am happy to meet with Mr Cook to try to sort out these issues. He may not know what is happening in Sydney Water but on these particular matters I don't either. So it would be very helpful if we took this off line and sorted it out.

THE CHAIRMAN: Thank you for that, Dr Schott. I am sure Mr Cook will accept that.

MR BRUCE: Firstly, should IPART be more involved in regulating DSPs - I understand last year there was a study into DSPs in country areas. I saw the industry submissions showed that there were vast anomalies there and perhaps some interference or intervention along the way will be warranted. We will await your outcome.

THE CHAIRMAN: We are waiting too. It has been lodged with the minister for some time.

MR BRUCE: The minister denied that this morning. The minister confirmed this morning that the WICA Act and regulations should be out fairly soon. I assume that by the end of the year when the Competition Act is up and running there will be a number of private providers running around trying to compete with Sydney Water, and the other water authorities as well. So it could well be that within 12 months or so there could well be some decent tests on the DSP processes, et cetera. So four or five years may be a long time before the next review comes through.

THE CHAIRMAN: That is where we flagged throughout the day the advent of the WICA Act is an important consideration. If you are right in the worst case scenario that it has such an impact that we need to review the methodology, we would. Right now, so far as we can, we forecast the impact

of the WICA Act and adjust our procedures insofar as is necessary to take account of the expected impact of the WICA Act. That is what we are trying to do right now. We might move to the last session.

MR READ: This session relates to some issues that relate to Wyong Council and an issue raised by Hunter Water. The three topics are Wyong discounts, Wyong stormwater, and the treatment of land assets. The original IPART determination mentions that it sought to manage pricing impacts by imposing individual adjustments on each agency. 85 per cent cap on Wyong Council's developer charge was imposed at the time. What this means is that after Wyong calculates charges under normal methodology it has to take off 15 per cent of that for its final charge. Wyong Council seeks the removal of this cap and comments that the cap results in the $750,000 cross-subsidy from other areas, and that removing the cap would make the charges more cost reflective and the process more transparent.

The UDIA, however, comments that the cap was originally imposed because of flawed demographic assumptions and that Wyong should demonstrate that the problem has been addressed before the cap is removed.

So the key questions are what are the impacts of removing the 85 per cent from Wyong Council's developer charges, and have the issues with the demographic assumption been addressed?

The second topic is the Wyong stormwater. This is a bit more complicated to explain. Because of the legislative impediments, Wyong Council does not have a periodic or an annual stormwater charge as do the other agencies. However, IPART allows council to recover stormwater capex through periodic revenue, but not the associated operating expenditure.

As a result, the reduction amount is distorted by the inclusion of stormwater capital in periodic charges with no offsetting capital charge in the DSP. It means that the stormwater capex increases the reduction amount but doesn't have an impact on the capital charge portion of the equation. Wyong Council believes that the stormwater revenue should be excluded from developer charges calculation.

The key questions are should the determination require that the value of stormwater revenue be subtracted from the reduction amount. Alternatively, should the issue be resolved by council seeking change to allow periodic stormwater charges to be determined through legislation. If that was the case this would mean that the calculation of charges for Wyong would be the same as Sydney Water, Hunter and Gosford.

The third topic is the treatment of land assets. The determination defines assets for inclusion as those that provide services to developments. This is just a general definition for all assets in the determination. However, there is no specific reference in the determination to the treatment of land costs. Hunter Water will be impacted because the determination is silent on the issue of land costs and including a land (inaudible) is very important for land acquisition and will be significant.

The key question is should the determination be amended to detail how land costs are to be treated in calculations like any other asset. In other words, is there a need for the determination to be amended to detail specifically the land costs should be treated in calculations like any other asset. So that is the main questions for this session. .

THE CHAIRMAN: Thank you. I think I will let Wyong go first. Two of these issues are very Wyong centric. Then perhaps Hunter is most affected by the land issues.

MR GRANTHAM: First of all, my initial comment would be after 10 years now working with this methodology, I think all agencies are I suppose now fully coming to grips with some of the detailed implications of it. I think sitting around this table we have heard what a number of those issues are. I reinforce Kevin's earlier statement that it possibly is worthwhile getting together now we have 10 years experience, and we are better off saying how this methodology is better applied.

In relation to Wyong's situation, just like in 1996 3 per cent discount for Hunter and Sydney to existing assets, or pre 1996 assets and zero per cent discount to Gosford and Wyong assets. That is an affordability issue. To the best of my memory, Wyong's assets peaked at 85 per cent of the calculated charge. It was purely an

affordability issue. This issue of demographics, the first time I had even heard of this was when it was raised in one of the submissions. But if there is any concern about demographics, I think it refers to ABS statistics. In fact, ABS statistics are not used; the Department of Planning figures are used going forward.

I suppose from Wyong's perspective we have tried to make sure that our DSPs are transparent and cost reflective. We would like to see them go forward that way. Having appealed to the tribunal about half a dozen times to have this factor removed, I would like to appeal again. Having seen this demographics issue raised, I would like to appeal that if it is retained that the exact reasoning for it also be spelt out so that as we go forward everyone knows exactly why the 85 per cent exists.

The second issue is really associated with the historic charge (inaudible) and then came under IPART. At that point previous to coming under IPART charges have been levied under the Local Government Act. We still have a situation where we are raising section 94 contributions under the Local Government Act, but where we came from drainage charges are in fact charged from the water supply authorities side of things.

In our last review about developer charges we raised a number of these anomalies with IPART. For instance, we wished to reduce our consumption charge because our consumption has gone down. It is a fixed determinant within the determination. There's a number of other variables which have changed. Another thing that came to light is just the effect that while we have our IPART determination, there is a very transparent charge which is directly going to drainage from both water supply and sewerage. In fact, that charge is being treated within the operating surplus amount as though it was an income to water supply or sewerage, so we requested that this adjustment occur, so again we are consistent with the original intent of the determination.

THE CHAIRMAN: Chris, you have been trying to catch my eye. Do you want to talk about Wyong in particular?

MR TAYLOR: Yes, I do. I can shed some light on that 85 per cent because I caused it. In 1985 IPART engaged me to review the draft DSP from Wyong Council. It was only a three-day contract, so I couldn't do much. One of the things I picked up was that in the pricing there was a loading for summer peak loading of holiday visitors to the Central Coast, or to the Wyong Shire. I made the point at the time that a lot of the people who are coming in in these new areas were going to be permanent residents, not holiday people. In fact, over summer a lot of those people would probably go elsewhere for their holidays, so there needed to be some adjustment on this traditional holiday peak loading, given the fact that the growth was going to be permanent residents. That is why, I believe, the adjustment was made, the 85 per cent.

Just as a personal comment, if the holiday loading is still there, still factored into your calculations, even though we have many more permanent residents in the Wyong Shire, maybe the adjustment should stay. But if it isn't, obviously it is fair to take it away.

MR GRANTHAM: Thanks for the interpretation, Chris.

MR TAYLOR: It was why the 85 was brought in.

THE CHAIRMAN: Does anybody else want to comment on Wyong's particular problems? Right, we will go to land and that is a particular problem for the Hunter.

MR YOUNG: I think intuitively we all think that land on which assets are constructed should be part of the value that is included in DSPs. When we prepare our DSPs that includes future assets we include the land component (inaudible). Also when we commission it for the first time it has the land component included.

What we are finding as we then apply the MEERA valuation as we revalue those assets. The MEERA applies to the built asset, and we are effectively not carrying forward the value of the land component. This really hasn't been a major issue to date, because we have not purchased a lot of land to build assets on, but as was mentioned in the introduction, (inaudible) has a significant land purchase component, and we are seeing as more developments occur that there are occasions when we have to buy land for pump stations or whatever.

So we are seeking clarification that as we revalue the assets, we should have the MEERA value of the built assets,

but also include some value for the land component. We are proposing that that could be the cost value of that land. So that is an issue that we see at the current time.

MR COX: Can I ask you, John, that is purely a MEERA related issue? In other words, the MEERA does not relate to land.

MR YOUNG: That is right.

MR GRANTHAM: If I could make a couple of comments there. Having been involved in these discussions, and I think it ties in two points - and I am going on memory here, going back 10 years, so there might be some different interpretations. That issue of affordability in the discussion on land came in because at the time, and therefore it was convenient to drop out land from the affordability perspective. But the other issue that came in is should agencies make a windfall gain on prices of land increases, because that clearly was the only way land prices would go into the future, and I agree with John's initial comment, that logically there should be some allowance for land because the land is a real cost that is incurred and must be incurred. I think that affordability issue meant it didn't get fully addressed or adequately addressed in 1996, but I think it would be useful going forward if it was addressed.

MR YOUNG: In terms of the land value increasing, a lot of the land that we will be purchasing to build infrastructure on becomes part of the operational asset and really doesn't increase, so the land we are buying (inaudible) will be under water for its life, so in terms of significant capital gains in the land I think that will only materialise in very few situations where we are able to decommission pump station or reservoir or something and potentially dispose of the site.

MR GRANTHAM: I think it was more the value of North Head treatment plant.

THE CHAIRMAN: Any other comments on these issues?

MR READ: Do you intend to revalue of the land when you do your MEERA valuation?

MR YOUNG: Proposing to put it in at cost.

THE CHAIRMAN: That would seem to be the only sensible thing to do.

MR PRICE: It can't appreciate because you don't propose to sell it.

MR BRUCE: I can see some issues with the dams. Other assets would just sit on the land and the land is always there. Certainly the technical assets will deteriorate over time and need replacing, and certainly Sydney Water has an asset disposal program.

THE CHAIRMAN: Are there any comments or questions from the rest of the room? In that case I might try to wind up. First of all I would like to thank you all for your participation today. At least from our point of view it has been a very interesting day. I don't think these are easy matters for us to reach conclusions on, so I will not tell you what our determination will say right now.

I think, however, I can say that this morning the key issue at least for me that emerged was this balance between being cost reflective, and I think it is fair to say we have always seen the need to be cost reflective - except price cost signals that were price reflective. On the one hand we are trying to do that. On the other hand you want to keep something that is reasonably simple and transparent. As Dr Schott put it, at the end of the day while I know the developers think it is a large sum of money, it is $50 million. There is a question about how much time and effort should go into determining the exact amount, and the total is of the order of $50 million. So it is a question of getting that balance. That will be a critical question for us.

There is one other question. If we were persuaded to go in the direction that Sydney Water has proposed, which I sensed had the broad support of the development industry - although they might like to go a bit further in reducing the total - my sense was that Sydney Water's proposal had broad support of the development industry. If we were minded to go in that direction, as Hunter brought out, but I think also Sydney's own submission shows, that does involve a significant amount of reallocation between different areas. We would need to give serious thought to how we transition to that. If you just do it overnight,

just in one hit, well, an issue would be how far you are creating windfall gains and losses that may have already been built into the purchase price of the land. It may have been capitalised on. So that would be an issue if we were minded to go in the direction that Sydney Water is proposing to start the transition path to be adopted.

This afternoon was very much on technical issues. Clearly I think we have heard enough today to identify that there are some significant technical issues that need to be resolved relating to future consumption, not just BASIX. ET multipliers are where the evidence today from Aldi was at least for me particularly graphic. You just wonder how some other developer would have fared that didn't have, if you like, the record and data that Aldi was able to lay its hands on to convince Sydney Water to change its position.

MR TAYLOR: Or the financial strength.

THE CHAIRMAN: That too. So there are significant technical issues. I think for us there is a question which we canvassed a bit which is how far, if at all, we should seek to provide more explicit guidance about the interpretation of our determination on the one hand. On the other hand, I think it would be useful if, as Kevin Young's suggestion were followed up, the utilities did have an exchange of views and if we were either involved or informed about where you came out on that. That would need to occur sooner rather than later. You know the timetable for our exercise. It would be better if we had it before we finished this.

Once again, I would like to thank you all for your participation. It has been very helpful for us. I hope you think you have had a useful exchange of views also. Thanks very much.

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