

# **WATER INDUSTRY FORUM**

## **REPORT ON DEVELOPER CHARGES FOR WATER, SEWERAGE & DRAINAGE SERVICES**

**1999 Report**

**INDEPENDENT PRICING AND REGULATORY TRIBUNAL  
OF NEW SOUTH WALES**

## **WATER INDUSTRY FORUM**

### **REPORT ON DEVELOPER CHARGES FOR WATER, SEWERAGE & DRAINAGE SERVICES**

**1999 Report**

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# **WATER INDUSTRY FORUM 1999 REPORT**

## **1 INTRODUCTION**

This report is the third report presented by the Water Industry Forum to the Independent Pricing and Regulatory Tribunal (IPART). It covers the period from November 1997 to November 1999. The report has been prepared to assist IPART in resolving problems that may have arisen from the implementation of a net present value (NPV) based developer charges methodology for the calculation of developer charges (DC). The NPV methodology was adopted by IPART in determinations for the Sydney Water Corporation (SWC) in December 1995, and for the Hunter Water Corporation (HWC), Gosford City Council (GCC) and Wyong Shire Council (WSC) in June 1996.

## **2 BACKGROUND**

### **2.1 Second Water Forum Report, November 1997**

The second Water Industry Forum report commented on the various issues that had been presented to the Forum for discussion since the release of the initial report. The second report commented:<sup>1</sup>

Not all the issues have been resolved to the satisfaction of all Forum members. As well as being discussed at Forum meetings, the issues have been reviewed in direct discussions between water agencies and their customers. The Forum has provided ongoing advice to the Tribunal as issues have emerged. Some issues are complex. This prompted the Tribunal to employ an independent actuarial firm<sup>2</sup> to undertake mathematical analysis of some of the problems. The consultant has produced two reports for the Tribunal. These have been distributed to Forum members. In July 1997 the Tribunal published a Clarification Note, addressing some of the most pressing concerns of the Forum.

The issues discussed in the second Water Forum Report are:

- developer charges calculations
  - differing interpretations of the mathematical application of the NPV method
  - amortisation of charges to reduce the risk of “sterilisation” of land
  - the effect of lot release schedules on calculations
- the varying methods for apportioning assets
- the amortisation period for long lived assets
- the impact of charges on housing affordability
- differential operating costs

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<sup>1</sup> Water Industry Forum, *Report on Developer Charges for Water, Sewerage and Drainage Services*, November 1997.

<sup>2</sup> William M Mercer Pty Limited

- allocating costs on a system wide basis versus an incremental basis
- the effect of seasonal variations in population density
- efficient costs and over-engineering of infrastructure.

The Water Forum Report commented that many of the issues above are complex. The report detailed how IPART had employed William M Mercer to provide mathematical analysis of some of the problems. The analyses discussed:

- the need to amortise the NPV of future capital expenditure and operating surpluses
- SWC's method to achieve the amortisation process
- three different NPV methodologies (basic NPV, amortisation assuming equal annual lot release, weighted annuity)
- apportioning of assets
- the effect of the term to capacity on amortisation methods
- issues involved in reviewing charges.

The Water Forum Report then spoke about the effect of the consultant's analyses. The analyses prompted the Forum to recommend that IPART should address the issue of calculation of the operating surplus. Subsequently IPART published a Clarification Note. The Clarification Note outlined the procedure that would calculate charges after taking into account the effect of lot release schedules.

The Water Forum Report then concluded with discussions about: the Forum's support for mediation to resolve disputes; the progress of release of Development Servicing Plans (DSPs); and the Seminar and Information Brochure designed to assist participants in understanding the developer charges process.

### **3 ISSUES DISCUSSED AT FORUM MEETINGS**

Since the second Water Industry Forum report, there have been three meetings of the Water Forum. The first meeting was held on 24 March 1998, the second meeting was held on 17 December 1998 and the third on 3 November 1999.

#### **3.1 Holding costs**

Questions about the application of holding costs to existing assets have arisen. The first meeting of the Forum discussed this issue. In particular, the issue was whether a holding cost could be applied to an asset constructed before 1996 when the asset had been revalued by indexing its historical cost.

SWC's methodology applies both an indexation of historical costs and a holding cost. Some Forum members believe that such an approach is unreasonable and inappropriate for financial management reasons.

There is some disagreement among Forum members whether the issue had been discussed or agreed to at Forum meetings before the determinations.

### **3.2 Offset amount**

The water businesses calculate the revenue component of the offset amount by using an algorithm based on price times an average usage. Some Forum members believe that these calculations should be supported by reference to revenue figures in the published annual reports of the water businesses.

### **3.3 Developer charges consultancy**

In late 1998, IPART decided to review the methodology for the calculation of developer charges. A consulting team from PriceWaterhouseCoopers and the Centre for International Economics were commissioned by IPART to prepare a report on developer charges issues. Forum members discussed issues with the consulting team at the Forum meeting on 17 December 1998. The final report of the consultants' was presented to the Forum on 3 November 1999.

The report recommends that the Tribunal

- retain the current NPV methodology
- issue a Clarification Note which includes a revised version of the original IPART spreadsheet model that agencies should be compelled to use
- develop a common format for DSPs for compulsory use by agencies
- require agencies to publish the rationale for DSP boundaries
- use an audit process to address problems such as nexus and excess capacity of assets
- require agencies to apply the same DC for the life of the DSP
- only allow agencies to adjust DCs between reviews in a downwards direction
- encourage the use of DSP specific operational expenditure
- require agencies to disclose the impact of proposed DCs, relative to existing DCs, in DSPs
- link DCs and periodic charges
- include DC assets in the Regulated Asset Base (RAB) while reducing allowable revenue by the value of the DC assets in the year they are added to the RAB
- consider adopting a rate of return on assets process for the 2000 review based on a RAB as proposed above.

## **4 CONCLUSION**

There are several issues remaining in the area of developer charges. The report from the consultancy team appointed by IPART is available on IPART's website. The report will assist IPART in determining what is needed to further establish a reliable method of calculating developer charges. IPART will determine medium term price paths for the water businesses in 2000. It may be opportune for IPART to address issues in the developer charges area as part of that medium term price setting process.

## **APPENDIX: MEMBERS OF THE WATER INDUSTRY FORUM**

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## **APPENDIX 2      ACKNOWLEDGEMENTS AND MEETING DATES**

### **Resignations**

- Mr Terry Goldacre, Taylor Woodrow (Australia) Pty Ltd

### **Water Industry Forum Meeting Dates**

- 24 March 1998
- 17 December 1998
- 3 November 1999