



Department of Water  
Government of Western Australia

# Submission to the economic regulation authority

Issues paper - Inquiry into developer contributions to the  
Water Corporation

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## About the Department of Water

The Department of Water is the lead agency in the Government of Western Australia for the management of the state's water resources and lead adviser to the Minister for Water Resources on water policy and governance. These responsibilities include:

- water resource management and planning
- water source protection
- water governance
- water services policy
- water reform, including the National Water Initiative, State Water Strategy and State Water Plan
- Indigenous water services.

The department operates throughout Western Australia with offices in 8 regional areas.

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### Disclaimer

The views expressed in this submission are those of the Department of Water and should not be taken to reflect the views of the Minister for Water Resources or the Government of Western Australia.

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# 1 Introduction

This submission is made in response to the issues paper released by the Economic Regulation Authority on 31 October 2007 to outline the direction of its *Inquiry into Developer Contributions to the Water Corporation*. The authority advises in the issues paper that it is required to make recommendations on the most appropriate method to calculate developer charges and, for headworks charges only, make recommendations on the appropriate level of charges to apply from 1 July 2008.

The Department welcomes the inquiry, especially as the intention is to review and clarify the authority of the Minister over water charges and prices under the proposed water reform legislative program.

## 2 Background

Developer charges are widely used in differing jurisdictions by local governments and utility companies to fund infrastructure developments. In the water sector, developer charges are used for water supply, wastewater treatment and drainage works.

The charges are typically up-front payments as a contribution towards the cost of the infrastructure development. Developers usually recoup the cost of the charge through retail pricing of developed land or by offering a lower value for pre-development land.

A number of reviews and inquiries into developer charges in recent years is evidence that there is strong public interest in the appropriateness of the charges. In Western Australia the Public Accounts Committee of the Legislative Council conducted a wide-ranging review that made a number of findings [*Inquiry into Developer Contributions for Costs Associated with Land Development*, Report No 8 2004].

As noted by the Public Accounts Committee in its report, developer charges have a significant impact on urban and residential development, especially water infrastructure charges because of the higher cost. The impact of water developer charges on residential development does not appear to be a central focus of this inquiry but it would be relevant to examine the impact on allocative efficiency through the distortion, if any, of investment/development decisions.

The impact of developer charges accounts for strong public interest in the issue. In the water sector, there is a lack of a consistent approach between jurisdictions and a reason here may be that the charges are not the result of market dynamics and as a consequence not based on the true cost of the development. So far, there is no general agreement as to the most appropriate approach and method.

### 3 Issues with the current arrangements

A number of issues about the current arrangements for developer charges are set out below.

#### Unclear and complex governance

The governance framework for the regulation of developer charges is unclear and complex within the existing legislative framework. The legislative authority for the Water Corporation to apply developer charges is through the:

- *Water Corporation Act 1995*  
Empowers the Corporation in respect to its various powers and functions, including the capacity to enter into contractual arrangements with developers that are commercial-in-confidence.
- *Water Agencies (Powers) Act 1984* and by-laws  
Prescribes Corporation powers and governance provisions. There is significant reference to developer charges.
- *Planning and Development Act 2005*  
This Act provides a general framework for planning and development in Western Australia. The arrangements for developer charges are set out in the Western Australian Planning Commission [WAPC] *Planning Bulletin No 18* issued under the previous legislation – the *Town Planning Development Act 1928*. Schedule 1 of the Bulletin gives broad details of the developer arrangements for the Water Corporation. Further information on these charges is set out in the Attachment.

The intention in the legislative review being undertaken by the Department of Water is to focus on enabling powers and clarify the governance requirements rather than the current legislative approach which is overly prescriptive and complex.

#### *Urban Development Advisory Committee*

Since 1994 the Urban Development Advisory Committee has advised the Water Corporation (and its predecessor) on:

- 1 the application of Corporation policies, standards and technical services;
- 2 administrative procedures and charges associated with all phases of development; and
- 3 the Corporation's performance in discharging its related responsibilities.

The Urban Development Advisory Committee includes the following members:

- Department of Industry and Resources
- Consulting Surveyors Of Western Australia [Inc]
- Association of Consulting Engineers Australia

- Civil Contractors Federation
- LandCorp
- Housing Industry Association
- Urban Development Institute
- Master Builders Association
- Western Australian Local Government Association
- Water Corporation.

In practice, this body is an advisory rather than regulatory body.

## Insufficient funds for drainage

As part of this inquiry the authority is encouraged to examine the adequacy of funding for drainage. The Department of Water believes that some environmental groups and local governments have a perception that drainage is not funded to a level that allows for the improvement in drainage design. It is also the case that drainage development now has a greater strategic focus as a potential water source.

## Current drainage services

In the metropolitan area the Water Corporation maintains an arterial drainage network across urban areas, with rates collected from landowners within these networks. The Water and Rivers Commission / Department of Water is responsible for designing and overseeing the implementation of the arterial drainage network. Local governments are important partners in managing drainage in the Perth metropolitan area, and in many situations drains under their management are connected to the arterial systems managed by the Water Corporation.

The areas outside the metropolitan area that have significant drainage networks maintained by local government include urban areas such as Bunbury, Albany, Geraldton and Kalgoorlie. This maintenance protects urban areas and includes flood mitigation planning and management. In some rural areas, such as Busselton and Bunbury, the drainage works to prevent flooding are maintained by the Water Corporation with support through a Community Service Payment (CSO).

The Water Corporation also maintains river levies in some rural areas. These levies were originally built to protect rural land, but encroaching urban development is now within the flood control area.

## Lack of transparency

The complexity of the current legislative provisions is an impediment to transparency. Transparency will need to be reviewed in the context of the

information required by the Minister to exercise authority to determine charges under the proposed legislative changes.

Also, there is a perceived lack of transparency in developer charges which are subject to commercial-in-confidence arrangements.

## Lack of incentives for water-sensitive developments

The structure of standard headworks charges offers no incentives for water-sensitive urban design or for targeting strategic outcomes such as water efficiency, stormwater collection and quality, and water recycling.

Alternative water-supply measures undertaken by developers and water-sensitive urban design can reduce the loads on shared water supplies, wastewater and drainage infrastructure. The Authority is encouraged to consider whether water-wise urban design would be encouraged through incentives built into developer charges.

## Uniform tariff policy

The final Report of the *Inquiry on Country Water and Wastewater Pricing in Western Australia* noted that the objectives of the uniform pricing policy (UPP) were to provide affordable water across the state at a level considered to be the minimum required for basic human needs, including subsidised costs up to the consumption level of an average household. The shortfall is funded through Community Service Obligation (CSO) payments to the Water Corporation.

In areas where both the UPP and standard headworks charges (SHC) are in place, some part of the current CSO payment may contribute to recouping the cost of any shortfall from the SHC.

Further, if SHCs are not considered part of the UPP, the most economically efficient price signals may be different under the constraints of the UPP than under more cost-reflective pricing.

There is some debate about whether increased development costs are built into the sale price of new developments or result in reduced revenue for developers and/or pre-development land owners – the Public Accounts Committee Report referenced above found the latter to be the case.

Irrespective of who actually bears the cost of development charges, it is not necessarily the role of the UPP to subsidise development in high-cost areas.

The uniform tariff policy may have imposed revenue constraints on the Water Corporation for self-funded infrastructure development and this has led to the development and application of the current level of charges. The authority is encouraged to examine the relationship between the UPP and developer charges as part of the inquiry.

## 4 Principles and criteria for assessment

There are well-established principles and criteria by which to assess pricing and charging arrangements and developer charges are no exception. These include:

- efficiency
- equity
- transparency
- simplicity.

### Efficiency

In general terms an efficient price is one that results in the most productive allocation and use of resources. In the context of this inquiry, there is also a need to ensure that prices and charges stimulate efficient supply decisions.

In a recent report on developer charges for drainage services prepared for the Department of Water (independently of this inquiry), ACIL Tasman noted the Baumol–Willig conditions for efficient pricing, including the allocation of joint and common costs inherent in networks where there are economies of scale and scope. These conditions state:

- no price, or set of prices, should exceed the stand-alone costs of providing the service or services, where stand-alone costs are determined as the costs that an efficient competitor would incur in providing just that service or group of services
- no price, or set of prices, should be less than the incremental (or avoidable) costs of providing the service or services, where incremental costs are the additional costs incurred by the monopolist in providing just that service or group of services.

These conditions define the ‘efficient pricing band’ in which prices need to be set. The floor price ensures that all services cover their incremental or avoidable costs; in economic terms this means that they are free of subsidy. The ceiling or stand-alone cost ensures that users are not artificially priced out of the network.

This inquiry also has a relevant inter-temporal aspect to efficiency. Because of the nature of water infrastructure, there is typically excess water capacity at the time of construction and it may be some years before the asset is fully utilised. One issue is whether current or future users should fund the cost of development.

### Equity

The policy of standard headworks charges means some degree of equity as all developers, more or less, face the same charges. However, equity should



not necessarily mean the same charge to all; it could mean that charges reflect actual costs and developers are required to pay higher or lower costs.

The existing balance between upfront headworks charges and annual charges suggests that new customers are not fully covering the costs of growth in new developments. As a consequence they would be cross-subsidised by existing customers.

## Transparency

The Department encourages the authority to examine the transparency of the current methods of setting developer charges and whether there are any concerns about transparency.

A high level of transparency contributes to public confidence in the appropriateness of both the level of developer charges and method used to set them.

## Simplicity

The current method of charging for SHC would pass a 'reasonableness' test for its simplicity. Insufficient information is available for special contribution areas to assess if the charges are simple.

# 5 Summary and conclusions

The authority is encouraged to examine:

- the impact, if any, of developer charges on allocative efficiency through the distortion of decisions about land development
- whether there are insufficient funds for drainage
- the desirability of using developer charges to encourage water-sensitive residential planning
- the relationship between the uniform pricing policy for water tariffs, CSOs and developer charges
- the need for greater transparency in the application of developer charges, especially in special contribution areas
- issues about inter-temporal equity and efficiency in the current structure of charges.

Overall, it is difficult to see a practical alternative to developer charges and it would be an important contribution for the authority to determine the best level and structure.

## Attachment

The Water Corporation applies five types of developer charges depending on the type and location of development. These charges are:

- standard headworks contributions (SHC)  
A state-wide, standard contribution for all new urban developments
- special developer contribution area charges  
Special developer contribution areas are determined by the Water Corporation to have a need for a special contribution, typically in non-metropolitan areas. An additional charge is levied based on the incremental cost of the service to fund development that is beyond the current development front for large urban developments.
- major customer charges  
Significant users of water and wastewater services may be required to enter into a major customer's service agreement. The charges are based on the 'notional cost' method and agreed on a case-by-case basis by the customer and the Water Corporation.
- headworks contributions for temporary developments  
These are annual charges for the duration of the development, which is usually less than two years. Examples include construction camps and establishing new vegetation in a development or median strip.
- Drainage headworks charge  
These charges are based on full scheme costs.

The SHC covers 40 per cent of the total capital costs of major headworks, for water, sewerage and drainage. Standard headworks charges apply if the development occurs within the Water Corporation's headworks front. The remaining 60 per cent of the cost is funded by the Water Corporation and recouped over time through annual charges. Headworks charges are raised at two stages: at the subdivision stage and at the building stage when the service demand can be determined more accurately.

## Method of calculation

It is understood that the standard headworks charge is calculated by deriving a total replacement value for all existing headworks infrastructure and dividing this value by the total number of residential units serviced by its network. The developer contribution is calculated by the average cost per lot of the modern equivalent asset value (MEAV) for existing assets.

The standard headworks contribution (SHC) is calculated on a per lot basis:

$$\text{SHC} = \text{MEAV} / \text{SRE} \times 40\%$$

where

MEAV = modern equivalent asset value

SRE = single residential equivalent, the basic measure of demand placed on Water Corporation systems by a single residence in a typical urban location.

The SHC is calculated using the modern equivalent asset value of existing capital only. Hence, the cost of the proposed capital works is not explicitly included in the developer charge.

Where developments occur beyond the existing headworks front for water and sewerage services, additional headworks contributions may be applied by the implementation of special developer contribution areas. Alternatively, the developer may be required to pre-fund the full cost of the required headworks infrastructure. Servicing requirements and financial contributions in special developer contribution areas are determined by the Water Corporation on a case-by-case basis.

Where developers pre-fund all of the cost of any required headworks infrastructure, the Water Corporation will refund the cost to the developer after an agreed period, which is generally less than 10 years. In broad terms, the developer is paying the financing cost of bringing forward the expenditures, rather than the total expenditure.

To ensure that the Water Corporation is not charging twice to cover the same costs, the combined amount of revenue from headworks charges and annual charges cannot exceed the total revenue requirement, as regulated by Economic Regulation Authority.