15 January 2007

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Dear Ursula,

HIA SUBMISSION TO THE ECONOMIC REGULATION AUTHORITY (ERA)

Please find enclosed a Submission by the Housing Industry Association in relation to the Inquiry into Developer Contributions to the Water Corporation.

A hardcopy shall also be sent to yourself at the above address.

Should you have any queries please do not hesitate to contact myself on 9492 9200.

Kind regards
HOUSING INDUSTRY ASSOCIATION

SHERYL CHAFFER
EXECUTIVE DIRECTOR

SUBMISSION BY THE

Housing Industry Association

to the

Economic Regulation Authority (ERA)

in relation to its

Inquiry into Developer Contributions to the Water Corporation

January 2008

Contact Details

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Statement:

The enclosed submission has been prepared by the Housing Industry Association (WA Region) in response to the ERA's *Inquiry into Developer Contributions to the Water Corporation*.

Sheryl Chaffer
Executive Director
WA Region
Housing Industry Association Ltd

S. Chaff

Date: 14 January 2008

Introduction

This submission has been prepared by the Housing Industry Association (HIA) in response to the Western Australian Economic Regulation Authority's (ERA's) Inquiry into Developer Contributions to the Water Corporation.

As a matter of principle, and in the interests of economic efficiency and equity, HIA believes that community-wide and social infrastructure (including water and sewerage headworks) should be paid for by the whole community through general taxation measures. These types of facilities benefit the whole community and are fundamental to the operation of our cities and towns.

Up-front developer charges (for headworks) are inefficient and inequitable. They apportion a charge regardless of actual use and provide existing residents a benefit without contributing to the cost of new capital.

This submission suggests a number of principles that should apply in the setting of appropriate service charges for residential development. HIA urges the ERA to acknowledge and address the position presented in this submission prior to the setting of revised charges to apply from 1 July 2008.

Issues of Concern to Residential Development

1. Basic Principles of Infrastructure Funding

All too often increases in private developer contributions are meeting the cost of transport, power, water and other services, this trend has had devastating implications for housing affordability.

'Social' or 'shared' infrastructure is that which governments have traditionally accepted general revenue funding responsibility for in recognition of external or 'redistributive' benefits. It includes the headworks components of water, sewerage and power supplies, urban improvement initiatives, local and regional community facilities, regional transport and open space facilities.

HIA submits that in practice the pricing approach for social or other shared infrastructure should follow the recommendation contained in the Committee of Inquiry into Housing Costs, namely that:

"Developers should continue to be responsible for internal development works in residential land development, including reticulation of services. All other developer contributions, including headworks and area contributions, contributions for amplification of services and off-site drainage and like schemes, should be removed."

While these principles were outlined 30 years ago they remain the key to equitable and efficient delivery of infrastructure in a way that does not compromise housing affordability.

Unfortunately, over the last 30 years, governments have increasingly sought to recover the full costs of public works and have steadfastly eschewed public borrowings in order to reduce public debt. This approach has more recently been brought into question as the housing affordability implications of up-front charging are more widely understood and appreciated.

For long lived capital assets, it is inequitable for new residents to finance social infrastructure that the whole community can access. It makes more sense to smooth the impact of upfront capital costs by borrowing funds and repaying the upfront capital and interest costs over time. This better reflects the extent to which the benefits from such investment are enjoyed over time (and across generations).

As a matter of principle, and in the interests of economic efficiency and equity, HIA believes that community-wide and social infrastructure should be paid for by the whole community through general taxation measures. These types of facilities provide a public benefit and are fundamental to the operation of cities and towns.

In Western Australia's case there is a clear and urgent requirement to increase State Government investment in the delivery of current and future urban infrastructure and water infrastructure. Current housing affordability conditions would suggest that this policy approach is now imperative. Government commitments to the provision of water and other urban infrastructure should be made on the basis of a 10-year rolling plan and integrally linked to the opening up of new development areas.

Importantly for Western Australians, Government commitment not only to the funding of urban infrastructure is required but to resourcing the Water Corporation so that it can effectively forward plan the provision, assessment and approval of infrastructure works. At present our developer members state that they have experienced significant delays in obtaining Corporation clearance for planned works, which, apart from delaying production of residential lots, constrains their ability to meet bond obligations. Urban development is also being delayed in key growth areas in the metropolitan region because timely approval of environmental clearances for major wastewater treatment plants in the southern and northern corridors have not been planned with sufficient lead time. The East Rockingham wastewater treatment plant, which has been plagued by slow environmental assessment and clearance and delayed urban development in the southern corridor, is a particular case in point. The planned urban development of Alkimos in the northern corridor requires forward planning, environmental assessment and determination of an associated wastewater treatment facility now to enable urban development to proceed over the next 5 – 10 years to accommodate future population growth. Delays in the planning and provision of these key elements of urban infrastructure have serious cost implications for home buyers and warrant immediate action.

2. Applying Basic Principles to the Current Review

The ERA's Issues Paper (October 2007) seeks to apply the principles espoused by the Productivity Commission's 2003 findings that developer charges should be:

- *necessary, with the need for the infrastructure concerned clearly demonstrated;*
- *efficient, justified on a whole-of-life cost basis and consistent with maintaining financial disciplines on service providers by precluding over-recovery of costs;*
- *equitable, with a clear nexus between benefits and costs and only implemented after industry and public input.*

It is important to note that the Productivity Commission also found that social and economic infrastructure that provides benefits across the wider community should "desirably be funded out of general revenue sources". It also noted that an advantage of upfront charging is its ability to deal with out-of-sequence development.

In particular, the Productivity Commission found that "investment to install, upgrade or augment system-wide components that provide comparable benefits to users in long-established areas, would in principle be better funded out of borrowings and recovered through rates or taxes (or the fixed element in periodic utility charges). This would include, for example, water supply headworks and major sewerage treatment plants."

In applying the Productivity Commission's principles, therefore, it is essential to first establish whether the application of an upfront developer charge is indeed necessary or whether alternate funding mechanisms are more appropriate. This would require an analysis of the various types of infrastructure improvements, their capacity to support existing communities or provide general systemic improvements that benefit all, and the equity variables associated with different funding models.

A preferred industry solution is for the cost of wider benefit infrastructure to be met through government borrowings, supported by federal grants and other payments as a direct investment in the infrastructure that the majority of Australians depend upon.

HIA suggests that the principles of certainty, simplicity, transparency and reasonableness are vital to the setting of remaining service charges for residential development (i.e. those required to cover the cost of connecting development to the network). Developers and builders need to know up-front what charges will apply to a specific development area in order that these can be factored into cost estimates. There should be simplicity and transparency in the way the charges are calculated and the industry needs to be sure that it is not being asked to subsidise other users or generations of users. Lastly, any service charge for the provision of water and sewerage must have regard for the totality of other charges imposed on residential development, in order that housing affordability is kept in check.

Whilst there is a degree of acceptance for a differentiated pricing approach based on locational cost differences, industry is concerned that a strict application of cost-based marginal pricing will essentially ignore the costs incurred by previous generations in the creation of existing infrastructure. Such an approach could see locational advantages emerge in areas where there is spare infrastructure capacity, to the disadvantage of new fringe development, which is typically the domain of new home buyers. Accordingly, industry also accepts the notion of transparent cross subsidies where they assist in achieving certainty and simplicity.

Applying these principles to the very complex set of considerations in price setting would require:

a. Developers to carry the costs of reticulation within a development;
b. Establishing what connection costs need apply and what headwork costs are necessary to augment the system over the life of the development and beyond;
c. Setting connection costs according to location but allowing cross-subsidies in the interests of housing choice and affordability and regional development;
d. Direct government funding of relevant current headwork costs; and
e. Applying user charges to cover maintenance costs and the marginal costs of future system improvements (including capital works).

User charges can signal upcoming costs associated with system improvements that provide a benefit to all. They also send appropriate price signals to consumers about the need to be more efficient with water usage. It would be relevant for those system improvements to be covered by user charges to be predominantly related to works which generate greater efficiencies of use. In this way consumers would be billed specifically for those works which will deliver future price efficiencies.

Developers should also be encouraged to adopt water sensitive urban design initiatives in their developments. These should be provided on a least-cost-per-household basis, which typically means that solutions lie in higher order, estate-based infrastructure rather than individual household innovations. Governments should directly fund or provide financial incentives for ensuring that these broader-based infrastructure solutions can be made available to future residential communities.

It would appear from the research undertaken by ERA that the pricing system that exists in England and Wales most closely represents that which would suit the development industry here in Australia. This involves developers paying for the reticulation of services within an estate, the application of a uniform charge for connecting a development to a distribution network (presumably involving locational cross-subsidies) and headwork costs being met through annual user charges, except that in Western Australia, there is a current opportunity for more direct State Government funding of urban infrastructure.

3. *Methodology for Recovering Headwork Costs*

Having established the principles upon which service charges should be set, HIA is of the view that headwork charges for wider benefit infrastructure should not apply at all.

Should headwork charges be limited to system upgrades required to service a particular development alone, then HIA suggests the following methodology should apply:

- Area based user charges should be investigated in terms of their ability to more equitably meet costs over time;
- The principle of reasonableness should be applied to any upfront developer charges, with consideration to the impacts of such charges on housing affordability. A housing affordability impact assessment should be undertaken for all new charges (it being noted that the affordability scenario in Western Australia has changed markedly since the 2003 Marsdon Jacob review);
- If location based charging is to be introduced it should, in the interests of simplicity and certainty, be based on the least number of areas as possible and reflect the marginal costs of providing additional capacity in a manner that flattens the price structure;
- Appeals on the amounts charged or their coverage should be allowed.

4. *Methodology for Recovering Costs of Connecting Works for Frontal and Out-of-Sequence Development*

HIA accepts that out of sequence development should be allowed where the costs of extending services can be met by the developer, provided that these upfront costs are reimbursed as the proportion of the service or infrastructure initially provided is used by future residents.

The same methodology should apply for minor works and for major infrastructure items.

Infrastructure charges should not be used in this instance as a "go tax", as is the case for precinct acceleration in Sydney's Growth Centres. If development is consistent with regional growth strategies or has separately obtained a whole-of-government endorsement, then infrastructure charges should not be used to penalise development that seeks to occur out of sequence.

5. *Methodology for Recovering Costs for High Volume Customers in Country Areas*

This scenario would normally apply to high users such as mining and specific agricultural pursuits. HIA is not well placed to comment on these issues, other than to say that residential developers and home buyers should not be required to compensate in any way the demands of such users. Obviously, the pricing arrangements for regional residential development would need to be sufficiently transparent to ensure that this is not the case.

Recommendations

The State Government should look to forecast and directly fund a ten-year Water Infrastructure Plan, developed as an integral part of the proposed State Infrastructure Strategy and implemented through the State Water Plan, Metropolitan and other regional planning schemes and Water Corporation Capital Works programming. The plan should capture infrastructure liabilities associated with new development and provide the necessary funding to deliver the required assets.

It is important that the principles and methodologies applied to the setting of infrastructure charges for water and sewerage services do not shift the costs of city-wide basic infrastructure to new homebuyers alone.

The result of a misguided approach to infrastructure charges that overly relies on upfront developer contributions or quasi levies through private tendering conditions to cover recurrent and capital costs are and will continued to erode housing affordability and will continue to stall development.

HIA supports the application of the principles of certainty, simplicity, transparency and reasonableness in the setting of appropriate service and infrastructure prices. These principles should be set against an overriding objective of maintaining housing affordability.

It is important that the ERA refrains from a change in policy that seeks to collect revenue from new users to pay for assets that benefit existing users.

Infrastructure provision should be planned, developed, and implemented in a coordinated manner by water service authorities. Governments play a lead role in providing social infrastructure that benefits the broader community.

Price signals can communicate to the market the need to use water wisely. Similarly, Governments have a role in coordinating and making available for use by the wider community the sorts of infrastructure that enable Western Australia's citizens to live sustainably.

The methodology used in calculating developer charges should be simple and easy to follow, and decisions to impose charges must be appealable. Flawed financial assumptions and calculations will cause inconsistent results.