



INTERIM SUBMISSION

ECONOMIC REGULATION AUTHORITY

**INQUIRY INTO DEVELOPER CONTRIBUTIONS
TO THE WATER CORPORATION**

DECEMBER 2007

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EXECUTIVE SUMMARY

Local governments in Western Australia are actively involved in encouraging sustainable development and in regulation of developments within their jurisdictions. Consequently the local government sector is directly and indirectly impacted by developer contributions charged by government corporations and instrumentalities, particularly through the impact of these charges on planning and local development viability. As the peak body for local government, WA Local Government Association (WALGA) wishes to provide a range of recommendations to the Economic Regulation Authority on behalf of the sector.

These recommendations are:

1. In conducting its review of Developer Contributions to the Water Corporation, the Economic Regulation Authority (ERA) obtain independent advice concerning the appropriate engineering standards and delivery costs of those standards relative to world's best practice.
2. The same level of regulatory review applied to the Water Corporation should also apply to other water service providers such that the application of regulation does not lead to distortions or inefficiencies in the market. If the Water Corporation is to continue to use a cost per lot averaged across the state, then there is an argument that similar costing should apply to developments within the Aqwest and Busselton Water areas which may otherwise be preferentially or adversely affected by their location relative to the boundaries.
3. That the ERA review the principle of developers contributing 40% of the average per lot cost for headworks, to confirm whether or not this provides acceptable equity between current and future users.
4. Reviews of methodology and costs of Developer Contributions continue to be regular and scheduled (eg triennial) whether conducted by the consultative process or the Regulator.
5. Any changes to Developer Contributions resulting from reviews should be implemented over time to minimise adverse impacts on third parties or perverse incentives to bring forward or delay developments.
6. Retain an average cost per lot approach except where it can be demonstrated that development in a particular location will always result in infrastructure costs (whole of life) more than (say) two standard deviations from the mean.
7. Source costs should be reflected in user charges rather than developer charges.
8. The Department of Local Government and Regional Development, in conjunction with the Economic Regulation Authority review the overall impact of fees and charges set by regulated government entities on regional development and provide recommendations on the establishment of Community Service Obligation type payments to encourage development in areas which maximise the overall benefits to Western Australia, including external benefits and costs.
9. The developer contributions should provide incentives for developers to lower demands on water and drainage infrastructure; and provide incentives for the Water Corporation to seek and invest in innovative technologies to deliver these essential services in more efficient ways.

10. A mechanism for appeal and review of any proposed charges should be established.
11. The UDAC committee which provides on-going dialogue and advice to Water Corporation (and other water service providers) should be maintained.
12. A system be established whereby developers may elect to bring forward expansion of the network by funding the opportunity cost of under-utilised infrastructure until such time as that infrastructure would have been developed.
13. Sufficient time is allowed for effective consultation with local government on key issues which impact upon the sector.

ABOUT WALGA

The West Australian Local Government Association (WALGA) is the united voice of Local Government in Western Australia. The Association is an independent, membership-based group representing and supporting the work and interests of all 142 Local Governments in Western Australia.

The Association provides an essential voice for almost 1,400 elected members and over 12,000 employees of the Local Governments in Western Australia and Christmas Island and Cocos (Keeling) Island Councils. The Association also provides professional advice and offers services that deliver financial benefits to the Local Governments and the communities they serve.

This Interim Submission on behalf of the Local Government sector has been prepared with limited consultation due to the tight time frames provided by the Economic Regulation Authority since the release of the Issues Paper on 31 October 2007.

1.0 PRINCIPLES FOR SETTING DEVELOPER CHARGES

Local Governments across Western Australia are strongly supportive of sustainable development within their communities and regions. Local Governments are actively involved in all stages of planning and implementing land developments in their jurisdictions and value the opportunity to provide input into the Inquiry into Developer Contributions to the Water Corporation.

Growth and development incurs initial costs and the sector recognises that Developer Contributions to the Water Corporation (and other water service providers) are a long established mechanism for part funding infrastructure development.

WALGA believes that Developer Charges should meet six key principles, many of which are referred to in the Issues Paper prepared by the Economic Regulation Authority (ERA). These principles are:

1.1 Transparency

The Water Corporation uses a current cost approach to calculate an average per lot cost of current state-wide headworks. This cost is then shared between the developers and final water users (40:60). Water service users contribute through the combination of rates and consumption charges.

While conceptually this approach is simple, the actual average network development cost is not clear. In particular both developers and water consumers need to be able to be confident that:

- Development contributions are not needed to address previous under-provision of infrastructure, or inadequate maintenance and upgrading practices; and

- An economically optimal standard of engineering is applied, neither “gold-plating” the infrastructure nor under-investing, leading to high operating / maintenance costs or repeated need to upgrade the system.

The National Competition Policy, National Water Initiative and Productivity Commission reports all indicate the need for independent regulatory review of such charges where there is a natural or legislated monopoly in the provision of distribution services. The rigour of this process is not clear; in particular whether the regulator is able to balance its own risks. In setting prices in a regulated private monopoly there are clear signals resulting from setting prices too high or too low. If prices are set too high, this will most likely be reflected in the profits (and share price) of the regulated companies. If prices are set too low, this will be reflected in inadequate investment and poor performance of the distribution network. Where the regulated entity is a public corporation such as the Water Corporation, the consequence of setting prices too low is likely to become apparent in the medium term (inadequate infrastructure) while the consequences of setting prices too high (leading to “gold plating”) are much more difficult to discern.

Recommendation: In conducting its review of Developer Contributions to the Water Corporation, the ERA obtain independent advice concerning the appropriate engineering standards and delivery costs of those standards relative to world’s best practice.

Recommendation: The same level of regulatory review applied to the Water Corporation should also apply to other water service providers such that the application of regulation does not lead to distortions or inefficiencies in the market. If the Water Corporation is to continue to use a cost per lot averaged across the state, then there is an argument that similar costing should apply to developments within the Aqwest and Busselton Water areas which may otherwise be preferentially or adversely affected by their location relative to the boundaries.

1.2 Equity

The actual costs of building water, drainage and sewerage infrastructure in new developments will be site specific and depend on a range of factors such as lot size, depth to groundwater, presence of acid sulphate soils etc. However, these costs are met directly by the developer and so are already factored into the development decision at a particular location.

Headworks charges for pumping stations, sewerage mains etc are not so clearly linked to a particular development or necessarily clearly different in different parts of the state, although there are strong economies of scale in the provision of water services.

WALGA strongly supports the principle that essential services should be affordable for all customers. However, it is not logical that this means that uniform pricing should apply to developer headworks charges.

Equity over time is critically important to ensure that new developments are not subsidising existing infrastructure, or leaving a legacy of costs for the future.

Recommendation: The ERA review the principle of developers contributing 40% of the average per lot cost for headworks, to confirm whether or not this provides acceptable equity between current and future users.

1.3 Certainty

Developers seek to manage and minimise risks associated with land developments, including headworks costs which are essentially outside of their control. The methodology for calculating headworks charges, the basis of any escalation arrangements and review periods should be clearly articulated in advance.

Recommendation: Reviews of methodology and costs continue to be regular and scheduled (eg triennial) whether conducted by the consultative process or the Regulator.

Recommendation: Any changes to headworks charges resulting from reviews should be implemented over time to minimise adverse impacts on third parties or perverse incentives to bring forward or delay developments.

1.4 Efficiency

1.4.1 Location Signals

Any differential in the cost of providing water services at a particular location within the interconnected network is the result (at least to some extent) of previous decisions made regarding the development of the network, rather than as a result of the location of a particular development per se. If the existing infrastructure is equally utilised across the network (eg all at 90% capacity) then many of the step cost issues would not exist. It is possible to conceive a situation where connecting a particular development to the network requires extensive and costly upgrades to trunk mains, pumping stations etc. However, a subsequent, adjacent development would have very low costs due to the surplus capacity installed earlier. As these decisions are outside the control of individual developers, an average costing approach is reasonable in most situations.

Recommendation: Retain an average cost per lot approach except where it can be demonstrated that development in a particular location will always result in infrastructure costs (whole of life) more than (say) two standard deviations from the mean.

WALGA recognises that a wide range of subsidies, incentives and other factors influence the cost of developing and / or living in a particular location. While it is not appropriate to justify one subsidy on the basis of another, it should be acknowledged that subsidies do exist and distort the relative value of land or land developments (eg land near subsidised public transport).

New water sources in an interconnected network are required as a result of increased demand (from existing and new customers), rather than from an increase in the number of taps from which the water is distributed.

Recommendation: Source costs should be reflected in user charges rather than development charges.

1.4.2 Regional Development

Cumulative infrastructure charges levied by Western Power, Water Corporation (or other service providers), and local governments may send inconsistent market signals to developers regarding the community value of a development in a specific location, and fail to account for the externalities associated with land developments occurring in certain locations.

Recommendation: The Department of Local Government and Regional Development, in conjunction with the ERA review the overall impact of fees and charges set by regulated government entities on regional development and provide recommendations on the establishment of Community Service Obligation type payments to encourage development in areas which maximise the overall benefits to Western Australia, including external benefits and costs.

1.4.3 Innovation

The fundamental weakness of a regulatory determination of developer charges is the lack of incentive for innovative approaches to delivering the service. While the regulator may confirm that there is no over-recovery of costs; there is little or no incentive for the provider to seek to lower costs, as these are simply passed on.

There is also the need to recognise a fundamental conflict of interest where the supplier of water (who presumably wishes to sell more water) is also the supplier of the infrastructure to deliver that water.

Recommendation: The developer contributions should provide incentives for developers to lower demands on water and drainage infrastructure; and provide incentives for the Water Corporation to seek and invest in innovative technologies to deliver these essential services in more efficient ways.

1.4.4 Simplicity

A complex, site specific regime may delay development, and add significant costs without demonstrable benefit.

Consistency

A clear set of guidelines are required to define situations where Special Developer Contribution Areas are declared.

1.5 Right of Consultation and Review

The current arrangements allow the Urban Development Advisory Committee (UDAC) and the ERA to interact with the Water Corporation concerning developer contributions. However, there is no mechanism for individual developers or local governments to seek review or appeal against developer contributions proposed by the Water Corporation.

Recommendation: A mechanism for appeal and review of any proposed charges should be established.

Recommendation: The UDAC committee which provides on-going dialogue and advice to Water Corporation (and other water service providers) should be maintained.

1.6 Accountability

WALGA supports the independent review of developer charges, although argues that this cannot be conducted independently of a review of service and usage charges along with the efficient costs of providing the service. If the various charges are reviewed separately (or some are reviewed and others are not) then it is unlikely that the most efficient outcomes will be achieved.

The review process should include an assessment of how effective the existing (at any point in time) mechanisms have delivered value to each stakeholder. That is the review should consider questions such as:

- Has the Water Corporation recovered the expected proportion of headworks costs (did actual headworks cost estimates over or under-estimate the outcome?)
- Have the headworks been delivered using demonstrably world's best practice and appropriate engineering;
- Have efficiencies been delivered over time?

From such a review it should be possible to determine whether there is sufficient revenue flowing into the Water Corporation to maintain the existing network, should all land development (and hence all developer contributions) cease, confirming that developer contributions are not required for on-going maintenance of the network.

2.0 OUT OF SEQUENCE DEVELOPMENTS

Essential service providers, including Water Corporation have developed their own plans regarding sequenced development with varying levels of consultation with other agencies and corporations. As this is neither an integrated planning system, nor a fully regulated environment the opportunity for developers to bring forward connecting works should be available. There are commercial incentives for developers to bring forward developments in some cases, so it is recommended that the developer pay the additional marginal cost of underutilised infrastructure until such time that the new works achieves an agreed level of utilisation (ie via new connections). This is effectively an interest cost which would need to be underwritten. This is likely to be more efficient than the developer acting as a financier to Water Corporation (although a developer may take this option rather than a bank guarantee acceptable to Water Corporation).

Recommendation: A system is established whereby developers may elect to bring forward expansion of the network by funding the opportunity cost of under-utilised infrastructure until such time as that infrastructure would have been developed.

3.0 CONSULTATION

The State – Local Government Partnership Agreement on Communication and Consultation (2004) commits both parties to a minimum 12 week period for consultation on matters concerning each party. It is noted, that on this occasion only 6 weeks has been made available following release of the Issues Paper for preparation of a response by the sector.

Recommendation: Sufficient time is allowed for consultation with local government on key issues which impact upon the sector.