

2008 Water Price Review
Consultation Paper
Framework and Approach

**VICTORIAN WATER INDUSTRY
SUBMISSION**

NEW CUSTOMER CONTRIBUTIONS

FEBRUARY 2007



VICTORIAN WATER
INDUSTRY ASSOCIATION INC.

"Innovation, Cooperation and Sustainability"

Victorian Water Industry Submission New Customer Contributions

February 2007

Background

Customer contributions are a cost levied by water businesses on customers (developers) for the provision of water and sewerage infrastructure to service land.

The Water Act 1989 and The Water Industry Act 1994 provide water businesses with the ability to require new customers to make an upfront contribution to the costs of connecting to the existing water and sewerage networks. Existing non-serviced property owners are also required to make upfront contributions for the cost of connection.

The Essential Services Commission (the Commission) has the power to regulate standards, conditions of service and supply and price under clause 6 of the Water Industry Regulatory Order (WIRO) for both a declared and a prescribed service. The WIRO outlines a number of regulatory principles that the Commission must be satisfied have been met before it can either approve the proposed customer contributions or the method. Clause 14 of the WIRO outlines these regulatory principles. The principles are broad and include:

- ◆ Prices must provide for a sustainable revenue stream to the business that nonetheless does not reflect monopoly rents and/or inefficient expenditure by the business.
- ◆ Prices must provide incentives for the sustainable use of Victoria's water resources by providing appropriate signals to water users about:
 - the costs of providing services including costs associated with future supplies
 - periods of peak demands and/or restricted supply
 - choices regarding alternative supplies for different purposes
- ◆ Prices must provide businesses with incentives to pursue efficiency improvements and to promote the sustainable use of Victoria's water resources.
- ◆ Prices must enable customers or potential customers of the regulated entity to readily understand the prices charged by the regulated entity for prescribed services, or the manner in which such prices are to be calculated or otherwise determined.

Current 2005 Regulatory Period Arrangements

The key aspects of the current arrangements for new customer contributions (NCC's) are:

- ◆ New customers are responsible for providing assets to be installed specifically to service their property or development.
- ◆ The maximum NCC was set at \$500 per lot per service for water and sewerage (total \$1,000 per lot). Water businesses may charge a per lot charge up to the scheduled charge for each new property connected.

- ◆ Water businesses are responsible for infrastructure assets that are generally provided to service more than one development.
- ◆ Water businesses may apply to the Commission to levy a NCC above the scheduled charge where shared assets must be constructed ahead of schedule to service a new property or development. In these cases and subject to approval by the Commission, the water business may recover the capital financing costs that are attributable to bringing forward construction of the shared assets.
- ◆ Reticulated assets are defined as the infrastructure assets that are explicitly provided in relation to prescribed services for one development and are not required to be upsized to support other future developments, and may include a pipeline, a water storage tank, a local treatment plant, pumping station, rising main, sewerage flow control facilities, local booster disinfection plant and/or a local sewage pre-treatment system. A water main that is 150 mm or less in diameter and a sewerage main that is 225 mm or less in diameter, and all associated assets that relate to those sized assets are generally considered to be reticulation assets, although there may be some situations where these sizes are inappropriate.
- ◆ Shared distribution assets are defined as infrastructure assets that are generally provided in relation to prescribed services for more than one development and do not include reticulation assets, headworks and tailworks.

Basis for the Current 2005 Regulatory Period Arrangements

The Commission's review during the 2005 determination found the industries approach to setting NCC's to be inconsistent and incompatible with the principles of the WIRO. The Commission's decision reflected the view that NCC's should:

- ◆ reflect incremental costs (at a minimum should not include the costs associated with sunk costs, shared assets, headworks or tailworks costs)
- ◆ provide locational signals to encourage new customers to connect where there is existing infrastructure and reflect a higher cost associated with out of sequence developments

The Commissions' basis for the final decision of a flat fee of \$500 for each service was adopted in the interest of simplicity and ease of understanding.

Some businesses had proposed NCC's lower than \$500 and these were also adopted by the Commission.

Water Industry Proposed Approach to New Customer Contributions for the 2008 Regulatory Period

The 2008 Water Price Review consultation paper, issued by the Commission in December 2006 suggests moving to a cap of \$1,000 per service. This proposed cap would be accompanied by a principle that contributions reflect the per lot costs of shared infrastructure associated with the development, but only if shared assets are provided by the water authority.

In the paper the Commission has acknowledged that an upfront contribution for water infrastructure has little bearing in providing locational signals relative to other factors. "In a 1999 report for IPART, PricewaterhouseCoopers found that upfront developer contributions have no broad impact on urban planning."

In terms of tariff structures more generally, the paper notes the importance of designing tariff structures in a way that contributes to the achievement of broader demand-supply objectives which include providing appropriate signals to water users about the cost of services, future supplies, periods of peak demand and times of restrictions. We must also be cognisant of who the customer is. NCC's are usually levied on the developer (who embeds the price in land/development prices) and the end user (who bears the ongoing usage based tariffs).

The Water Industry believes there are opportunities to improve on the current arrangements, particularly in relation to incentives for Water Sensitive Urban Design (WSUD) developments. Currently the consequences are that larger more water-intensive developments face the same charge as higher-density more water efficient developments. Therefore, to be more consistent with the WIRO principle of signalling and providing appropriate incentives for sustainable water use, the Water Industry suggests that NCC's should send a stronger message to encourage and reward more water sensitive developments.

Current arrangements do not recognise the effect of development decisions on existing regional water customers, where development is designed to attract more people to regional centres resulting in large water intensive developments. Incremental developments will, collectively and over time, generate the need for additional investment in upstream capacity. The WIRO requires tariffs to be designed having regard to the interests of all customers, consequently the NCC level should be considered in terms of what is an appropriate balance to strike between full upfront funding or funding over time.

The Water Industry's proposal allows for an upfront contribution thereby reducing the financial impact on the total customer base. This reflects an equitable sharing of funding for growth assets between the two different groups of customers. These charges, coupled with incentives for WSUD, will discourage inefficient development decisions; are in the interests of the broader customer base (particularly smaller regional communities); are consistent with the provisions of The Water Act 1989 and The Water Industry Act 1994 and can be structured in a way that avoids undue complexity.

Proposal

With these considerations in mind, the water industry proposes the following amendments as the approach to be followed in the preparation of the 1st of May 2007 draft Water Plans, which are to be released for public comment prior to formally submitting them to the Commission in September.

1. A standard schedule of charges, detailed below, to be determined and scaled according to the water-sensitivity of particular developments and the demand for future infrastructure. (The categories a), b), and c) will need definitions developed according to planning regulations etc.):
 - a) Where a New Customer Contribution is to be applied, a minimum charge of \$500 per lot per service for water and sewerage (total \$1,000 per lot) for developments which are designed in a manner that will have minimal impact on future water resource demands, and can be catered for without additional investment within the medium-term distribution capacity. For example: a two lot subdivision that will not require system augmentation capital expenditure beyond 2013;
 - b) \$1,000 per lot per service for water and sewerage (total \$2,000 per lot) for water sensitive urban developments which will require further investment in infrastructure within a six year period to serve these developments,or,
where shared assets must be constructed ahead of schedule to service a new property or development, and the calculated 'bring-forward' costs, as per the current NCC guideline is greater than \$1,000 (per lot for water and sewerage), the calculated charge shall apply;

- c) \$2,000 per lot per service for water and sewerage (total \$4,000 per lot) for developments designed in such a way that properties will create demand for water resources over and above high-density, water efficient homes e.g., standard quarter acre block with large outside water-use, no recycled water, no water tank etc, and which will influence near term investment in infrastructure decisions.
2. A business would have the discretion to charge zero if it is believed that the short and long term incremental costs were negligible.
3. The schedule should not apply to developments where the application would result in a higher contribution than that which is allowed under the provisions of the current water legislation.
4. Proceeds from developer charges are to be offset from future revenue in a manner that does not impact on the compliance of usage tariffs within the requirements of the WIRO (i.e. not to distort usage charges such that they no longer provide appropriate incentives for sustainable water use to end customers).
5. In the event of disputes over the categorisation of a particular development or the substantiation of particular costs where the schedule does not apply, the relevant developer can lodge a dispute with the Commission, which will make a binding decision on the matter.
6. Charges are maximums (ie caps) except for a) where a minimum charge has been set, and b) where the calculated 'bring-forward' costs as per the current developer contribution guideline is greater than \$1,000 (per lot for water and sewerage), the calculated charge shall apply.
7. Current arrangements to apply with respect to applying forecast contributions to the overall revenue requirement of the water authority (as an offset to capital expenditure).
8. The Water Industry proposal is dependant on new customers continuing to be responsible for providing reticulated assets to be installed specifically to service their property or development. The definition of reticulated assets should continue to include the 150mm water main and 225mm diameter sewer main on the basis that this criterion provides a clear process to ensure developers and water authorities know when a main of this size must be funded by the developer and not by the water business. In line with the current definition, the industry reserves the right to treat some assets above this size as reticulation assets. In particular, when they are specifically required to service a single development.
9. Developers in dual pipe areas will also be required to install the additional reticulation assets for the recycled water. An upfront charge may also be levied that reflects the principles contained above.

The above approach is designed to:

- ◆ Provide appropriate incentives for WSUD, without distorting location decisions (as it applies generally and is independent of location).
- ◆ In the interests of existing customers, generate a contribution from developers towards future investment in infrastructure, as is envisaged in water legislation, while not impacting on the design of usage tariffs to provide price signals for both new and existing customers reflecting the costs of increasing demand at that location and the ability of usage tariffs to also provide incentives for sustainable water use of Victoria's water resources.
- ◆ Provide price signals to developers where they decide to develop land in a location and in a way that allotment sizes etc. require the 'bringing-forward' of significant infrastructure investment (i.e. over and above \$1,000).