



WATER SERVICES
ASSOCIATION OF AUSTRALIA



WSAA Submission

**Kickstarting the
productivity conversation**

NSW Productivity Commission





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About WSAA

The Water Services Association of Australia (WSAA) is the peak body that supports the Australian urban water industry. Our members provide water and sewerage services to over 20 million customers in Australia and New Zealand and many of Australia's largest industrial and commercial enterprises.

WSAA facilitates collaboration, knowledge sharing, networking and cooperation within the urban water industry. The collegiate approach of its members has led to industrywide advances to national water issues.

Overview

WSAA is pleased to provide a submission to the NSW Productivity Commission Discussion Paper: Kickstarting the productivity conversation. WSAA agrees with the NSW Productivity Commission's position that water is key to all sectors of the economy as it underpins business operations and household living standards. In addition, we agree there are a number of challenges facing the urban water industry including population growth and climate variability.

WSAA has been discussing the role of urban water in communities and planning as well as considering community engagement for purified recycled water for drinking. This brief submission highlights WSAA's analysis of these issues as set out in three recently released reports:

- [Urban Water Update 2019: Drought, Growth and Liveability](#)
- [Blue + green = liveability: the value of water to liveable communities](#)
- [All options on the table: lessons from the journeys of others](#)

WSAA commends these reports to the NSW Productivity Commission and looks forward to discussing these issues with the PC as it develops its Green Paper and recommended reform agenda.

The Discussion Paper asks how governance and institutional arrangements could be improved in the urban water sector. We would like to comment on two issues.

Firstly, most metropolitan water utilities were corporatised as part of the National Competition Policy Reforms of the 1990s. These reforms have determined the structure of the industry today. We have not undertaken a specific assessment of corporatisation in NSW. However, at the national level, WSAA has been advocating for a general recommitment from governments to the corporatisation model for metropolitan utilities.

Secondly, Sydney and Hunter are one of the few metropolitan areas in Australia without developer charges for water and wastewater. We believe an efficient system for developer charges critical to funding growth infrastructure and this is the major issue we seek to address in this submission.

Water's role in productivity

WSAA agree with the NSW Productivity Commission's assessment that water and energy are:

'priority areas for productivity-enhancing reform due to their crucial role in supporting production for industry, as well as the living standards of households.'

Our report [Blue + green = liveability](#) outlines the value of water to liveable communities.

It seeks to increase understanding and explain how the urban water industry enables broader liveability outcomes including contributing to green and blue infrastructure to deliver benefits to physical and mental health by making communities cooler, healthier and more attractive places to live, work and play. This is in addition to the provision of safe, secure and affordable drinking water and wastewater services.

However, while planning for green and blue infrastructure can start to unlock improved liveability outcomes there are often no clear pathways to deliver and fund these initiatives.

We are calling on Australian and New Zealand governments at all levels to collaborate with the urban water industry and take leadership to enable green and blue infrastructure to deliver liveability outcomes for cities and regions by:

- Harnessing the full water cycle with all water supply options on the table and by coordinating the incorporation of stormwater
- Integrating our approach to planning
- Implementing an effective framework for measuring health and liveability benefits
- Creating new funding and financing models for green and blue infrastructure as social infrastructure.

Future challenges

WSAA agrees with the two challenges identified by the NSW Productivity Commission: population growth and increasing climate variability.

While water is valued as a vital part of life, many people don't understand its true value. Ironically it is often only during drought that we begin to recognise the true value of water. It highlights the longer-term issues in providing water for future generations. With assets that last up to 100 years, the industry has always taken a long term view on water security. In dealing with long term water security the industry needs to respond to a number of drivers including population growth, climate change and the need to ensure sufficient water for liveable communities.

With Australia's population growth among the highest of any industrialised country we also have a population that is densifying and we are one of the most urbanised in the world. With this growth comes opportunities and challenges. Growth allows us to create new innovative communities that are water efficient and great places to live. Growth also requires planners and utilities to work together to maintain affordability to ensure liveable, sustainable and productive cities.

In relation to climate variability, the water industry understands the need to plan for uncertainty and to be agile and flexible in its approach. In response, WSAA and its members have developed tools and guidelines to manage the impacts of climate change. An example is WSAA's Climate Change Adaptation Guidelines which provides the Australian and New Zealand water industry with consistent, clear and practical guidance in building climate resilience across all aspects of a water utility business. The Guidelines draw upon the experience of the water industry, identify current best practice and provide clear principles to guide the industry forward in a pragmatic and defensible approach to adaptation.

Water supply options

WSAA agrees that considering the role of water recycling and greater water-use efficiency is part of ensuring safe and secure water supplies for the future.

WSAA agrees that diversification of supplies is critical and good water industry planning means having all options on the table for consideration. WSAA does not advocate specifically for any single water supply solution, but rather the consideration of all options including purified recycled water for drinking alongside desalination, water efficiency, dams and recycling for non-drinking purposes.

The Discussion Paper notes that:

'Community acceptance of recycled water options is crucial. Government can play an important role in engaging the community on options, noting large-scale water recycling has proven viable in major cities such as London, Los Angeles, and Perth.' (page 59)

In this context WSAA’s All options on the table report provides insights and perspectives regarding community engagement on purified recycled water around the world. Community engagement for purified recycled water has evolved significantly over recent decades and the report includes 10 lessons and case studies from around the world as well as recommended actions based on the learnings from these case studies. It also includes maps showing 35 locations around the world already using purified recycled water for drinking and more that are considering it.

In relation to water efficiency, WSAA and its members acknowledge that it remains critical for both customers and utilities and is an essential part of ensuring protection for future climate scenarios.

Water utilities across the country, including in NSW, are investing in world leading water efficiency knowledge and engagement. Examples are included in WSAA’s paper [Water Efficient Australia](#).

Governance

The most significant aspect of the Australian model of government business reform, which extended to water utilities, is the introduction of commercial business disciplines through corporatisation. The reforms of the 1990s have determined the structure of the Australian urban water industry today.

Water utilities moved from being government-run departments, to operating at arm’s length from government under an independent board structure, accountable for their financial and operational performance.

Water businesses were mostly established as statutory corporations, but in some instances as corporations under Corporations Law. This subjected the businesses to similar disciplines as the private sector.

Figure 1 sets out the typical governance framework for a corporatised utility.

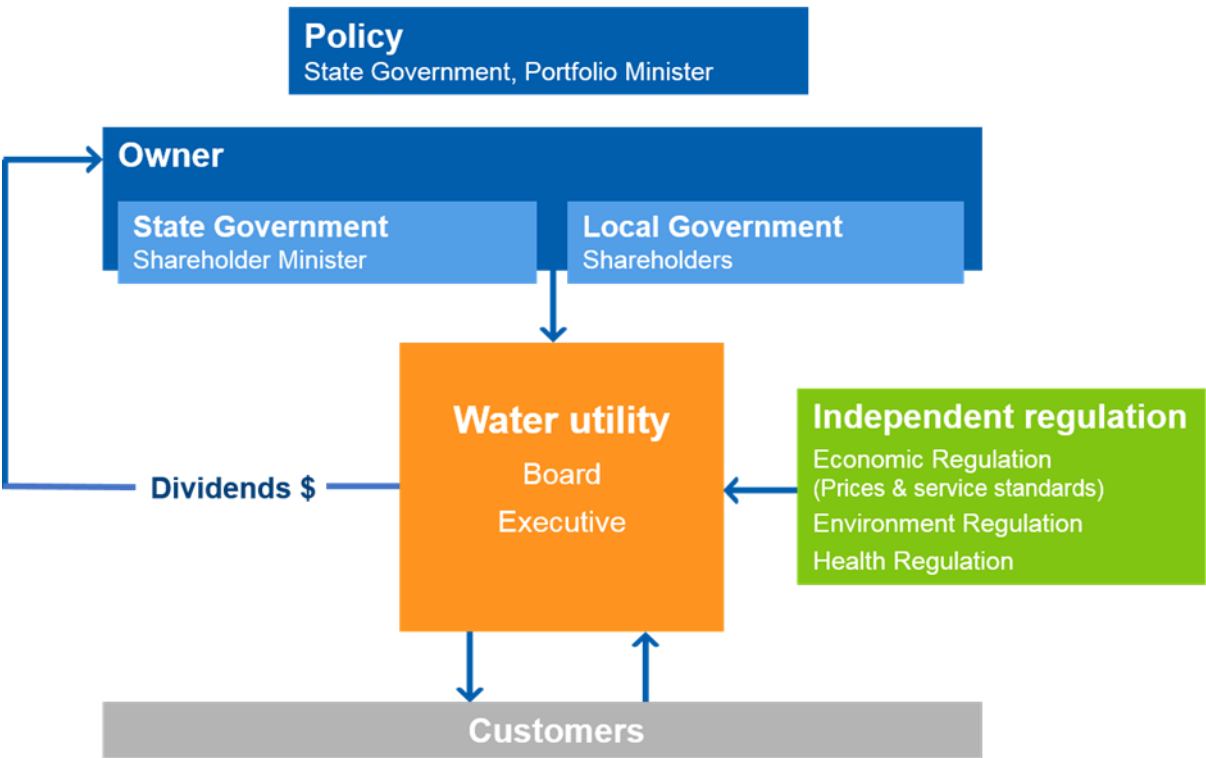


Figure 1: Typical governance framework for a corporatised utility

The main elements of the framework are:

- a direct relationship with the customers of the business to understand their needs and values
- independent skills-based boards – to provide governance, strategic direction and accountability for performance of the business encompassing financial, technical, marketing, risk management and compliance aspects
- cost-reflective pricing to provide efficient resource allocation and demand signals – water businesses are expected to cover the full cost of their activities including a return on the capital the community (through the government) has invested in the business
- efficient capital structures – allowing the business to access commercially priced debt to fund infrastructure that benefits current and future generations, while providing a dividend to the community for its investment in the water business
- maintaining an investment grade credit rating to allow for commercial debt to be raised reflecting the low risks of the water businesses and to be financially sustainable in the long term
- shareholder performance monitoring – accountability to ensure the business is delivering for customers today, meeting shareholder expectations, and is sustainable in the long term.

We have not undertaken a specific assessment of governance arrangements in NSW. However, at the national level, WSAA has been advocating for a general recommitment from governments to the corporatisation model for metropolitan utilities. We believe that there would be value in the NSW Productivity Commission reconsidering the performance of governance arrangements against the framework for a corporatised utility.

Developer charges

The Discussion Paper recognises population growth as a significant future challenge. Traditionally water utilities have received contributions from developers to assist with the costs of providing growth infrastructure however as noted in the Discussion Paper:

‘Infrastructure contributions paid by developers to state and local governments are not applied on a consistent basis’ (Executive Summary).

Indeed, the Sydney and Hunter regions are alone among Australian water utilities in not receiving cash contributions from developers.

The Discussion Paper asks the question:

‘How might developer contributions be improved to support growth in new areas and service growing community needs?’ (pg 127).

WSAA considers it is essential that developers contribute a fair share to the costs of servicing growth in our cities and towns. A well-designed system of developer charges will not affect housing affordability. A first step is for jurisdictions with no developer charges to gradually introduce them.

Our cities are growing

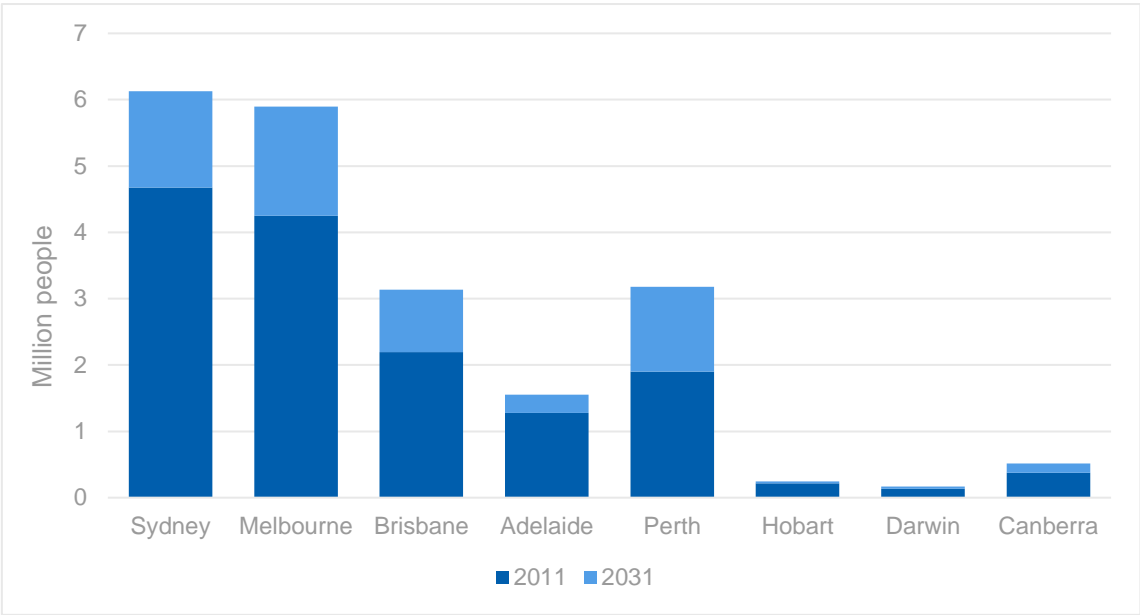
Many of the challenges the water industry faces in providing better services to its customers and the community coalesce around servicing new growth. Medium level projections from ABS show Australia’s population growing from 22.3 million in 2011 to 30.5 million in 2031. The majority of this growth is projected to be in Sydney, Melbourne, Brisbane and Perth, increasing by 5.9 million

people to 18.6 million in 2031. Population growth drives a rising demand on urban infrastructure which is already under pressure. As was stated in Infrastructure Australia’s Australian Infrastructure Plan in 2017:

“Growing communities need places to live, work and enjoy our great Australian way of life, placing pressure on existing infrastructure networks. But if we plan for this growth now, we can further develop our cities as thriving, world-class centres of growth and prosperity.”

We have great visions for our growing cities, to make them attractive and liveable places where people want to be. Urban water businesses are in a unique position to contribute to green space, amenity, waterway health and recreation alongside growth. Through an appropriately funded, holistic planning framework we will be better enabled to achieve overall growth objectives.

Chart 1: Australia's urban populations in 2011 and projected to 2031



Source: Australian Bureau of Statistics (2013)

The Role of Developer Charges

In WSAA’s view, a well-designed system of developer charges and contributions is an important element for funding growth, providing signals on the societal cost of development, and facilitating fair pricing of water services. Developer charges are a mechanism for funding growth infrastructure and have been applied in the urban water industry across Australia for many years.

The costs of servicing growth — particularly greenfield growth — are significantly higher than the costs of servicing existing areas. For example, in their Price Proposal 2020-24 Sydney Water states that currently “significant new infrastructure is required to service greenfield locations, typically at five to six times the cost per property of infill developments”. For infill growth, if there is existing capacity redevelopment can increase density at modest costs. However, many existing systems are reaching capacity. In the long term, all customers are responsible for using the capacity of the water and wastewater systems and eventually the costs of upgrading capacity in existing areas also involves significant costs.

However, utilities do not charge higher prices to customers in growth areas. Overwhelmingly utilities in Australia operate under a system of postage stamp pricing whereby customers across an area of operations pay the same charges regardless of the cost of delivery. As a consequence of postage stamp pricing, water and wastewater revenue recovered from new customers is less than

that required to cover the costs of extending the network. The traditional role of developer charges has been to partially or fully fund that gap. In this way cities can grow without putting significant pressure on existing water bills.

All water utility infrastructure costs must be recovered in one way or another. Without a developer charging framework, the additional costs of new growth will necessarily be recovered through water and wastewater service charges from existing customers, placing additional pressure on general water and wastewater prices. The pattern of development may also be different in the absence of developer charges playing their role in supplementing planning decisions by providing a price signal on where to develop. Without this signaling, the water network build will be inefficient in that developers will be encouraged to develop high cost sites rather than low cost sites.

ONE SIZE DOES NOT FIT ALL

A striking feature of the developer charge regimes across Australia is their diversity. All seek to recover the costs of development but in widely different methods. These regimes are not the product of long-standing practice or history; a number are relatively new or have been reviewed recently. Why such diversity? Developer charges is one instrument that is designed to meet a number of objectives: cost recovery, providing location-specific investment signals, and equitable funding of investment. Inevitably one instrument cannot meet multiple objectives perfectly and trade-offs will be necessary. Pragmatism and flexibility in regime design are necessary.

Developer charges and housing affordability

While developer charges are payable by the developer, they do not generally get passed onto the prices paid by homebuyers. In this way they do not affect housing affordability. This conclusion is well supported by economic research and is explained in the attachment to this statement.

Governments have been increasingly looking at forms of value capture to fund infrastructure. Developer charges are an attractive funding source because, if well-designed, they recover the additional costs of servicing new growth through a form of value capture. Moreover, they may reduce the additional costs through incentivising developers to develop lower cost sites. There is no evidence of a negative impact on affordability from jurisdictions with significant cost base contributions.

Who pays developer charges?

A fundamental point is that while developer charges are payable by the developer, they do not necessarily impact on the prices paid by homebuyers. Zoning rules constrain the quantity of land available for development. When agricultural land is rezoned for houses, industrial land is rezoned for residential, or residential land rezoned for higher levels of density, its value will increase significantly. This leads to a windfall gain or profit which will be shared in some combination by landowners and developers. Developer charges remove part of that profit to fund infrastructure. Knowing that they will pay a developer charge, developers will pay less for rezoned land than they would if there were no developer charges; and this may offset the developer charge. In this way developer charges capture part of the increase in land value when land is rezoned to higher value residential uses. But as long as some windfall profit remains, there is still a strong incentive for development to occur to meet demand for new housing.

This important conclusion that developer charges do not exacerbate pressure on housing prices or affordability is well supported in the economic literature. The rationale is set out in Abelson 1999, but also more recently in the Henry tax review. As Abelson said:

"If, as seems generally plausible in Australian cities, demand is elastic and supply is inelastic, the

main incidence [of developer charges] will be borne in lower raw land prices."

More recent Australian empirical research by Murray (2018) found no evidence that developer charges increase the price of new dwellings.

This does not mean that Governments do not have to be mindful of the level of the total imposts initially levied on developers. If these total imposts exceeded the value uplift in raw land then developers could not afford to pay more than the value of the land in its existing use. If too high, developer charges will constrain the supply of viable development land. Any formula needs to take this practical factor into account.

The economics explained

The impact of developer charges depends on the nature of the market; in a simple competitive market, the relative elasticities determine the burden of the charges. However more complicated models, incorporating structural features of the Australian housing market, may easily lead to results that may perhaps be considered counterintuitive. Australia specific research indicates that the incidence likely falls on developers and landowners rather than home buyers (Abelson (1999), Ruming, Gurrán & Randolph (2011), Davidoff & Leigh (2013) and Murray (2018)). The most reliable Australian evidence is consistent with this view with little credible evidence to the contrary.

The basic principles behind this can be seen the figures below. The price of residential land depends on demand for housing and the supply of land zoned for residential use (Figure 1). Where land is rezoned for development, owners of raw land will receive a value uplift (Figure 2). Developer charges recover part of this value uplift to fund the cost of water and sewerage services provided. They do not affect the price to home buyers per lot (Figure 3).

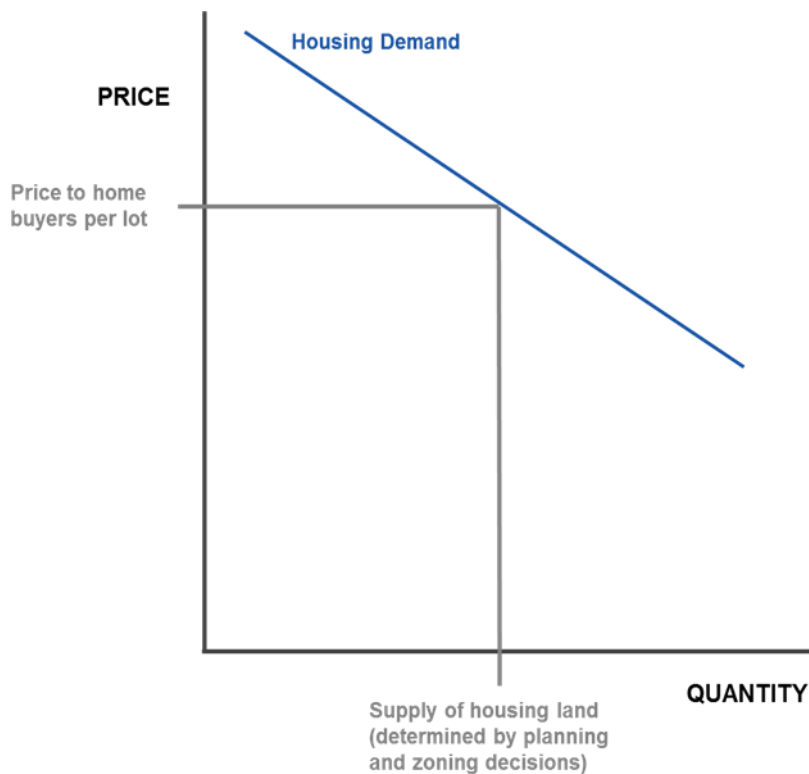


Figure 1 - Supply and demand for housing

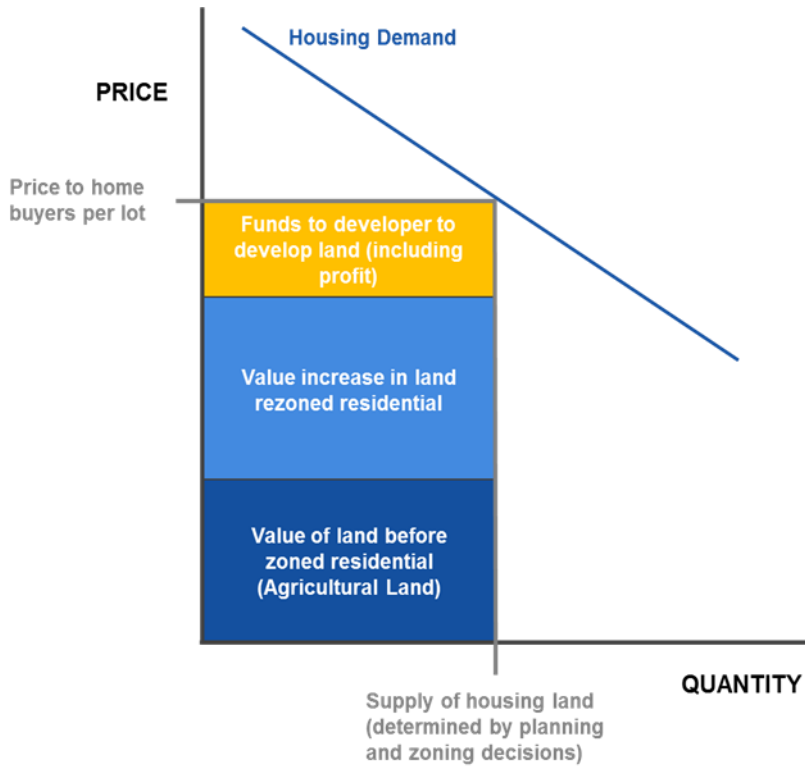


Figure 2 - Value uplift with rezoned land

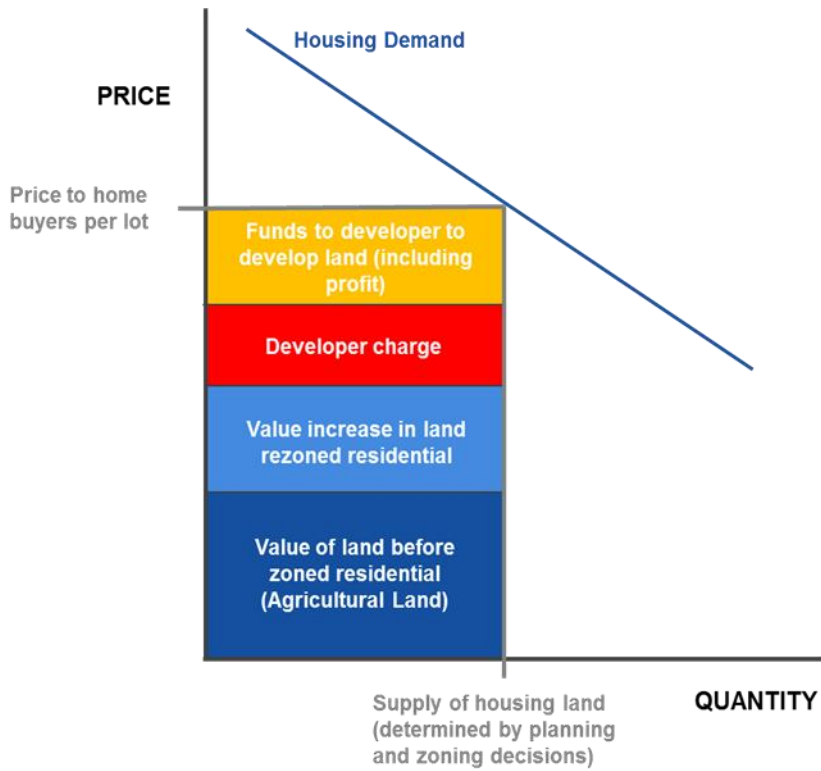


Figure 3 - Impact of developer charges

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Contact Details

WSAA welcomes the opportunity to discuss this submission further. If there are any details you wish to follow up on please contact:

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