

Developer Contribution Framework

SA Water's 2016-17 Pricing Policy Statement

Introduction

SA Water's *Water and Sewerage Retail Services: 2016 to 2020 Price Determination* (Regulatory Determination) (ESCOSA, 2016, Section 4.2) requires SA Water to provide ESCOSA with an annual compliance statement relating to excluded services (which includes developer contributions).

ESCOSA has also requested that SA Water produce a separate compliance statement relating to developer contributions.

This document sets out how SA Water's developer contribution framework achieves compliance with ESCOSA's requirements, as outlined in Section 4 of the Regulatory Determination.

Description of Developer Contributions

Connections:

Developments considered 'connections' are those where a water or sewerage main already exists but where an additional property is being added, resulting in the need for a new connection. A typical example is the addition of a new connection in the case of a property sub-division.

For a full list of connection charges please see SA Water's miscellaneous fees and charges list available at sawater.com.au.

Connection charges are considered to be an 'excluded service' and form part of the Excluded Services Compliance Statement.

Developer Contributions: Extensions

Extensions to existing mains include any development where an established main is lengthened, or a new main is installed, typically to supply an existing or new allotment not currently serviced.

Where the required investment is attributable to an individual developer and is required early in the life of the development, an up-front contribution from the developer is appropriate, but SA Water will contribute 50% of the material costs in recognition of the additional benefits accruing to other customers.

However, where the proposed investment provides no potential future benefits accruing to other customers, SA Water may not offer to contribute to the project.

Where the investment is within the development area, the developer will continue to directly fund the investment.

Augmentation Charges

The establishment of an augmentation charge will be considered by SA Water where SA Water's expenditure to service the proposed development is significant and considerable elements of the expenditure will be required over an extended period of time.

Augmentation charges allow for revenue to be collected over time, better aligning the timing of revenue to the timing of the investment (which is also over time). However, while augmentation charges will typically provide the funding for significant infrastructure, some developers may require additional infrastructure, over and above that provided for by the augmentation charge. Any additional expenditure not covered by an augmentation charge will be subject to other elements of SA Water's developer contribution framework.

In making its decision to establish an augmentation charge, SA Water may take into consideration:

- developer support;
- Whether there are multiple developers who will benefit from the infrastructure, i.e. it is not feasible to break the expenditure into individual elements that can be attributed to individual developers;
- whether there are multiple stages that will be required and these stages extend beyond medium term planning periods, i.e. past the next regulatory determination;
- whether the overall expenditure is significant, for example the expenditure would need to be approved by the Public Works Committee;
- risks and certainty that the expenditure will actually be required; and
- number and timing of new customers the infrastructure will service.

Due to the time taken to develop land, many augmentation charges will be active for extended periods of time. SA Water currently has 23 active augmentation charges. Information on these charges can be found at sawater.com.au (or by searching "SA Water augmentation"). Effective from 1 July 2016 existing Augmentation charges, which are included in our miscellaneous fees and charges, will increase by CPI (1.3%).

Additional Infrastructure (Upsizing)

In certain situations, the developer may be requested to upsize new mains or undertake additional work to service future growth. Generally this occurs where the cost of upsizing during construction is relatively minor compared to the cost of upsizing or duplication in the future.

SA Water will offer to fund the additional costs imposed on the developer.

Where can I go for further information?

Land Development and Connections

Email: cc@sawater.com.au

Fax: (08) 7003 1118

Phone: 1300 650 951

Location: SA Water, 250 Victoria Square / Tarntanyangga, Adelaide SA 5000

Statement of Compliance

Introduction

Below outlines how the 2016-17 prices for developer contributions (extensions) and augmentation charges comply with each of the relevant pricing principles specified in Section 4 of the Regulatory Determination. These principles include the NWI Pricing Principles for the recovery of capital expenditure (Principle 1), principles for setting urban water tariffs (Principles 7-10), and the four additional pricing principles for excluded services determined by the Commission.

Scope of Statement of Compliance

The scope is limited to how charges relating to 'extensions to developments' comply with the principles. Specifically, this includes developer contributions (extensions) and augmentation charges. The following items are not discussed in this compliance explanation:

- Other excluded services, namely miscellaneous fees and charges including connection charges, which are the subject of a separate compliance statement;
- Costs associated with infrastructure within a development area, as these costs are met directly by developers, hence is not an excluded service.

Compliance explanation

Each of the principles is outlined below, with a discussion of how the prices for developer contributions and augmentation charges comply with the principles.

NWI - Pricing Principle 8: Setting Developer Contributions

Developer contributions should reflect the investment in both new and existing assets required to serve a new development and have regard to the manner in which ongoing water usage and service availability charges are set.

Note: Where there are benefits beyond the boundary of the development, the developer charge should have regard to the share of capacity required to serve the development.

For the purpose of addressing developer and augmentation charge compliance with this principle, we consider two categories of investment in assets:

- *New investment* in new and existing assets (e.g. upgrades to existing assets) required to provide services to a new development.
- *Historic investment* in existing assets that benefit both new developments and existing developments. We note that historic assets would not be in existence if they were only for the benefit of new developments, but must instead have been created for the benefit of existing developments.

By being based on the estimated cost of *new investment*, SA Water's developer and augmentation charges reflect the costs of new investment in both new and existing assets. In contrast, *historic investment* in existing assets is reflected in rates and sales, derived through a return of and return on the regulatory asset base (RAB).

This is a common approach to recovering the costs of existing assets that benefit multiple parties. As such, developer and augmentation charges consider the manner in which ongoing water usage and service availability charges are set, namely rates and sales.

We note that this principle requires that where there are benefits beyond the boundary of the development, the developer or augmentation charge should have regard to the share of capacity required to serve the development. As described below in our explanation of compliance with NWI principles 7 and ESCOSA principle 1, where there are multiple beneficiaries beyond the boundary of a development:

- the contribution made by the initial developer is reduced to reflect these beneficiaries (either, in the case of developer contribution by half of the material costs, or in the case of augmentation charges divided by the number of beneficiaries); or
- where SA Water requires specific works to be undertaken beyond the minimum standards required to service the development, the estimated cost used to calculate the developer contribution or augmentation charge is reduced by the incremental cost of the additionally required works.

We acknowledge that SA Water's allocation of costs with regard to the share of capacity is imperfect. For example, in the case of a developer, our approach to reduce the contribution paid by developers (by half of the estimated total materials costs for the extended main) will, in instances where there are other potential benefits, mean that the contribution made by the developer is only an approximation of the costs imposed by the developer.

However, we also note that:

- Investment in networks, by their fundamental nature, result in benefits to a wide range of parties connected to the network (often all parties connected to the network). Attempting to precisely reflect in prices the costs imposed by all individuals connected to a network is virtually impossible. Approximations in cost reflectivity are inevitable and the degree of precision of cost reflectivity is bounded by the administrative costs of implementation.
- Our methodology for reducing the paid by developers by half of the estimated total materials costs for the extended main, in instances where there are other potential but not immediate beneficiaries:
 - has a long precedent within SA Water;
 - is well recognised and has previously been accepted by developers; and
 - is easy, transparent and predictable to calculate.

For these reasons, we consider our developer contributions and augmentation charges meet the intent of this principle.

NWI - Pricing Principle 9: Capping Developer Contributions

Developer contributions should not exceed the costs of serving new developments which includes investment in both new and existing assets required to serve a new development.
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Developer contributions and augmentation charges are set based on estimated efficient costs for new investment, reduced to reflect that SA Water or other customers are likely to benefit from the investment. As a result, the **maximum** developer contribution or augmentation charge is the estimated cost of new investment to service the new development.

NWI - Pricing Principle 10: Revenue from Developer Contribution

To avoid over-recovery, revenue from developer should be offset against the total revenue requirement either by excluding or deducting the contributed assets from the RAB or by offsetting the revenue recovered using other mechanisms.

Consistent with the Regulatory Determination (pp. 58), SA Water's actual efficient capital expenditure has been rolled into the regulatory asset base (RAB), net of customer contributions (including developer contributions and augmentation charges). The RAB will not include capital recovered via developer or augmentation charges; hence developer or augmentation charges will not be recovered twice or in any other way over-recovered.

NWI – Principle 1: Capital Expenditure Recovery

For new or replacement assets, charges will be set to achieve full cost recovery of capital expenditures (net of transparent deductions/offsets for contributed assets and developer contributions and transparent community service obligations) through either:

- a) Return of capital (depreciation of the RAB) and return on capital (generally calculated as rate of return on the depreciated RAB); or
- b) Renewals annuity and a return on capital (calculated as a rate of return on an undepreciated asset base (ORC)).

Consistent with the Regulatory Determination 2016 (pp. 133 – 134), SA Water's actual efficient capital expenditure will be rolled into the RAB net of customer contributions (including developer and augmentation charges). Capital cost, including the financing cost of the capital, will therefore be recovered in full, either up front through customer contributions, or via rates and sales through a return of capital and return on capital through the building block approach to determining SA Water's required revenue.

NWI – Principle 7: Differential water charges

Water charges should be differentiated by the cost of servicing different customers (for example, on the basis of location and service standards) where there are benefits in doing so and where it can be shown that these benefits outweigh the costs of identifying differences and the equity advantages of alternatives.

Note: Differential pricing may be achieved by upfront contributions.

Developer contributions

Developer contributions are differentiated by location. The charge is based on estimated costs for each specific development location (exclusive of any SA Water requests for additional investment), reduced to reflect that SA Water or other customers are likely to benefit from the investment.

Augmentation charges

Augmentation charges are differentiated by the geographic boundaries for which each augmentation charge is set to cover. The charge is based on the estimated cost to service that particular development, divided by the forecast number of lots (beneficiaries) at that particular development.

ESCOSA – Principle 1

Where a service is provided for the sole benefit of the recipient, the beneficiary should pay the full efficient cost of the service, and other consumers should not be required to contribute to the cost of the service.

We note two key terms in the principle:

- that costs are **efficient**; and
- that costs are **paid in full**.

Costs are efficient

Costs are demonstrably efficient as:

- Work is outsourced to third party contractors subject to a competitive tendering process.
- SA Water will provide to the customer transparent information regarding the cost estimated to be incurred by SA Water.
- In the case that developers do not consider the estimated cost are efficient, they can seek their own estimates for the works (given the standards required of the works by SA Water). The main exception is for work relating to connections to live mains, commissioning or inspections, which may have to be undertaken by SA Water.

Costs are paid in full

With regard to whether costs are paid in full, SA Water's developer and augmentation charges take into account whether or not the service is provided for the sole benefit of the recipient. If so, the recipient pays the full efficient cost of the service; other customers do not contribute to the cost of the service.

We note that for all types of developer contributions, where SA Water requires additional work or capacity to ensure SA Water is able to meet future growth, SA Water will fund the additional costs, as compared to the cost to service the development. This might happen in circumstances such as SA Water requiring upsizing of mains to ensure capacity to meet future growth beyond the current development area.

Developer contributions

In the large majority of cases, it is likely that future and/or existing customers will benefit from the network enhancement and hence the charge does not (and is not required by the principle to) reflect full cost. Rather, the charge is designed to allow a reduction in full cost (by half of the materials cost) to reflect the value of the benefits provided for existing or potential future customers.

SA Water reserves the right not to reduce the charge by half of the materials cost, reflecting that in a small minority of cases there is likely to be no other beneficiaries of the investment. In this case, **full** estimated capital costs will be recovered from that individual.

Augmentation charges

The sum of the augmentation charges forecast to be recovered from an augmentation area is equal to the estimated cost of the relevant infrastructure for that development. As such, the **full** estimated capital cost of the infrastructure is forecast to be recovered by all of the beneficiaries of the infrastructure, with each individual charge reflecting a share of the total cost, in keeping with the principle.

ESCOSA – Principle 2

Where a service is provided to a distinct group of customers (e.g. trade waste audits are provided to trade waste customers only), prices to a customer should reflect the incremental cost of supplying the service to the customer, and a reasonable allocation of the fixed costs of providing the service, where relevant.

As discussed under ESCOSA's Principle 1, developer and augmentation charges will be based on estimated efficient costs.

These estimates will include:

- an estimate for the incremental cost of the new infrastructure (such as the cost of the materials and labour to undertake the work);
- an allocation of SA Water's fixed costs for the service (such as corporate overheads).

ESCOSA – Principle 3

Prices should reflect the efficient cost of the particular service provided, although in circumstances where the cost of implementing differentiated prices to different customers is likely to outweigh the benefits, non-differentiated prices can be implemented.

We note that the issues raised in this principle are materially the same as:

- NWI Principle 7, with regard to the need for charges to be differentiated; and
- ESCOSA's Principle 1, with regard to the need for prices to reflect efficient costs.

To demonstrate how developer and augmentation charges meet this principle, we refer you to our discussion of how our developer and augmentation charges meet the above principles.

ESCOSA – Principle 4

SA Water must provide credible, evidence-based and transparent information as to how the costs and prices for excluded retail services have been calculated, derived and applied.

SA Water's developer and augmentation charges are set based on:

- The estimated cost of the particular service. SA Water is able to provide these estimates on a case-by-case basis.
- A clear and reproducible methodology to alter this estimated cost in circumstances where there are multiple beneficiaries and/or the costs are incurred over time. SA Water is able to produce the workings to demonstrate how charges have been derived.