7th July 2023

Roch Cheroux
Managing Director
Sydney Water Corporation
PO Box 399
PARRAMATTA NSW 2124

Via email: infrastructure.contributions@sydneywater.com.au

Re: Reintroduction of Sydney Water DSP Developer Charges

Dear Roch

The Urban Development Institute of Australia NSW (UDIA) is the state's leading development industry body, representing more than 450 member companies and agencies across the public and private sector. We invest in evidence-based research to inform our advocacy to Government, which enables our members to create liveable, affordable, and connected smart cities.

UDIA appreciates the opportunity to formally respond to the Draft Water and Wastewater Development Servicing Plans (DSP) on public exhibition by Sydney Water. The delivery of water and sewer infrastructure is vital to support development and the supply of new homes in NSW. UDIA maintains that the provision of enabling infrastructure is even more important now as NSW faces an acute housing supply and affordability crisis exacerbated by record low approvals and completions, increasing interest rates and construction costs, and weakening consumer confidence.

However, without increased certainty that water and sewer infrastructure will be delivered in a timely manner that supports development outcomes, UDIA opposes the reintroduction of DSPs. We strongly recommend developer charges remain set to zero and the consideration to reintroduce DSPs is deferred until a full suite of infrastructure contributions reforms is implemented by the NSW Government and productivity gains to offset new costs are proven.

The DSP charges were set to zero in 2008 in recognition of the challenging economic conditions experienced during the Global Financial Crisis (GFC). UDIA contends that the global inflationary pressures being experienced now, resulting from the disruption of the global pandemic, is creating equal or worse conditions. Introducing new charges on development at this time will erode development viability and result in further stagnation of the development industry, leading to even less housing supply.

This position is consistent with Recommendation 21 of the UDIA NSW *Housing Crisis Action Plan – June 2023* (attached) (hereinafter referred to as 'The Action Plan'), that no new developer charges that will negatively impact development feasibility, and without any commitment to productivity gains, be introduced during a housing crisis.

The Sydney Water DSP rates are markedly higher than what the Productivity Commission's *Review of Infrastructure Contributions in New South Wales - November 2020* (PC Final Report)

recommended, and we are now in a period where housing supply and affordability have clearly deteriorated in NSW.

This submission was informed by the UDIA NSW Infrastructure Contributions Taskforce and our broader membership base, incorporating their unparalleled experience and knowledge of development in NSW.

UDIA has worked constructively with Sydney Water over many years, and we look forward to continuing our close engagement to find a fair, transparent and productive model for the delivery of water and sewer infrastructure.

Executive Summary

DSPs are looking to be reintroduced at a time when NSW is in a severe housing supply crisis, with housing approvals, commencements, and completions at decade-low rates. Without immediate government intervention this crisis will only get worse and have lasting negative social and economic outcomes for our state. In recognition of this crisis, UDIA released The Action Plan in June 2023, recommending immediate actions to turn the housing crisis around and bring confidence back to both developers and consumers.

Along with Recommendation 21 covered above, another key recommendation of The Action Plan, and a continued priority for UDIA NSW, is supporting initiatives that improve the coordination and delivery of enabling infrastructure with strategic land use planning to support more new homes and jobs.

UDIA's Greenfield Land Supply Pipeline Report – October 2022 surveyed developers across the Sydney Megaregion with a portfolio of over 130,000 lots regarding their development intentions and the apparent project constraints through to the end of the decade. The research shows that issues with enabling infrastructure are consistently the main constraint for Councils and developers alike, with sewer and water delivery being the two largest constraints on the future pipeline of greenfield housing (see Figure 1). Over 54,300 lots reported the provision of sewer services as a blockage on development. This represents a notable 7% increase compared to 2021 survey results. Close to 47,000 dwellings in the future pipeline reported the delivery of water infrastructure as a constraint and many projects sit in both water and sewer categories. While challenges are acute and project specific, the data highlights that the broader governance and service delivery framework is failing and housing supply is delayed.

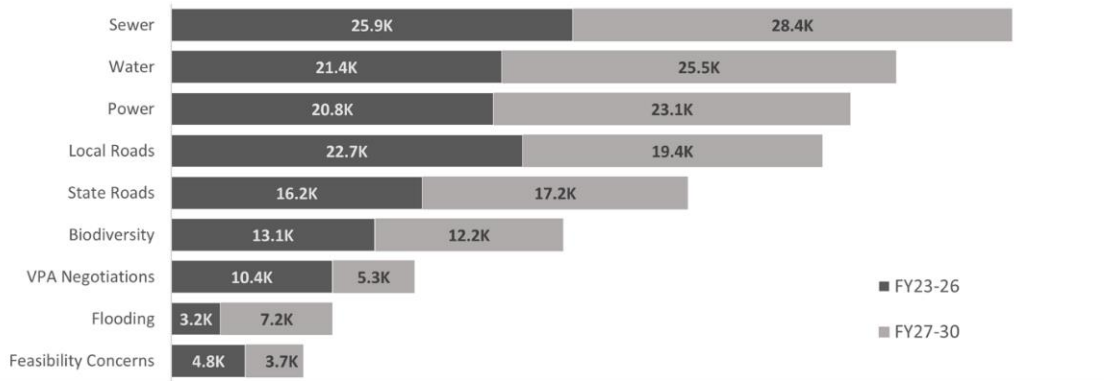


Figure 1: Number of Lots Impacted by Constraints, Six Cities Megaregion
Source: UDIA NSW Greenfield Land Supply Pipeline Report 2022

The exhibition documents do not explain how the reintroduction of DSPs will improve the productivity or delivery of water and sewer infrastructure. There is however certainty that DSPs will negatively impact the future viability of new housing, with UDIA analysis showing impacts on profit margins by close to 8 percentage points if implemented at their proposed rate (see Feasibility Analyses in Annexure A). Given the very challenging state of affordability for purchasers, this will be likely to result in developers electing not to proceed with projects due to the increased costs and risk and the potential that they take their business operations interstate.

We recommend: ***Defer the reintroduction of DSPs and keep developer charges set to zero until such time as the full suite of infrastructure contributions reforms is implemented by the NSW Government and productivity gains to offset new costs are proven.***

If DSPs proceed against our considered recommendation, we offer these recommendations:

1. ***Consistent with the Productivity Commission's Review, honour a temporary exemption from DSP developer charges for projects that have purchased land before 1 July 2023, with a commitment to complete and register the first stage of the project before 1 July 2028.***

2. ***Delay the reintroduction of DSPs, to allow both development feasibilities and the market adequate time to adjust and prepare for them. This proposed transition would provide for a more appropriate adjustment period; 20% from July 2024, 40% from July 2025, 60% from July 2026, 80% from July 2027, with full charges applying from July 2028.***

3. ***Significantly wind back all charges, and cap the maximum total charge (water and wastewater) at $12,000 per Equivalent Tenement (ET) for Sydney, aligning with the recommendation of the Productivity Commission. We recommend a maximum cap for charges in the Illawarra-Shoalhaven at $8,500 per ET.***

4. ***Sydney Water to reconsider spreading future operating, maintenance, and administration costs between developers and Sydney Water general rates.***

5. ***Sydney Water interrogate its application of the IPART methodology in its calculations to address key flaws that, if resolved, could result in a lower and more reasonable DSP charge per ET for residential development, and provide for a more accurate and transparent estimate for employment lands.***

6. ***The NSW Government should exhibit an 'Infrastructure Delivery Guarantee (IDG)' to identify critical enabling infrastructure to allow for development, and timeframes for when it would be delivered.***

7. ***The NSW Government must resolve servicing delays and governance models to ensure that water and sewer services are available 2 years after rezoning, as recommended in UDIA's NextGen West Manifesto – Feb 2023 (attached).***

8. ***A detailed Works-In-Kind policy be provided to improve the strategic and timely delivery of infrastructure by developers.***

Background

DSPs form one part of the PC Final Report, and in 2021 UDIA provided feedback into the Parliamentary inquiry of the Report, making special note of our opposition to DSPs:

"We believe the re-introduction of service charges for water infrastructure is a retrograde step, having previously been abolished because they created a large administrative burden without delivering more timely water infrastructure" (UDIA NSW, 2021).

The UDIA submission further noted that the result of not getting these reforms done once, and done right, would be increased housing costs for new home buyers, and an exacerbation of the housing supply and affordability crisis. That is exactly what is occurring now as contributions reform is being implemented in a piecemeal fashion, and without thorough consideration to the cumulative impacts of total contributions on development and housing supply.

The new housing market in NSW has reached a new low. Even with prices dropping 14% over 2022/23, the median dwelling value in Sydney remains over $1 million. The rental market fares no better, with median weekly rents for apartments rising over 20% in the 12 months to May 2023. To deliver new housing supply in this environment, developers must contend with the largest building cost increases since the 1980's, a shortage of staff, and the fastest interest rate hikes in Australia's history. Oxford Economics' is forecasting new housing supply to drop as low as 36,000 homes per annum over 2023 – 2025 (Figure 2), which if this trend sustains, will create a shortfall of 134,000 homes in the next 5 years across the state.

Figure 2: Projections of the Future NSW Housing Pipeline
Source: Oxford Economics; ABS; UDIA NSW

Adding more upfront costs to development at this time, and without any commitment to improved productivity outcomes, will be disastrous for development and housing supply as well as the economic and social well-being of our communities.

UDIA's Recommendations

The Market Context of 2008 vs. the Industry in 2023

The current DSP exhibition FAQ's note that *"Infrastructure contributions for water and wastewater were set to zero in 2008 because of [sic] concerns they might impact the housing market."* The average Sydney Water DSP charge in 2006 was around $5,000 per ET for wastewater and $2,000 per ET for water. These charges were considered a material impediment to the commercial viability of housing and a disincentive to housing supply.

There were however additional reasons behind the decision to abolish DSP charges in 2008 which provide us with valuable lessons to consider with the proposed re-introduction of DSP charges in 2023. Sydney Water revenue from DSP charges in the years prior to 2008 was around $50 million per year. Sydney Water identified in their 2007 Submission to IPART: Review of Developer Charges that *"revenues in 2005-06 and 2006-07 were significantly less than the $58 million a year forecast in IPART's previous priced determination… due to fewer than expected dwelling completions."* Sydney Water had identified a number of issues:

1) The DSP income stream was unpredictable. DSP revenues were reliant on dwelling commencements, which were subject to market forces. The uncertainty of DSP revenue made it difficult to budget for growth infrastructure.
2) The income stream was unsynchronised. DSP revenues were collected by Sydney Water after the infrastructure was needed. The phasing of infrastructure demand was at odds with DSP charge collections.
3) The DSP charge adversely impacted the cost-base of dwellings. Whilst demand for housing in 2008 was strong, development costs were too high for the market price-point, resulting in fewer dwelling commencements than forecast.

In addition to these issues, Sydney Water and the development industry had found that the DSP system required significant administrative effort compared to the value it generated. This DSP revenue stream represented only a fraction of Sydney Water's total revenue of about $1.8 billion. Further, since DSPs were set to zero, Sydney Water has maintained healthy profits, and has been able to pay over $6 billion in dividends to NSW Treasury over 14 years.

The management of the contributions framework, levying the charge through the e-Developer system by Water Servicing Coordinators, and monetary collections and distribution is a resource-intensive process. Sydney Water was resource constrained during the previous DSP regime and it is not clear that the resourcing position has improved since.

Sydney Water further stated in its 2007 Submission to IPART: Review of Developer Charges that *"to the extent that developer charges are passed on to the owners of new dwellings, higher charges… increase the disparity between the existing owners (who pay uniform prices for water and wastewater) and new dwelling owners that pay both the water and wastewater prices and the developer charges."* It calculated that in the absence of DSP charges the annual prices for water and wastewater to Sydney Water customers would increase by around two per cent. Subsequently Sydney Water, being "neutral to the form of cost recovery applied to new developments" replaced the DSP charge with a broad-based customer charge to equitably fund population growth infrastructure and improve the quality of the revenue stream.

The DSP framework in 2008 had become an ineffective funding mechanism for Sydney Water growth infrastructure. DSP charges were uncertain (dependent upon housing completions), untimely (collected after the infrastructure was needed), inefficient (low return on administrative effort), and counter-productive (reduced dwelling supply). Many of these issues remain today and proliferate due to development costs and new magnitudes of unaffordability.

Sydney Water revenue certainty and resource efficiency are more important today than in 2008 and the proposed reintroduction of DSP charges through a non-integrative reform package will manifest as a retrograde policy that overlooks the lessons of the previous regime.

UDIA recommends:

Defer the reintroduction of DSPs and keep developer charges set to zero until such time as the full suite of infrastructure contributions reforms is implemented by the NSW Government and productivity gains to offset new costs are proven.

No Sign of Service Delivery Improvement

The PC Final Report 2020 premised the reintroduction of DSPs on the desire to create a price signal. The Review states: *"Zero developer charges introduce a range of distortions into development decision-making: industry does not receive a price signal about where and when to develop to ensure best use of existing water and wastewater assets" (PC Final Report 2020, pg.101).*

UDIA accepts that there can be benefits from price signalling, and in an ideal scenario this creates a prioritisation framework for the delivery of infrastructure based on need and timeliness. However, according to Sydney Water, DSPs will be payable by all developments that require a Section 73 Certificate and must be paid before the Certificate can be issued. Sydney Water outlines a number of development types that require Section 73's to be paid, and all of these will now be subject to DSPs.

Some Section 73 Certificates are not required until 2 to 4 years following development approval. This could create outcomes where shovel-ready projects are asked to pay the DSP charge, which risks the feasibility of projects already in development. This is a critical flaw in Sydney Water's just-in-time approach to delivery and the governance model they work under. It is this stagnated model that continues to be an impediment on new supply and will worsen affordability, and it is therefore disingenuous to pin this on the zero developer charges, as Sydney Water has done – *"The zero-charge policy has reduced the affordability of our services for all customers."*[1]

For efficient price signalling to occur, the developer charge must be factored into the feasibility analysis of the development project. This is most fairly and efficiently accomplished during negotiation of the land purchase price, i.e., the charge should be known prior to land acquisition.

According to the PC Final Report (2020, pg.103), *"Further, a temporary exemption would be appropriate to ensure that developments underway are not unduly affected by the change."* UDIA notes that the DSP developer charge was not known prior to the exhibition by Sydney Water on 28 April 2023. The PC Final Report also recommended that "*the land is developed within a reasonable timeframe*."

UDIA believes a reasonable timeframe would align with the regular DA validity period of 5 years, noting that it is common in NSW that the entire process from approval to lot registration, including enabling infrastructure delivery, can take as long as this period. This PC Final Report recommendation does not appear in Sydney Water's public exhibition, and we contend that these exemptions should be a minimum commitment from Sydney Water.

UDIA recommends:

1. ***Consistent with the Productivity Commission's Review, honour a temporary exemption from DSP developer charges for projects that have purchased land before 1 July 2023, with a commitment to complete and register the first stage of a project before 1 July 2028.***

[1] Sydney Water's *How we apply IPART's pricing method,* April 2023 (page 4).

The Cumulative Impact of Taxes, Levies, and Contributions

The phased reintroduction of DSP charges over a period of time, allowing some room for industry adjustment, is critical. However, having regard to current development conditions and the economic environment, as well as for the cumulative impact of piecemeal contributions reform, this timeframe should be extended beyond the proposed 3 years.

UDIA remains supportive of comprehensive contributions reform to create a simpler, more transparent and more equitable system in NSW, where productivity gains can offset costs. However, industry is currently being asked to accept multiple new and increased contributions, each resulting in increased costs and with no regard to the cumulative impact on development feasibility.

Concurrently and during worsening economic conditions, industry is facing the reintroduction of DSPs, the Housing and Productivity Contributions Bill (H&PC) charges, changes to the National Construction Code, through increased BASIX requirements and increased local infrastructure contributions. The cumulative impact of these multiple additional changes will destroy development feasibilities, which are already precariously low, and exacerbate the existing housing supply crisis. Figure 3 highlights this for the cost of new apartments and greenfield lots in NSW, which are especially significant in context of our conservative average assumptions of current local contributions.

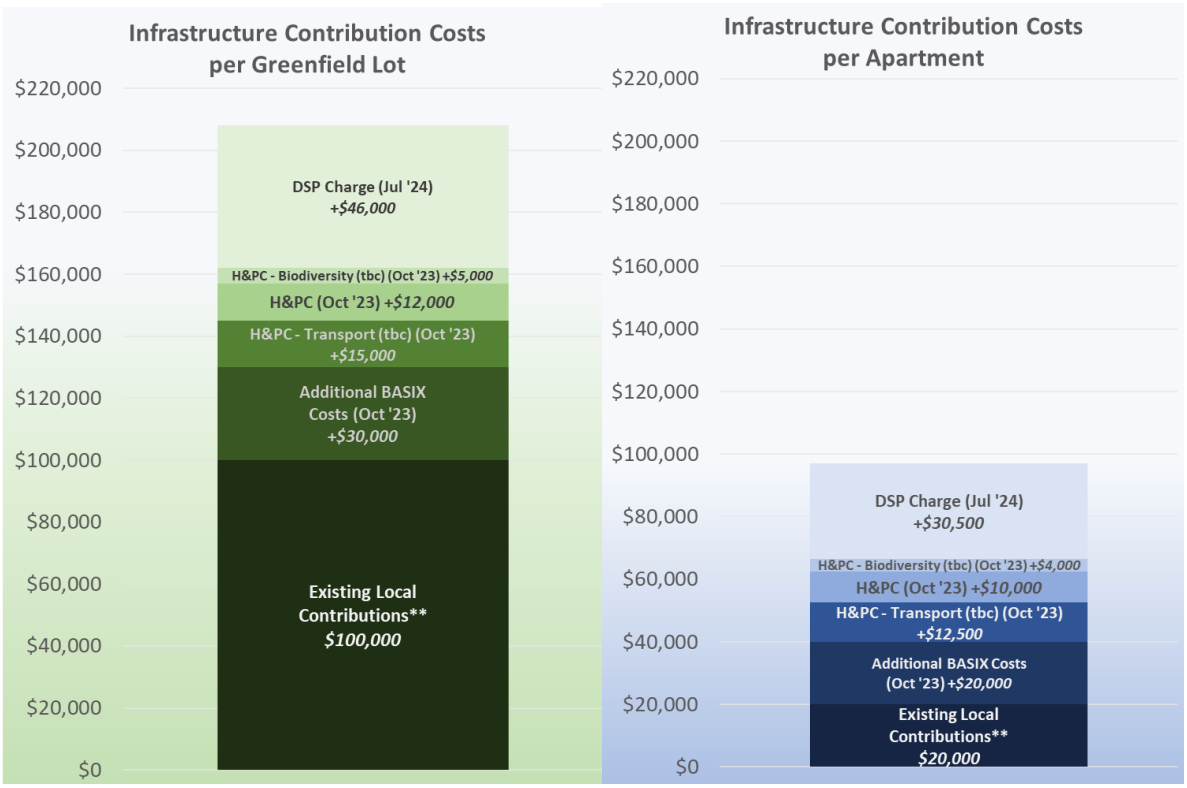


Figure 3: Cumulative Impact of Existing and Proposed Contributions in NSW, by Typology.
Source: UDIA NSW, Homeworld, Rider Levett Bucknall.
NOTES: The modelling on DSPs are based on the highest DSP charges proposed. The additional BASIX costs are based on updated modelling by Homeworld. The H&PC transport and biodiversity charges are assumptions.
**conservative baseline assumption of local contributions based on feedback from industry

The cumulative impact of these reforms has the potential to add up to $110,000 to the total development cost, and hence end price of a house, and nearly $80,000 to an apartment. DSPs, based on the highest charges proposed in both typologies, are the main contributor to this increase. In the specific case of apartments, the total Greater Macarthur DSPs could be in the order of 150% of our estimate for current local contributions, creating a significant impact on density in Western Sydney (noted in further sections).

Figure 4 further compares the breadth of development taxes, contributions and levies for new apartments across the eastern seaboard Australian states. NSW is a clear outlier when considering these as a proportion of total development costs.

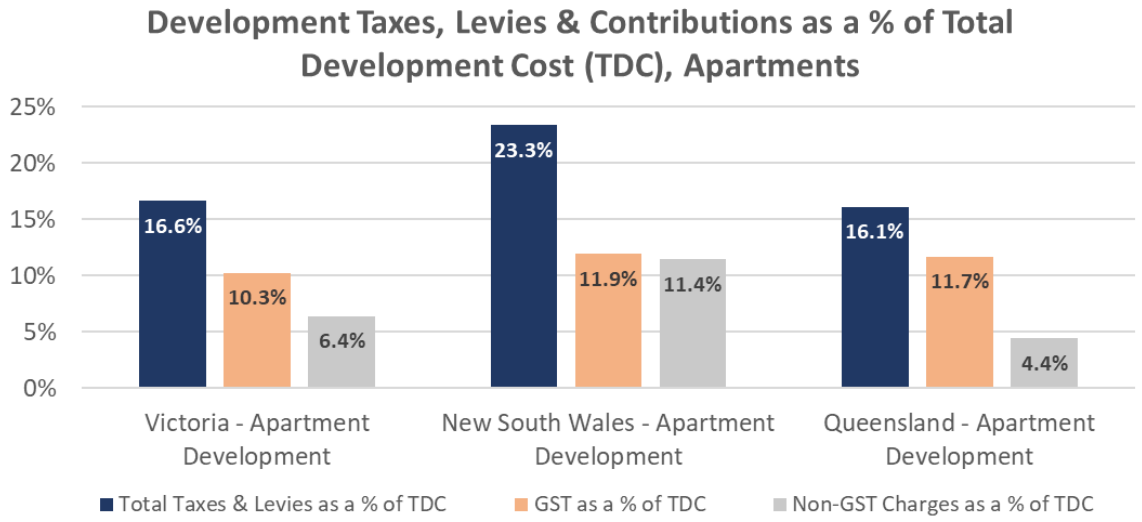


Figure 4: Development Taxes, Levies and Contributions by State
Source: UDIA NSW Member Case Study

When excluding GST from these calculations (which accounts for between 10-12% across all three states), the proportional magnitude of NSW's charges becomes even more clear, at almost double Victoria's and closer to triple Queensland's charges.

The above analysis indicates that developers in NSW are already subject to the highest taxes, levies and contributions in Australia. If DSPs are introduced under the current economic conditions, they will simply materialise as yet another increased tax, and hence a barrier for first homebuyers, excluding them from the already premium Sydney and Illawarra housing markets.

Many developers, who will have no option but to pay the DSP to progress their projects, will see feasibilities markedly impacted, and restrict their financing capabilities in an already tight lending environment. Developers in NSW are battling to meet the targeted 15-20% risk return profit margin to access development financing. This risky environment is shelving a historically high number of projects, with the more affordable end of the housing market being the least able to manage this erosion. This is reflective in unprecedented rates of builder insolvency amidst a high interest rate environment, and building costs rising by more than 30% over the last 3 years.

To soften this impact, we recommend a longer phase in of the charges.

UDIA recommends:

2. ***Sydney Water must delay the reintroduction of DSPs, to allow both development feasibilities and the market adequate time to adjust and prepare for them.***
   This proposed transition would provide for a more appropriate adjustment period; 20% from July 2024, 40% from July 2025, 60% from July 2026, 80% from July 2027, with full charges applying from July 2028.

Significant Departures from the PC Final Report 2020

The approach to infrastructure contributions reform has been premised on a principle-based system that is *"accessible, more consistent, and simple to administer"* (PC Final Report, 2020, pg.6). The framework proposed under the DSP public exhibition is a departure from these principles and will result in increased inequity of housing across geographic boundaries, and a distortion in the proportional impact on prices. Existing developed areas will continue to benefit from a lower charge, while growing regions will be increasingly sensitive to the larger charges (Figure 5).

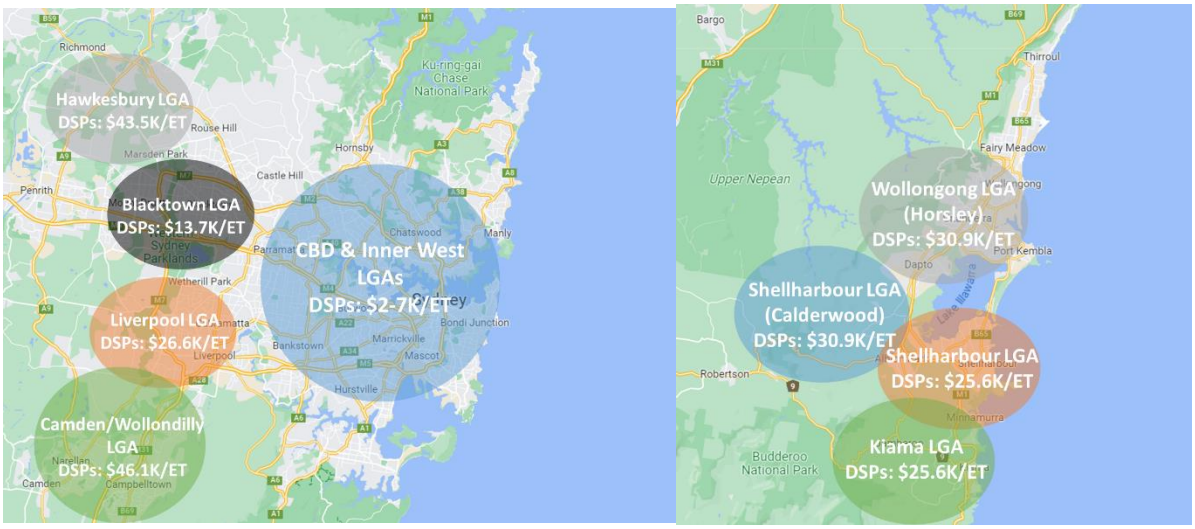


Figure 5: Maps of Proposed Sydney Water DSPs per ET by LGA (selected regions).
Source: UDIA NSW

Unlike the pre-2009 DSP charges, which reflected wide geographic variability and equally disparate DSP charges, ranging up to $100k in areas with almost no development, the highest charges proposed in 2023 are in well identified and prospective growth regions in the north and south west of Sydney. Deterring development from these regions through unwieldy charges is a catastrophic misidentification of the future growth potential of the Sydney megaregion.

To quote the Productivity Commission:

"Sydney Water's early estimates suggest that development in established areas would attract small connection charges of $1,500-3,500 per equivalent tenement, which would translate to approximately $1,000-$2,500 for apartments. Greenfield development would attract charges of $5,000-$12,000 per equivalent tenement, depending on the growth area."
(PC Final Report, 2020, pg.102)

Development takes a considerable length of time from concept through planning, acquisition, approvals and to delivery, hence certainty throughout the process is essential to ensuring realised outcomes. DSPs were projected to be no more than $12k in Sydney, and yet the proposed charges in some places (Camden and Wollondilly) exceed $46k per equivalent tenement (ET). In most of the Illawarra-Shoalhaven, charges exceed $25k per ET. The exhibited charges markedly exceed those estimated by the Productivity Commission and will severely impact on development feasibility (again refer to Annexure A).

UDIA contends that it is more reasonable to cap charges so as to not exceed the estimates in the PC Final Report in order to limit uncertainty and become workable for development in collaboration with a longer transition (as recommended). In the Illawarra-Shoalhaven, where disappointingly no charge was proposed, we suggest aligning with the next best benchmark, which are those charges proposed for the Lower Hunter & Greater Newcastle.

UDIA recommends:

3. ***Sydney Water significantly winds back all charges, and caps the maximum total charge (water and wastewater) at $12,000 per Equivalent Tenement (ET), aligning with the recommendation of the Productivity Commission. Further, without a priced range provided for the Illawarra-Shoalhaven in the PC Final Report, we recommend considering the proposed Lower Hunter charges as the best benchmark, and cap charges at $8,500 for this region.***

A More Consistent Funding Stream

UDIA appreciates the sentiment of Sydney Water attempting to rebalance costs away from their general rates through the imposition of DSPs, lessening the burden on households. We acknowledge that the crisis facing residential and employment lands development is not the only societal issue that Government must deal with, as many homeowners attempt to weather recent consecutive cash rate hikes in the order of 400 basis points over a 14-month period.

Sydney Water stated in its notice to market for the DSP exhibition, of a $200 a year charge that individual consumer bills could additionally incur under zero developer charges. We contend that DSPs will in fact not induce the intended reprieve to overall cost of living pressures, especially when comparing costs in the short and long term.

For example, the long term (30-year) cost to homeowners of bills being inflated by $200 a year would be $6,000. However, to maintain a base development profit, the impact of DSPs alone (taking the Nepean proposed DSP of $26,000 as an example) would increase the cost of a typical project home and land package by around $35,000. This is but one element of the broader reforms currently being introduced, and hence the cumulative impact on homes could easily be in the magnitude of $100,000 (recall Figure 3), significantly more than $6,000.

The proposed approach threatens to increase inequity, despite proclaiming to do the opposite. Under an impactor-pays-only DSP model, Sydney Water's revenue stream is entirely contingent on development proceeding. As our feasibility analyses in Annexure A show, profit margins are expected to be significantly impacted under the cumulative impact of new and existing developer contributions, such that development will meet a stalemate and likely not proceed. If this reality transpires, Sydney Water will not receive any certain or consistent revenue stream.

A more equitable process should consider all the above i.e., keeping new development feasible, not placing untold pressure of households, and maintaining a consistent revenue steam for Sydney Water to continue its operations. The fairest approach, should Sydney Water understandably not wish to significantly increase water rates, is to spread the base between impactor and end user. This would serve to bring rates back to an alignment with the PC Final Report recommendations.

UDIA recommends:

4. ***Sydney Water to reconsider spreading future operating, maintenance, and administration costs between developers and Sydney Water general rates.***

Sydney Water's use of IPART's Methodology

UDIA is not convinced, from the publicly exhibited documents, that Sydney Water is using the most efficient and cost-effective operating expenditure model based on IPART's methodology. Our Taskforce has identified significant gaps that will require greater transparency. This is particularly significant when we again consider how Sydney Water ended with such a discrepancy between the charges proposed in the PC Final Report (at no more than $12k per ET) and the now exhibited charges (reaching as high as $46k per ET).

One simple deduction is that the methodology and formulas exist to calculate the maximum price chargeable to developers by Sydney Water. There is both capability and discretion for proposed charges to be set at a price less than this upper limit, without Sydney Water contravening their Operating Licence.

This detail is misconstrued in the application of IPART's methodology, which simply elects for the maximum charge possible. Adhering to the methodology does not imply or recommend that these maximum prices should be final, which is especially true given that many factors of the calculation are dependent on Sydney Water inputting reliable and contemporary variables, that are also unregulated by IPART. UDIA takes this opportunity to highlight where some of these discrepancies may exist, or where more details are required.

For example, UDIA suggests that Sydney Water reconsider, and make transparent, the dwelling capacity in the DSP charge areas. **We are sceptical that Sydney Water is not accurately accounting for common situations where realised supply will exceed planned yield and we call on Sydney Water to be transparent with the detailed modelling assumptions.** This was proved true in one of Australia's fastest growing local government areas - Blacktown identified through their 2020 Local Housing Strategy *"The growing shortfall in infrastructure in the North West Growth Area is a funding and planning challenge which must be addressed."*[2] The proliferation of this shortfall can be accounted for by improper planning for unexpected growth. Blacktown Council reports that actual development exceeded planned yields by 32,000 dwellings, with population also exceeding original plans by over 102,000 people. This is a trend consistent in many growing Councils areas across the Sydney Megaregion and speaks to the issue of using minimum expected yields when planning.

[2] Blacktown Housing Strategy 2020 (pages 57-58)

The cost of getting these assumptions consistently wrong is untold pressure on social and public infrastructure and it is costly to redress in the future through retrofitting augmented infrastructure. This is also comparatively small against the incremental cost increase in catering for a larger dwelling base initially, which causes a likely overcharging. We would therefore welcome the chance to convene with Sydney Water consistently to help them understand the true future development pipeline. UDIA is well progressed on a digital tool which will map the Development Ready Pipeline and identify enabling infrastructure constraints that would enable improved prioritisation, transparency and certainty. We would embrace the opportunity to discuss this project further with Sydney Water.

Similarly, we express some concerns in the spreading of Sydney Water's infrastructure costs over a defined revenue collating period. DSPs for every type of development would be better operated under the presumption that individual developments will contribute to their proportional contribution over the entire development of the area, and income will hence be generated over the undisclosed life cycle of the asset. Adding restrictions on time is an unnecessary caveat and is tantamount to poor modelling.

Contingency and Transparency

UDIA questions how Sydney Water has applied contingency within the DSP charge calculation. Inferring a baseline assumption for a "P50" costing, contingency would typically comprise around 30% of the cost. Industry is worried that this provision for contingency, which relates to a program of works rather than just single projects, is excessive. However, we are referring to these as baseline assumptions as contingency is not a documented line item in the publicly exhibited calculations. **UDIA therefore requests, for transparency, that the contingency rate is listed as its own line item in the cost calculations. Further, a framework should be put on exhibition for how the contingency is managed throughout the process as design and construction occurs.**

Impact on Housing Diversity

UDIA also expresses concern about the ramifications that DSP charges will have on housing diversity, particularly in those locations that are best positioned to quickly respond to the current housing shortage and affordability crisis. Our concern stems from unfounded claims regarding the use of ETs for non-standard residential dwellings.

UDIA is aware that the use of ETs is not based on case-by-case occupancy rates, and instead uses blanket assumptions for a standard low-density dwelling. Development feasibilities are hence being based on assumptions of what 1 ET represents, leaving developers increasingly uncertain of their future overall costs.

The DSPs non-definitively consider that up to 80% of an ET charge for wastewater could apply to an apartment. UDIA disagrees with the assumption that an apartment places up to 80% of the water and wastewater demand of a standard detached dwelling. According to Australian Bureau of Statistics 2021 Census data, the average detached household across NSW is home to 2.5 people (although in locations like Camden and Liverpool this is closer to 3.5). Most detached households are 4-people homes. This is compared to medium density (1.8 people per dwelling) and apartments (1.7 people per dwelling), which are both mainly dominated by 2 people dwellings and reflect less of a range across geographic location. By consistency, this equates to demand more in the order of 50-68% of a standard low-density dwelling. Refer to Annexure A –

Feasibility Example #2 to see details behind how a remodelled DSP based on true occupancy rates could significantly reduce the impact on development feasibility.

In the Western Parkland City over the last 10 years, multi-unit dwellings have comprised, at different points, between 15% and 45% of total new completions, with the peak sustained between 2018-2020. Recently, this has dropped closer to 20% of all new supply, which is aligned with NSW-wide trends of a weakening apartment market. The reintroduction of DSPs and disproportion cost for apartments will severely threaten the future viability of diverse and dense housing opportunities within these regions. UDIA contends that Sydney Water reconsiders how ETs are calculated for medium and high-density developments to avoid perverse outcomes on housing diversity. Looking at true and localised occupancy rates, for example, can help extrapolate a more realistic and grounded model.

Non-Residential Development

Sydney Water has proposed that DSPs for employment land developments will be calculated based explicitly on estimated demand loads, with no obvious correlation to the ET methodology. This is due to the heavy residential focus of the DSPs. Attempting to quantify the expected DSP impact on employment lands is threatening to create further uncertainty in this already undersupplied and tight employment land market, especially as worked estimates are revealing charges in excess of $1.3 million per hectare for stormwater DSPs, which will bring industrial development to a standstill. Sydney Water must consider further options for dealing with this market.

One potential solution, for example, could be the adoption of a DSP calculation for employment lands that utilises ‘smart meters’ to provide actual water usage. Under this method, a bond could be provided at Section 73 to the developer, to ensure the Section 73 certificate can be issued, with then a subsequent ‘true-up’ of the potable water meter completed 12 months after Occupation Certificate to determine actual impact on demand, and hence the appropriate charge. Not only would using a potable water meter create a more accurate and evidence-based ‘ground truthing’ for charging employment lands for water and sewer infrastructure, but it also becomes a less intensive process for Sydney Water. As mentioned above, it also avoids the difficult task of retrofitting standardised methods to quite differentiated employment land typologies.

UDIA enquires as to whether these non-residential development types have been appropriately considered in Sydney Water’s DSP charge calculations, and we urge Sydney Water to consider how this might help reduce the charge. We request more information on how these DSPs apply to the diverse non-residential development market.

There are further issues that UDIA members have identified with the application of IPART’s Methodology. These include the use of Modern Engineering Equivalent Replacement Asset (MEERA) values, retrospective discounting, and the many instances of double dipping, including in charging for infrastructure assets dating back to the 1970’s that would have been covered by previous DSP iterations, as well as for infrastructure delivered between 2009 and 2023 when DSPs were not applied but the infrastructure was provisioned and funded. We appreciate the difficulty in working to create an equitable model across geographies and typologies, but there are clear concerns that Sydney Water must review and reexhibit. Addressing the above concerns could feasibly provide a path for Sydney Water to reduce the charge per ET in line with the recommendations of the PC Final Report.

UDIA recommends:

5. ***Sydney Water interrogates its application of the IPART methodology in its calculations to address key flaws that, if resolved, could result in a lower and more reasonable DSP charge per Equivalent Tenement (ET) for residential development, and provide for a more accurate and transparent estimate for employment lands.***

Unintended Impacts across Government Departments

It is clear from UDIA's analysis that the reintroduction of DSPs will significantly impact the viability of housing, and therefore be counterproductive to Government objectives and priorities. The DSP charges will further affect the commercial viability of all forms of residential and industrial developments, including housing for the most vulnerable in our state, such as aged care facilities and social and affordable housing.

UDIA NSW is also concerned that unintended consequences arise from the DSP policy and will have impacts on planning and growth in NSW across multiple sectors including manufacturing, tourism, health and transport. These unintended consequences may cut across the planning objectives and strategies of the NSW Department of Planning & Environment, Transport for NSW, and local councils. The goals of other NSW Departments in health, education, tourism, trade, employment and social services may also be adversely affected, with impacts compounding to reduce investment in NSW, shrink Treasury receipts, and place upward pressure on inflation.

The reintroduction of DSPs must be embedded in a broader discussion of Government initiatives around productivity gains, or else there will be significant unintended consequences to the commercial viability of key precincts. Industry has not been given any evidence the proposed DSP charges will deliver any productivity gains, and as noted, this could proliferate across Government departments. In many cases, water services are available much later than when industry is ready to deliver development, increasing development costs again and delaying housing supply.

To avoid further adverse impacts on the ability to deliver other types of enabling infrastructure, and subsequent competition between priorities, the Government should exhibit an 'Infrastructure Delivery Guarantee (IDG)' to identify critical enabling infrastructure providing increased certainty on priorities and timeframes. Further, the Government should commit to our high level comments that productivity gains must be the only reason for introducing new costs in a housing crisis.

UDIA recommends:

6. ***The NSW Government should exhibit an 'Infrastructure Delivery Guarantee (IDG)' to identify critical enabling infrastructure to allow for development, and timeframes for when it would be delivered.***

7. ***The NSW Government must resolve servicing delays and governance models to ensure that water and sewer services are available 2 years after rezoning, as recommended in UDIA's NextGen West Manifesto – Feb 2023 (attached).***

The Future of Water Infrastructure

Recycled Water & Mamre Road

UDIA notes that NSW and Sydney Water are progressively gearing towards recycled water solutions. The PC Final Report predicts as such, with the DSP reintroduction proposed to begin the rebalance away from traditional water services to a recycled program. This presents preferrable outcomes for the environment and for future climate mitigation, and UDIA supports this circular principle, however not the potential DSP charging regime. These charges are not yet revealed to industry.

Currently, the expenditure required to implement recycled water on a property is significant and typically only delivered out of a centralised base. This does not allow more decentralised locations, such as those growth areas subject to the highest proposed DSP charges, to reap its benefits in a cost-effective manner. The processes required for the private sector to retrofit these in hindsight poses a cost so significant that it will almost always end up cheaper to revert to traditional water and wastewater processes. Therefore, the inadvertent impact of a shift towards recycled water will be a significant increase in inequity across the Greater Sydney basin and a burden on development.

The current proposed strategic approach in Mamre Road, for example, is unviable as it has been introduced retrospectively. If introduced prior to rezoning the costs could have been reduced and accounted for in development feasibilities.

Should Sydney Water consider its long-term intentions for recycled water, UDIA encourages it to consider if this could induce a double dip between water/wastewater DSPs and recycled water DSPs. To alleviate this, Sydney Water could consider implementing a reduction in standard ETs and in potable water demands for employment lands if we can assume that non-potable water requirements will be met by a future recycled water network.

Works-in-Kind: An Alternative Policy Solution

UDIA acknowledges that there are mechanisms where taxes and contributions significantly benefit industry and support the timely and equitable provision of infrastructure and well-located development. We remain supportive of Works-in-Kind agreements which enable the private sector to deliver enabling infrastructure for their own projects, ensuring housing is delivered systematically.

The exhibition fails to state whether DSPs will be supported by a Works-in-Kind credits framework. UDIA has long maintained that a Works-in-Kind framework sitting above a contribution obligation can be a key driver for integrated infrastructure delivery and housing supply. Providing these opportunities will improve the comprehensiveness of the DSP regime.

UDIA has been impressed with Works-in-Kind policies applied by Hunter Water and has received very positive feedback from our members operating in this region on the *Funding and Delivery of Growth Infrastructure Standard* policy, since its introduction in 2016. The policy allows developers to deliver, connect, augment and fund enabling infrastructure assets and be fully reimbursed upon handing the asset to Hunter Water for management. This has allowed Hunter Water to evolve into a highly productive service provider.

UDIA has done extensive work on Works-in-Kind and has attached our detailed policy paper in Annexure B for your benefit.

UDIA recommends:

8. ***A detailed Works-In-Kind policy be provided to improve the strategic and timely delivery of infrastructure by developers.***

Conclusion

UDIA NSW and Sydney Water have maintained a long and constructive relationship. We acknowledge that Sydney Water, as a State-Owned Corporation, must operate as efficiently as any comparable business and maximise the NSW Government's net investment. We also appreciate that you are responding to the mandate given by the previous Government's Treasurer.

We maintain that our primary position is to defer the reintroduction of DSPs, due to the current economic conditions and housing supply and affordability crisis, and we provide recommendations to progress only where this position is not supported.

UDIA remains supportive of comprehensive contributions reform to create a simpler, more transparent and more equitable system in NSW, where productivity gains can offset costs. However, industry is currently being asked to accept multiple new and increased costs, without evidence they will deliver any productivity gains, and without regard to the cumulative impact on development feasibility. These added costs will stall housing supply and damage affordability, making the housing crisis worse and creating lasting negative social and economic outcomes for our state.

UDIA commits to continue working with Sydney Water towards solutions that will create improved infrastructure coordination, funding, and delivery, and to ensure growth infrastructure is equitably funded and delivered in line with development, having regard to development feasibility.

For further information on this submission or to arrange a meeting with UDIA please contact Michael Murrell, Director Policy and Research on 0413221195 or mmurrell@udiansw.com.au.

Kind Regards,

Steve Mann
Chief Executive Officer
UDIA NSW

cc: **The Hon. Daniel Mookhey,** NSW Treasurer
The Hon. Rose Jackson, Minister for Water, Housing, Homelessness, Mental Health, Youth, and the North Coast

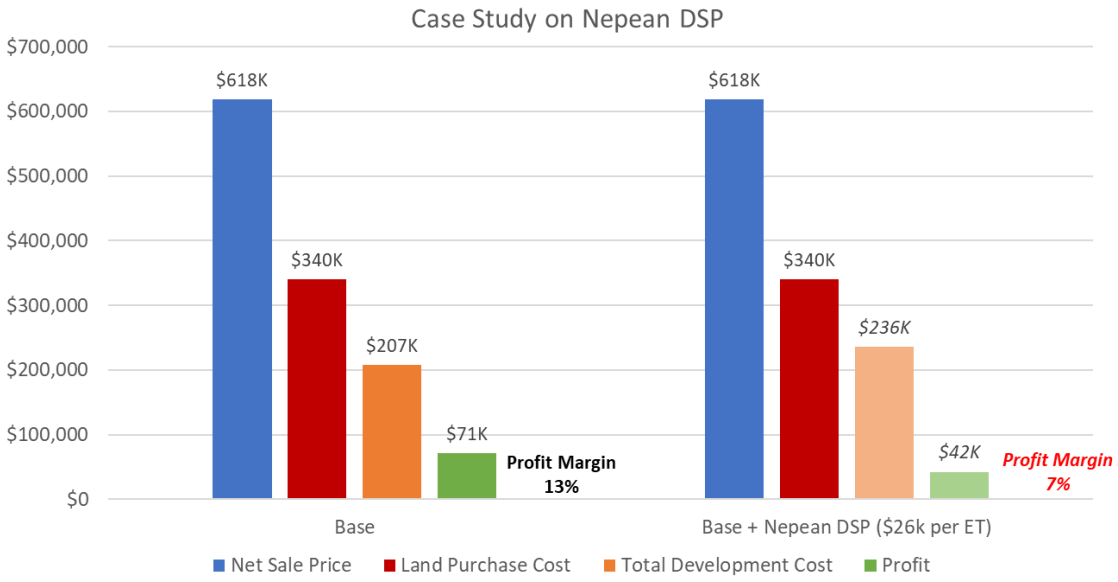
ANNEXURE A

FEASIBILITY CASE STUDIES

The following feasibilities have been prepared by members in support of UDIA's submission and demonstrate the impact of the reintroduction of DSPs on the viability of housing. Their analyses depict a concerning future for new housing.

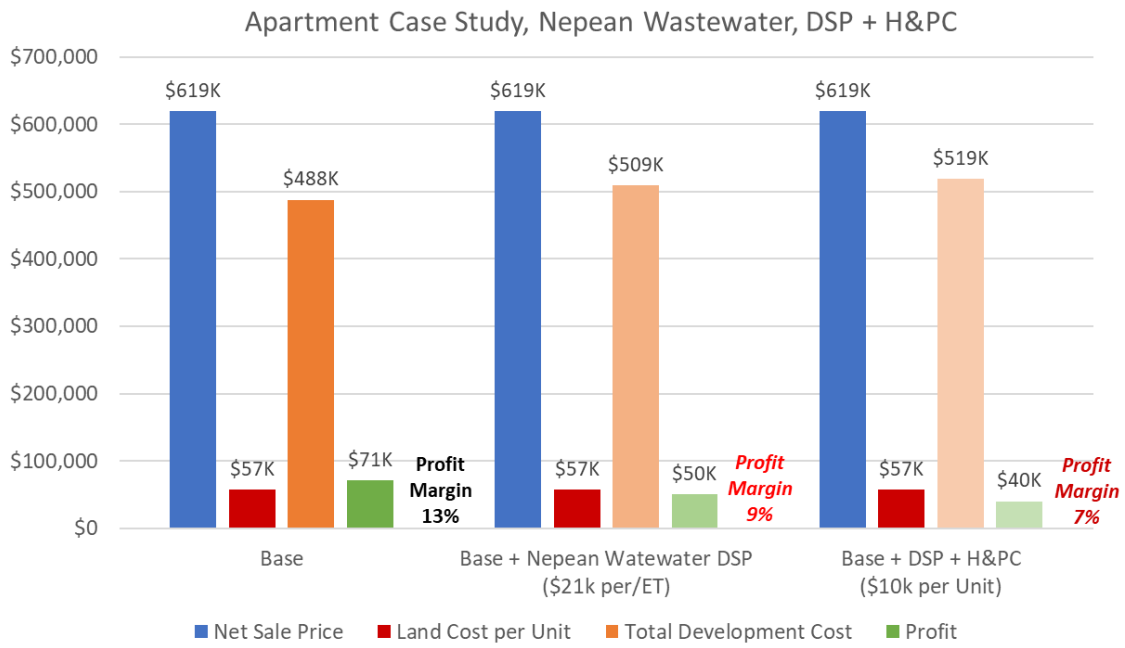
These feasibilities reflect the most likely situation where projects, to remain feasible, will only proceed on the basis that the proposed Sydney Water developer charges get passed on to an end purchaser, further impacting housing affordability.

Feasibility Example #1 – Standard Western Sydney Lots



Feasibility Example #1 depicts a 43% decline in profit margin that would be required to maintain the same net sale price for a project subject to the total Nepean DSP (proposed at $26k per ET). Compared to the base rate, DSPs make this project significantly less viable. The developer also ran outcomes for the DSP at the upper PC Final Report limit ($12k) and the lower limit ($5k), which found the eroding of profits pared back to 19% and 8% respectively. If the developer aimed to maintain profit margins, the lower limit proposed by the PC Final Report would see the impact on home prices 81% lower than that of the proposed $26k DSP per ET.

Feasibility Example #2 – Apartments

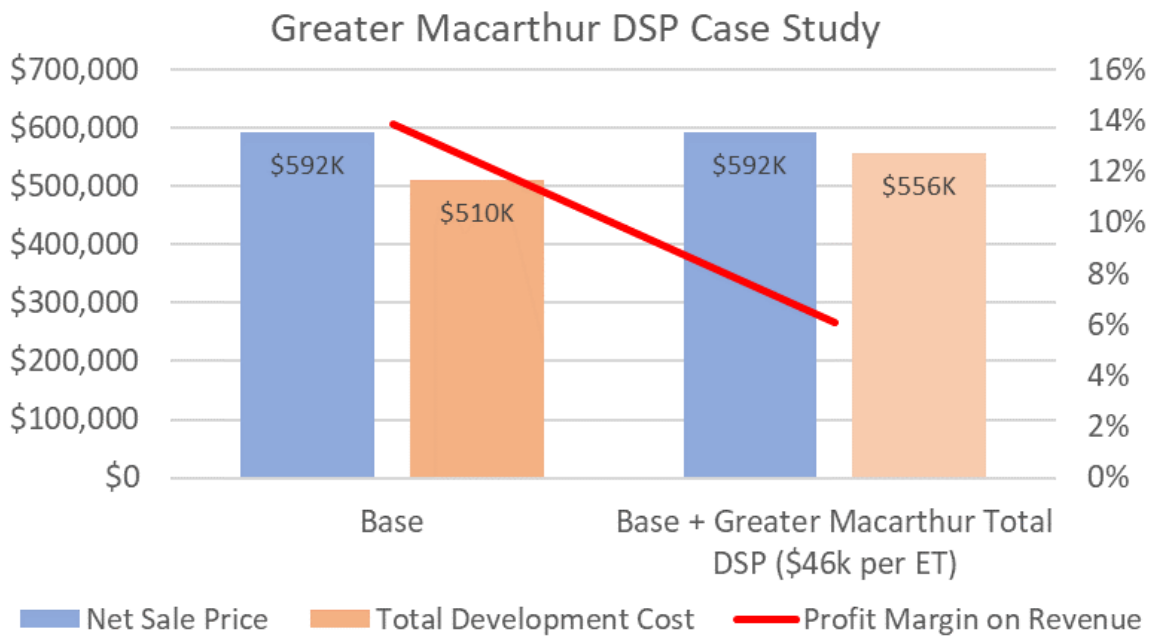


Feasibility Example #2 depicts a 32% decline in the profit margin to maintain a net sale price for an apartment subject to the Nepean DSP wastewater charge, proposed at $21k per ET. Going one step further, and considering this base case is an already financially tight project, the feasibility also indicates how the Housing & Productivity Contributions Bill, introduced at $10,000 per apartment, will impact profit margins. The overall impact of DSPs and the H&PC will be a 47% decline in the profit margin, down to around 7%.

As previously highlighted, Sydney Water's current proposition is for one detached house to account for 1 ET. The development used for Feasibility #2 has also modelled an alternative for apartments which reflects our previous concern that the assumption of 0.8 * 1 ET for an apartment was flawed.

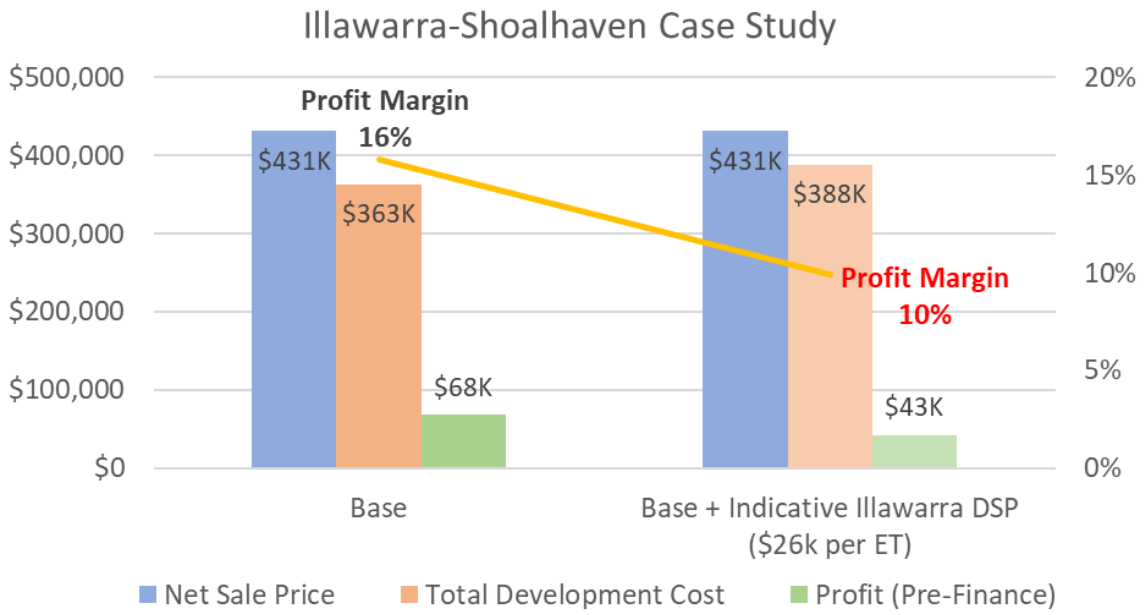
The feasibility was remodeled under an assumption that DSPs were reduced to a standard $10,000 per ET. Using evidenced data of occupancy rates for a similar apartment project, the developer found that the weighted average DSP could be as low as $4,800 per apartment. Under this model, and jointly considering a H&PC model that adopts the same methodology based on occupancy rates (instead of 'per unit'), profit margins only dropped to 11%. Significant improvements could be achieved if the ET for medium and high density was based on bedroom sizes or real occupancy rates.

Feasibility Example #3 – Greater Macarthur



Greater Macarthur has the highest proposed DSP charges in the Sydney Water basin - Example #3 shows a standard Greater Macarthur project. At the proposed rate, DSPs will add 9% to the base total development cost and erode profit margins by **7.8 percentage points** (to around 6%). This has a substantial impact on the commercial viability of the project and is significantly lower than the developer's targets, failing financing hurdles.

Feasibility Example #4 – Illawarra-Shoalhaven



The impact on regional markets is as pronounced as that being observed in the Sydney market, with commercial viability expected to fall significantly under the weight of comparatively large DSPs in the magnitude of $25-30k per ET across the Illawarra-Shoalhaven. Feasibility Example #4 demonstrates this exact reality, with a 6-percentage point depletion in profit margin expected. Despite cheaper land prices in the Illawarra, the depth of the DSP impact is synonymous with the more premium Sydney market. It is also noted that these DSP charges are well in excess of the Hunter Water proposals.

ANNEXURE B

UDIA NSW Infrastructure Contributions Taskforce

Works in Kind Agreements & Tradeable Credits

Background

UDIA NSW believes that Works-in-Kind Agreements (WiK) are crucial for an efficient planning system for Local and Regional State infrastructure and the principals for our previous submissions were drawn from the 2013 White Paper, including beneficiary pays, avoidable cost and contestability should guide the direction of the current reform process.

We also believe there is significant precedent over a long period supporting a beneficiary pays infrastructure contributions model and where a developer has to step-in as the impactor and deliver WiK which is over and above the benefits for a development, we believe the Final Productivity Commission Review supports tradeable WiK Credits across all the stakeholders, if a simple system can be developed!

UDIA NSW gave the following feedback in our submission in August 2020 to the questions in the Review of Infrastructure Contributions – Issues Paper by the NSW Productivity Commission (The content below has been expanded upon since our original submission).

Issue 4.11: Works-in-kind agreements and special infrastructure contributions

Develop a tradeable credit scheme underpinned by the ability to 'cash-in' credits

Should developers be able to provide works-in-kind, or land, in lieu of infrastructure contributions?

Works-in-kind and land dedication provides a guarantee of delivery of infrastructure directly related to the development. It may also present opportunities for a developer to forward fund and accelerate the delivery of a particular item of infrastructure in advance of Government's procedural business planning and budgetary activities. This has added public interest benefits and may achieve broader social, economic and other objectives. Therefore, UDIA strongly supports works-in-kind arrangements and believe they should be strongly encouraged.

These arrangements can be more challenging when sites are in fragmented ownership. In those instances there may need to be either, tradeable credits or another mechanism to encourage works-in-kind, particularly where the size of works may be greater for an individual scheme and their attributable contributions.

Developers may accrue works-in-kind credits that exceed their monetary contribution. Should works-in-kind credits be tradeable? What would be pros and cons of credits trading scheme?

Recognition of SIC offset credits and credits for excess value of WiK by a proponent (i.e. ***"Infrastructure Credits")*** has already happened in a number of projects and this now needs a policy framework.

There are two components of this, established by two types of developers:

1. Developers of larger projects that may have the capacity and the immediate need or opportunity to deliver infrastructure items;
2. Developers of smaller projects that may, by virtue of the capitalisation of the company, the scale of the project or the lack of opportunities to deliver infrastructure, have no choice but to make the contribution as a cash payment.

The use of tradable infrastructure credits can bring these two component parties together for Government in the form of:

- willing and able forward funders and builders of infrastructure (the large project developer); and
- willing and able financiers of infrastructure (the smaller project developer).

To achieve this scenario Infrastructure Credits must be tradeable. This has four purposes:

1. To maintain certainty for developers, and equity (parity) and fairness between development projects and / or Infrastructure Precincts;
2. To prevent developers from ending up with an unrealisable and unviable 'excess of credits' once they complete a works-in-kind project;
3. As an additional benefit, it may incentivise a developer to forward fund certain infrastructure items if there is a strategic or marketing benefit for the developer to do so; and
4. To incentivise smaller fragmented landowners to enter private collective agreements to fund works in kind, secure in the confidence they can distribute credits proportionally and fairly for the works funded.

However, to create a market for credits they must be able to be 'cashed-in' and purchased by a Government Authority or a third-party purchaser to ensure that their value is realised and there is confidence in the credit market.

UDIA suggests a centralised government register for infrastructure credits is developed and operating rules are determined to ensure credits are purchased and extinguished at the next available opportunity in all appropriate circumstances. The book and final sale value of the credit should be managed to ensure that the Infrastructure Credits do not become monetised. This may require the individual value of each credit to be capped at its original price plus CPI (or some other mechanism) in order to avoid price escalation in an elastic market, and erosion of value of contributions to Government as a result.

A centralised Credit Register of Infrastructure Credits would provide confidence (certainty) for the developer that the additional investment in WiK could be realised. However, to be effective we envisage that it would require four additional characteristics:

1. Immediately that cash contributions are collected in an infrastructure plan it should be used to purchase and retire any credits that may be on the register (with a proviso that the oldest credits are given priority);
2. Similarly, any private purchase of credits would prioritise the oldest credits in the system;
3. Credits are able to be traded directly between parties; and
4. A sunset date be included in the process that would require credits of a certain age to be purchased by Government. On first reading this may appear to be an onerous obligation to be placed upon Government, however:
    - It is necessary in order to give confidence to the development industry that its investment in infrastructure will be recouped within a reasonable period of time (and not remain as an unrealisable accounting asset); and
    - Importantly for Government it would not need to be treated as an onerous obligation if the register is viewed as part of Government's Infrastructure budgeting processes and an allowance to fund the purchase of credits forms part of the budgetary allowances identified annually for infrastructure development.

The prioritisation of credits would not be expected to pose any issues as all credits would be the same (unlike biodiversity offset credits which are different, depending on species and subject to different levels of supply and demand).

What are implications of credits being traded to, and from, other contributions areas?

Enabling credits to be traded between contribution areas is a matter of creating an accounting and banking system to ensure that the total contributions are balanced, similar to the pooling of contributions. It also enables the benefits of private sector investment in infrastructure to be achieved across a broader area of NSW, rather than credits being "locked up" in a particular Growth Centre, where their value may not be realised for some time, or capitalised upon until there was a willing purchaser. This will provide opportunities to forward fund infrastructure that do not exist under the current system.

In the Final Review into Infrastructure Contributions in NSW – November 2020, we are concerned that despite broad support for a WiK trading system, the scope of reforms will overlook this crucial element of a productive planning system and remain an impactor pays model?

We quote as follows from the *Final Review – November 2020* - 6.2 Works-in-kind agreements:

> *As works are completed, the equivalent value is offset against the developer's infrastructure contributions obligations. Where a developer completes work of a higher value than their contributions obligation, a 'credit' is recognised. This may be used to offset future contributions. Some developers have sought a tradeable credits scheme to allow for the sale of credits to a third party. This would build on arrangements currently in place in the Western Sydney Growth Areas, where developers are able to use credits anywhere within the Growth Areas, but not to sell them to a third party.*

Stakeholder views:
Both councils and industry generally support the option to use works-in-kind agreements. They provide flexibility and allow for infrastructure to be delivered earlier than councils would otherwise achieve… Councils suggest that development of a template and practice note to establish a

standard approach to valuation, offsetting and liability periods would be beneficial. Councils do not support tradeable works-in-kind credits, suggesting it would be difficult to administer and add complexity. Industry, however, supports tradeable credits on the basis they would help encourage works-in-kind agreements by ensuring that any excess credits would have value.

Recommendation 6.2: Promote consistency and transparency in works-in-kind agreements.

Develop a practice note to guide efficient and consistent use of works-in-kind agreements.

Recommendations

1) It is good to encourage any party to deliver planned infrastructure as soon as possible, particularly in-line with or enabling development. Any parties delivering planned infrastructure should be paid for works above a contribution obligation, as per the costing in the Plan.

2) WiK credit system should cover two scenarios; one where a developer is delivering under or equal to their obligation and one where they are delivering over their obligation. A Planning Agreement should be used to enable works beyond a proponents site.

3) Recognition that informal trading of credits presently occurs and there would be greater transparency and productivity for it to be formalised:
   - There should be better and centralised Plan reporting.
   - Getting through neighbours land can be difficult – potential standard documents and practice notes to improve productivity.

4) Local Infrastructure Contributions (LIC)
   - There could be a register of credits owing, next cash in a plan goes to repay credits for infrastructure already built and a sunset date for Government to buy back credits over a four-year timeframe.
   - We support the PC recommendation to use debt to fund more infrastructure and this can also fund payment of credits owing. Work needs to be done on the prudent debt funding parameters and the approach to interest accruing in a Plan and for Credits owing?
   - Is there opportunity to include 7.12 WiK?

5) Regional Infrastructure Contributions (RIC)
   - Unlike SIC, RIC is not proposed to have a list of infrastructure to be delivered or projects based on nexus. To benefit from faster WiK delivery, Treasury should bring forward annually as part of the State Budget a four year list in-line with the forward estimates of projects open to WiK. Treasury should also consider out of sequence unsolicited proposals based on merit and

community impact.

- Request for more rigour to accurately cost RIC infrastructure items (e.g. TfNSW can use contingencies of up to 80%).
- WiK based on actual costs and VPA - but when is that a clear pathway?

6. Service Authority WIK
   - Liaison and agreement with service authorities for the upfront delivery of lead in services to unlock development , especially in fragmented ownership, should also be considered and aligned with those agencies. These credits should also be able to be traded across projects and LGA's

7. Value locked in and agreed up front
   - Once agreed and locked in WIK credits should be frozen. Developer takes the risk on unders and overs, therefore creating certainty in costs and potential credits. The Costs need to be aligned with an agreed scope document to avoid scope creep through approval and implementation phases.

Conclusion

We believe there is significant precedent over a long period supporting a beneficiary pays infrastructure contributions model and where a developer has to step-in as the impactor and deliver WiK which is over and above the benefits for a development and we believe the Final Productivity Commission Review supports tradeable WiK Credits across all the stakeholders, if a simple system can be developed.

WiK provides the opportunity to shorten the timeframe to deliver planned infrastructure and provide greater industry certainty to support development. It is crucial that we find these productivity gains in the challenging NSW Planning system to counter growing housing supply and affordability challenges.

The recommendations in this paper serve to highlight solutions for a simple and transparent WiK system for Local Infrastructure and Regional Infrastructure. UDIA is keen to work with DPIE in the working groups to encourage resolution of the issues surrounding WiK and tradeable credits presented in this Policy Paper and its role as part of the broader infrastructure contributions reform.