Water infrastructure that is efficiently & fairly funded

The case for developer charges: fair water infrastructure contributions promote better development outcomes and reduce infrastructure costs to the community

Developer groups have opposed Sydney Water and Hunter Water's planned reintroduction of infrastructure contributions (or 'developer charges'). These charges to developers help recover the area-specific, development-contingent costs of providing or upgrading the water, wastewater and stormwater drainage networks to serve new development.

However, such contributions have never been more important to the community. These charges signal to developers the costs of providing infrastructure in different areas, and thus promote socially optimal development decisions – i.e., development in locations where the benefits to the community exceed the costs. They also minimise price increases to customers' water bills (helping to reduce cost of living pressures), and they allow some of the land value uplift generated by rezoning to fund much needed infrastructure.

Cost-reflective infrastructure contributions can also be an efficient and fair funding source for infrastructure provided by local councils to serve new developments, including much needed public open space, transport (eg, local roads) and local stormwater infrastructure.

The reintroduction of water and wastewater developer charges

The term 'rent-seeking' was first used to describe the wasting of resources by entrepreneurs to fight for artificially created wealth transfers. This is an apt description for the time spent in recent years by developers seeking to convince the NSW Government to resist the reintroduction of cost-reflective water, wastewater and stormwater infrastructure contributions (or 'developer charges') in Sydney and the Hunter.

Following a review by the NSW Productivity Commission in 2020, the NSW Government committed to reform the infrastructure contributions system, with a key element being the phased reintroduction of developer charges for Sydney Water and Hunter Water's water, wastewater and stormwater services. This follows over a decade of these charges being set to zero (set by Ministerial direction in 2008). The consequence has been that Sydney Water and Hunter Water's additional costs to provide water infrastructure to service new developments has not been recovered from developers, but from all water, wastewater and stormwater customers via their quarterly bills.

Under the methodology set by the NSW Independent Pricing and Regulatory Tribunal (IPART), these infrastructure contributions would recover Sydney Water and Hunter Water's costs of providing water, wastewater and stormwater services to new development areas that are above and beyond the retail price revenue the water utilities will receive from servicing customers in the new development areas over time.[1]

Developers have long opposed paying these infrastructure contributions, arguing these costs should be borne by the wider community. They have suggested a broader revenue base (i.e., anyone but them) for infrastructure funding is needed, and that there is limited public benefit to infrastructure contributions.

Given concerns about housing affordability, the community is naturally interested in the key supply-side and demand-side drivers of house prices. Seeing an opportunity, developer groups have sought to re-prosecute their case opposing the developer charges as they claim they increase development costs and house prices.[2]

However, given the incentives at play, this requires closer scrutiny. Do these charges really increase development costs and house prices? What are the implications to the broader community and water customers if these infrastructure contributions are not reintroduced?

A cost to whom?

Infrastructure contributions may be a new cost to developers, but not to society. That is, infrastructure contributions do not create costs, they just represent a way of recovering them.

Since 2008, the costs of providing development-contingent water infrastructure have been paid by all water, wastewater and stormwater customers across Sydney Water and Hunter Water's areas of operation through their regulated prices. IPART, with responsibility for setting maximum charges levied by Sydney Water and Hunter Water, explicitly accounts for these when setting the charges that are levied on customers via their quarterly bills. This decade old subsidy *from* water customers (including households) *to* developers has added billions of dollars to water bills of households and businesses, directly impacting the affordability of these essential services.

In 2019, IPART estimated that by 2029, Sydney Water's average customer would be paying an additional $140 per year for their water, wastewater

1 Retail prices to customers reflect network-wide average costs (i.e., all customers face the same prices, regardless of their location within the utility's network). Infrastructure contributions therefore recover the difference between the costs of servicing a specific development area and network-wide average costs.

2 Daily Telegraph, *Water torture for new housing*, May 12, 2023.

and stormwater services if infrastructure contributions were to continue to be set to zero.[3]

Despite the overwhelming current media focus on the cost of living, this impact on the affordability of water is one of the few areas that has escaped public scrutiny.

Re-introducing cost-reflective infrastructure contributions would simply reallocate these costs back to developers, who are creating the need to incur them and benefitting from them. This is in line with the "impactor pays" principle, enshrined in the Council of Australian Government's National Water Initiative Pricing Principles, which were designed to increase the efficiency of Australia's water resources and infrastructure assets. This principle also underpins funding for a range of other critical services.

The reintroduction of infrastructure contributions would provide bill relief to all water customers, which will be increasingly important as major metropolitan centres in Greater Sydney and the Hunter continue to grow, and households face cost of living pressures.

Supporting planning objectives and efficient development

Cost-reflective infrastructure contributions also support planning objectives, by signalling to developers the costs of providing water infrastructure to different areas in Sydney and the Hunter – with some areas being higher cost and others lower cost to service, and these variations being ideally reflected in infrastructure contributions.

This price signal would encourage efficient development decisions. Currently, without such cost-reflective infrastructure contributions, developers do not need to consider the different cost of providing water infrastructure to different areas in Sydney. This means there is a risk they develop in areas where the costs to the community of providing such infrastructure exceeds the benefits of the development.

Smearing development-contingent costs across all water customers risks diluting one of the key signals related to the cost of development between locations, which in turn can contribute to inefficient investment in relatively high-cost areas.

As the NSW Premier and Productivity Commission have recently said, we need to improve how we plan and develop Sydney to minimise stretching of infrastructure services, including building more housing in infrastructure corridors to enhance amenity, lower infrastructure costs and improve housing affordability.[4]

Infrastructure contributions and house prices

Provided developers have sufficient line of sight of infrastructure contributions (i.e., they are aware of these contributions before they purchase developable land), the economics of housing supply tells us that these costs are not necessarily passed through to homeowners through higher house prices.

As observed through numerous studies across multiple jurisdictions and the NSW Productivity Commission (see Box 1), they are likely to be factored into the prices developers pay for developable land – resulting in a lower than otherwise price to the landowner, who may still receive significant windfall gains by virtue of their land being rezoned or deemed developable.

3 IPART, Prices for Sydney Water from 1 July 2020, Issues Paper, September 2019, p 29.

4 *NSW Premier Chris Minns puts Sydney NIMBYs on notice,* 15 May 2023; Sydney Morning Herald, *Sydney's richest suburbs need to be higher, denser to solve housing crisis*, 31 May 2023.

Box 1: Infrastructure contributions and housing costs

The amount of the infrastructure contribution should theoretically be reflected in price of land purchased by the developer.

When developers bid for a parcel of land, they will typically calculate the 'residual value' of the land based on the estimated revenue achievable from sales, less the range of costs, taxes and charges involved with delivering the development, and a profit margin (Abelson, 2018). The 'residual' then reflects the value of the land to the developer and will inform any bid that it is willing to make. Provided that the residual land value is still higher than its opportunity cost (or next best use) to the vendor, it is still in the owner's interest to sell.

The introduction of an infrastructure contribution should only reduce housing supply in cases where the land is more valuable in its existing use than what a developer is willing to offer (e.g., as the existing house or farmland), and the project falls through. This is most likely to be in locations where demand, and prices, are relatively low.

As long as the contributions applied to a development are reflective of the true costs to society, for example of delivering the infrastructure, it is not necessarily a problem that unviable projects do not go ahead at a particular point in time. As demand grows, developments that were unviable may become viable.

Source: NSW Productivity Commission, Review of Infrastructure Contributions in New South Wales, Final Report, November 2020, p 33.

That is, infrastructure contributions can allow some of the land value uplift generated by rezoning to fund much needed infrastructure.

If there are occasions where this means the landowner is not willing to sell to the developer, this would indicate that the benefits of the potential development in that location (as measured by what the developer is willing to pay for the land) does not exceed its costs to the community. However, this is unlikely to be common, as in an environment of increasing population, the value of developable land in and surrounding cities often exceeds its opportunity cost in alternative uses (e.g., for industrial use or agricultural production).

This key conclusion – that housing affordability is not exacerbated by infrastructure contributions, provided developers are aware of these contributions before they purchase developable land – is also backed up by empirical literature. Abelson (1999)[5], Ruming, Gurran and Randolph (2011)[6], Davidoff and Leigh (2013)[7] and Murray (2018)[8] all found that the incidence of development contributions likely falls on developers or landowners rather than home buyers.

The most reliable Australian evidence is consistent with this view; with little credible evidence to the contrary.[9]

5 Abelson, P, 1999, 'The real incidence of imposts on residential land development and building', *Economic Papers*, vol. 8, no. 3.

6 Ruming, K, Gurran, N, & Randolph, B, 2011, 'Housing Affordability and Development Contributions: New Perspectives from Industry and Local Government in New South Wales, Victoria and Queensland', *Urban Policy and Research*, vol. 29, no. 3, pp. 257–274.

7 Davidoff, I & Leigh, A, 2013, 'How do Stamp Duties Affect the Housing Market', *Economic Record*, vol. 89, no.286.

8 Murray, CK, 2018, 'Developers pay developer charges', *Cities*, vol. 74, pp. 1–6.

9 Bryant (2017) finds a substantial impact on house prices however there are a number of concerns with the empirical approach taken. UQ Economist Cameron Murray's paper, in response to the work of Bryant, is more convincing, having applied a clear empirical strategy exploiting unanticipated changes to the developer charge

The NSW Productivity Commission has observed that, as a policy to increase housing supply, setting Sydney Water and Hunter Water's infrastructure contributions to zero has been ineffective and costly, predominantly resulting in a transfer of wealth from water customers to owners of developable land, "including those that would have developed land regardless".[10]

Where to from here?

Cost-reflective infrastructure contributions can help to fund infrastructure more fairly, reduce pressure on water bills to residential and non-residential customers, and support better planning and development outcomes.

The focus should not be on whether these contributions should be reintroduced, but rather how to:

- ensure water, wastewater and stormwater infrastructure solutions and services provided by Sydney Water and Hunter Water meet the community's expectations and needs, including in relation to enhanced environmental, amenity and liveability outcomes;
- set infrastructure contributions to ensure they reflect the efficient costs of development-contingent water, wastewater and stormwater infrastructure to various areas within Greater Sydney and the Hunter; and
- phase in and administer these charges to provide sufficient line of sight and certainty to developers to enable them to consider and respond to these important price signals, for the benefit of the community.

Resources spent on doing these well, rather than "rent-seeking", will deliver value to the whole community, including developers.

Importantly, for the same reasons as outlined above, cost reflective infrastructure contributions can be an efficient and equitable funding source for infrastructure provided by local councils to serve new development – including public open space, transport (such as local roads) and stormwater infrastructure.

regime to identify the impact of these developer charges, finding no impact on house prices and therefore house buyers. Even more illustrative is the replication of the results of Bryant (2017) when ignoring the mechanical relationship between house characteristics and developer charges.

10 NSW Productivity Commission, Review of Infrastructure Contributions in New South Wales, Final Report, November 2020, p 101.

Contact Us

Frontier Economics has been providing independent advice to businesses, regulators and governments for over 20 years. From offices in Australia and Singapore, our team has a diverse range of skills and experiences to support the needs of our clients. And includes specialist econometricians and modellers. To speak with one of our economists, please contact:

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