IPART
Independent Pricing and Regulatory Tribunal
New South Wales

Our reference: 17/138

[redacted]

27 November 2019

Peter Achterstraat AM
NSW Productivity Commissioner
NSW Treasury
52 Martin Place
SYDNEY NSW 2000

Dear Peter,

Submission to *Kickstarting the productivity conversation*

Thanks for the opportunity to respond to this discussion paper.

IPART is the independent economic regulator in NSW for water, public transport and local government. We are also the licence administrator for water, electricity and gas and the scheme administrator and regulator for the Energy Savings Scheme.

We have served as the Government's economic advisor and policy think tank. Our role and experience makes us well-placed to contribute to your review.

Our submission has been approved by our Tribunal and is attached. It addresses the questions raised in the discussion paper most pertinent to IPART's current role and responsibilities. We provide specific commentary in the areas of water, energy, transport and local government.

Should you require further information, IPART's contact officer for this submission is [redacted]

Yours sincerely

[redacted]

IPART

Independent Pricing and Regulatory Tribunal
New South Wales

Submission to the NSW Productivity Commissioner

Kickstarting the productivity conversation

November 2019

[redacted]

[redacted]

[redacted]

[redacted]

[redacted]

[redacted]

[redacted]

[redacted]

[redacted]

Contents

1 Introduction and executive summary

IPART is the independent economic regulator in NSW for water, public transport and local government. We are also the licence administrator for water, electricity and gas and the scheme administrator and regulator for the Energy Savings Scheme.

We have served as the Government's economic advisor and policy think tank. Our role and experience makes us well-placed to contribute to the NSW Productivity Commissioner's review.

Our submission provides specific commentary in the areas of water, energy, transport and local government.

There is scope to enhance productivity in the water sector through improved governance, and improving strategic **water** planning. In particular, there should be clear responsibility and accountability for such planning. This is especially important in catchments or markets such as the Greater Sydney Area, where there are multiple private and state-owned water utilities.

The most effective way governments can ensure sustainable retail **energy** prices in the future is to provide a stable **policy framework** to enable investment in both generation and network infrastructure. We provide commentary on our review of changes to Distribution Network Service Provider (DNSP) reliability standards that could deliver bill saving to customers as well as opportunities to streamline the energy regulatory arrangements.

A sound **transport** network is critical for the functioning of a large, vibrant and economically advanced state such as NSW. We discuss road pricing and other opportunities to reduce congestion, both on the roads and on the rail network, as well as how to improve access to the rail network for freight.

In the area of **local government**, cost-reflective developer contributions are an economically efficient and equitable approach to funding infrastructure. They signal the costs of providing infrastructure for new developments, and ensure that development occurs where the benefits are greater than the costs. We support reforms that provide greater certainty, consistency and transparency around cost-reflective developer contributions, and we discuss opportunities for enhancing the developer contributions system. We also support enhanced performance monitoring and benchmarking of local councils, to assist in driving improvements in their performance.

2 Water

We consider there is scope to enhance productivity in the water sector through:

- ensuring shareholders of state-owned corporations (SOCs) are suitably active in driving the performance of the water utilities, and the governance arrangements around SOCs are best practice
- improving strategic water planning, including clarifying roles and responsibilities for planning and ensuring whoever is responsible has the resources for the function
- enhancing transparency around the responsibilities, efficiency and performance of the NSW Department of Planning, Industry and Environment (DPIE), WaterNSW, the Natural Resources Access Regulator (NRAR), the Murray Darling Basin Authority (MDBA) and Dumaresq-Barwon Border Rivers Commission (BRC) in bulk water supply and water management, and improving the provision of information to the bulk water market
- reviewing restrictions on the use of recycled water, the Government's policy of zero water and sewerage developer charges in Sydney and the Hunter, and environmental and planning regulation, and
- reviewing the structure and regulation of local water utilities, with the aim of enhancing economies of scale and capability to ensure sustainable and reliable service delivery.

2.1 Improving governance in the rural and urban water sectors

As the independent economic regulator of major water utilities in NSW we ensure prices reflect efficient costs, customers are protected from the potential abuse of monopoly power, and utilities have an incentive to operate efficiently and effectively for the benefit of their customers.

In general, we consider there is significant merit in the current model whereby government owned water utilities or SOCs are subject to independent economic regulation.

However, the governance and regulation of state-owned water utilities could be improved if the following were implemented:

- Shareholders of state-owned water utilities are more active in driving performance and efficiency gains, as they are in privately owned firms. This would help ensure that the SOCs are suitably responsive to the incentives created under the regulatory framework, and are continually looking to innovate and improve their efficiency and performance.
- Non-commercial objectives or requirements imposed on state-owned water utilities are clearly defined and funded; and non-commercial services are contestable where possible, rather than automatically imposed on or granted to state-owned water utilities.

- State-owned water utilities are subject to best practice governance requirements. The duties of officers of statutory SOCs[1] were modelled on the Commonwealth *Corporations Act* as it stood in 1995.[2] Since then, the corresponding provisions of the *Corporations Act* have developed substantially. We consider that the governance requirements in the SOC Act should be reviewed to ensure they are consistent with best practice governance principles and requirements, principles of competitive neutrality, and the Government's objectives in relation to SOCs, drawing on the current *Corporations Act* where relevant.[3]
- Environmental and other regulatory requirements imposed on water utilities are subject to best practice regulatory principles, including consideration of all viable options and the adoption of approaches that achieve objectives at lowest net cost or greatest net benefit - ie, value for money.

2.1.1 Improving strategic water planning

We also consider there are significant benefits to be gained in improving strategic water planning. In particular, there should be clear responsibility and accountability for it. Better strategic planning can be undertaken centrally, but be informed by and draw on the market for water services, to deliver better outcomes. This is especially important in catchments or markets such as the Greater Sydney Area, where there are multiple private and state-owned water utilities. Ideally, these parties should be operating in a market to deliver outcomes, at lowest cost or greatest net benefit, consistent with one overarching strategic plan. Ultimate accountability for such a plan should rest clearly with one entity, which regularly reviews and updates the plan as necessary, and consults with and receives input from market participants, but which is also at arm's length from these participants.

This planning should identify the most efficient way of ensuring the supply of water services meets demand in a catchment over the long-term, while accounting for fluctuations in supply and demand due to drought. This should include considering all viable options – including 'traditional' network based solutions as well as a greater use of integrated water cycle management approaches, such as recycled water, where efficient. It should also consider seeking expressions of interest from the market to deliver given quantities of water (or water savings), in accord with specific time and other supply requirements – to realise the benefits in innovation and efficiency that can be captured through 'competition for the market' (ie, outcomes focused competitive sourcing).

2.1.2 Improving transparency of costs in the rural water market and facilitating efficient trade

There are several initiatives that would improve the transparency of costs in the rural water market and/or facilitate efficient trade in water allocations and entitlements.

---

1 Currently all SOCs listed in the SOC Act, including Hunter Water Corporation and Sydney Water Corporation, are statutory SOCs.

2 NSW, Parliamentary Debates, Legislative Assembly, 23 May 1995, p 52 (Bob Carr).

3 IPART, *Submission to the Issues Paper on the Review of the Legislative Framework that provides for the Governance and Accountability of State Owned Corporations*, February 2014, https://www.ipart.nsw.gov.au/files/sharedassets/website/trimholdingbay/ipart_submission_to_the_issues_paper.pdf.

Greater clarity around the allocation of Water Administration Ministerial Corporation functions

We set the maximum prices that the Water Administration Ministerial Corporation (WAMC) can charge its customers for a range of water management services. These services include ensuring that available water is shared according to agreed rules, the integrity of water rights is protected, and water resources are managed sustainably. They are undertaken on behalf of WAMC by a combination of DPIE, NRAR and WaterNSW.

In recent years, there have been several reallocations of WAMC functions across these agencies. In 2016, compliance and enforcement functions and the majority of licensing functions transferred from DPIE to WaterNSW. In 2018, compliance and enforcement functions were transferred from WaterNSW to NRAR.

We consider that DPIE, NRAR and WaterNSW should work together to ensure there is greater clarity to stakeholders around the allocation of WAMC functions across these agencies, including how these functions are proposed to be resourced and delivered. IPART will also seek to clarify arrangements through our upcoming review of WAMC's prices, which is due to commence in mid-2020 for new prices to apply from 1 July 2021.

Independent oversight of charges for Murray Darling Basin Authority and the Border Rivers Commission

The MDBA and the BRC are inter-jurisdictional bodies that co-ordinate water resource management and bulk water activities from a 'whole of system' perspective. The NSW Government contributes to the cost of these activities,[4] and WaterNSW and WAMC recover some of these costs from their customers through their rural bulk water and water management prices.

IPART determines the maximum amount WaterNSW and WAMC can charge to recover their MDBA and BRC costs from their customers. This requires us to assess the efficiency of MDBA and BRC costs, which can be problematic as there has been limited information available on these costs. We therefore consider that jurisdictions that contribute funding to the MDBA and BRC should ensure the costs of these entities are more transparent, to allow independent review of their efficiency.

Stakeholders have also noted there is a lack of publicly available information on MDBA and BRC expenditure. Regular and publicly reported reviews of their expenditure would provide much needed transparency and improve customer confidence.

Increased market confidence to facilitate efficient trade in water entitlements and allocations

In NSW, the main active market for water entitlements and allocations is in the southern and northern Murray Darling Basin.[5] It is designed to ensure sustainable water resource management and efficient allocation of water between users.

4 The costs of construction, operation and maintenance of assets under the MDBA's and BRC's arrangements are jointly paid for by the signatory states. The costs are allocated to each state in a proportion defined under the terms of the agreement

5 Water 'entitlements' involve ongoing perpetual rights, whereas water 'allocations' relate to actual water available for use each year.

We consider there are several ways to increase confidence in this market:

- Improving the quality of information provided by DPIE and WaterNSW to market participants about water availability.
- Providing greater transparency about WAMC and WaterNSW's expenditure and prices, would assist market participants to better understand the costs of water management and delivery.
- Ensuring DPIE, the NRAR and WaterNSW are held accountable for performance of their WAMC functions.

WAMC is not subject to an operating licence. To assist in holding it accountable to entitlement holders who pay its water management charges, we have established a reporting framework against its price determination. WAMC reports annually to us against 'output measures' established at our last determination of WAMC's prices, and we place this report on our website.

2.2 Expanding the role of water recycling and greater efficiency

IPART's pricing framework recognises the system-wide benefits of recycled water, and ensures that recycling will be viable where the benefits it creates for customers exceeds its costs. This provides incentives to get the right solutions in place to meet the demands of customers and the broader community.

However, there are also other broader policy considerations that can impact significantly on the viability and uptake of recycled water. Below we discuss these, along with our pricing framework.

2.2.1 Policy considerations that impact on recycled water

At the request of the NSW Government and Infrastructure NSW, Frontier Economics (Frontier) has recently examined barriers to the take-up of cost-effective water recycling in NSW.[6] Of the 32 recommendations made by Frontier, 18 were directed to IPART. We have responded to these in our recent *Recycled Water Review.*[7]

However, Frontier also made broader policy recommendations directed to Government, which can significantly impact on the viability and uptake of recycled water. These included Frontier's recommendations for the Government to review:

- **Its policy of zero water and sewerage developer charges in Sydney and the Hunter**
  - Frontier found that rescinding the Government's policy of zero water and sewerage developer charges (ie, re-introducing cost-reflective developer charges) would remove a clear bias against recycled water and new entrants and, more broadly, provide locational price signals. In line with Frontier's findings, IPART

6 Frontier Economics, Economic regulatory barriers to cost-effective water recycling – A report prepared for Infrastructure NSW, July 2018.

7 IPART, *Review of pricing arrangements for recycled water and related services*, *Final Report*, Appendix A, July 2019.

also considers there are strong economic efficiency and equity arguments in favour of cost-reflective developer charges.

- **Restrictions on the use of recycled water**
  - Restrictions on the use of recycled water mean that costs are often incurred to build and maintain an additional pipe network that keeps recycled water separate from the potable water network. Using policy levers to expand the permissible uses of recycled water could significantly reduce some cost barriers. There is potential for indirect or even direct potable reuse to be explored as a way of providing secure and high quality services at good value to customers.
- **Environmental and planning regulation**, to ensure it is proportionate, flexible and efficient in line with best practice principles.
  - Environmental regulation should be optimally designed and set, so that the community's desired environmental outcomes are achieved at least cost. Greater clarity and identification of optimal environmental, liveability and other regulatory outcomes and requirements may mean that recycled water is a more viable supply option.

2.2.2 Our framework for private water businesses

In NSW, private water businesses are able to enter the market under the *Water Industry Competition Act* to provide and sell recycled water services and on-sell 'wholesale' water and wastewater services they purchase from public water utilities such as Sydney Water or Hunter Water.

IPART does not currently regulate the price of private recycled water services. Nor has it set a price or any tariff for the 'wholesale' water and sewerage services Sydney Water or Hunter Water provides to privately owned on-sellers who operate recycled water plants. Sydney Water or Hunter Water and the private water businesses can negotiate prices that best reflect the costs and benefits of each scheme. IPART will only set a price if the parties cannot reach agreement and one of them asks us to determine prices. We are yet to be asked to set any such price for Sydney Water or Hunter Water.

If we were asked to set Sydney Water's wholesale prices to an on-seller with a recycled water plant, we would discount prices to reflect the net benefits that the recycling scheme provides to Sydney Water's broader customer base (for example, if it reduced the need for Sydney Water to invest in sewage treatment). We would also ensure the wholesale services provided to the on-seller are priced in a way that puts the wholesale supplier and wholesale customer on a level playing field (ie, does not unduly advantage or disadvantage either party), and also does not unreasonably add to the prices paid by Sydney Water's other customers.

Private water businesses rely heavily on the public water utility's network, and hence they impose costs on this network. For example, in addition to recycling, a private water business might purchase potable water from Sydney Water and sell it to its own retail customers, and also dispose of wastewater to Sydney Water's network to allow it to retail (or on-sell) sewerage services to its end use customers. It should pay a reasonable price to Sydney Water for these services.

2.2.3 Our framework for public utilities

We consider that water utilities should always consider recycling when assessing options to deliver water and wastewater services to their customers. They should invest in recycling when it is the best way of delivering the services and environmental outcomes that their customers want.

We allow the costs of a public utility's recycled water scheme to be recovered from general water and/or sewerage prices to its broader customer base when:

- it is the least cost way of delivering water and/or wastewater services, while complying with environmental and other regulatory requirements
- it avoids or reduces costs the broader customer base would normally or otherwise pay (for example, expanding sewage treatment plants), or
- the utility's broader customer base is willing to pay for the external benefits the scheme generates.

Any residual costs of the recycled water scheme are then recovered from recycled water customers up to their willingness to pay and/or from developers via recycled water developer charges (in accordance with our recycled water pricing principles and recycled water developer charges determination).

Our pricing framework recognises the system-wide benefits of recycled water, and ensures that recycling will be viable where the benefits it creates for customers exceeds its costs.

2.3 Improving service delivery in regional areas

We considered the regulation of water supply and sewerage services by Councils in regional NSW (ie, Local Water Utilities or 'LWUs') in our 2016 *Review of reporting and compliance burdens on Local Government*. We consider this to be an important area, where significant gains in efficiency and service delivery can be made.

In line with our recommendation from 2016, we welcome a move to catchment based water planning.[8] This approach helps to ensure that water resources are managed optimally.

There are also minor improvements that can be made to current reporting requirements for most LWUs.

In its 2017 inquiry into National Water Reform, the Commonwealth Productivity Commission recommended that for regional water services in NSW, an appropriately qualified independent body review financial performance frameworks for local water utilities.[9] We consider that such an assessment framework would help ensure that LWUs were meeting the pricing principles set out in the National Water Initiative.

Given the fragmented nature of LWUs, largely owned and operated by regional and rural councils, the structure and regulation of services in regional and rural NSW should be

8 https://www.industry.nsw.gov.au/water/plans-programs/water-mgmt-strategies.
9 National Water Reform – Productivity Commission Inquiry Report No 87, December 2017, p 219.

revisited. We consider that structural reforms would deliver significant improvements in operating and financial performance, including from:

- Providing the opportunity for LWUs to benefit from economies of scale, which would improve efficiency through improved sophistication and specialisation of staff and systems.
- Improving the planning, levels of service, management and assessment of risk.
- Improving the system for managing long term water variability and drought response.
- Enhancing the flexibility of utilities to raise debt and optimise their capital structures, and enhancing the incentives for and ability of LWUs to invest in new infrastructure.
- Improving the economic performance of utilities.
- Implementing a more corporatised governance structure, giving utilities and their council owners the associated goals, and financial and performance incentives and accountability.

3 Energy

The most effective way governments can ensure sustainable retail energy prices in the future is to provide a stable and predictable energy market framework. This stability will encourage new investment in the wholesale market, which is essential to increase supply and replace existing generation as it reaches the end of its asset life.

Workably effective competition – in combination with the consumer protections in the National Energy Rules and general consumer law – should provide the best outcomes for customers in the retail electricity and gas markets in the medium term. The incentives for retailers to outperform their competitors should lead to retailers efficiently purchasing wholesale electricity and providing new types of product that are tailored to different types of customers, and providing quality customer service through efficient systems. This should mean prices reflect efficient costs and better products for customers.

3.1 A Default Market Offer was introduced on 1 July 2019

Over the past 12 months, governments have made changes to the retail regulatory framework to implement a wide range of measures to assist customers engage in the retail energy market and put pressure on retailers to offer lower prices. These changes include implementing a Default Market Offer (DMO) which limits the prices that retailers can charge customers on standing offers. These changes in the regulatory framework need to be given time to take effect before definitive findings can be made on their impact. We recommend that the recent changes to the retail regulatory framework including the DMO should be given 12 months to become fully embedded, and their effects fully understood, before further intervention with energy retail prices is contemplated.

3.2 Efficiently determining distribution reliability standards

IPART has been asked by Government to recommend changes to electricity distribution reliability standards that could deliver bill savings to customers. The reliability standards were last updated in 2014, following a review by the Australian Energy Market Commission (AEMC) in 2012. We will release a Draft Report by mid-2020, and a Final Report by end of October 2020.

Reliability standards could be set by applying an economic assessment that identifies the efficient level of reliability for which customers are willing to pay. This is where the costs of providing electricity to this standard equals the costs to customers of experiencing outages. If the standards are too high, then it is more costly to provide the reliability than the avoided outages the standards provide for. If standards are set too low, then it would be cheaper to deliver higher standards than the cost of the outages that would otherwise occur.

3.3 Streamlining the energy regulatory arrangements

3.3.1 Retail energy market

IPART is one of four agencies that monitors the electricity retail market in NSW. We recommend that the Government removes IPART's responsibility to monitor the retail electricity market in NSW as:

1. Both the AEMC and the AER (Australian Energy Regulator) monitor the electricity market in NSW and provide detailed information by network area as part of their reporting.
2. The ACCC (Australian Competition and Consumer Commission) has stronger information gathering powers that allows it to undertake more in depth analysis of specific areas such as retail margins and wholesale costs.
3. The retail electricity market has become more competitive each year since we started monitoring the energy retail market. As the market becomes more competitive there is a decreasing need for multiple agencies to monitor the same retail market.
4. There are additional costs of multiple agencies monitoring the same retail market. These costs are funded by taxpayers. There are also costs incurred by stakeholders (retailers and consumers) engaging in multiple market monitoring reviews.
5. IPART's role is restricted to monitoring the retail market whereas the ACCC, AEMC and AER each monitor the wholesale and retail markets. Further the AER also regulates the electricity network businesses.

Market monitoring by multiple agencies increases costs for taxpayers, retailers and consumers. Rather than requiring IPART to duplicate annual market monitoring, a better use of resources would be for IPART to investigate or review NSW specific matters as required.

3.3.2 Other regulatory activities

IPART is responsible for administering the licensing regimes for electricity transmission and distribution network operators, natural gas reticulation network operators and LPG distribution network operators. We are also responsible for regulating the reliability and safety of NSW electricity networks.

IPART does not regulate the safety or reliability of gas reticulation or distribution networks.

We consider that there is scope to consolidate the following energy-related functions within a single regulatory agency:

1. Licensing/accreditation of both electricity and gas network operators/service providers, including in relation to future energy sources (such as hydrogen) and new types of networks (such as electricity 'micro grids').
2. Monitoring and reporting on compliance with technical and reliability standards for electricity networks (currently performed by IPART) and applicable requirements for gas networks (currently performed by DPIE) under legislation and/or licences and authorisations.

3. Monitoring and reporting on compliance with applicable safety regulations and standards with SafeWork NSW retaining worker safety responsibilities.
4. Enforcing statutory provisions and licence conditions in relation to both electricity and gas network operators/service providers, including in relation to safety.

In addition to the benefits of consolidation set out in the Issues Paper, we expect benefits would include:

1. Cost savings through reduced duplication of functions and other efficiencies.
2. Specialised administrative decision-making and reporting to Government under the energy regulatory framework applicable to the energy sector.
3. Consistency of approach to compliance and enforcement action across all regulated entities.

NSW Fair Trading has consumer protection functions which include safeguarding consumer rights, and educating and engaging with relevant consumers and traders, and the licensing of electricians and gas installers. Due to the specialist nature of the consumer protection functions, we consider that these functions should remain with NSW Fair Trading.

In some circumstances, embedded networks and micro grids would be considered to be both distribution systems and installations. We also recommend that the Productivity Commissioner review when an embedded network and micro grid should be regulated as a distribution network and when an embedded network and micro grid should be regulated as an installation.

3.3.3 Assisting customers to make informed choices

The ACCC will introduce a Consumer Data Right for energy customers from 1 July 2020.[10] Additionally, the AEMC's 'Power of Choice' reforms are increasing the penetration of interval and smart metering. This creates an opportunity for NSW Energy Switch and the AER's Energy Made Easy to improve customer service. If these websites could import interval and smart metering data, from the consumer's data, they could provide more accurate estimates for customers on time of use and demand charges. This should help more customers find the best offer for their needs.

10 Australian Government The Treasury, *Consumer Data Right*, https://treasury.gov.au/consumer-data-right accessed 2 October 2019.

4 Transport

A sound transport network is critical for the functioning of a large, vibrant and economically advanced state such as NSW. Improvements in the transport network benefit every household in NSW by raising productivity and lowering production costs. The role for Government includes integrating transport planning with land use planning and setting the strategic direction for the transport sector. This includes setting performance standards of transport operators, evaluating operators' performance, holding them accountable, and creating effective incentives for them to innovate and improve their performance.

Fares paid by public transport users cover around 25% of the ongoing cost of the public transport network and every dollar invested in public transport creates a future cost for the community that needs to be paid for either by users through fares or from taxes[11]. Public transport is currently the third largest cost to taxpayers after health and education[12]. Public transport benefits both users and non-users of the services. The main benefit for non-users is reduced congestion on the city roads.

4.1 Options to alleviate congestion

Road pricing represents a significant opportunity for reform. Apart from providing a more efficient link between road use and road charges, there are two main areas of potential benefit from reforming the road pricing system. The first is addressing urban congestion. The second is allowing more efficient use of the existing road network by heavy vehicles.

Congestion imposes direct costs on all road users. During periods of peak demand, roads are allocated through queuing which imposes a far greater cost to road users and the economy than would an effective pricing mechanism. The current system of charging for roads results in distortions that affect other modes of transport, such as public transport. It also means that road users face little incentive to shift demand from peak to off-peak periods and thereby make more efficient use of existing road infrastructure.

Road user charges and pricing are highly contentious issues. Gaining community acceptance is a major obstacle to the greater use of pricing as a tool to manage congestion.

Heavy vehicles are currently restricted from accessing large parts of the road network. This is because local councils are unable to recover the additional maintenance costs that would result if heavy vehicles were able to access these roads. We consider all parties could be made better off if heavy vehicles had a choice of paying to use these roads and if this revenue went directly to those responsible for maintaining the roads.

11 IPART Review of Opal Fares Issues paper, April 2019, piii.
12 IPART Review of Opal Fares Issues paper, April 2019, pii.

4.2 Reducing congestion in peak periods on the rail network

Passengers' travel decisions are driven by a range of factors such as travel times, frequency and reliability of transport services, ease of access to transport near their origin and destination (versus alternate modes such as driving) and the cost (public transport fares versus alternate modes).

The rationale for a price differential between peak and off-peak fares relates to the higher costs of public transport services in periods of peak demand. The efficient costs of these services are characterised by high infrastructure costs (rail lines, trains, buses, ferries) and relatively low operating costs (electricity, fuel, drivers). Much of the infrastructure is required to meet the demand for services in peak times – for example, to get commuters to and from work on weekday mornings and afternoons (71.5% of commuters use public transport to travel to and from the Sydney CBD in peak hours).[13] In off-peak times, such as the middle of the day and weekends, the infrastructure may have spare capacity. Peak fares are currently well below operating costs for the rail network in the peak.

Higher prices in peak periods, and hence lower prices in off-peak periods may promote more efficient use of spare capacity and delay the need for expensive investment in infrastructure to meet demand. It would encourage some passengers to travel outside of peak times to spread the passenger load and reduce external costs of passenger crowding and boarding delays. It may also encourage passengers who are not current users of public transport to use the network in off-peak times.

As indicated in our April 2019 Issues Paper on Opal fares, an increase in peak fares can lead to a decrease in peak adult journeys.[14] While fares are only one of the factors that influence demand, there is evidence that they can have a large influence on travel behaviour - for example, the $2.80 Sunday travel cap[15] has contributed to certain Sydney ferry services regularly being at maximum capacity (ie, at 100%) on Sundays, which is not usually observed even during the weekday peak periods (across the Sydney ferries network).[16, 17]

4.3 Access to the rail network for freight

The NSW rail network is used to transport both passengers and freight. Passenger transport is prioritised over freight. Moving freight by rail can lead to positive externalities in terms of avoided pollution, road congestion and accidents. The NSW Rail Access Undertaking (the Undertaking) provides for third party access to the rail network in NSW, including specifying certain pricing principles that rail owners must apply in negotiating access prices.

13 BTS, NSW and Sydney Transport Facts – April 2016, p 5.
14 Depending on the elasticity of demand for public transport.
15 As at 25 November 2019, fares on Sydney ferries are $6.12 (for 0-9km) and $7.65 (for 9+km) during weekdays and Saturdays. However, passengers may pay less depending on whether they meet the daily/weekly cap or have travelled more than 8 trips during the week.
16 TfNSW, Opal data, 18 June 2019.
17 We note that the Manly fast ferry is an alternate faster service for those travelling between Manly and Circular Quay and operates at high capacity during the weekday peak hours.

The Undertaking was drafted in 1999. At that time, the infrastructure covered by the regime was different and access regimes across the country were in their early stages of development. Twenty years on, there is information to suggest that the regime is in need of review.

Recently we have received a range of complaints about the current regime. Reviewing and updating the Undertaking should address these complaints. There is broad support for a review of the Undertaking particularly from rail access seekers, users of rail freight services and other regulators. Stakeholders have also questioned whether the current regime does adequately reflect the benefits to the community of moving freight from road to rail and that this mode-shift should be one of the aims of reviewing the Undertaking. A review could also address the inadequacy of the compliance/enforcement regime, as well the regulatory overlap between the NSW and federal access regimes.

We recommend that Government ask IPART to undertake a review of the Undertaking.

5 Local Government

Cost-reflective developer contributions are an economically efficient and equitable approach to funding infrastructure. They signal the costs of providing infrastructure for new developments, and hence ensure that development occurs where the benefits are greater than the costs. We support reforms that provide greater certainty, consistency and transparency around cost-reflective developer contributions, and we discuss opportunities for enhancing the current developer contributions system.

We also support enhanced performance monitoring and benchmarking of local councils, to assist in driving improvements in councils' performance and ensuring their costs and rates are reasonable.

5.1 Applying principles to the developer contributions system

We support the objectives of transparent, consistent and efficient outcomes in the developer contributions system. Exploring broader reforms in the contributions system may deliver more efficient developer contributions.

IPART has a role in assessing some local infrastructure contributions plans[18] and our assessments aim to ensure that contributions reflect the reasonable costs of infrastructure required for a new development. If costs in a contributions plan are higher than the reasonable costs of infrastructure needed for the development, developers or the NSW Government will pay too much for local infrastructure. But, if costs in the plan are lower than the reasonable costs of infrastructure required for the new development, the new development would effectively be subsidised by the council's existing ratepayers. Cost-reflective developer contributions ensure that development occurs where the benefits of the development exceeds its costs.

Our assessment role is important in ensuring the transparency and consistency of contributions plans. The assessment is a public process, with consistency driven by the directions in a Practice Note[19] to consider a plan's alignment with the Essential Works List, the establishment of nexus for land and works in the plan, and reasonable cost. We improve the accountability of local infrastructure contributions through verifying the estimates and assumptions used in the councils' analysis.

IPART's independence supports the Government's objective of efficient outcomes in the developer contributions system. Councils, developers, ratepayers, taxpayers and the Government have different planning objectives and incentives, and independent assessment ensures conflicting priorities do not impact on efficient outcomes.

18 IPART is required to assess contributions plans which propose a contribution per residential lot or dwelling above $20,000, or $30,000 in specified areas. We undertake our assessment in accordance with the guidance in the *Local Infrastructure Contributions Practice Note 2019* (Practice Note).

19 Department of Planning and Environment, *Local Infrastructure Contributions Practice Note*, January 2019 (Practice Note).

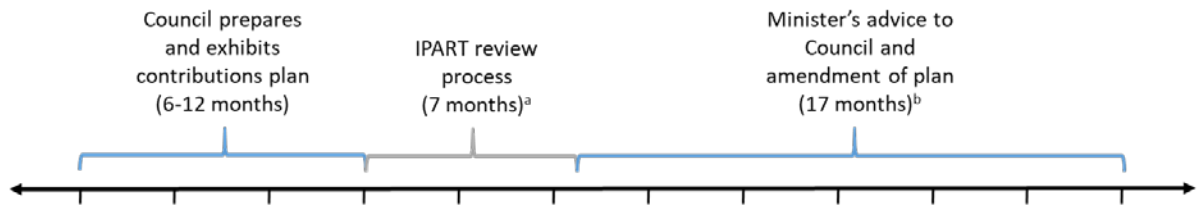
Efficiency in the developer contribution system is also achieved through the appropriate apportionment of costs. Across a range of reviews and services, including our reviews of local infrastructure contributions plans, we have applied the following funding hierarchy to guide cost allocation:

1. Preferably, the party that created the need to incur the cost (the impactor) should pay in the first instance.
2. If that is not possible, the party that benefits (the beneficiary) should pay. Further, it is preferable for direct beneficiaries to pay, but if that is not possible then indirect beneficiaries should pay. In some cases, the impactor and the beneficiary are the same.
3. In cases where it is not feasible to charge either impactors or beneficiaries (for example, because of social welfare policy, public goods, externalities, or an administrative or legislative impracticality of charging), the government (taxpayers) should pay.

5.2 Improving developer contributions to support growth in new areas and service growing community needs

Developer contributions should be determined in a timely, consistent and transparent way to promote investment certainty and support growth in new areas. As shown in Figure 5.1, a local infrastructure contributions plan can take on average 30 to 36 months from plan preparation through to receipt of advice from the Minister on recommended amendments.

Figure 5.1 Contributions plan timeline



a Average review time for all completed assessments (excluding when plans are 'on hold'). This has not increased over time, despite an increase in the number of plans being assessed by IPART and the introduction of an additional stakeholder engagement stage with the release of a Draft Report.

b Average number of months between IPART's final report and receipt of advice from the Minister, for all plans finalised after June 2016. The time taken by councils to action the recommendations and adopt the plan has not been included in this estimate.

Data source: IPART estimates

Opportunities for DPIE to enhance the local infrastructure contributions system, by improving the timeliness and certainty of the process, include:

- Updating guidance for councils on how to prepare contributions plans.
- Ensuring the Essential Works List that applies to local infrastructure contributions plans above certain thresholds remains fit for purpose.
- Enhancing consistency in how land values and costs are estimated, potentially through, for example, the Valuer General providing advice to councils on average land values and other costs associated with land acquisition for local infrastructure, or other means.

- Developing local infrastructure cost benchmarks for use in preparing contribution plans that apply to areas in the early stages of growth, to reduce the time and cost associated with preparing plans.
- Introducing a requirement for regular review (eg, every three to five years) of contributions plans to ensure they reflect the latest planning controls and population assumptions.
- Integrating local infrastructure contributions plans with the NSW Planning Portal, so that developers can access up to date estimates of contribution amounts.

5.3 Enabling councils to deliver better services

Since 2010, IPART has had a role in regulating council rate increases. This role includes determining the annual rate peg, and reviewing applications from councils for special variations above the rate peg and minimum rate increases.

We support enhanced performance monitoring and benchmarking of local councils to improve transparency around their performance and their accountability to their constituents. This could enhance the effectiveness of the democratic process in driving improvements in councils' performance and ensuring their costs and rates are reasonable. Similarly, we see value in regular community satisfaction surveys, to enhance councils' understanding of what their constituents want and to make them more responsive to their residents.

A performance monitoring and reporting framework should allow a comprehensive comparison of councils' costs and outcomes (or service levels), while recognising or factoring in uncontrollable differences in councils' operating environments such as population and geographic area. It should also be easily accessible and understandable to the general public, and be kept up to date.

The NSW Government currently collects and reports performance statistics for local councils through the *Your Council* website. This allows constituents to access over 100 performance statistics on the operation of their local council and the profile of their local community, and benchmarks councils against the average for like councils. However, the *Your Council* website is currently largely limited to financial performance, and does not provide adequate information to gauge the quality of councils' service delivery or provide performance benchmarks to drive productivity improvements.

We understand that in 2013 the Office of Local Government, together with local government sector representatives, commenced work on a new performance measurement framework for NSW councils, to include measures in four key areas: financial performance, asset management, governance and service delivery.[20]

Until this new framework is complete and performance monitoring and reporting is at a suitably refined or advanced stage such that it can genuinely be used by constituents to hold their councils to account, we consider that the publically available information on councils'

20 www.olg.nsw.gov.au/sites/default/files/Performance-Framework-Discussion-Paper.pdf.

performance should be seen as a complement to, rather than a substitute for, the current system of a rate peg and special variations.

We note that Victoria introduced its *Local Government Performance Reporting Framework* in 2014. The framework aims to improve the transparency and accountability of council performance to ratepayers by providing around 60 performance measures and a governance and management checklist of 24 items. Victoria has also conducted annual council community satisfaction surveys since 1998. Despite the availability of this information, for the 2016-17 year, the Victorian Government introduced the *Fair Go Rates* system, which caps the annual amount that councils can increase their general rates without seeking approval.

The Commonwealth Productivity Commission's *Shifting the Dial* report in 2017 recommended that in undertaking its scheduled review of rate capping by 2021 that the effectiveness of the performance reporting regime in promoting the quality and efficiency of council services should be examined to test whether it can lessen the need for stringent rate controls. A similar review should be incorporated into any new performance measurement framework for NSW.

In terms of the current system, we observe the following:

- The special variation process has enabled councils to increase rates above the rate peg where justified, and provided a legitimate avenue for councils wishing to address revenue shortfalls. Between 2011-12 and 2019-20, only 6.6% of the 166 applications for special variations were not approved.[21] The vast majority of administrative costs incurred in the special variation process are related to councils communicating with their ratepayers about the proposed special variation (which is what they should do when seeking to increase rates to fund specific services or outcomes, regardless of the requirements of the special variation process).
- As rate pegging only applies to councils' general income,[22] other ratepayer costs such as domestic waste management service charges would benefit from increased transparency. We plan to investigate councils' domestic waste management service charges further in 2020.
- We conducted a comprehensive review of the Local Government Rating System,[23] and made a number of recommendations to Government to improve the equity and efficiency of the ratings system. This included that Government consider implementing the Capital Improved Value (CIV) valuation methodology as the basis for levying local council rates, and that rates revenue be allowed to increase above the rate peg in proportion to the increase in CIV. This would provide councils with a method of increasing their revenue with growth. Government is currently considering a number of our recommendations from this review.[24]

21 IPART's assessments of special variations from 2011-12 to 2019-20 are available at: www.ipart.nsw.gov.au.
22 For almost all councils, general income consists entirely of rates income. For a small number of councils, general income also includes some annual charges such as drainage levies.
23 IPART, *Review of the Local Government Rating System – Report*, December 2016.
24 See: www.olg.nsw.gov.au/strengthening-local-government/ipart-local-government-reports-consultation-2019

- Incremental improvements to the current special variation process may also be able to provide councils with funds to service growth. For instance, there may be benefit in introducing streamlined processes below a threshold for special variation increases of, for example, 1% above the rate peg if a council could demonstrate population growth and its impact on costs. This process could be similar to a Crown land adjustment (ie, where a council's maximum income is adjusted to reflect former Crown land becoming rateable for the first time) where growth can be demonstrated.